



TOP NEWS FROM THE POLISH MARKET

MACROECONOMICS

- Inflation in January equal to 1.7%. Net inflation at 1.6-1.7%
 - Wages grew in January by 7.8% y/y
 - The annual growth rate of employment dropped to 3.8%
 - M3 rose by 19.3% y/y in January
 - C/A deficit amounted to 915 m EUR, trade deficit exceeded 1 b EUR
 - MPC members concerned with the rising wage growth, but the rate hike unlikely to happen soon
 - Budget surplus of 3.1 b PLN in January, excellent indirect taxes income
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- Play range

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MACROECONOMICS

Inflation in January equal to 1.7%

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C/A deficit amounted to 915 m EUR, trade deficit exceeded 1 b EUR

Annual CPI grew in January to 1.7% from 1.4% in December, which was in line with our and market expectations. It is noteworthy that the growth of inflation resulted mostly from an enormous increase in food prices (1.3% m/m, 2.8% y/y). On the contrary, transport prices (inc. fuels) dropped on a monthly basis by 0.7%. It means that the increase of excise has been offset by a drop in oil prices on the global markets. The prices of clothes and footwear dropped for the second month in a row, which stays in line with our view of the deflationary impact of globalization on consumer prices. According to our estimation net inflation amounted to 1.6-1.7%. It indicates that inflationary pressure is under control. It should be emphasized that the data published by GUS are preliminary data, which is based on the old inflation basket. The final data will be known in March. We assume that after the new inflation basket is implemented inflation will be corrected down by 0.1% to 1.6%.

We expect that in March annual CPI will be at 2.0-2.1% and at the end of year at 2.3-2.4%.

The average wage in the enterprise sector amounted, in January, to 2663.55 PLN which gives an annual growth rate at 7.8% (BRE forecast: 7.2%, consensus: 6.6%). Apart from one-off events (the bonus in copper mining pushed up the annual index by 1.2%) this data show the acceleration of wages growth. This bonus-adjusted growth rate exceeded 6.0% for the second month in a row. We expect that this trend will be continued. In February the unadjusted dynamics may amount to 4.5-5.0% y/y but in the coming months it will return to higher levels.

The number of employees in the enterprises sector grew in January by 3.8% as compared with the analogous month of the previous year (BRE forecast: 4.4%, consensus: 4.2%). This drop may be connected with the change of enterprises sample made by GUS in January (the enterprises where the number of employees exceeds 9 people have been added to the monitored sample). Usually such a change leads to rise of the aggregated employment index, but this year the effect has been lower than we anticipated (53k). Thus, it doesn't change the outlook on the labour market, and we expect that the growth rates will near 4.0% in the coming months.

The published data show clearly that after a two year period of productivity growth the wages dynamics start to accelerate. Thus, we think that due to high margins in enterprises and strong globalization impact the growth of unit labour costs will not fully pass through to consumer prices. In our opinion the growth of inflation will be moderate and annual CPI will reach to the middle of the target 2.5% at the turn of the year.

M3 money supply in January rose to 485 b PLN (19.3% y/y). The exceptionally high increase was mainly due to a rise in household loans (36% y/y). The pace of M3 growth started to accelerate in 2006, for 2 major reasons – fast economic growth (allowing for excellent financial results of companies) and the exceptionally high demand for housing loans (which grew by over 50% in 2006). The latter effect is particularly important – it may help to explain the lack of higher CPI due to rapid growth of monetary aggregates. The current rise in prices is unbalanced with the housing prices rising at double figure pace. It is excluded from the CPI, but influences the whole price deflator in the whole economy, thus the observed divergence in real GDP, CPI and M3.

The C/A deficit in December reached 915 m EUR, mainly on the trade deficit exceeding 1 b EUR. Exports dynamics dropped to 8.3% y/y, imports rose by 17%. The lower growth of exports may be explained by lower economic activity in December due to a decrease in working days compared to 2005, and the significant divergence in imports and exports growth was caused by a one-off transaction recorded on the imports side (as was stated by the NBP). We think the drop in exports is temporary and its dynamics should return to above 10%, though it is obvious that with higher domestic demand the trade balance should deteriorate in 2007. The C/A deficit

MPC members concerned with the rising wage growth, but the rate hike unlikely to happen soon

may grow to 2.8% of GDP in 2007 (2.2% in 2006).

The release of macroeconomic data last week was an opportunity for the MPC members to comment on the prospects of inflation and monetary policy.

It seems that the MPC is concerned about the rising wage growth but there is still no consensus as to whether and when it could translate into an inflationary pressure. The MPC members also differently assess the necessity of monetary tightening this year.

In Mr. Nieckarz's opinion the year 2007 will be the yet another year in which the Polish economy experiences non-inflationary growth. The inflationary pressure may become more apparent at the end of 2008, where the wage growth rate may surpass that of productivity. Then, the inflation rate may breach the level of 2.5%. In his opinion, an interest rate hike is very unlikely in 2007 but the Council may reconsider tightening monetary policy at the beginning of 2008 (provided that the risks to inflation are realized).

According to J. Czekaj, the most recent data did not come as a surprise and he does not translate it into a necessity to hike interest rates sooner. Czekaj expressed his concern about the rising wage growth but noted that it is not clear whether the trend will be sustained in the future. A similar opinion has been expressed by M. Pietrewicz.

We are especially pleased with the comment by S. Owskiak, who stated that the interest rate hike may follow if inflation jumps from 1.4% to 2.5% within two-three months. In the same interview he stressed, however, that the short term increase in the inflation rate can only be attributed to higher food prices. In the mid-term wide basis of the economic recovery, foreign investment and the convergence with the EU economies would restrain inflation.

Much more hawkish was H. Wasilewska-Trenkner saying that a rising wage growth may force the Council to hike the rates soon. This view is supported by M. Noga who claims that in order to keep inflation from breaching the 2.5% target, the rates should be raised "now".

Our comment:

We are sticking to our view that interest rates will remain unchanged this year. The majority of the MPC members think inflation will only rise gradually and be muted by high margins in the companies, globalization and PLN strengthening. This was implicitly stated in the recent communiqué and is now being repeated in current statements.

Budget surplus of 3.1 b PLN in January, excellent indirect taxes income

Budget surplus after January reached 3.1 b PLN, visibly above the early estimates presented by MF officials. The excellent result was possibly due to high indirect tax income – excise (13.3% of the annual plan was executed in January) and VAT (ca. 2 b PLN may have been shifted from December 2006). Spending execution reached 7.4% of the limit and was below the levels observed in previous years (spending execution exceeded 8%). Detailed data confirm our view on the budget execution this year – with the high pace of domestic demand the income plan should be achieved and the threat of overshooting the deficit is marginal.

The excellent condition of the budget may already be used to finance cuts in social security rates this year, as was announced last week. A reduction in rates by 3 pct pts from July may reduce FUS income this year by ca. 3 b PLN. We think that the MF may be able to generate such savings in this year's budget, but it must be underlined that the coalition partners may push to devote budget savings onto some current social spending.

FIXED INCOME**Quiet week behind,
quiet week ahead...**

Last week hasn't brought much excitement to the market. All prices stayed within narrow range and the turnover was very low, as there were no signals to push the yields either direction. All data come out broadly in line with consensus, MPC members' comments are mixed, giving no new hints regarding future rate moves. Therefore we do not expect much change this week either, today's Industrial Output and PPI data (our forecast 12.5% y/y and 2.8% y/y respectively) should be ignored. We expect MinFin to offer 1.5bio PS0412 on Wednesday auction, which should meet good demand. In our opinion, good budget situation, low bond supply and positive signals coming from core markets should support curve flattening.

RECOMMENDATION:

Play range

MONEY MARKET**Cheap days ahead?**

A bit too high open market operation (19 billion pln and 17 billion pln expected) did not manage to squeeze the market. Hence, it may mean that the whole next week and a bit longer (end of the reserve) will be quite cheap or very cheap. Depending on view it may be the last chance to play carry trade on shortest OISs.

**Bullish sentiment
seems to be unthreatened
in the nearest future**

As for longer terms it should be bullish in the nearest future. CPI as expected, surplus of the budget spending (around 3 billion pln), plus bullish statement of B. Bernanke, all supports this view. The only scratch was wages growth, slightly higher than expected (7.8% vs 6.6%), but the market seems to ignore this figure. As for now pln rates seem to be unthreatened a little longer then discounted in MM curves.

RECOMMENDATION:

Offer long Polonia.

FOREIGN EXCHANGE**Zloty stronger**

Last week, as anticipated, the Zloty strengthened to 3.8950. With EUR/USD rising on the Bernanke's comments about the US economy to 1.3150, the USD/PLN traded at 2.9600-2.9800.

Volatility higher

Volatilities traded lower last week, with the main reason for that being of course the stronger Zloty. On Friday 1M ATM EUR/PLN traded at 7.3, whereas 1Y at 7.2. 1M USD/PLN traded at 9.1, while the long end (1Y) decreased only a bit to 9.2.

RECOMMENDATION:**Zloty stable**

Spot:
Main supports / resistances:
EUR/USD: 1.3050 / 1.3200
EUR/PLN: 3.8800 / 3.9200
USD/PLN: 2.9500 / 3.0000

Long Vega

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. That is why we recommend long Vega positions the following week.

MARKET PRICES UPDATE**MONEY MARKET RATES**

Money market rates (Closing mid-market levels)						
date	3M		6M		1Y	
	FXSW	WIBOR	FXSW	WIBOR	FXSW	WIBOR
12-02-07	4.14%	4.20%	4.21%	4.26%	4.42%	4.43%
13-02-07	4.14%	4.19%	4.22%	4.26%	4.41%	4.43%
14-02-07	4.13%	4.20%	4.21%	4.26%	4.39%	4.44%
15-02-07	4.13%	4.20%	4.21%	4.26%	4.39%	4.44%
16-02-07	4.14%	4.20%	4.21%	4.27%	4.43%	4.43%

FRA MARKET RATES

FRA Market Rates (Closing mid-market levels)					
date	1X4	3X6	6X9	9X12	6X12
	12-02-07	4.23%	4.29%	4.45%	4.60%
13-02-07	4.23%	4.29%	4.45%	4.59%	4.57%
14-02-07	4.22%	4.29%	4.46%	4.60%	4.58%
15-02-07	4.21%	4.29%	4.47%	4.61%	4.58%
16-02-07	4.21%	4.30%	4.47%	4.62%	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
12-02-07	4.43%	4.19%	4.71%	4.31%	4.98%	4.83%	5.05%	5.14%
13-02-07	4.43%	4.15%	4.72%	4.32%	4.98%	4.85%	5.06%	5.16%
14-02-07	4.44%	4.17%	4.73%	4.34%	5.01%	4.87%	5.11%	5.20%
15-02-07	4.44%	4.17%	4.70%	4.31%	4.98%	4.80%	5.07%	5.16%
16-02-07	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
12-02-07	9.30	9.30	9.35	9.35	1.30	1.35	0.40	0.65
13-02-07	9.30	9.30	9.35	9.35	1.30	1.35	0.40	0.65
14-02-07	9.30	9.30	9.35	9.35	1.30	1.35	0.40	0.65
15-02-07	9.30	9.30	9.35	9.35	1.30	1.35	0.40	0.65
16-02-07	9.30	9.30	9.35	9.35	1.30	1.35	0.40	0.65

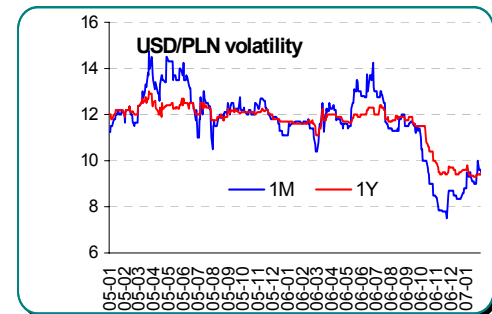
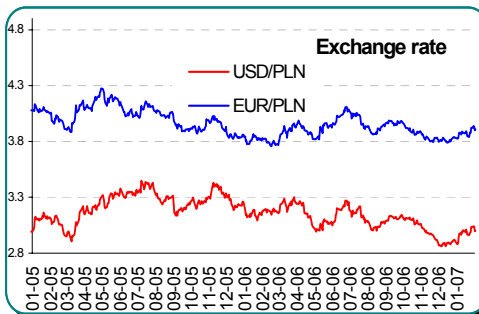
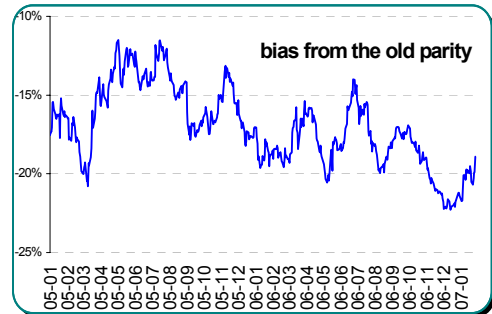
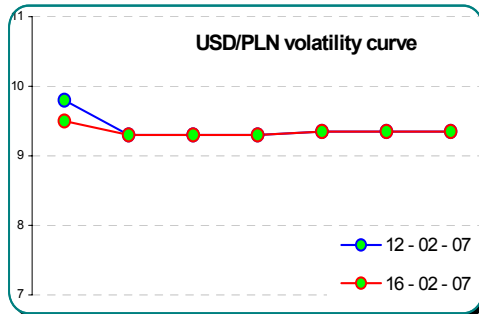
PLN SPOT PERFORMANCE

PLN spot performance			
date	USD/PLN	EUR/PLN	bias
12-02-07	3.0090	3.9065	-19.37%
13-02-07	3.0145	3.9180	-19.17%
14-02-07	2.9864	3.9100	-19.58%
15-02-07	2.9830	3.9065	-19.66%
16-02-07	2.9769	3.9090	-19.70%

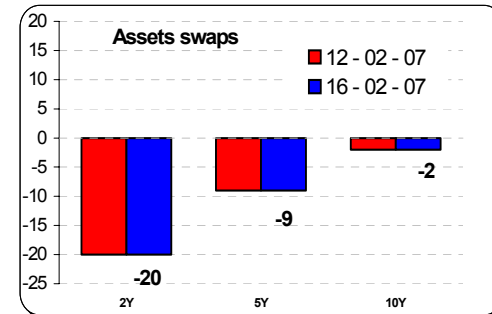
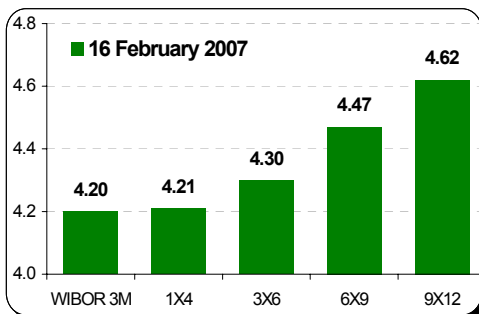
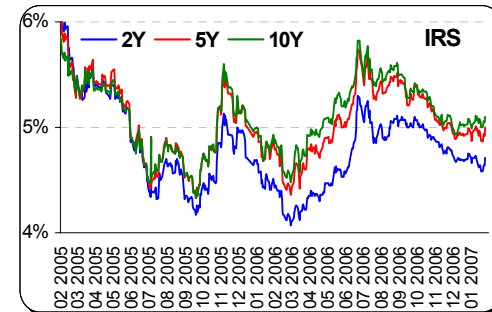
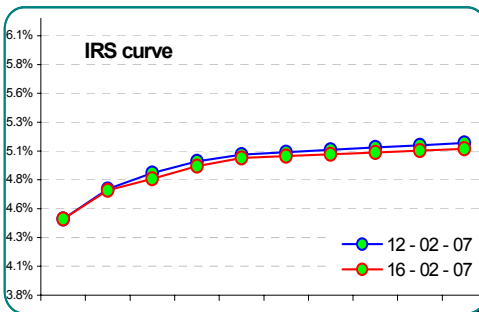
Note: parity on 11/04/00 – USD= 4.3806, EUR=4.2196, basket share 50:50
Mid-market volatility of vanilla option strategies

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%	0.5%	14-03-07	
CPI y/y	1.4%	1.4%	1.7%	14-03-07	
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	2663.6	15-03-07	
Average wages in enterprise sector y/y	3.1%	8.5%	7.8%	15-03-07	
Unemployment	14.8%	14.9%		23-02-07	15.1%
Budget realisation (%)	60.7%	82.3%	-10.3%	15-03-07	
Current account [EUR mn]	-531	-915		14-03-07	
Balance of foreign trade in goods (transaction basis) [EUR mn]	-287	-1080		14-03-07	
Exports growth y/y (transaction basis)	21.9%	8.3%		14-03-07	
Imports growth y/y (transaction basis)	20.6%	17.0%		14-03-07	
Current account [% of GDP]	2.0%	2.2%		14-03-07	
Money supply (M3)	465.7	477.0	485.5	14-03-07	
Money supply growth y/y	14.4%	15.7%	19.3%	14-03-07	
Total PLN loans [PLN bn]	361.5	367.3	376.5	14-03-07	
Households PLN loans	183.3	188.5	193.9	14-03-07	
Corporate PLN loans	141.3	143.3	144.6	14-03-07	
Total PLN deposits [PLN bn]	385.3	397.2	404.8	14-03-07	
Households PLN deposits	214.8	223.1	226.6	14-03-07	
Corporate PLN deposits	116.9	125.2	123.8	14-03-07	
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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