BRE BANK SA

POLISH WEEKLY REVIEW

November 10, 2011

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Comment on the upcoming data and forecasts

On Monday M3 will be published. We expect higher growth against last announcement. It results from money outflow from mutual funds, rising households and enterprises deposits because of risk aversion, further PLN depreciation and increasing competition on deposits market. Inflation that will be announced on Tuesday, is expected to be higher. The increase mainly arises from rebound in food prices (1.7% MoM) and higher fuel prices (3.4% MoM). Higher current account deficit is expected. Exports and imports seasonally accelerate. Stable balance of services and negative funds transfer from EU are expected. On Friday employment and wages in enterprises sector will be announced. Employment is going to ease mainly because of gradual weakening labor market. Wages growth is expected to be slightly higher, actual trend is set to be continued.

Polish data to watch: November 14 to November 18

Publication	Date	Period	BRE	Consensus	Prior
M3 y/y (%)	14.11	Oct	10.8	10.3	10.1
CPI y/y (%)	15.11	Oct	4.2	4.0	3.9
C/A (mln EUR)	15.11	Sep	-2156.0	-1820.0	-1730.0
Employment y/y (%)	18.11	Oct	2.5	2.5	2.8
Wages y/y (%)	18.11	Oct	5.3	5.1	5.2

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	11/16/2011	3600	5.105	10/19/2011
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	-3.6
Unemployment rate (end of period %)	9.5	11.9	12.3	12.6	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	4.1	3.6
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

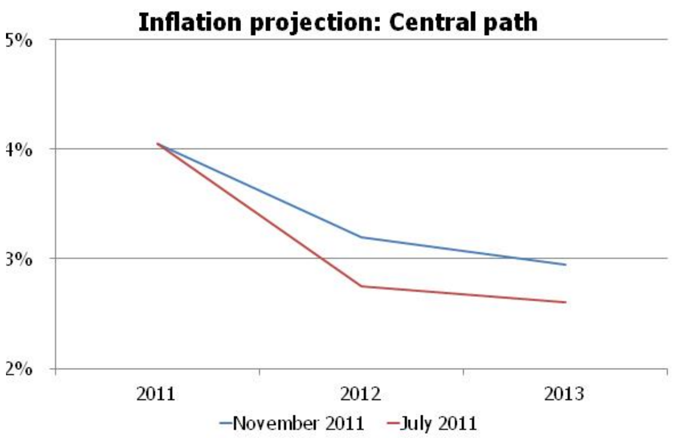
F - forecast

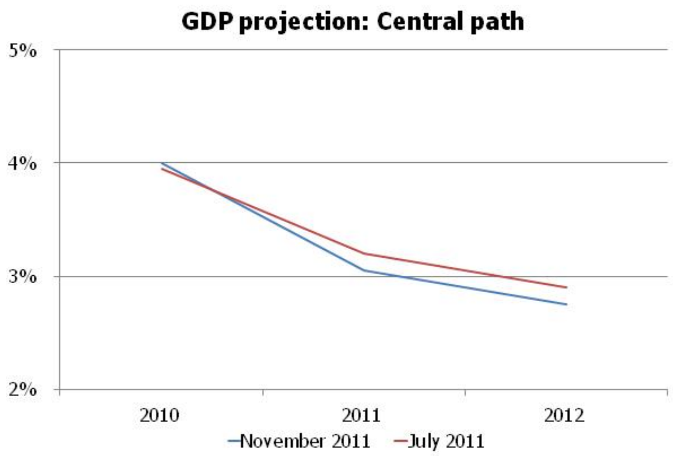
Economics

Rates on hold, inflation projection notably higher

In line with expectations, MPC did not decide to change rates which remained at 4.5%. The statement, and the subsequent comments during the conference seem to convey the more cautious message with regard to the real sphere in Poland (despite recent surprises) and abroad, and the accompanying balance of risks seems to have been tilted more to the downside. However, at the same time MPC states, to cite M. Belka, that inflation stays at very high level which is worrisome for rate setters. Although part of inflation reflects past developments (higher energy prices at the beginning of the year, VAT hike effects), return to the target in the mid-term can also be long and bumpy owing to only moderate growth slowdown expected on the horizon and lagged effects of PLN depreciation. In those circumstances MPC had no other option than to stick to its former guidance that it may be warranted to raise rates should inflation's return to target becomes more risky.

The fresh inflation projection corroborates the risk for higher inflation - inflation path was lifted notably upwards in 2012 and 2013 whereas at the same the GDP growth underwent only minor adjustments downwards (see the graphs). We think it is inflation projection, along with unstable exchange rate, that constitute the main reason why the MPC cannot afford to cut rates fast in the environment of all the risks to global growth.





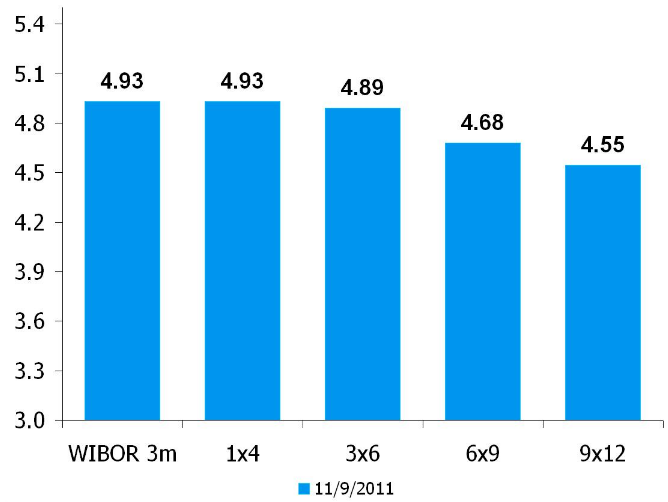
Easing pressures may come back at the start of 2012. Then the risk of speculative zloty depreciation driven by the risk of breaching the debt threshold will cease to be a factor beefing up zloty volatility, therefore closing disparity gap between Poland and EMU would not be harmful and turn into a reasonable argument for reversing some of the monetary tightening delivered at the beginning of 2011. Moreover, in the first half of 2012, the slowdown of consumption demand will become more evident (along with overall GDP growth deceleration). This may constitute the final argument for easing, which now seems hardly to be accounted for by the majority in MPC owing to the unexpectedly solid real sphere data inflow.

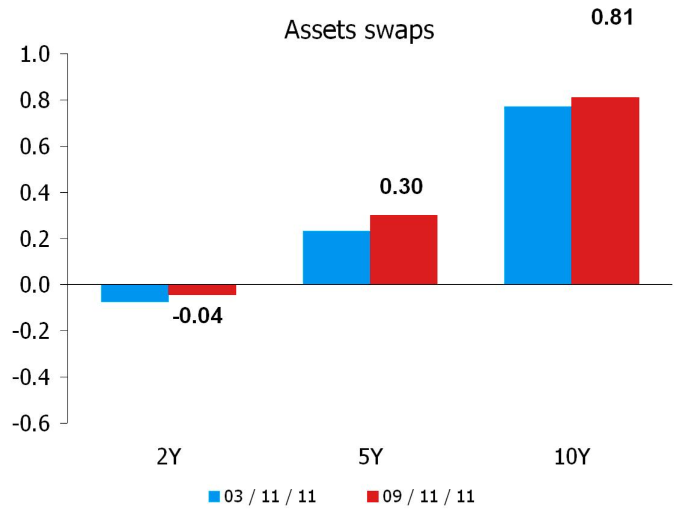
Fixed income

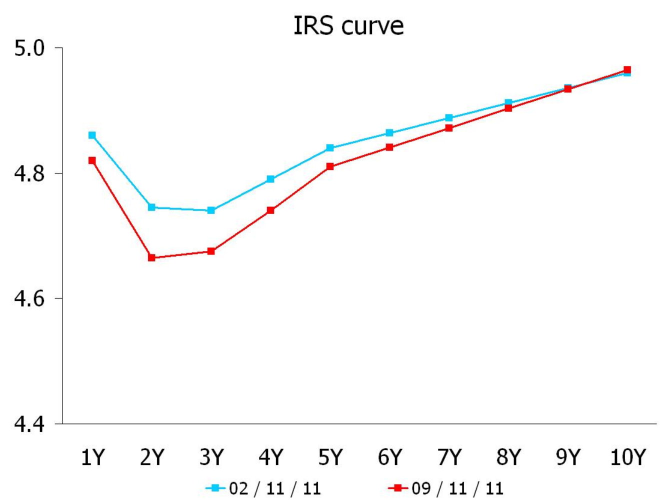
No crisis spotted

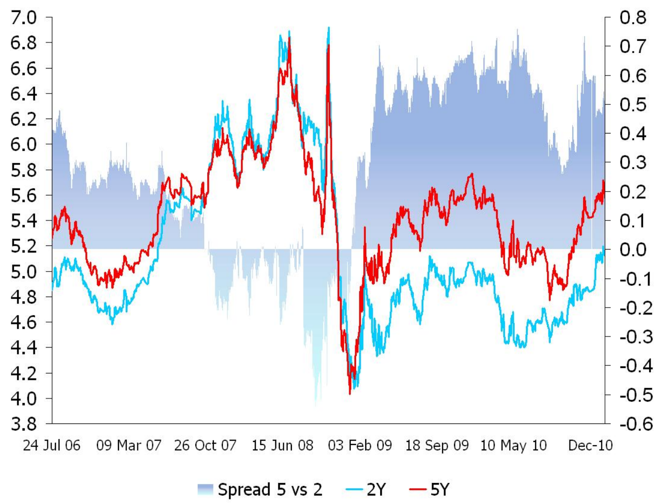
„No signs of deep economic slowdown seen in Poland” - stressed central bank governor Belka after the MPC meeting. On the other hand we cannot rule out CPI would fail to fall to the monetary policy target in the mid 2012. As a result, it might be quite unlikely to expect the polish MPC would follow the global interest rate „japanization” process soon, especially if we could still face quite substantial inflationary pressure in coming months. Moreover, the MPC could be expected to be more determined fighting with the price growth if the CPI falling path was jeopardized. Surprisingly, the better prospects for the domestic economy combined with the plan of the fiscal reforms announced by the new government would easily make the long treasury securities more attractive ever. Taking into account the fact that the 3M Wibor rate has jumped over 20bp to 4.94% for the last couple of weeks probably as a result of covering the bonds positions over the year-end, makes it quite comfortable receiving rates even if the MPC surprises markets with a rate hike (quite unlikely and short-lived if occurs). Nevertheless, some paying pressure on the short-end of a curve is inevitable.

Concluding... Despite the global turmoil that generates higher volatility and uncertainty and makes the yield curve more steeper or flatter day-by-day without any particular reason, we should consider starting to enter a strategic receiving position for the next year preferring more bonds than IRS with an assumption the yield curve would have a flattening tendency especially in 2y5y sector.







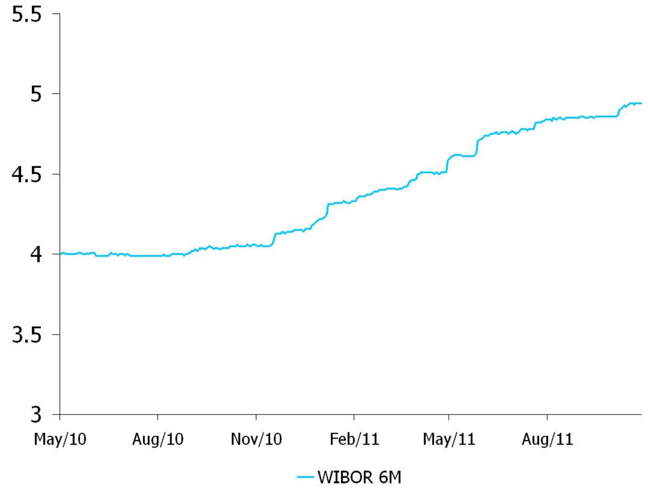


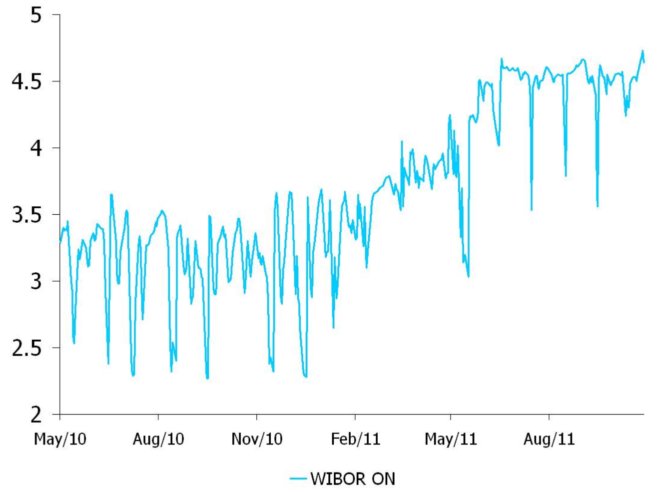
Money market

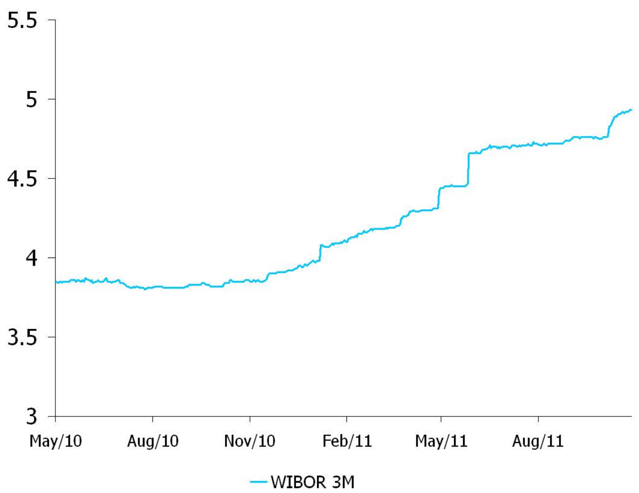
Expensive cost of carry. Italy adds some volatility. The MPC without surprise.

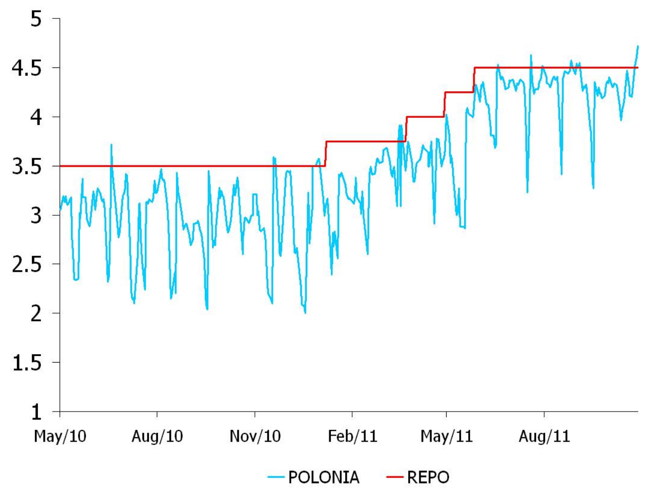
Quite expensive week as far as the cost of carry is concerned, due to the shortage that occurred after the last OMO. We thought that market would underbid today's operation, but we were wrong. Market remains slightly short, therefore to see any cheaper carry we shall wait for another week.

Rates driven mainly by the global factors (Italy this time), however movements on the local market not significant both ways. The MPC left the rates unchanged, which was fully expected, hence without any impact. Statement was quite hawkish, however not enough to change the market view, which is bullish for the first half of the next year. Next stop on Tuesday with the CPI figure.





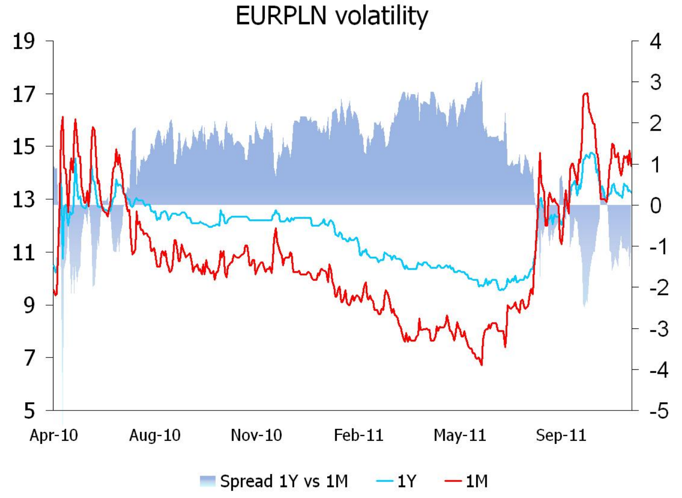




Forex

Zloty volatile The relief rally on Zloty took us to EUR/PLN 4.3300 low, the rising yields on Italian bonds were the game changer for whole CE3. The EUR/PLN picked to 4.4120 as the result, and the heat was felt even on CZK which was believed to be crisis proof. The Polish Ministry of Finance via state owned BGK was really active on the market selling hard currency against PLN around 4.3850/4.4050 on Thursday, and that helped a lot to cap the EUR/PLN gains.

Volatility up The move up in spot, was naturally accompanied by the move up in Vols. But the move was half hearted as the spot is still in well known 4.25/4.45 range. To see the real fire works, we have to wait till 4.50 would be broken (if we get there), till then is business as usual. The wide spreads are not helping in trading and thin liquidity is sometimes we should get used to.

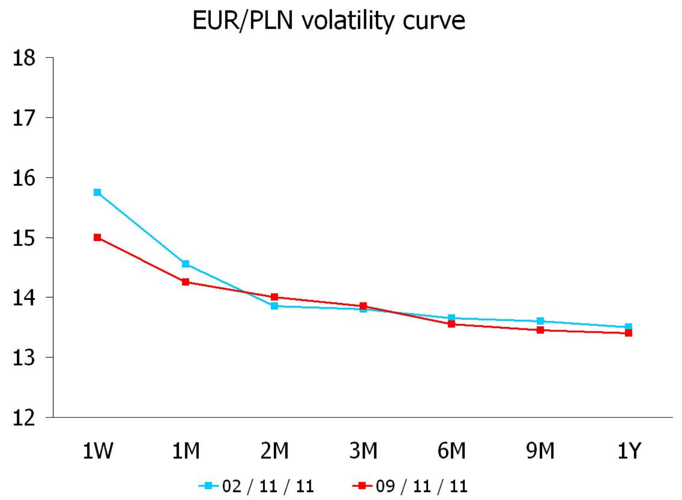


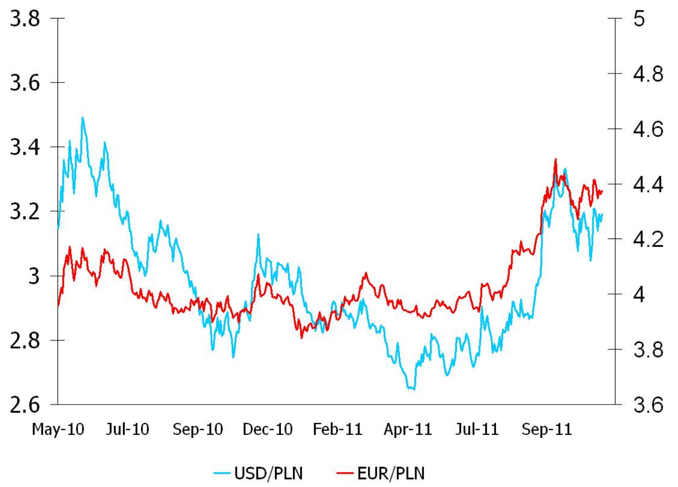
Short-term forecasts

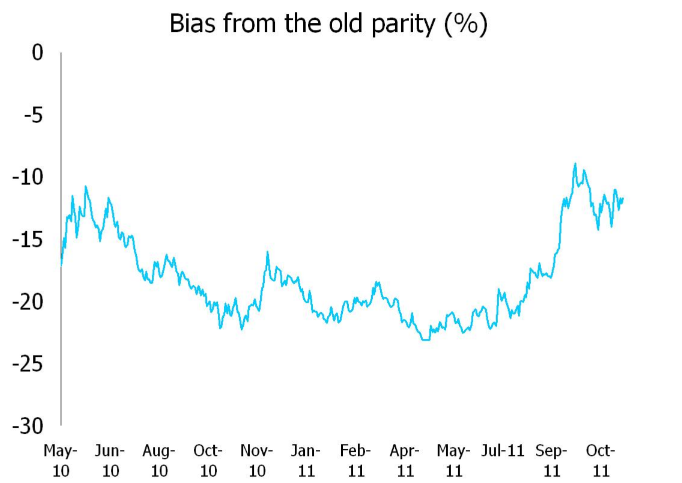
Main supports and resisances
EUR/PLN: 4.2600 / 4.4500
USD/PLN: 3.0500 / 3.2500

Spot. The rabbit came out of the hat, once again. Thanks to Ministry of Finance's intervention, on the market we have not broken the important 4.45/4.50 resistance level (as yet). We believe playing the wide range is still the best approach. Considering unsettled global environment the 4.25/4.30 looks like solid support zone, above 4.445/4.5000 resistance zone the market would have to face not only the BGK firepower but also potentially National Bank of Poland.

Derivatives. View unchanged. With mounting worries over Greece's and Italy's fiscal and political problems weighing on investor appetite for risky assets, the Zloty is expected remain volatile. The ideal position to have is to be long Vega in 3m-6m and short out of the money call for December. The net effect is the long Vega and long Gamma and only tiny theta. EUR/PLN should be protected from rising to high too fast as our CB and Ministry of Finance are the potential sellers till the year end.







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
11/3/2011	4.69	4.91	4.84	6.49	4.79	6.59	4.92	4.89	4.68	4.57	4.43	4.74
11/4/2011	4.70	4.92	4.83	4.84	4.79	4.84	4.93	4.88	4.68	4.55	4.36	4.72
11/7/2011	4.72	4.92	4.85	4.84	4.80	4.84	4.95	4.89	4.69	4.55	4.42	4.74
11/8/2011	4.75	4.93	4.89	4.84	4.84	4.85	4.93	4.88	4.65	4.53	4.37	4.72
11/9/2011	4.67	4.93	4.85	4.84	4.83	4.84	4.93	4.89	4.68	4.55	4.46	4.70

Last primary market rates							
Paper	Au. date	Maturity	Avg. price	Avg. yield	Supply	Demand	Sold
52W TB	5/30/2011	5/30/2012	95.57	4.58	600	2667	505
OK0113	8/10/2011	1/25/2013	89.58	4.58	5000	4934	1889
PS0416	10/19/2011	4/25/2016	98.44	5.11	3600	11200	3638
DS1020	7/21/2011	10/25/2021	99.53	5.80	3000	5608	3000

Fixed income market rates (closing mid-market levels)								
Date	1Y WIBOR	1Y T-bill	2Y IRS	OK0113	5Y IRS	PS0416	10Y IRS	DS1019
11/3/2011	6.590	4.425	4.645	4.570	4.790	5.023	4.950	5.722
11/4/2011	4.840	4.425	4.640	4.581	4.780	5.052	4.950	5.742
11/7/2011	4.840	4.425	4.630	4.582	4.790	5.059	4.963	5.742
11/8/2011	4.850	4.425	4.610	4.603	4.765	5.059	4.920	5.729
11/9/2011	4.840	4.425	4.665	4.621	4.810	5.111	4.965	5.776

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY	
Date	1M	3M	6M	1Y	1M	1Y	1M	1Y
11/3/2011	14.65	14.00	13.70	13.50	13.50	4.53	1.01	0.82
11/4/2011	14.30	13.70	13.55	13.30	13.30	4.53	1.01	0.82
11/7/2011	14.85	13.80	13.55	13.35	13.35	4.51	0.46	0.77
11/8/2011	14.25	13.60	13.50	13.25	13.25	4.51	0.36	0.87
11/9/2011	14.25	13.85	13.55	13.40	13.40	4.51	0.46	0.77

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
11/3/2011	4.3809	3.1800	3.6082	4.0758	1.4317	0.1741
11/4/2011	4.3464	3.1385	3.5574	4.0230	1.4304	0.1738
11/7/2011	4.3764	3.1913	3.5393	4.0891	1.4256	0.1752
11/8/2011	4.3619	3.1681	3.5117	4.0614	1.4162	0.1731
11/9/2011	4.3757	3.1925	3.5459	4.1121	1.4092	0.1727

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