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FINANCIAL MARKETS DEPARTMENT

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POLAND WEEKLY REVIEW

MACROECONOMICS AND FINANCIAL MARKETS

PREVIEW: The week of November 30th to December 6th

Indicator	Date of release	Period	BRE forecast	Consensus	Last	Comment
GDP y/y	**Nov 30**	**Q 3**	**5.8% y/y**	5.9%	6.4%	Anticipated slowdown in GDP growth stems from two main observations: lower retail sales that negatively influenced consumption (for Q3 we see a 6.1% rise in consumption and regard the Q2 fall in dynamics as an outlier) together with flattened construction and industrial output: proxies for lower growth of fixed capital investment (we see 15% y/y rise).
FinMin's forecast of inflation	**Dec 3**	**Nov**	**3.5% y/y**	3.3%	3.0%	Inflation rises on the back of higher food prices

In Focus / Macroeconomics

Polish MPC hiked the rates by 25 bps – more hikes likely to come

In our opinion, the chances for the December hike stay now at 50/50

The MPC has met market expectations by hiking the rates by 25 bps to 5.0% and issuing quite a hawkish statement. The Committee acknowledged that the economic growth may slow down a bit in the coming quarters, in line with the actual central bank's projection. However, the focus shifted clearly towards mounting inflationary risks. In the statement the Committee pointed to rising wages and labor costs, higher food price pressure coming from the global economy and pro-cyclical fiscal policy. Importantly, the MPC admitted that antyinflationary effects related to superior financial standing of enterprises and high investment may not balance the second round effects coming from elevated CPI inflation. The "hawkishness" of the statement is clearly visible in its last passage: the Committee skipped the usual part that the implemented hikes have lowered the inflation risk and added that the future monetary policy should pull the inflation back to the target level of 2.5%.

During the Q&A session the influential MPC members Slawinski and Wojtyna listed the reasons behind their decision; the Committee responded to rapid wage growth, demand driven inflationary pressure, higher food prices. In Woityna's opinion there was no need for 50 bps steps now, as the situation is not changing in a really unexpected manner. The comments that followed and especially their coverage by information agencies may seem however a bit confusing; during the Q&A Session the Committee members have been confronted with an awkward question whether the Committee missed their chance to stabilize inflation. One could expect only one answer – the members stated that the Committee still operates in a comfort zone and prevented the real rates to fall below zero.
The MPC may be still very unwilling to hike the rates at its meeting in December. Other MPC member, J. Czekaj, stated that there may be not enough new data to decide on an eventual hike. This argument seems not very convincing to us – by the 19th of December inflation, wages and production data will be released.

In our opinion, the chances for the December hike stay now at 50/50. Higher inflation reading for December (3.5% according to our estimates), rising wages and fairly good data on industrial output may raise the likelihood of the December rate hike. Any downward deviations of the actual figures may be seen as a good excuse for the Committee to postpone the hikes till January – note that, contrary to market participants, the MPC place much more attention to the scale of the tightening, not its actual timing. We expect the rates to top 5.75% by the end of the first quarter of 2008 on the back of rising inflation.

New Polish government - trust credit granted, it is time for action

J. Rostowski, the new Minister of Finance, announced recently the priorities of the new government. Among them there are: limiting public debt, simplification of tax system, raising expenditures on education and road infrastructure, accelerating privatization and preparing Poland for an entry to euro zone. So far, the new cabinet has to base on the budget bill prepared by the former government, however, the deficit is planned to be ultimately reduced by up to 1.5 bn PLN.

Although there is no time to change the budget bill considerably, the new government wishes to make some alterations on the expenditures side

Although there is no time to change the budget bill considerably, the new government wishes to make some alterations on the expenditures side. The reduction of the deficit will be achieved by trimming the growth rate of government outlays and not their absolute volume. It is consistent with inter-temporal approach to fiscal policy. The same applies to the reasoning concerning taxes. The new head of the Ministry of Finance claims that lowering the marginal tax rate promotes economic growth and thereby allows the level of revenues to rise. Such a boost to public treasury may then be used to finance "justified" social-spending. It is the way the new government reconciles the liberal interests with elements of welfare state. It is said that such fiscal experiments were successful in Slovakia, although there are still concerns whether the extraordinary growth had been indeed triggered by tax stimuli or rather it had been promoted by consequently realized policy of government outlays on infrastructure. As in most such cases, the truth lies somewhere in between.

J. Rostowski is willing to meet with the MPC in order to elaborate a more beneficial policy-mix. It has to be regarded as a very positive sign towards fiscal and monetary policy cooperation. Such an approach is to be welcomed by the MPC, recently grumbling on the extent of government expenditures. However, the 2008 budget bill is lost to major amendments – the discussion may then be focused on future spending composition and thus on mid-term perspective (consistent with monetary policy horizon). The meeting with MPC may also touch issues concerning the Poland's entering to euro zone. A more balanced view (entering the EMU after complying with the convergence criteria) presented by the Ministry of Finance is to be, in our assessment, warmly welcomed not only by the National Bank of Poland but also by the European Central Bank.

Already large trust credit given to the new government has been recently extended. Moody's and Fitch promised to raise the rating of Poland in case when the planned reforms are realized. It is then of greatest importance for the government to truly reduce (even slightly) the size of deficit in the new budget bill and win the struggle to stick with it.

MEDIUM-TERM FORECATS

Indicator	2006	2007	2008
GDP y/y (%)	6.1	6.5	5.4
Inflation rate (%)	1.0	2.4	3.5
Current account (% of GDP)	-2.1	-4.5	-5.3
Unemployment rate (end-of-year)	14.9	11.5	9.8
NBP repo rate (end-of-year)	4.00	5.00	**6.0**

Source: GUS, NBP, BRE Bank, ***bold*** *change on last week*

Fixed Income

Falling behind the curve...

MPC's decision to hike rates by 25bp was in line with market expectations and caused hardly any reaction. The statement that followed suggested Council's growing concern about the future - they didn't reiterated that already delivered tightening is helping to curb inflation, they also see worsening ratio between wages and productivity. For us that means the actions they undertook so far are not enough and they're constantly falling more and more behind the curve. What is really surprising (not to say scaring or shocking) is, how relaxed about the policy some of the members are. Inflation is accelerating, economy is booming, wages are growing. Wait-and-see policy and small-hike-once-in-a-while isn't convincing the market, that situation is under control. Moreover, MPC's wording and reaction seem to rely strongly on current inflation. We expect the next headline CPI to come out at 3.5, data for December even higher than that. Also core inflation will start growing soon, and wages are still in the uptrend. Therefore we think rate hike in December is a possible outcome, also 50bp move within next few months cannot be ruled out. In such circumstances, short end of the still presents good value. We recommend paying 3x6 FRA and adding to that position on all the strengthening.

RECOMMENDATION:

Pay 3x6 FRA

AUCTIONS

	next auc.	offer	avg yield last	last auction date
13 Week T-bills	-	-	4.208%	1/16/2006
26 Week T-bills	-	-	3.943%	4/24/2006
52 Week T-bills	12/3/2007	-	5.312%	11/5/2007
2Y T-bond OK0709	12/5/2007	-	5.676%	11/5/2007
5Y T-bond PS0413	2/6/2008	-	5.943%	11/21/2007
10Y T-bond DS1017	2/13/2008	-	5.699%	10/25/2007
20Y T-bond WS0922	1/9/2008	-	5.796%	9/12/2007

Money Market

Another squeeze at the end of the reserve

December will be very nervous month for liquidity

The MPC raised all market rates by 25 bps.

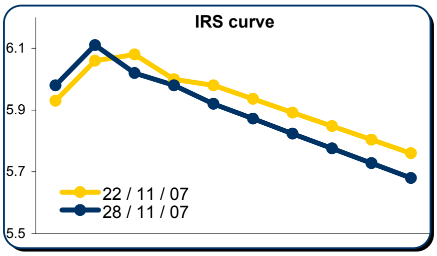
Too high open market operation squeezed the market for the whole last week of the reserve requirements settlement period. Even though surplus of the cash in the system should provide cheap carry, unsymmetrical liquidity layout plus counterparty limit problems lifted shortest rates very high. Open question is why market participants bought all those money bills? We do not see any reasonable answer. Next week should be stable nearby the main market rate, even if this time to less money bills will be absorbed, everyone will use this opportunity to build the reserve. December will be very fragile month as far as liquidity is concerned.

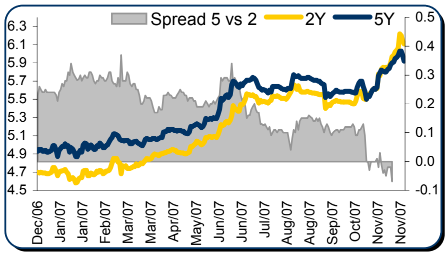
The MPC raised all the market rates by 25 bps, just as majority expected. Clinching that forecast was an unexpectedly robust set of October indicators, including 11% annual increase in corporate wages and 19.4% rise in retail sales, both suggesting increasing demand pressure. That comes on top of a food-driven surge in annual inflation to 3%. Nonetheless, we bet on another 25 bps hike in January.

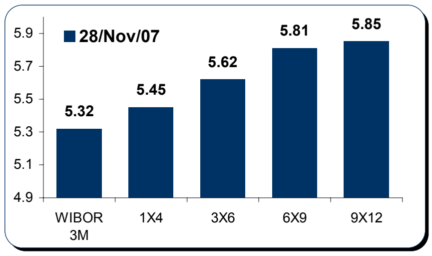
RECOMMENDATION:

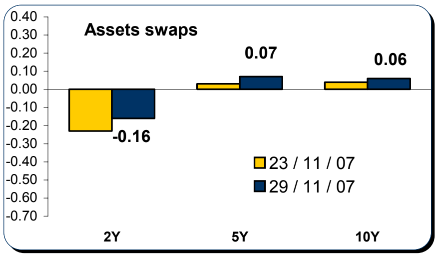
Pay 6m OIS.

FIXED INCOME & MONEY MARKET CHARTS









Foreign Exchange

Zloty stronger

This week złoty was traded between 3.7000 and 3.6350. Such performance improving was caused by high expectations for rate hikes and fresh statements from rating agencies about possible economy betterment.

Volatility curve still reversed

Slow approaching toward EURPLN option barriers placed at 3.60 and below keeps short end on demand side with 1M trading around 7 and above.

RECOMMENDATION:

Look for upticks to sell EURPLN

Spot:
Main supports / resistances:
EUR/PLN: 3.6000 / 3.6750
USD/PLN: 2.4200 / 2.5000

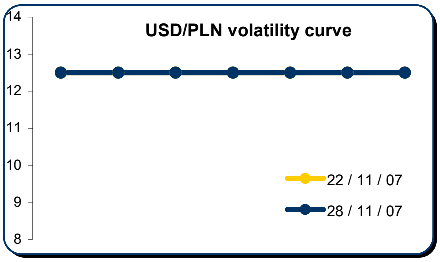
We believe zloty will go stronger before Christmas with 3.6000 as first target.

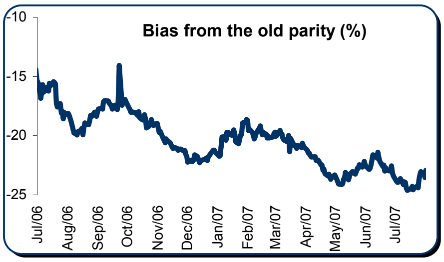
Options:

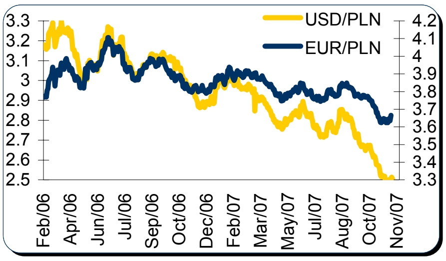
Sell mid-curve vega

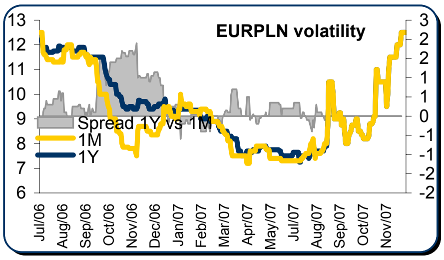
We see 2M and 3M present levels as opportunities to take some short vega/gamma, especially due to Christmas being part of options life.

FX CHARTS









MARKET PRICES UPDATE

MONEY MARKET RATES

Money market rates (Closing mid-market levels)

date	3M		6M		1Y	
	FXSW	WIBOR	FXSW	WIBOR	FXSW	WIBOR
22/11/07	5.50%	5.43%	5.49%	5.64%	5.77%	5.86%
25/11/07	5.50%	5.43%	5.49%	5.64%	5.77%	5.86%
26/11/07	5.50%	5.43%	5.49%	5.64%	5.77%	5.86%
27/11/07	5.50%	5.43%	5.49%	5.64%	5.77%	5.86%
28/11/07	5.50%	5.43%	5.49%	5.64%	5.77%	5.86%

FRA MARKET RATES

FRA Market Rates (Closing mid-market levels)

date	1X4	3X6	6X9	9X12	6X12
22/11/07	5.57%	5.78%	5.97%	6.02%	6.04%
25/11/07	5.57%	5.78%	5.97%	6.02%	6.04%
26/11/07	5.57%	5.78%	5.97%	6.02%	6.04%
27/11/07	5.57%	5.78%	5.97%	6.02%	6.04%
28/11/07	5.57%	5.78%	5.97%	6.02%	6.04%

FIXED INCOME MARKET RATES

Fixed Income Market Rates (Closing mid-market levels)

date	1Y		2Y		5Y		10Y	
	WIBOR	TB	IRS	OK0709	IRS	PS0511	IRS	DS1017
22/11/07	5.86%	5.08%	5.57%	5.29%	5.72%	5.69%	5.73%	5.76%
25/11/07	5.86%	5.05%	5.57%	5.29%	5.71%	5.68%	5.72%	5.76%
26/11/07	5.86%	5.05%	5.57%	5.34%	5.71%	5.67%	5.71%	5.76%
27/11/07	5.86%	5.05%	5.56%	5.30%	5.71%	5.65%	5.72%	5.75%
28/11/07	5.86%	5.03%	5.56%	5.34%	5.70%	5.68%	5.70%	5.75%

PRIMARY MARKET RATES

Last Primary Market Rates

	au. date	maturity	avg price	avg yield	supply	demand	sold
52W TB	07/10/22	08/10/22	95.056	5.14%	500	1177	500
OK0709	07/11/07	09/07/25	90.993	5.68%	1700	3622	1700
PS0413	07/11/21	13/04/25	96.810	5.94%	2200	2611	2200
DS1017	07/10/10	17/10/25	96.607	5.70%	1800	5061	1800

FX VOLATILITY

	USD/PLN 0-delta stradle				25-delta RR		25-delta FLY	
date	1M	3M	6M	1Y	1M	1Y	1M	1Y
22/11/07	11.25	10.50	9.80	9.50	0.60	0.75	0.30	0.35
25/11/07	11.25	10.50	9.80	9.50	0.60	0.75	0.30	0.35
26/11/07	11.25	10.40	9.80	9.50	0.60	0.75	0.30	0.35
27/11/07	11.50	10.30	9.60	9.50	0.60	0.75	0.30	0.35
28/11/07	11.50	10.15	9.60	9.35	0.60	0.75	0.30	0.35

PLN SPOT PERFORMANCE

PLN spot performance

date	USD/PLN	EUR/PLN	bias
22/11/07	2.4857	3.6855	-33.23%
25/11/07	2.4725	3.6754	-33.47%
26/11/07	2.4876	3.6912	-33.14%
27/11/07	2.4851	3.6649	-33.48%
28/11/07	2.4720	3.6445	-33.84%

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

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