



TOP NEWS FROM THE POLISH MARKET

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MACROECONOMICS

Fitch upgraded Polish sovereign rating to A-

On Friday the Fitch Ratings Agency upgraded Poland's foreign currency Issuer Default rating to A- from BBB+. The decision, though unexpected, came after the Ministry of Finance announced that the budget deficit figure for 2006 was lower by 5.5 bn PLN than planned. Fitch pointed to a strong overall economic performance and reduction in external financing risks. It is also very likely that the Debt GDP ratio will improve in the coming years. In the response to Fitch's decision S&P and Moody's affirmed their assessments of the Polish economy. Even though Moody's representatives added that they would review the credibility of the country, S&P in fact ruled out any upgrade in Poland's ratings.

Wages grew by 8.5% in December, apart from one-off factors also the headline growth is higher

The average corporate wage rose to 3027.1 PLN in December, which implies an annual growth rate of 8.5%. This is well above market expectations (6.1%) and our forecast (6.7%). To some extent higher wages growth results from the mining bonuses shift (they were paid in November 2005 and December 2006), but in our opinion the effect cannot explain the observed growth rate. In our opinion the wages adjusted for the one-off factor rose by ca. 6% (an exact estimate will be possible later this week after sector data are published). Also in January wages growth will be higher – due to a bonus payment in KGHM, wages growth may reach 7.5-8%. In the coming months growth rates of around 6% may be observed.

In January we also expect high growth rate due to bonus payments

Corporate employment rose by 4.1% (consensus 3.9%, BRE forecast 4.0%). Apart from the very positive labour market trend observed in the recent months, good weather conditions allowed for a further pick up in employment growth.

Labour market data will not cause a change in the MPC stance. Firstly the MPC is fully aware of one-off factors influencing the monthly data. Secondly we must bear in mind the financial results of the companies. Rising productivity, declining share of labour costs in the total cost structure or current declines in commodities all allowed for a safety buffer in wages growth and at the moment all those factors limit the price pressure.

PPI in December slightly below expectations at 2.8%

Producer prices in December dropped by 0.3% as compared with November, which resulted in the annual dynamics at 2.8%, slightly below our forecast and the market consensus. The annual growth rate is higher than in the previous month but it is only the result of unfavorable "base effect". It is noteworthy that the annual PPI in manufacturing was equal to 1.7% and the headline figure has been pushed up by annual dynamics in mining at 10.6%. We expect that in the coming months commodity and fuel prices will continue the downward trend, which in the face of the strong zloty may cause a deflation of annual PPI in the July-August period.

CPI at 1.4% in December, yet again below expectations

CPI in December dropped by 0.2% m/m and rose by 1.4% y/y, which is still below the lower band of the inflationary target (consensus and BRE forecast 1.6%). The drop is attributable to lower food prices – they dropped by 0.3% m/m (which is uncharacteristic for December). Also tradable goods (e.g. clothing and footwear) dropped in December. According to our estimates net inflation rose to from 1.6% to 1.7% y/y.

Net inflation estimated at 1.7%

We have lowered the CPI path in the coming months. In January a figure of 1.6% y/y may be expected (it must be stressed that the fuel excise hike was neutralized by lower fuel prices). In March CPI may peak at 1.8-1.9%, in the summer months it will stay below 1.5%.

MPC member Wojtyna: The rates may remain unchanged in the coming months

MPC member Professor Andrzej Wojtyna said that the Polish economy is more resistant to inflationary shocks and in his opinion interest rates may remain unchanged for several months. He added that strong data from the labour market shift the risk balance for inflation but very low CPI in recent months support his view that the factors which lower the inflation (globalization and high margin of enterprises) are always of high importance. He added that the pro-

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**Industry output rose
by 5.7% y/y (10.5% y/y
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**C/A deficit at 510 m
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inflationary short term impact of investments is rather weak and in the longer term investments will increase the potential output and push up the "speed-limit" for the economy.

In an interview for Reuters Wojtyna didn't exclude the need for the rates hike in the first quarter, but in our opinion such a verbal statement will not be followed by a real movement in the interest rates.

A similar view has been expressed by two other MPC members who belong to the "dovish" part of the MPC. Professor Jan Czekaj said that the current inflation data are the evidence for low inflationary pressure from the demand side. He added that whilst CPI remains below the lower band of the target the MPC will not hike the interest rates.

Professor Mirosław Pietrewicz excluded a hike in the coming months as well. In his opinion low current inflation is a very good starting point for the next inflation projection, which according to Pietrewicz may be lower in 2007 and 2008 than the previous one.

Only Professor Dariusz Filar presented a more hawkish view on inflation. He expects that CPI will exceed the inflation target of 2.5% in Q3-Q4 2007 and the MPC should react as fast as possible to avoid higher movements in the future.

Our comment:

We believe that in the face of falling fuel prices and the strong zloty CPI in 2007 will be permanently below the middle of inflation target. Thus we expect that core inflation will exhibit an upward trend, but in 2007 it will remain below 2.0%. In our opinion the probability that the CPI will exceed the upper band of the target in 2008 is very low. Low current inflation and a very favorable future inflation path should hold the MPC against interest rates hikes. We think the rates will remain unchanged at least until the middle of the year.

Industry output rose by 5.7% y/y (consensus 8.6%, BRE forecast 6.3%) in December. Lower growth rate results from the working days difference (2 days fewer than last year), and after the seasonal adjustment the dynamics equaled 10.5%, close to November's rate. The data available so far indicate that GDP growth rate in Q4 was close to 6%, but below the MF's forecast of 6.3%.

We think the trend in industry output will be kept in the coming months and growth of 10-11% should be observed. In 2007 we expect the structure of growth to change slightly – in terms of supply we expect a shift towards services and in terms of demand – a shift towards consumption.

Constructions output rose by 17.9% y/y, slightly below expectations based on favorable weather conditions. This doesn't change the view that the contribution of constructions to GDP growth in Q4 was sizeable.

The C/A deficit in November reached 510 m EUR (consensus -475, BRE forecast -650 m). Exports rose by 22% y/y, imports by 20%. The data confirm the general economic outlook with stable growth generated by domestic demand and exports. Trade deficit amounted to 246 m EUR, lower than in previous months. Services and transfers balances were similar to previous months, FDI inflow in November reached 1.4 b EUR. The C/A data have had virtually no effect on the market for the past few quarters and it was also the case this time.

FIXED INCOME

PS0412 a "best-buy"

It was a bullish week on the FI market. At first, lower than expected CPI published last Monday (at 1.4% y/y) sparked some 5-7bp strengthening, mainly on short end of the curve. Wednesday's 5Y auction was also a success with bid/cover ratio close to 5. Fitch's upgrade of Poland's rating sparked another rally, and also reversed the recent steepening tendency. This week economic releases - core CPI and retail sales shouldn't bring much of a change for the outlook. Also the

RECOMMENDATION:

switch auction scheduled for Wednesday should be neutral. Therefore we expect market to stay within a range for some time. We recommend using any strengthening behind 98.00 on PS0511 to sell bonds.

Range trading ahead. Sell into strengths.

MONEY MARKET***Stable carry***

***Bullish week, no reason ahead to break current levels
T-bills average yield down***

Another week of stable carry, despite of the fact that the liquidity projection by CB was missed again. Open market operation almost the same as week before (19.2 vs 19 billion pln) and it seems that this time we should see a surplus of the cash in the system.

Bullish CPI (1.4 vs 1.6% expected), bearish wages (8.5 vs 6.1 expected), excellent 5Y bonds auction, upgrade of Poland by Fitch, PPI and IO below the consensus. In total extremely bullish week and we moved 2 spreads left in prices. We should stay a while with current levels.

RECOMMENDATION:

Pay short Wibor sell long Polonia.

FOREIGN EXCHANGE***Zloty stronger******Volatility lower*****RECOMMENDATION:*****Zloty stable******Long Vega***

Last week the Zloty strengthened further to 3.8550, whereas USD/PLN traded a bit lower at around 2.9800.

Volatilities are correlated with the spot. As a result of the correction on the Zloty, volatilities fell again, especially in the front-end: EUR/PLN 1M trades at 6.8 (down from 7.4), 1Y at 7.2 (down from 7.4), USD/PLN 1M at 9.0, while the long end (1Y) decreased only a bit to 9.3.

Spot:
Main supports / resistances:
EUR/USD: 1.2860 / 1.3110
EUR/PLN: 3.8200 / 3.9000
USD/PLN: 2.9300 / 3.0200

In the following week we may see Zloty trade within a range. That is why we do not recommend any directional positions.

Options:

Any significant move of the spot outside the range should result in a considerable change of the volatilities levels as well. However, as long as spot maintains range bound, we do not recommend any directional positions.

MARKET PRICES UPDATE**MONEY MARKET RATES**

Money market rates (Closing mid-market levels)						
date	3M		6M		1Y	
	FXSW	WIBOR	FXSW	WIBOR	FXSW	WIBOR
15-01-07	4.10%	4.19%	4.20%	4.31%	4.39%	4.51%
16-01-07	4.10%	4.20%	4.20%	4.30%	4.38%	4.50%
17-01-07	4.10%	4.20%	4.20%	4.30%	4.40%	4.50%
18-01-07	4.09%	4.20%	4.18%	4.29%	4.35%	4.49%
19-01-07	4.09%	4.19%	4.16%	4.29%	4.31%	4.46%

FRA MARKET RATES

FRA Market Rates (Closing mid-market levels)					
date	1X4	3X6	6X9	9X12	6X12
15-01-07	4.23%	4.29%	4.47%	4.57%	4.55%
16-01-07	4.23%	4.28%	4.45%	4.57%	4.55%
17-01-07	4.23%	4.28%	4.45%	4.57%	4.55%
18-01-07	4.22%	4.24%	4.40%	4.51%	4.50%
19-01-07	4.22%	4.25%	4.41%	4.49%	4.51%

FIXED INCOME MARKET RATES

Fixed Income Market Rates (Closing mid-market levels)								
date	1Y		2Y		5Y		10Y	
	WIBOR	TB	IRS	OK1208	IRS	PS0511	IRS	DS1017
15-01-07	4.51%	4.19%	4.71%	4.31%	4.98%	4.83%	5.05%	5.14%
16-01-07	4.50%	4.15%	4.72%	4.32%	4.98%	4.85%	5.06%	5.16%
17-01-07	4.50%	4.17%	4.73%	4.34%	5.01%	4.87%	5.11%	5.20%
18-01-07	4.49%	4.17%	4.70%	4.31%	4.98%	4.80%	5.07%	5.16%
19-01-07	4.46%	4.16%	4.68%	4.27%	4.99%	4.80%	5.10%	5.19%

PRIMARY MARKET RATES

Last Primary Market Rates							
	au. date	maturity	avg price	avg yield	supply	demand	sold
52W TB	07-01-08	08-01-09	95.928	4.20%	900	2594	900
OK1208	06-12-06	08-12-12	91.311	4.62%	3800	10428	3800
PS0412	07-01-17	12-04-25	98.887	4.99%	2500	12108	2500
DS1017	07-01-10	17-10-25	100.070	5.24%	1800	4148	1800

FX VOLATILITY

date	USD/PLN 0-delta stradle				25-delta RR		25-delta FLY	
	1M	3M	6M	1Y	1M	1Y	1M	1Y
15-01-07	9.10	9.20	9.35	9.35	1.20	1.30	0.40	0.45
16-01-07	9.10	9.20	9.35	9.35	1.20	1.30	0.40	0.45
17-01-07	9.10	9.20	9.35	9.35	1.20	1.30	0.40	0.45
18-01-07	9.10	9.10	9.30	9.30	1.20	1.30	0.40	0.45
19-01-07	9.00	9.00	9.30	9.30	1.20	1.30	0.40	0.45

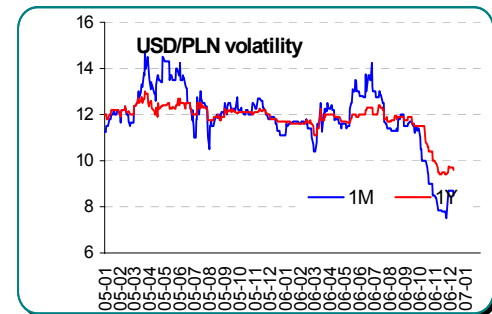
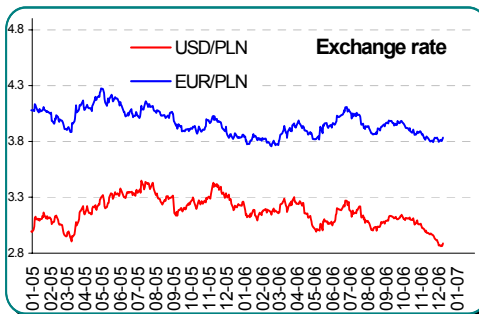
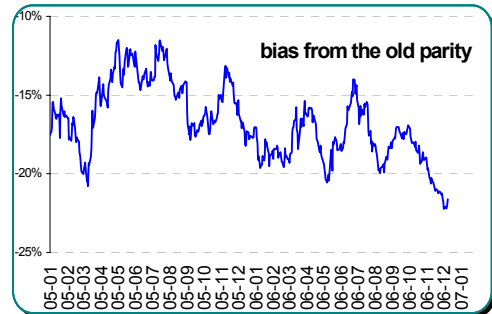
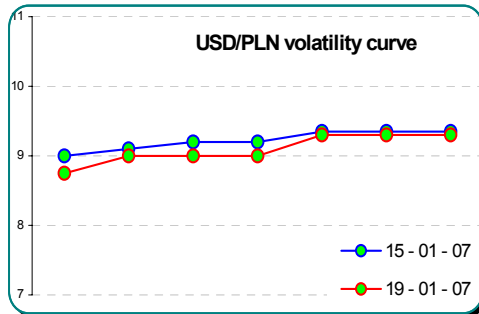
PLN SPOT PERFORMANCE

PLN spot performance			
date	USD/PLN	EUR/PLN	bias
15-01-07	2.9918	3.8728	-19.96%
16-01-07	2.9895	3.8770	-19.94%
17-01-07	3.0113	3.8914	-19.52%
18-01-07	2.9955	3.8787	-19.85%
19-01-07	2.9677	3.8490	-20.52%

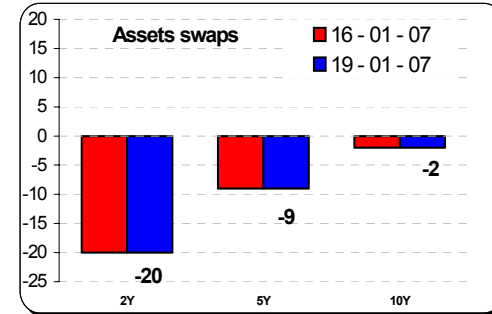
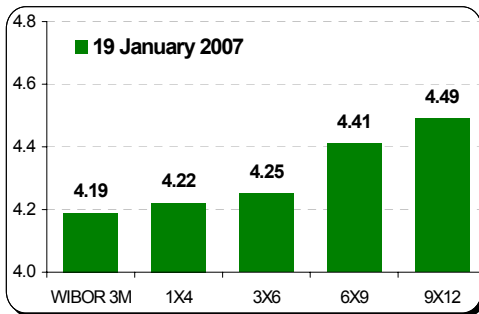
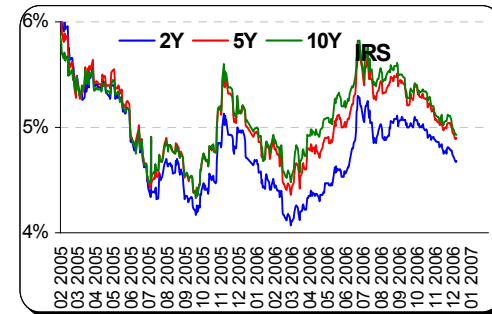
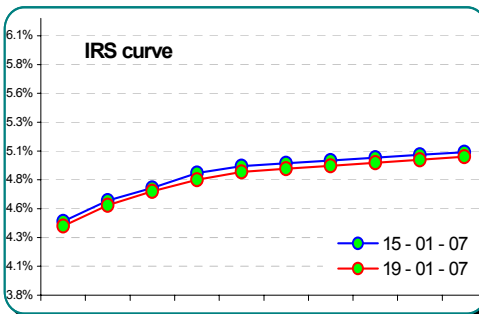
Note: parity on 11/04/00 – USD= 4.3806, EUR=4.2196, basket share 50:50
Mid-market volatility of vanilla option strategies

CHARTS

Foreign Exchange



Fixed Income



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CALENDAR

Macro

	October	November	December	Data Release	BRE Bank forecast
CPI m/m	0.1%	0.0%	-0.2%	15-02-07	
CPI y/y	1.2%	1.4%	1.4%	15-02-07	
PPI m/m	-0.5%	-0.7%	-0.3%	19-02-07	
PPI y/y	3.2%	2.5%	2.8%	19-02-07	
Industrial production growth m/m	4.3%	-2.7%	-6.8%	19-02-07	
Industrial production growth y/y	14.8%	12.0%	5.7%	19-02-07	
Average wages in enterprise sector [PLN]	2658.0	2759.7	3027.5	15-02-07	
Average wages in enterprise sector y/y	4.7%	3.1%	8.5%	15-02-07	
Unemployment	14.9%	14.8%		23-01-07	14.9%
Budget realisation (%)	54.4%	60.7%		25-01-07	82.0%
Current account [EUR mn]	-482	-510		12-02-07	
Balance of foreign trade in goods (transaction basis) [EUR mn]	-269	-246		12-02-07	
Exports growth y/y (transaction basis)	24.0%	22.0%		12-02-07	
Imports growth y/y (transaction basis)	27.7%	20.0%		12-02-07	
Current account [% of GDP]	-1.9%	-1.8%		12-02-07	
Money supply (M3)	458.6	465.7	477.1	14-02-07	
Money supply growth y/y	12.3%	14.4%	15.7%	14-02-07	
Total PLN loans [PLN bn]	353.0	361.5	367.3	14-02-07	
Households PLN loans	183.0	183.3	188.5	14-02-07	
Corporate PLN loans	139.6	141.3	143.3	14-02-07	
Total PLN deposits [PLN bn]	378.4	385.3	397.1	14-02-07	
Households PLN deposits	214.3	214.8	223.2	14-02-07	
Corporate PLN deposits	113.8	116.9	124.9	14-02-07	
NBP intervention rate	4.00%	4.00%	4.00%	31-01-07	4.00%

Auctions

	next auc.	offer	avg yield last	last auction date
13 Week T-bills	-	-	4.208%	16-01-06
26 Week T-bills	-	-	3.943%	24-04-06
52 Week T-bills	22-01-07	-	4.198%	08-01-07
2Y T-bond OK1208	07-02-07	-	4.617%	06-12-06
5Y T-bond PS0412	21-02-07	-	4.985%	17-01-07
10Y T-bond DS1017	11-04-07	-	5.240%	11-10-06
20Y T-bond WS0922	14-03-07	-	5.707%	13-09-06

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