



TOP NEWS FROM THE POLISH MARKET

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MACROECONOMICS

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CPI at 1.6% y/y in December according to Reuters survey

We lowered retail sales forecast after SAMAR data

The Parliament approved Sławomir Skrzypek for the president of the NBP. He didn't reveal his view on the monetary policy and whether his aversion to inflation is higher than the MPC median voter. We believe that he has no clear view on the further monetary policy and that this view will form in the coming months. In our opinion this nomination will not have a strong direct impact on the monetary policy conducted by the MPC because Skrzypek is only one out of 10 members with one vote. However Skrzypek is not only an MPC member but he is also the president of the central bank as well. He will have an impact on the inflation projection and other research prepared by NBP staff. We believe that this indirect influence on the MPC decisions may be stronger than direct voting.

It is noteworthy that the career of the new central governor is strongly connected with Polish president Kaczyński and it is questionable if he will be able to defend the independence of the central bank in face of political pressure.

It is very likely that in the near future Skrzypek will avoid controversial announcements, which may upset the market. We think the crucial issue for the assessment of his resistance against political pressure is staffing policy in the NBP.

According to MPC member Marian Noga, the Council should now hike the rates to prevent the inflation rising in 2008. Marian Noga indicates that not raising the rates would result not only in a higher inflation but would also curb the inflation expectations so that the Council would have to hike the rates more aggressively in the future. Simultaneously, Professor Noga notes that in the Council itself there is no majority required to change the stance on monetary policy and the rates will be hiked only if inflation unexpectedly breaches the level of 2.5%. In his opinion, however, inflation breaching 2.0% should be seen as a signal for the MPC to react. According to our own estimates the headline inflation will temporarily exceed 2.0% in March. The Council should however not raise the rates too early because inflation will fall again in the second and third quarters of 2007.

In the last week we also experienced quite a hawkish statement from Professor Sławinski. He said that in the wake of strong economic growth it would be necessary to tighten the monetary policy to stabilize inflation around the targeted 2.5%. The latest statements by Professor Sławiński indicate that he might have changed his view regarding factors affecting Polish inflation. Indeed, he did not point to the anti inflationary effects of globalization but shifted his focus towards domestic factors such as closing the output gap. As the change in Professor Sławinski's view on the inflationary processes has rather an evolutionary and not revolutionary character, we do not suspect that he will back the hikes in the upcoming months.

According to a Reuters survey, analysts expect CPI in December to have risen to 1.6% (in line with our forecast). Also the expected PPI complies with our forecast (3.0% y/y). Our forecasts of wages (6.7% y/y) and industry output (6.3% y/y) differ from the consensus more significantly (6.1% and 8.3% respectively). Most analysts expect that the MPC will hike interest rates this year by 50 bps, with the first hike taking place in March or April. The scale of hikes is in line with our base scenario, though we expect no moves in interest rates until at least April Q1.

The SAMAR institute published data on vehicle production and sales in December. Both dynamics were lower than in previous months (sales rose by 15.6% y/y, production by 3.1%). Whereas this has no influence on our industry output forecast (we expected the production to be lower in December), we decided to lower the forecast of retail sales to 13.8% (market consensus at 14.1%).

Unemployment rate rose to 14.9% in December, the rise is visibly lower than implied by pure seasonality

The MPiPS stated that the unemployment rate rose to 14.9% in December from 14.8% in November. The number of unemployed rose by 23.7k. The Ministry reckons that apart from seasonal lay offs, some active unemployment prevention policies ended in December causing higher unemployment registrations. We expected the unemployment rate to drop slightly in December, but the observed rise is still better than the seasonal pattern. In December the number of unemployed usually rises by some 50k and the unemployment rate by 0.3-0.4 pct pts. In January we expect the unemployment rate to rise by ca. 0.3 pct pts, in February a stabilization may be observed, and from March onwards we expect the unemployment rate to start dropping again.

M3 supply rose by 15.7% y/y in December

Money supply (M3) rose in December by 2.4% m/m (15.7% y/y), exceeding market consensus (14.3%) and our forecast (14.9%). The trends observed in previous months were strengthened in December – corporate loan dynamics grew yet again reaching 14.7% y/y. Also household loan growth remained firm (33.4% y/y). Corporate deposits in December grew by 8 b PLN. This is a partly seasonal effect (e.g. faster VAT refunds), but its scale is higher than in previous years. The constantly rising dynamics of corporate loans confirms the continuous pick up in investments

FIXED INCOME

Good 10y bond auction, 2y10y steepener trade of the week

Last week was rather calm on the FI market. The main event was the 10y bond auction which initiated some selling in longer end of the curve. The sentiment was rather poor not only in Poland but almost all EM currencies lost in the first 3 days of the week. Auction demand was quite high, minimum price came just at the low of market expectations, overall auction was much better than market had expected. This has changed the market sentiment. Last days of the week we saw significant steepening of the curve with 2y10y spread being the main trading contract. 2y10y spread moved by some 7-8bp to 43 middle. We have some figures this week, and we expect some to be surprise for the market, especially wages figure. We maintain our view that we will have higher rates in not so distant future. We recommend staying pay in the 9x12s FRA.

RECOMMENDATION:

Stay pay 9x12s.

MONEY MARKET

Stable carry

Stable carry all over the week plus again open market operation above the expectations (19 billion pln vs 20.3 billion pln – 18 billion pln expected). Moreover, again CB's liquidity projection shows nice surplus of the cash, but last week this projection was quite missed. Market is calm because it is the beginning of the reserve, however if they carry on like this we can not exclude another squeeze.

Lots of volatility but not for the rates up to 1Y

Painful week for the polish currency and bearish sentiment for interest rates, then a very nice 10Y bond auction and U turn for the sentiment, then Bank of England stopped the rally for the moment and then bullish end of the week counting on new president of the polish CB to delay rates hike. As we can see lots of volatility, however short rates were relatively small affected, the whole impact was in longer terms. Once the firm trend shows up, MM will follow it too.

T-bills average yield down

The average yield on Polish benchmark 52-week T-bill down to 4.198 from 4.212%. The Ministry sold all 0.9 billion pln of 52-week papers giving the bid-to-cover ratio of 2.88.

RECOMMENDATION:

Sell 6M Polonia.

FOREIGN EXCHANGE**Zloty stronger**

Last week the Zloty strengthened - EUR/PLN fell from 3.9100 (local high) to 3.8700, whereas USD/PLN traded stable around 3.000 due to the fall of the EUR/USD.

Volatility lower

Volatilities are correlated with the spot. As a result of the correction on the Zloty, volatilities fell, especially in the front-end: EUR/PLN 1M from 8.4 to 7.6, 1Y from 7.6 to 7.4, USD/PLN 1M from 9.5 to 9.1, while the long end (1Y) stayed flat at 9.5.

RECOMMENDATION:**Zloty stable**

Spot:
Main supports / resistances:
EUR/USD: 1.2860 / 1.3110
EUR/PLN: 3.8500 / 3.9000
USD/PLN: 2.9300 / 3.0500

In the following week we may see Zloty trade within a range. The weakening to 3.9500 is still possible, however at the moment it doesn't seem to happen soon. Long term we are bullish on the Zloty.

Long Vega

Options:

We still believe that there is potential for a move up, especially on the long end. That is why we still recommend long Vega positions..

MARKET PRICES UPDATE**MONEY MARKET RATES**

Money market rates (Closing mid-market levels)						
date	3M		6M		1Y	
	FXSW	WIBOR	FXSW	WIBOR	FXSW	WIBOR
08-01-07	4.11%	4.20%	4.23%	4.30%	4.43%	4.51%
09-01-07	4.11%	4.20%	4.23%	4.30%	4.43%	4.51%
10-01-07	4.11%	4.20%	4.23%	4.31%	4.43%	4.51%
11-01-07	4.11%	4.20%	4.23%	4.31%	4.46%	4.51%
12-01-07	4.11%	4.20%	4.23%	4.31%	4.46%	4.51%

FRA MARKET RATES

FRA Market Rates (Closing mid-market levels)					
date	1X4	3X6	6X9	9X12	6X12
	08-01-07	4.25%	4.35%	4.53%	4.65%
09-01-07	4.24%	4.33%	4.53%	4.64%	4.65%
10-01-07	4.25%	4.35%	4.56%	4.68%	4.66%
11-01-07	4.24%	4.34%	4.53%	4.64%	4.64%
12-01-07	4.24%	4.34%	4.52%	4.62%	4.64%

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
08-01-07	4.51%	4.19%	4.71%	4.31%	4.98%	4.83%	5.05%	5.14%
09-01-07	4.51%	4.15%	4.72%	4.32%	4.98%	4.85%	5.06%	5.16%
10-01-07	4.51%	4.17%	4.73%	4.34%	5.01%	4.87%	5.11%	5.20%
11-01-07	4.51%	4.17%	4.70%	4.31%	4.98%	4.80%	5.07%	5.16%
12-01-07	4.51%	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
PS0511	06-11-15	11-05-24	97.047	4.99%	2000	4852	2000
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
08-01-07	9.30	9.25	9.40	9.40	0.90	1.25	0.40	0.45
09-01-07	9.30	9.25	9.40	9.40	0.90	1.25	0.40	0.45
10-01-07	9.50	9.40	9.40	9.35	0.90	1.25	0.40	0.45
11-01-07	9.50	9.40	9.40	9.35	0.90	1.25	0.40	0.45
12-01-07	9.50	9.40	9.40	9.35	0.90	1.25	0.40	0.45

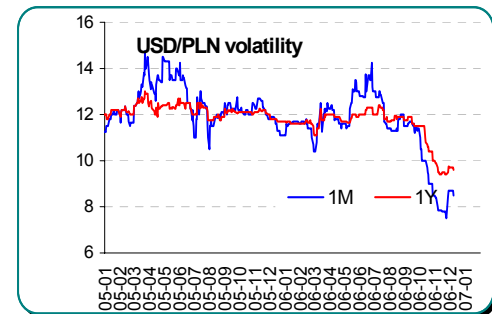
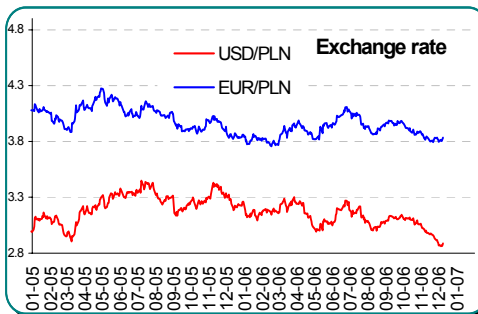
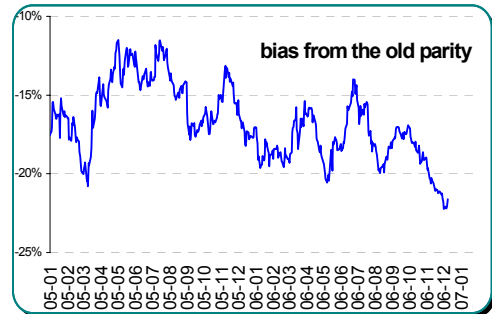
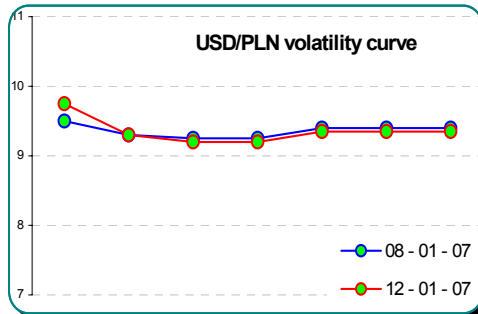
PLN SPOT PERFORMANCE

PLN spot performance			
date	USD/PLN	EUR/PLN	bias
08-01-07	2.9788	3.8754	-20.08%
09-01-07	2.9647	3.8635	-20.38%
10-01-07	2.9943	3.8898	-19.73%
11-01-07	2.9889	3.8771	-19.94%
12-01-07	3.0045	3.8785	-19.75%

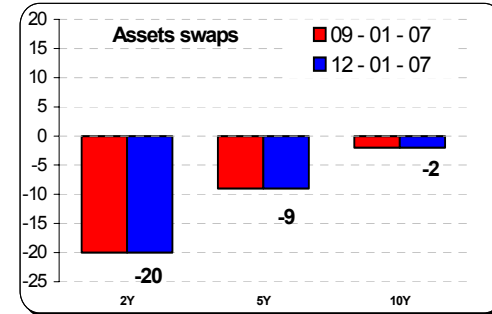
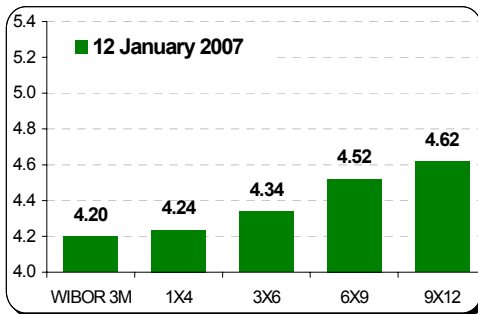
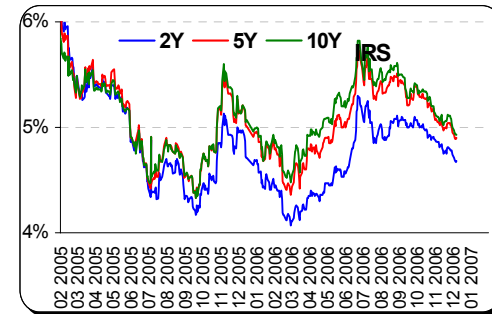
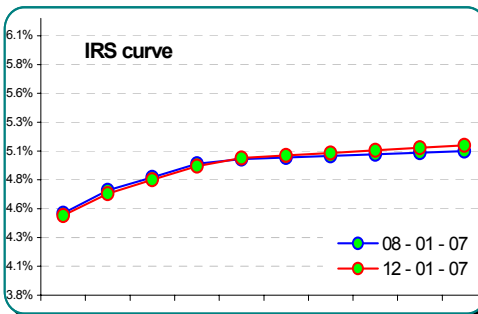
Note: parity on 11/04/00 – USD= 4.3806, EUR=4.2196, basket share 50:50
Mid-market volatility of vanilla option strategies

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%		15-01-07	0.0%
CPI y/y	1.2%	1.4%		15-01-07	1.6%
PPI m/m	-0.5%	-0.5%		19-01-07	-0.2%
PPI y/y	3.2%	2.6%		19-01-07	3.0%
Industrial production growth m/m	4.3%	-2.9%		19-01-07	-6.1%
Industrial production growth y/y	14.8%	11.7%		19-01-07	6.3%
Average wages in enterprise sector [PLN]	2658.0	2759.7		16-01-07	2976.0
Average wages in enterprise sector y/y	4.7%	3.1%		16-01-07	6.7%
Unemployment	14.9%	14.8%		23-01-07	14.9%
Budget realisation (%)	54.4%	60.7%		15-01-07	82.0%
Current account [EUR mn]	-482			16-01-07	-653
Balance of foreign trade in goods (transaction basis) [EUR mn]	-269			16-01-07	-526
Exports growth y/y (transaction basis)	24.0%			16-01-07	20.5%
Imports growth y/y (transaction basis)	27.7%			16-01-07	22.3%
Current account [% of GDP]	-1.9%			16-01-07	-1.8%
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 PS0511	17-01-07	-	4.987%	15-11-06
10Y T-bond DS1017	-	-	5.240%	11-10-06
20Y T-bond WS0922	14-03-07	-	5.707%	13-09-06

CONTACT DETAILS

BRE BANK SA

**ul. Senatorska 18
00-950 Warszawa
P.O. Box 728
Poland**

**Reuters Pages:
BREX, BREY, and
BRET**

Bloomberg: BRE

SWIFT: BREXPLPW

www.brebank.com.pl

Forex (BREX) - FX Spot & Options

*Marcin Turkiewicz (+48 22 829 01 84) Marcin.turkiewicz@brebank.com.pl
Jakub Wiraszka (+48 22 829 01 73)
Tomasz Chmielarski (+48 22 829 01 78)*

Fixed Income (BREP) - FRA, IRS, T-Bonds, T-Bills

*Łukasz Barwicki (+48 22 829 01 93) Lukasz.barwicki@brebank.com.pl
Paweł Białczyński (+48 22 829 01 86)*

MM (BREP) - MM, FX Swaps

*Tomasz Wołosz (+48 22 829 01 74) Tomasz.wolosz@brebank.com.pl
Bartłomiej Małocha (+48 22 829 01 77)*

Structured Products (BREP)

*Jarosław Stolarczyk (+48 22 829 01 67) Jaroslaw.stolarczyk@brebank.com.pl
Jacek Dereziński (+48 22 829 01 69)*

Institutional Sales (BRES)

Inga Gaszkowska-Gębska (+48 22 829 12 05)

Research

*Jacek Kołowski (+48 22 829 01 83) Research@brebank.com.pl
Ernest Pytlarczyk (+48 22 829 01 66)
Artur Ulbrich (+48 22 829 12 07)*

Financial Markets Department

Phone (+48 22 829 02 03)
Fax (+48 22 829 02 45)

Treasury Department

Phone (+48 22 829 02 02)
Fax (+48 22 829 02 01)

Financial Institutions Department

Phone (+48 22 829 01 20)
Fax (+48 22 829 01 21)

Back Office

Phone (+48 22 829 04 02)
Fax (+48 22 829 04 03)

Custody Services

Phone (+48 22 829 13 50)
Fax (+48 22 829 13 49)