



TOP NEWS FROM THE POLISH MARKET

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MACROECONOMICS

The MPC kept the interest rates on hold in January.

The MPC kept the interest rates on hold in January at 4.0%, in line with broad expectations. In its communiqué the Council stressed that the current interest rate level helped to keep the CPI inflation near target in the mid term. One could also find there quite hawkish phrases, such as “a rate rise may be needed to stabilize the inflation and economic growth”, which for the first time appeared in December’s communiqué. However, this time, the statements in question referred to the long term that seems to be beyond the monetary policy scope.

“The current interest rate level helps to keep the CPI inflation near target in the mid term” – stated the MPC

The council agreed that in spite of a gradual rise in wage growth, the inflationary pressure would remain subdued in the mid term. In addition, the external environment including lower oil price and low prices for tradables, will remain favourable for the CPI inflation. The Council stressed that the inflation may stay below the Central Bank staff’s forecast (see below) in the upcoming months. During the conference the MPC members directly expressed their doubts regarding the credibility of the ECMOD – an econometric model that is currently used for inflation forecasting at the Central Bank. S. Skrzypek said that the Council also took into account other data than those produced by the ECMOD forecasts when deciding on the interest rates. Professor Wojtyna added that the ongoing changes in the Polish economy including globalization may mean that existing models are misspecified and do not properly estimate the pass-through from the world economy.

The low oil price and lower prices of tradables will reduce the inflationary pressure

The following day the full version of the inflation report including inflationary projection was released. The opinions expressed by the Central bankers clearly reduced the impact the report had on the financial markets. In addition, the NBP staff admits that the model probably overestimates the negative impact of labour market processes on the inflation path.

NBP projection: CPI will hit 2.5% in Q2 07 and exceed 3.5% in 2009

According to the projection the CPI will hit 2.5% in Q2 2007 and after some easing in Q3, CPI will continue to rise later on, exceeding 3% in 2008 and 3.5% (the upper band of the inflationary target) in 2009.

MPC members still divided on interest rates hikes need

The conference after the MPC meeting was the first opportunity for the new governor of the Central Bank to express his view on the monetary and economic policy matters. S. Skrzypek was, let’s say, very “politically correct” and quoted widely accepted phrases of Milton Friedman and other founding fathers of monetary economics. The new governor gave notice that he generally opposed forex interventions but he was aware of the possibility to use this instrument in extraordinary situations.

H. Wasilewska-Trenkner stated that the MPC should start considering rate hikes soon, in the first half of the year at best. M. Noga presented a similar view, referring to inflationary projection. He thinks that because of inflation risks the MPC will have to consider tightening monetary policy soon, and he could not exclude such a move this year.

J. Czekaj on the other hand admitted that inflationary pressure is, at the moment, limited. He added however that the continued acceleration of GDP growth may start exerting some more significant pressure, forcing the MPC to tighten monetary policy.

MF: CPI rose to 1.7% in December

The MF presented its inflation forecast for January – 0.5% m/m and 1.7% y/y. The rise in CPI (from 1.4% in December) is due to higher housing costs (rise in gas prices causing a rise of over 1% m/m in the category) and food prices (0.8% m/m). The MF estimates are in line with our upper band of preliminary forecasts. If CPI was to rise to 1.7% in January, net inflation would rise to 1.7-1.8% from 1.6% in December.

We assess that the prospects for inflation will remain favourable in the mid term (our forecast for December 2007 is 2.3%; in 2008 inflation will oscillate around the central bank’s target). As the

In our view, the interest rates will remain on hold in 2007

Council clearly changed the way it communicates with the market (among other things the MPC aimed to publish its minutes), we can conclude that there is also a difference in the way they look at inflationary processes. We uphold our view that there will be no interest rate hikes in 2007. The higher inflation rates approaching 2% in the second half of 2007 and a gradual rise in the core inflation will probably induce expectations for interest rate hikes starting in autumn 2007.

FIXED INCOME

Dovish MPC statement

The main event on the PLN rates was MPC meeting. Monday and Tuesday we saw market weakening, as sentiment in the whole region was rather poor. We saw curve flattening, there was strong interest to pay short end of the curve, 1y3s traded as high as 4.50 and 2y at 4.73. The sentiment has changed after MPC conference. The statement was rather dovish, and we saw short part of the curve shifting lower. On the Thursday opening 2y traded as low as 4.62, 5y at 4.92. But the initial rally was spoiled by quite high MinFin CPI estimate for January (at 1,7% yoy). Thursday and Friday we saw some heavy trading, with lack of directions, curve did not managed to come out from the range in the 5y (4.90-5,00). Our best guess is we will stay in range, we prefer to stay pay in 9x12 ag short 3x6 or 6x9 FRA. We think 2-5y sector can drift higher in yield. This week we will have 2y bond auction, auction will be small, we expect prices to be rather high as there is limited supply in the short dated bonds.

RECOMMENDATION:

Short curve steeper

MONEY MARKET

Very cheap end of the reserve

Just as we were forecasting very cheap end of the reserve. The whole system located 2.5 billion PLN in the central bank for the last day and this amount best reflects how over liquid was the market. Hence, for the beginning of the week carry was nearby the deposit rate which is 2.5%. On Wednesday, as the new reserve started, shortest rates bounced back to the main rate levels. On Friday the CB offered 21,0 billion PLN of money bills (20,0 billion during the previous auction), which should more or less square the liquidity for coming days.

Higher then expected CPI forecast by Min-Fin

As for longer terms very boring week. Higher then expected CPI forecast by the MinFin was the only event. However, the reaction was not too intense. It seems that anyone has any idea what to do, and everybody is waiting for any trigger.

The MPC left all the rates unchanged

As for longer terms the MPC left all parameters of the monetary policy unchanged, just as everyone expected. However, bullish sentiment literally exploded after conference and the MPC statement. It was not bullish itself, however it seems that it was not as hawkish as majority expected as well. This sentiment dominated the end of the week.

Not too hawkish statement triggered bullish sentiment

Correction should be seen soon. Polish zloty has already lost some of its value.

RECOMMENDATION:

Sell Polonia up to 9 and 12 M on hikes.

FOREIGN EXCHANGE

Zloty volatile

Central European currencies were very volatile, last week. We started the week with the sour global sentiment due to partial unwinding of the carry trades (especially on XXX/CHF and XXX/JPY), that caused the correction on all C4 currencies. EUR/PLN reached its peak at 3,9520 which for USD/PLN was 3,0650. Later in the week FED comments brought the relief really for all EM currencies.

Volatility rising

The volatility kept its well defined correlation to spot, raising when we have hit 3,95 and falling slowly when Polish zloty rebuilds. We are still below last year's medians and we think that's "buy on dips" strategy is more rational in the current circumstances.

RECOMMENDATION:

Sell Zloty

Spot:
Main supports/resistances:
EUR/USD 1.2900 / 1.3050
EUR/PLN 3.8650 / 3.9300
USD/PLN 2.9850 / 3.0500

We see current pullback on EUR/PLN and USD/PLN as the buying opportunity. We think the global sentiment will be still exposed to carry trades reductions. That's puts C4 currencies on the line of fire. The technical picture is also backing that idea.

Warning, please be disciplined on executing stop/losses on the breaks of the supports. They are viewed as pivotal.

Long vega, long gamma

Options:

As the volatilities are below the yearly medians, that is why we still recommend positive vega position. We also recommend installing long up-gamma position by buying low delta calls in the short end of the curve (up to 1 month)

MARKET PRICES UPDATE**MONEY MARKET RATES**

Money market rates (Closing mid-market levels)						
date	3M		6M		1Y	
	FXSW	WIBOR	FXSW	WIBOR	FXSW	WIBOR
29-01-07	4.12%	4.20%	4.21%	4.28%	4.41%	4.43%
30-01-07	4.12%	4.20%	4.21%	4.28%	4.41%	4.43%
31-01-07	4.13%	4.19%	4.22%	4.27%	4.40%	4.44%
01-02-07	4.13%	4.19%	4.22%	4.26%	4.40%	4.44%
02-02-07	4.13%	4.19%	4.20%	4.27%	4.38%	4.43%

FRA MARKET RATES

FRA Market Rates (Closing mid-market levels)					
date	1X4	3X6	6X9	9X12	6X12
	29-01-07	4.23%	4.31%	4.51%	4.65%
30-01-07	4.23%	4.31%	4.50%	4.66%	4.62%
31-01-07	4.23%	4.30%	4.48%	4.61%	4.60%
01-02-07	4.23%	4.29%	4.44%	4.58%	4.58%
02-02-07	4.23%	4.29%	4.46%	4.59%	4.59%

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
29-01-07	4.43%	4.19%	4.71%	4.31%	4.98%	4.83%	5.05%	5.14%
30-01-07	4.43%	4.15%	4.72%	4.32%	4.98%	4.85%	5.06%	5.16%
31-01-07	4.44%	4.17%	4.73%	4.34%	5.01%	4.87%	5.11%	5.20%
01-02-07	4.44%	4.17%	4.70%	4.31%	4.98%	4.80%	5.07%	5.16%
02-02-07	4.43%	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	07-01-22	08-01-23	96.033	4.09%	900	1474	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
29-01-07	9.60	9.50	9.50	9.40	1.40	1.45	0.40	0.65
30-01-07	9.60	9.50	9.50	9.40	1.40	1.45	0.40	0.65
31-01-07	9.60	9.50	9.50	9.40	1.40	1.45	0.40	0.65
01-02-07	9.60	9.50	9.50	9.40	1.40	1.45	0.40	0.65
02-02-07	9.60	9.50	9.50	9.40	1.40	1.45	0.40	0.65

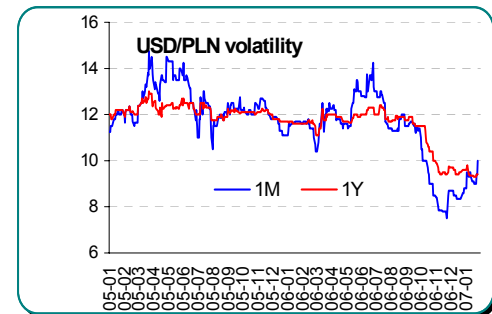
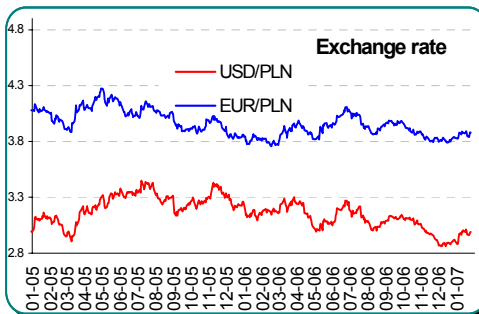
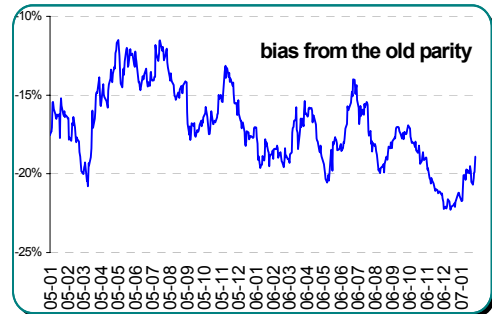
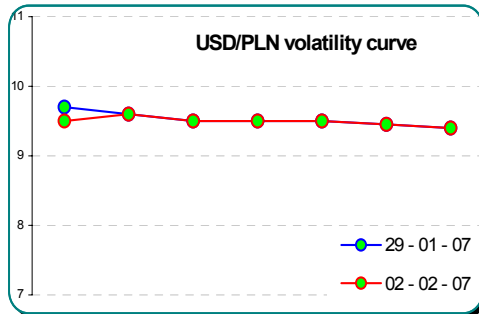
PLN SPOT PERFORMANCE

PLN spot performance			
date	USD/PLN	EUR/PLN	bias
29-01-07	3.0376	3.9240	-18.83%
30-01-07	3.0395	3.9385	-18.64%
31-01-07	3.0400	3.9320	-18.71%
01-02-07	2.9973	3.9010	-19.56%
02-02-07	3.0006	3.9068	-19.46%

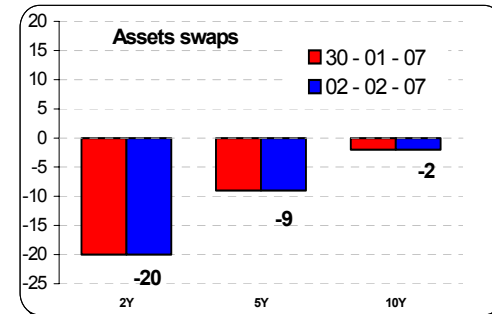
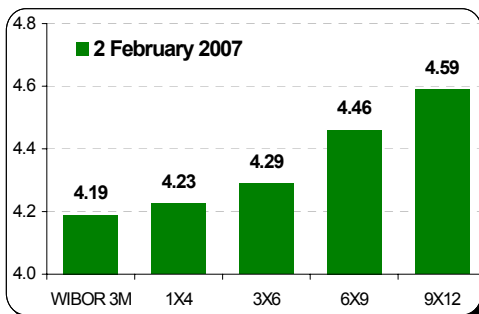
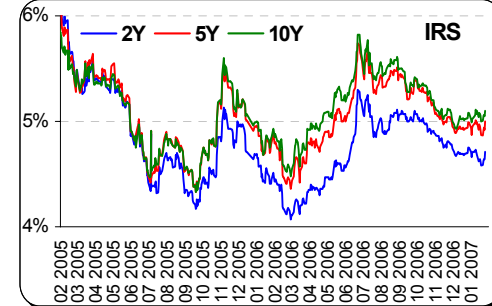
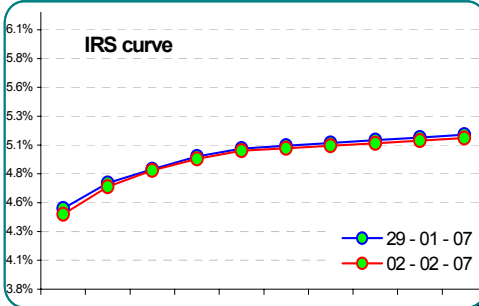
Note: parity on 11/04/00 – USD= 4.3806, EUR=4.2196, basket share 50:50
Mid-market volatility of vanilla option strategies

CHARTS

Foreign Exchange



Fixed Income



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CALENDAR

Macro

	November	December	January	Data Release	BRE Bank forecast
CPI m/m	0.0%	-0.2%		15-02-07	0.5%
CPI y/y	1.4%	1.4%		15-02-07	1.7%
PPI m/m	-0.7%	-0.3%		19-02-07	0.0%
PPI y/y	2.5%	2.8%		19-02-07	2.6%
Industrial production growth m/m	-2.7%	-6.8%		19-02-07	-3.3%
Industrial production growth y/y	12.0%	5.7%		19-02-07	12.5%
Average wages in enterprise sector [PLN]	2759.7	3027.5		15-02-07	2648.0
Average wages in enterprise sector y/y	3.1%	8.5%		15-02-07	7.2%
Unemployment	14.8%	14.9%		23-02-07	15.1%
Budget realisation (%)	60.7%	82.3%		16-02-07	2.0%
Current account [EUR mn]	-510			12-02-07	-334
Balance of foreign trade in goods (transaction basis) [EUR mn]	-246			12-02-07	-374
Exports growth y/y (transaction basis)	22.0%			12-02-07	16.5%
Imports growth y/y (transaction basis)	20.0%			12-02-07	14.8%
Current account [% of GDP]	-1.8%			12-02-07	-1.8%
Money supply (M3)	465.7	477.1		14-02-07	471.7
Money supply growth y/y	14.4%	15.7%		14-02-07	16.1%
Total PLN loans [PLN bn]	361.5	367.3		14-02-07	
Households PLN loans	183.3	188.5		14-02-07	
Corporate PLN loans	141.3	143.3		14-02-07	
Total PLN deposits [PLN bn]	385.3	397.1		14-02-07	
Households PLN deposits	214.8	223.2		14-02-07	
Corporate PLN deposits	116.9	124.9		14-02-07	
NBP intervention rate	4.00%	4.00%	4.00%	28-02-07	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	05-02-07	-	4.085%	22-01-07
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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