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POLISH WEEKLY REVIEW

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Bureau of Economic Analysis
(research)

Ernest Pytlarczyk, PhD, CFA
chief economist
tel. +48 22 829 01 66
ernest.pytlarczyk@brebank.pl

Marcin Mazurek, PhD
senior analyst
tel. +48 22 829 01 83
marcin.mazurek@brebank.pl

Paulina Ziembinska
analyst
tel. +48 22 829 02 56
paulina.ziembinska@brebank.pl

Artur Płuska
analyst
tel. +48 22 526 70 34
artur.pluska@brebank.pl

Financial Markets Department
(business contacts)

Lukasz Barwicki
head of trading
tel. +48 22 829 01 93
lukasz.barwicki@brebank.pl

Inga Gaszkowska-Gebska
institutional sales
tel. +48 22 829 01 67
inga.gaszkowska-gebska@brebank.pl

Bartlomiej Malocha, CFA
money market
tel. +48 22 829 01 77
bartlomiej.malocha@brebank.pl

Jaroslaw Stolarczyk
structured products
tel. +48 22 829 01 67
jaroslaw.stolarczyk@brebank.pl

Marcin Turkiewicz
fx market
tel. +48 22 829 01 67
marcin.turkiewicz@brebank.pl

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BRE Bank S.A.
18 Senatorska St.
00-950 Warszawa
P. O. BOX 728
tel. +48 22 829 00 00
fax. +48 22 829 00 33
http://www.brebank.pl

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Comment on the upcoming data and forecasts

On Tuesday wages and employment data will be published. We expect lower wage growth to be comparable to previous month. We also expect lower employment growth due to weakening economic activity (on monthly basis employment growth shoudl be close to zero, anything below confirms the slowdown gains speed). On Wednesday industrial production and PPI data will be published. In industrial production we expect significant fall to 4.9%. Last unexpected growth mainly resulted from climb in motor, paper and electrical appliances sections (very odd, close to one-off nature). Therefore industrial production should come back to trend. In PPI the rise is expected due to weaker exchange rate. On Thursday NBP will announce net inflation. According to last CPI publication net inflation should decline to 2.6%. We also look forward to MPC „Minutes" publication, although apart form more arguements on the slowdown in EMU and exchange rate stability issues we do not expect to find there anything striking.

Polish data to watch: October 17 to October 21

Publication	Date	Period	BRE	Consensus	Prior
Wages y/y (%)	18.10.	Sep	5.1	5.4	5.4
Employment y/y (%)	18.10.	Sep	2.9	2.9	3.1
Industrial production y/y (%)	19.10.	Sep	4.9	5.1	8.1
PPI y/y (%)	19.10.	Sep	7.7	7.2	6.6
Net inflation	20.10.	Sep	2.9	2.8	2.7
MPC Minutes	20.10.	Oct			

Treasury bonds and bills auctions

Paper	Next auction	Last Offer	Last yield (%)	Prev auction
52-week T-Bills	-	600	4.578	5/30/2011
2Y T-bond OK0114	-	3000	4.469	8/10/2011
5Y T-bond PS0416	10/19/2011	3000	5.256	8/10/2011
10Y T-bond DS1021	-	3000	5.803	7/21/2011
20Y T-bond WS0429	-	250	6.246	1/12/2011

Macroeconomic forecasts

Wskaźnik	2008	2009	2010	2011 F	2012 F
GDP y/y (%)	4.8	1.7	3.8	3.5	3.2
CPI Inflation y/y (average %)	4.3	3.5	2.8	4	3.4
Current account (%GDP)	-5.3	-1.6	-4.5	-4.9	-3.4
Unemployment rate (end of period %)	9.5	11.9	12.3	12.3	12.8
Repo rate (end of period %)	5.00	3.5	3.5	4.5	4.0

	2010 Q3	2010 Q4	2011 Q1	2011 Q2	2011 Q3 F	2011 Q4 F
GDP y/y (%)	4.2	4.5	4.4	4.3	3.6	3.4
CPI Inflation y/y (average %)	2.6	2.9	3.7	4.2	4.1	3.8
Repo rate (end of period %)	3.5	3.5	4.0	4.5	4.5	4.5

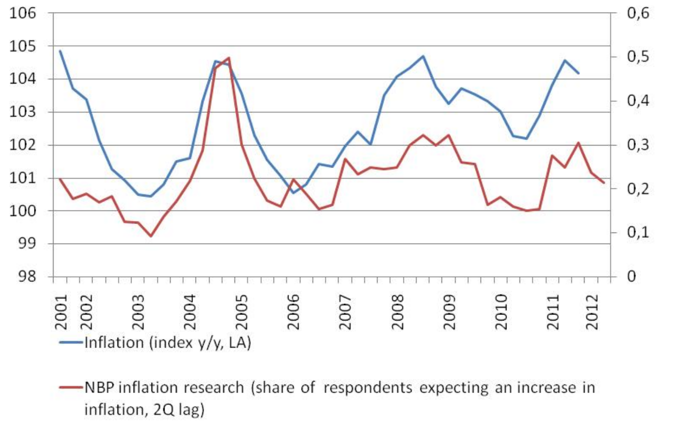
F - forecast

Economics

Lower CPI in September

In September CPI decreased from 4.3% in August to 3.9%. The decrease of CPI inflation in September is mainly attributed to lower food prices (usually in September prices increase, but this time they decreased by 0.2% m/m) and fuels (decrease by 1% m/m). Putting aside the supply factors, also demand side pressures seems to be on retreat. We expect core inflation to have fallen to 2.6% (without one-off increases in education it could have been even lower).

In the short term we expect CPI growth at comparable levels to September. Currently growing number of price promotions seems to be a viable sign of easing inflationary pressure - see chart below. Therefore we bet that CPI will decrease at the beginning of the year 2012 (mainly caused by base effects) but still will remain above 3% y/y on possible numerous rises of state-controlled prices including excise duty on fuels.



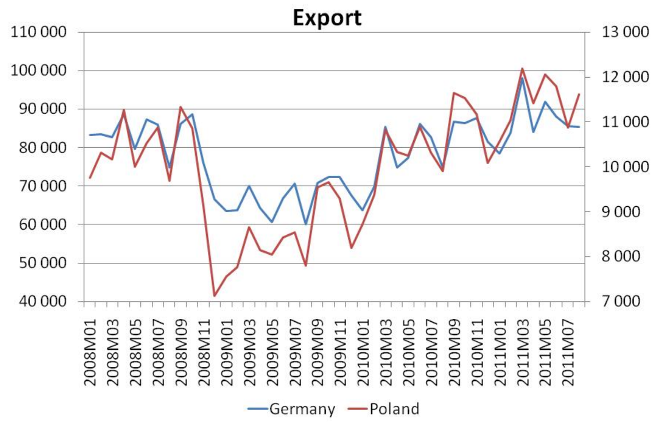
Latest CPI data strengthen market expectations on rate cuts in the future. However, swift rate cuts can be safely excluded owing to weak zloty and recent NBP's exchange rate intervention policy (apart from the fact that intervention policy will be counterproductive in environment of lower rates, high exchange rate bears also questions on exchange rate influence on debt-to-GDP ratio and banking sector stability). We expect MPC to come back to rate cuts discussion in Q1 2012 when the necessity of exchange rate stabilization and debt-to-GDP ratio issues lose its significance, and lower business activity and weaker inflation pressures become more perceptible.

Surprisingly high current account deficit

In September current account deficit amounted to EUR 1.7 bn (consensus at the level of EUR 1.2 bn, our forecast at EUR 1.05 bn). Data from the last 3 months have been revised (accordingly to the NBP's quarterly revision) downwards by about EUR 1 bn which - even by past standards - can be described as substantial change. Only last month has been revised from EUR -1.6 bn to EUR -2.05 bn.

As far as specific accounts are concerned, trade deficit surprisingly decreased, which was caused by significant exports acceleration with simultaneous lower imports growth. As far as imports are concerned, we fully agree that falling consumption would press that measure in the coming months and quarters. As far as exports go, though, the spike is by no measure explainable by our models, the overall global trade environment (although August was a month of positive surprises elsewhere) and close correlation with the German trade (see the graph). There were no surprise in the case of transfer balance and services. Quite low though, taking under consideration the ususal seasonality, turned out to be the income balance.

We do not consider the last data as signal of sudden trend reversal in current account and particularly trade deficit. We do not acknowledge that quite good exports data resulted from zloty depreciation (until August the zloty's depreciation was insignificant). Zloty's depreciation effect rather will become perceptible within middle-term perspective. Therefore sudden exports acceleration seems to be a one-off and in the forthcoming month trade deficit will come back to the levels of around EUR 1 bn. Adjustments towards lower deficit on the basis of narrowing trade account (weaker consumption) will take place, but the necessary time of adjustment should be measured by quarters, not months.



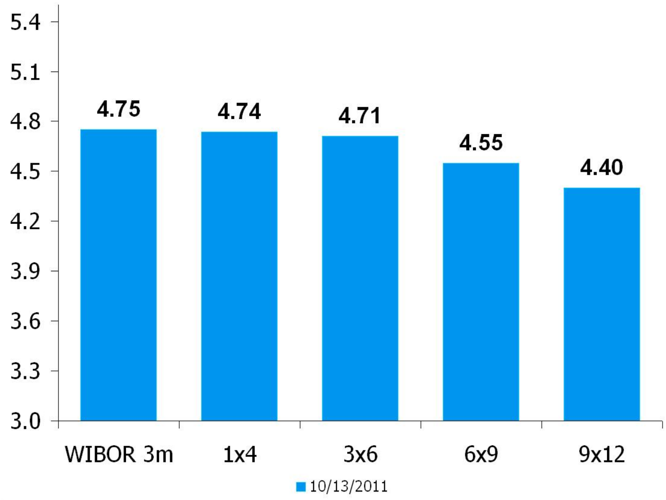
Fixed income

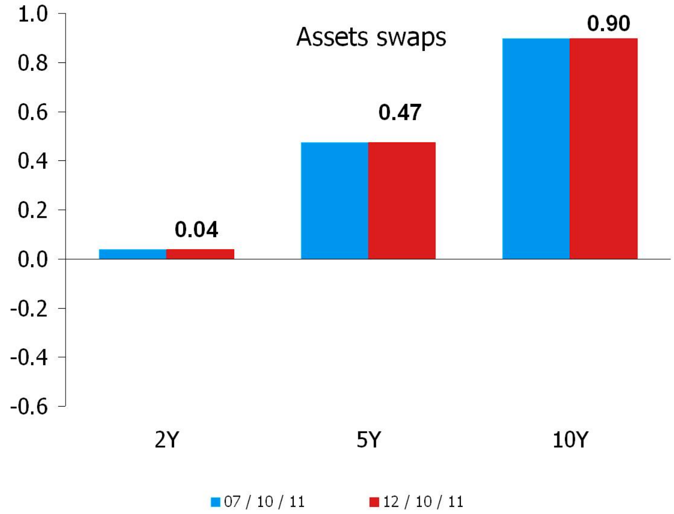
Steeper curve

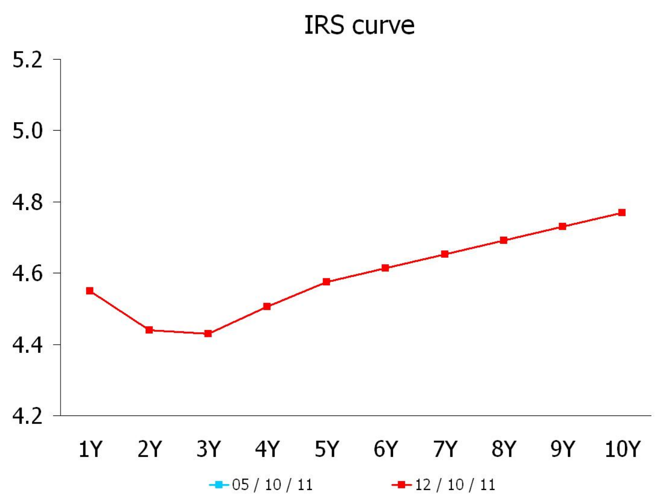
The results of the general elections in Poland did not turn out to be a real surprise to the markets. The ruling coalition of Civic Platform and Peasants Party obtained the majority in the new parliament that might be a guarantee that the next 4 year overall policy would likely remain unchanged. The initial euphoria to the election outcome seemed to be a short-lived event on Monday. The long end of a yield curve slumped by 8-10 basis points trading 10y at 4.75% and 5y at 4.60 respectively and then quickly moved up on a strong technically supporting paying interest. The CPI figure at 3.9% y/y released on Wednesday did not add much to the overall market scenario. The short end of a curve moved down by few points but seemed to be a good opportunity to buy-back receiving positions here.

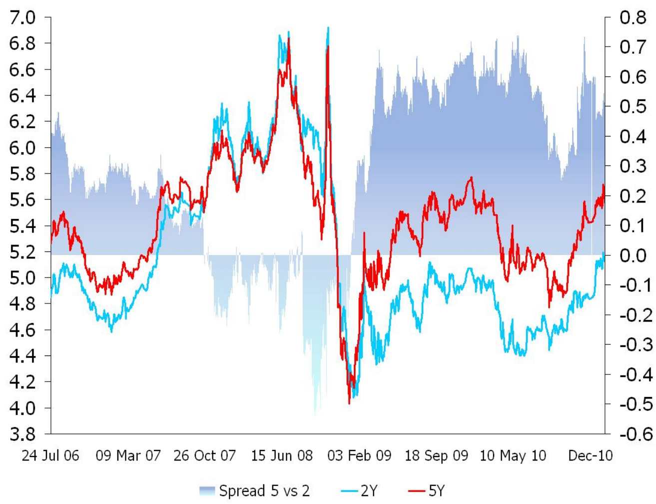
Taking into account the recent MPC members comments on a possible timing of monetary policy easing it is clear the potential change in MPC's stance would be seen in the first quarter of the next year. There are several reasons for that. First, when we look at the recent coordinated MinFin and central banks intervention on the forex market, we could easily find out the PLN rate near 4.50 to EUR would have adversely affected the debt to GDP ratio limit at 55%. The huge amount of Eurobonds sold by the State Treasury for the last couple of years turned out to be a huge problem keeping the ratio under the 55% limit while the world crisis climate had worsened. Second, the MPC would not be eager to change its stance and favor the rate cuts just not to provoke the next speculative actions against PLN, especially when the external risks have not vanished. Moreover, it would be more likely to face the short term intervention interest rate hikes if the next fear of a global crisis outraged as that would be less expensive move to protect the currency than to sell the currency reserves again. Third, The newly elected „old" Tusk's cabinet is not to eager to undertake, so called, „expensive" fiscal reforms at the moment that would not help the currency and the debt/GDP ratio for sure.

Having in mind the fact that MinFin surprisingly announced they might return to the longer end bonds issuance and the fact that the 3M PLN cash was trading around 5% we could try to predict the next possible market scenario. Resteepening of the yield curve is inevitable.







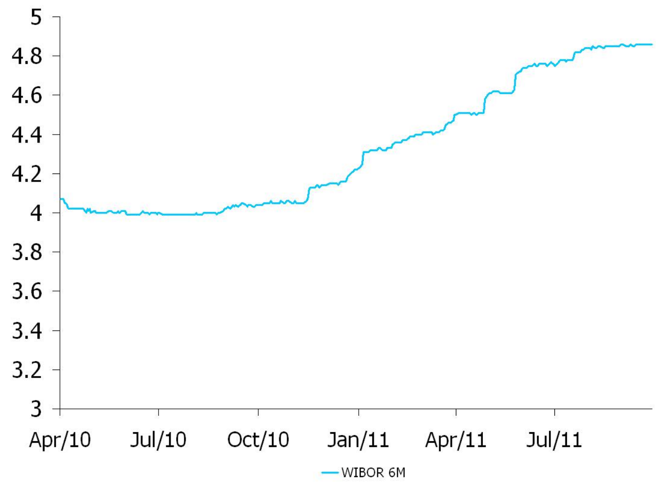


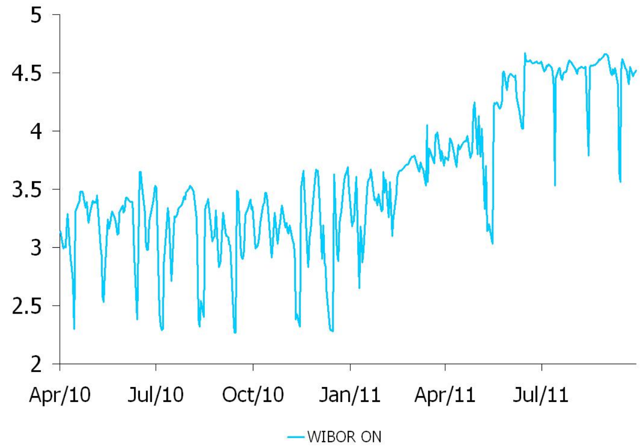
Money market

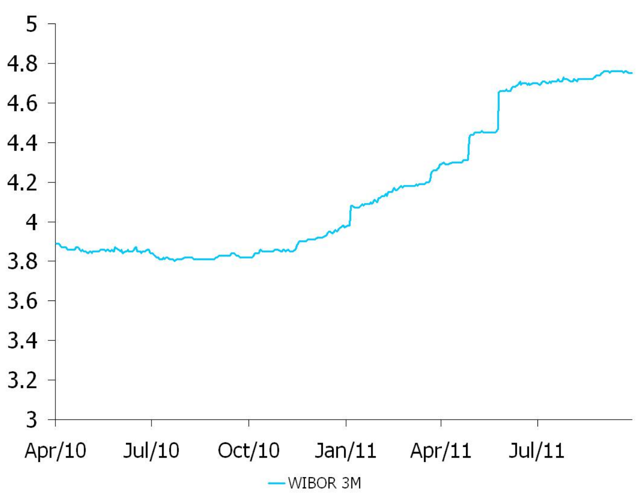
Polonia come back to normal level. Small reaction to CPI

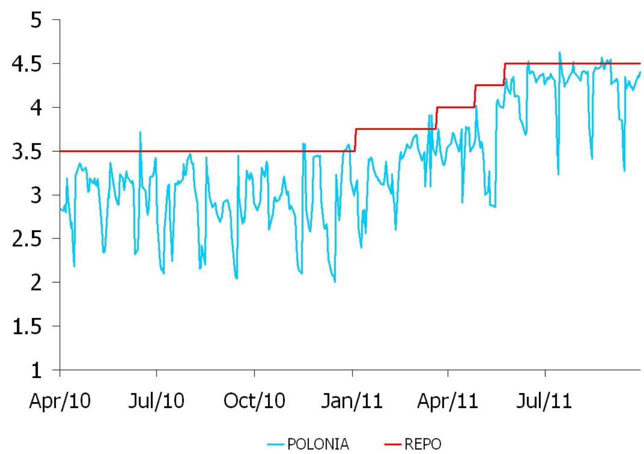
After last week's OMO cash was sterilized and polonia fixings came back to normal lvl (around 10-15 pips below ref rate). Today main event for the cash market is OMO result which will set the tone for the whole next week. We see that 96 bio would be perfect to sqr the market and any deviation from that number for less than 1 bio won't cause difference as its still some time till the month end. In case market buys less than 93 i will be really curious how the NBP will behave, comparing to last week 8 bio surplus and no additional OMO.

September's inflation came lower than market was expecting, that moved 1y OIS 3 bp lower, to 4.12 lvl. Although we see that the FRA and IRS market is already back or even higher than it was before CPI reading and that makes 1y OIS cheap which stays on the lower lvls, unless we start to calculate loosening in overnight money from NBP.

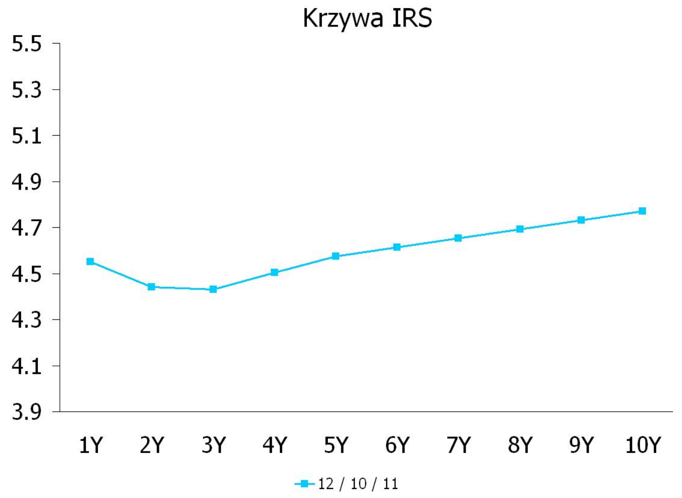








Forex

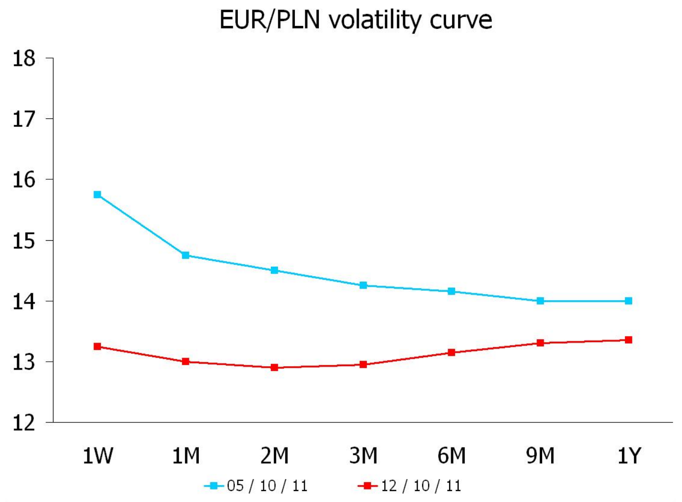


Zloty stronger It was good week for our currency. Initially fueled by better-than-priced election results Zloty has started its rally. EURPLN cross has opened week at 4.36 and have been sold down to 4.28. Move was intensified by decent global risk appetite which compared to HUF performance proved to be main driver (still) - both currencies have gained about 2% (what was elections influence then?).

Volatility lower The zloty has pared some of its heavy losses, and during last few days was trading at around 4.30 to the euro. It caused that last week was next one of drop of EUR-PLN volatility. The short term volatility 1w - 1m was traded even below 13%.The slope of the curve has reversed (short term volatility are lower than long term). We observed a selloff of risk reversals too. Currency spread (USDPLN against EURPLN) fell down from 10.25 to 9.50.

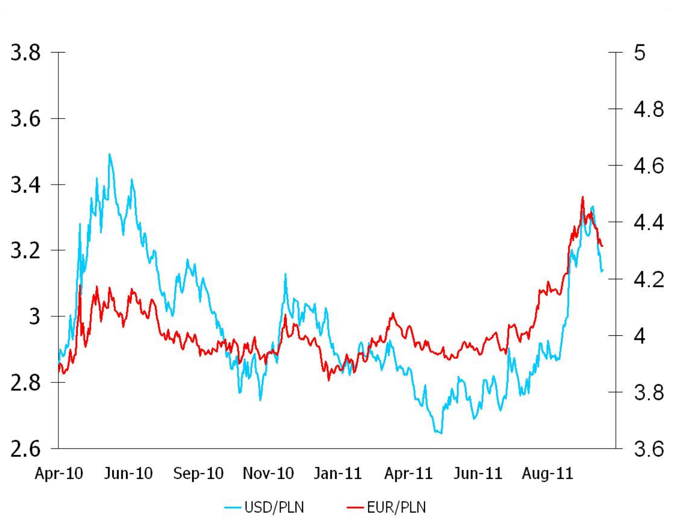
Short-term forecasts

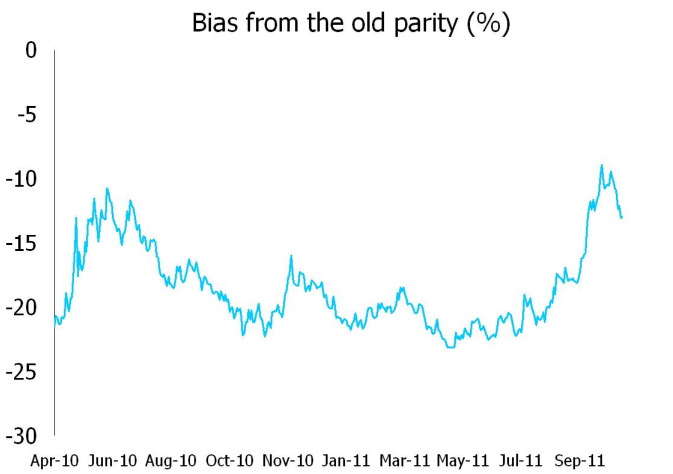
Main supports and resisances
EUR/PLN: 4.2800 / 4.3600
USD/PLN: 3.0500 / 3.2500



Spot. Constantly... We do not see substantial PLN inflow from foreigners. So although risks haven't diminished and although market positioning still seems to be short PLN we suggest to play 4.28/4.36 range where benchmarks provides direction (EU-RUSD, SPX ect). Anyway, positioning skews its range toward downside with magnetic 4.20 below, but... All eyes on stocks?

Derivatives. Last time we experienced real crash on EUR-PLN volatility. The realized short term volatility is higher than implied (1m 16.4% vs 12.95%, 3M 13.7% vs 12.9%). Taking into consideration also the fact that we still remains a hostage to the the global sentiment which is very shaky, we recommend to close short position on the gamma and vega, and if volatility falls below 12% we will think about buying vega.





Market prices update

Money market rates (mid close)								FRA rates (mid close)				
Date	FXSW 3M	WIBOR 3M	FXSW 6M	WIBOR 6M	FXSW 1Y	WIBOR 1Y	1x4	3x6	6x9	9x12	12x15	6x12
10/6/2011	4.56	4.75	4.68	4.76	4.62	4.79	4.74	4.72	4.61	4.49	4.38	4.69
10/7/2011	4.58	4.76	4.68	4.76	4.62	6.59	4.74	4.73	4.61	4.49	4.35	4.69
10/10/2011	4.54	4.76	4.73	6.49	4.68	4.79	4.74	4.71	4.59	4.46	4.31	4.66
10/11/2011	4.59	4.75	4.67	4.76	4.61	4.79	4.74	4.70	4.58	4.45	4.31	4.64
10/12/2011	4.59	4.75	4.68	4.76	4.62	4.79	4.74	4.72	4.56	4.43	4.26	4.63

Last primary market rates							
Paper	Au. date	Maturity	Avg. price	Avg. yield	Supply	Demand	Sold
52W TB	1/31/2011	1/31/2012	95.84	4.35	2000	2968	1961
OK0113	4/13/2011	1/26/2013	89.16	5.16	5500	7385	4758
PS0416	1/5/2011	4/25/2016	97.08	5.64	6500	2795	1140
DS1020	1/12/2011	4/25/2019	93.02	6.21	2250	4252	2250

Fixed income market rates (closing mid-market levels)								
Date	1Y WIBOR	1Y T-bill	2Y IRS	OK0113	5Y IRS	PS0416	10Y IRS	DS1019
10/6/2011	4.790	4.570	4.575	4.404	4.690	5.127	4.870	5.823
10/7/2011	6.590	4.530	4.555	4.593	4.670	5.144	4.845	5.743
10/10/2011	4.790	4.530	4.545	4.444	4.640	5.068	4.795	5.669
10/11/2011	4.790	4.570	4.585	4.461	4.690	5.106	4.855	5.719
10/12/2011	4.790	4.570	4.575	4.469	4.665	5.048	4.845	5.683

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY	
Date	1M	3M	6M	1Y	1M	1Y	1M	1Y
10/6/2011	13.95	13.65	13.65	13.60	13.60	4.83	0.61	0.87
10/7/2011	13.95	13.65	13.65	13.60	13.60	4.83	0.61	0.87
10/10/2011	13.00	12.90	13.20	13.35	13.35	4.74	0.59	0.88
10/11/2011	13.00	13.05	13.35	13.50	13.50	4.55	0.59	0.74
10/12/2011	13.00	12.95	13.15	13.35	13.35	4.31	0.51	0.82

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
10/6/2011	4.3765	3.2731	3.5421	4.2662	1.4816	0.1773
10/7/2011	4.3779	3.2593	3.5410	4.2527	1.4706	0.1767
10/10/2011	4.3235	3.1865	3.4922	4.1604	1.4740	0.1748
10/11/2011	4.3410	3.1936	3.5228	4.1646	1.4683	0.1750
10/12/2011	4.3150	3.1352	3.4870	4.0972	1.4717	0.1742

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