



TOP NEWS FROM THE POLISH MARKET

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- Unemployment rate up to 15.2% in January
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- Pay dips

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MACROECONOMICS

S. Nieckarz: CPI below 2.5% in 2007-08

No need to make pre-emptive rate hikes

Monetary policy overly restrictive in the past

A. Wojtyna: openness of the economy and globalization in reducing inflationary pressure significant

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Budget surplus in January likely

Unemployment rate up to 15.2% in January

The macro analyst

Stanisław Nieckarz of the MPC reckons CPI will not exceed 2.5% until the end of 2008 and even if it was to grow, the process should be fairly low and will be a consequence of rising wages pressure (as a result of rising emigration). He is opposed to the idea of preemptive interest rate hikes and reckons that rates will remain unchanged this year. He warns that should such preemptive hikes take place, the MPC would risk that the starting level for the move in the case of serious inflationary threat would be too high and as a result monetary policy would become overly restrictive for a prolonged period of time. In his opinion, even the comparison of past CPI rates and inflation target shows that monetary policy was overly restrictive in the past. He explicitly states that in the cycle of cuts initiated at the beginning of 2005 interest rates may have been cut further, down to 3%. He also added that the MPC has a limited scope to influence domestic loans as agents have access to foreign financing as well. At the same time he sees the pick up in monetary aggregates as a natural process – catch up phase compared to other European countries, where the household debt is significantly higher.

Andrzej Wojtyna indicated the changes occurring in the Polish economy that influence the inflationary environment. He pointed out that the openness of the economy increased significantly in the recent years and that the impact of globalization is not covered by present models. He also pointed out the excellent financial condition of companies that enables them to increase wages without raising prices. He thinks that comparing Poland to Baltic states is inadequate as the growth in Poland is not excessive and C/A situation is significantly different. For Prof. Wojtyna, the major factor influencing future rates decisions is the relation of wages to productivity, which for now does not threaten significant pick up in inflation.

Our comment:

We confirm our view that interest rates will remain unchanged in 2007, as was also declared by S. Nieckarz. We envisage, however, the discussion on hikes reappearing again in the autumn – with the rise of both CPI and net CPI to above 2% the key argument of the hawks – the need to anchor inflationary expectations will gain more significance. As both MPC members, we see the major risk to the inflation coming from the labour market, retail trade in particular (in this sector the rise in wages must be transferred to higher retail prices).

“In January, the budget revenues significantly surpassed forecasts” the MinFin pointed out laconically in its communiqué. This claim is at odds with the earlier assurances of finance ministry deputy Elżbieta Suchocka-Roguska, who ruled out a surplus in the first month of 2007. It seems, however, that a surplus of 3-4 bn PLN, resulting mainly from shifting the VAT revenues from 2006 and the overall good performance of the economy, is very likely. In addition, we expect the revenues to surpass the forecasts in the upcoming months as well.

According to preliminary estimates of the Ministry of Labour and Social Security the unemployment rate rose to 15.2% in January compared to 14.9% in December. The Ministry argues that the higher figure may be linked to the fact that émigrés who returned to Poland for Christmas registered temporarily to be eligible for health care. The unemployment figure at 15.2% is quite low by Polish standards and we expect it to ease to below 14% in June. At the end of 2007 the unemployment rate should fall to 13%.

According to a Reuters poll the macro-analysts expect the inflation rate to rise to 1.7% in January. Our forecast is in line with the consensus. Other figures that may have an impact on financial markets, i.e. industrial production, wages and retail sales are on average forecasted at

agreed on the short term prospects for the Polish economy

11.8%, 6.6% and 13.8% respectively. In general, the analysts seem to have a very similar view on the economy this month and the forecasts dispersion is very low. The only figures for which our forecasts deviate from the consensus are the wages (7.2% y/y) and a little bit lower retail sales.

Subdued inflationary pressure (an end-of-the-year inflation expected at 2.3%) caused the interest rate hike expectations to be shifted towards the second half of 2007.

FIXED INCOME

Boring week, boring auction

Last week was very quiet. Curve stayed in very tight range. Bond auctions are becoming less and less interesting as sizes offered on the primary auctions are very small (1 bio of new 2y bond ... and no extra auction). After auction curve moved a little higher in yield, but it is all rather a noise then real activity. We think this week we will have similar situation, only CPI and wages can be market movers. We suggest paying on strength this week, but we don't really believe curve can break out from tight range. Good Luck.

RECOMMENDATION:

Pay dips.

MONEY MARKET

Stable market for liquidity

Waiting for figures

T-bills yields up during the tender.

Stable carry for the whole week. Open market operation just like expected, which was 20 billion pln, hence another predictable week ahead. No volatility for longer terms, with bullish sentiment for the whole basket of emerging markets. Market is waiting for next week figures and until then interest rates will depend on currency condition.

The average yield on Polish benchmark 52-week T-bill moved up to 4.12 from 4.08%. The Ministry sold all 0.9 billion pln of 52-week papers giving the bid-to-cover ratio of 1.34. Yields should still follow upward direction.

RECOMMENDATION:

Sell 6M polonia above 4.05%.

FOREIGN EXCHANGE

Zloty weaker

With a lack of data last week on the Polish economy, the most important thing was the mood of foreign investors and their view of emerging markets. Last week the Zloty was gradually losing in value in terms of the deviation of the basket from the old parity. Generally on Monday at the end of the day the zloty traded at -20.37% (EUR/PLN 3.8505 and USD/PLN 2.9793) and on Friday close at -19.73% (EUR/PLN 3.8920 and USD/PLN 2.9917).

Volatility stable

The volatilities of both curves were stable throughout the week. Short term volatilities were higher than long term. On Friday, the benchmark 1M EUR/PLN traded at 7.4 % and the 1M USD/PLN at about 9.4%. One year volatilities traded respectively at 7.1 and 9.2%.

RECOMMENDATION:***Zloty weaker******Long Vega, long gamma***

Spot:

Main supports/resistances:

EUR/USD 1.2940 / 1.3105

EUR/PLN 3.8550 / 3.9400

USD/PLN 2.9600 / 3.0600

This week the market will be watching inflation data in Poland and events in the United States. Both of them should help predict plausible future behaviour of the Polish Monetary Policy Council. A significant resistance of 3.9000 (EUR/PLN) may be broken this week. If that happens, it is probably that the Zloty will test 3.9400.

Options:

Current levels of volatilities are much lower than 6mth average and we think that the further weakening of the Zloty on the spot may bring some increase of volatilities. That is why we still recommend long Vega and long up-gamma this week.

MARKET PRICES UPDATE**MONEY MARKET RATES**

Money market rates (Closing mid-market levels)						
date	3M		6M		1Y	
	FXSW	WIBOR	FXSW	WIBOR	FXSW	WIBOR
05-02-07	4.13%	4.20%	4.20%	4.26%	4.38%	4.42%
06-02-07	4.13%	4.20%	4.20%	4.26%	4.38%	4.42%
07-02-07	4.12%	4.20%	4.19%	4.26%	4.37%	4.42%
08-02-07	4.13%	4.20%	4.20%	4.26%	4.40%	4.43%
09-02-07	4.13%	4.20%	4.20%	4.26%	4.40%	4.43%

FRA MARKET RATES

FRA Market Rates (Closing mid-market levels)					
date	1X4	3X6	6X9	9X12	6X12
05-02-07	4.23%	4.29%	4.45%	4.59%	4.60%
06-02-07	4.23%	4.26%	4.44%	4.57%	4.59%
07-02-07	4.23%	4.29%	4.46%	4.60%	4.61%
08-02-07	4.23%	4.29%	4.46%	4.61%	4.61%
09-02-07	4.23%	4.29%	4.45%	4.60%	4.60%

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
05-02-07	4.42%	4.19%	4.71%	4.31%	4.98%	4.83%	5.05%	5.14%
06-02-07	4.42%	4.15%	4.72%	4.32%	4.98%	4.85%	5.06%	5.16%
07-02-07	4.42%	4.17%	4.73%	4.34%	5.01%	4.87%	5.11%	5.20%
08-02-07	4.43%	4.17%	4.70%	4.31%	4.98%	4.80%	5.07%	5.16%
09-02-07	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	07-02-05	08-02-06	96.001	4.12%	900	1204	900
OK0709	07-02-07	09-07-25	89.759	4.49%	1000	6581	1000
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
05-02-07	9.50	9.50	9.50	9.40	1.40	1.45	0.40	0.65
06-02-07	9.60	9.50	9.40	9.40	1.40	1.45	0.40	0.65
07-02-07	9.60	9.50	9.40	9.40	1.30	1.35	0.40	0.65
08-02-07	9.60	9.50	9.40	9.40	1.30	1.35	0.40	0.65
09-02-07	9.30	9.30	9.35	9.35	1.30	1.35	0.40	0.65

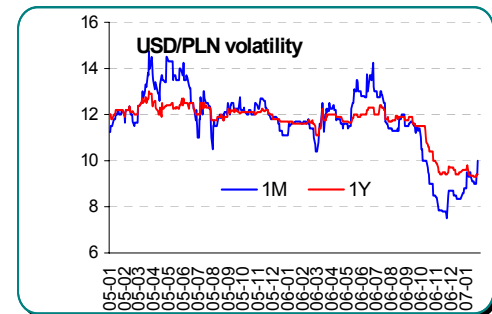
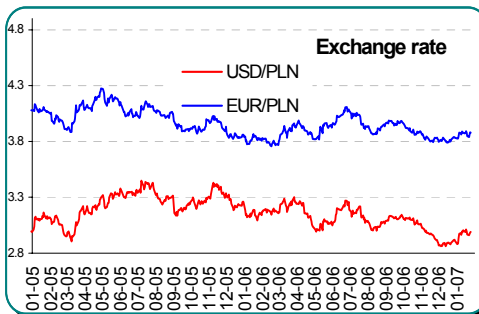
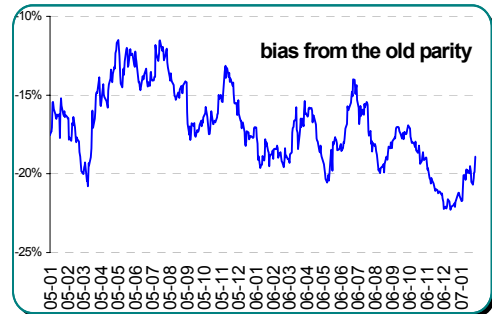
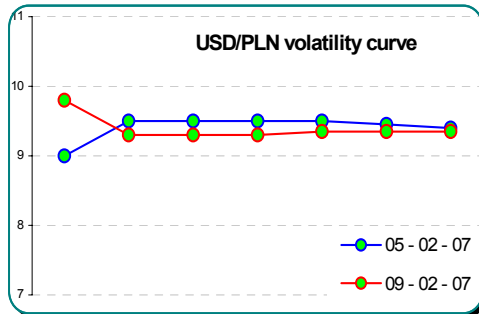
PLN SPOT PERFORMANCE

PLN spot performance			
date	USD/PLN	EUR/PLN	bias
05-02-07	3.0016	3.8842	-19.71%
06-02-07	2.9910	3.8710	-19.99%
07-02-07	2.9741	3.8629	-20.28%
08-02-07	2.9835	3.8744	-20.04%
09-02-07	2.9902	3.8888	-19.79%

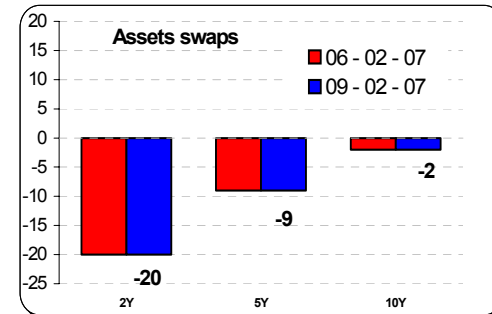
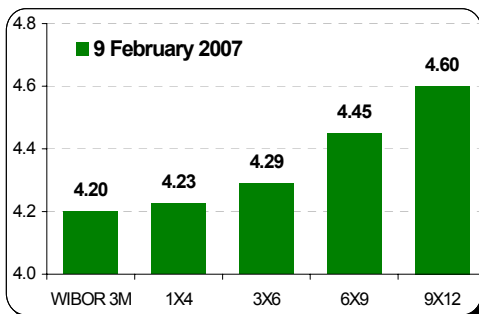
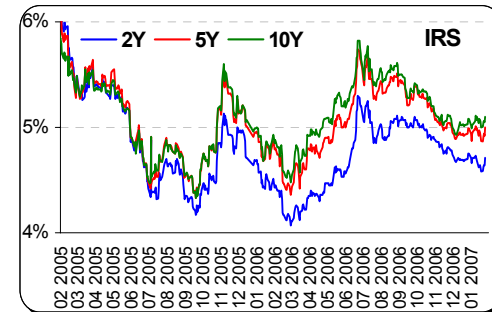
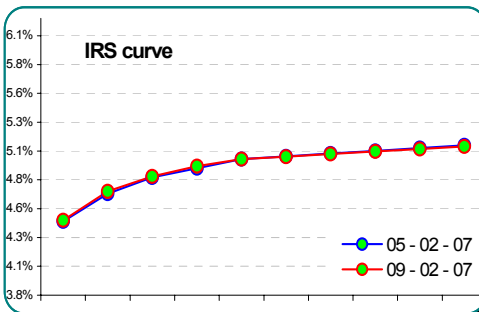
Note: parity on 11/04/00 – USD= 4.3806, EUR=4.2196, basket share 50:50
Mid-market volatility of vanilla option strategies

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	0.2%
PPI y/y	2.5%	2.8%		19-02-07	2.8%
Industrial production growth m/m	-2.7%	-6.8%		19-02-07	-4.0%
Industrial production growth y/y	12.0%	5.7%		19-02-07	11.8%
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	19-02-07	-	4.120%	05-02-07
2Y T-bond OK1208	07-03-07	-	4.494%	07-02-07
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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