



TOP NEWS FROM THE POLISH MARKET

MACROECONOMICS

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- *The trend dynamics of corporate wages may now exceed 6.5-7.0%*
- *As for today we assess the likelihood of interest rate hike in April only slightly below 50%*
- *C/A deficit of 678 m EUR in January, 2.2% of GDP; high trade gap on lower exports*
- *Deficit execution of 10.1% after February, budget income remains strong*

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MACROECONOMICS

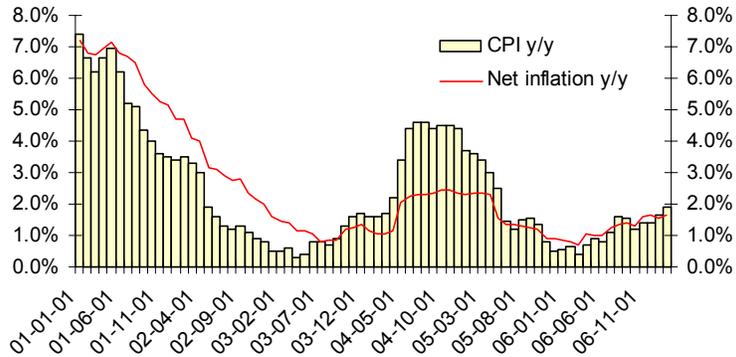
CPI rose by 1.9% y/y in February (January revised down to 1.6%)

In March CPI may rise to 2.2-2.3%, in April below 2% again

The trend dynamics of corporate wages may now exceed 6.5-7.0%

As for today we assess the likelihood of interest rate hike in April only slightly below 50%

CPI in February rose by 0.3% m/m, which implies annual growth of 1.9% (in line with expectations). At the same time GUS revised the January figure from 1.7 to 1.6% y/y (which is based on a new structure of weights in the consumption basket). According to our estimates, net inflation rose in February to 1.7% from 1.6% in January. It is worth noticing that most categories within the net inflation basket in February rose more strongly than in January.



Source: NBP, GUS

The data indicate that inflationary pressure in the economy has arisen, but the pace is still moderate. If it wasn't for advantageous base effects in April and July, the net inflation could reach 2.2-2.3% in December, but with those effects intact, we forecast it to reach 1.7-1.8%. Due to higher food and fuel prices headline inflation will be above net inflation – in March we expect 2.2-2.3%, in April ca. 1.9% and in May 1.7-1.8%. In December a rise to ca. 2.3% may be observed.

The average corporate wage was in February 6.4% up on an annual basis. The actual figure proved to be close to the consensus forecast but above our forecast of 4.8%. In our opinion the annual dynamics of corporate wages would be even higher, approaching 7%, if adjusted for one-off factors such as bonuses paid in the mining industry in February 2006.

The employment dynamics likewise surpassed the analysts' forecasts and amounted to 4.3% in February. Such an impressive increase in employment will, in our opinion, translate into rising wages and inflationary pressure in the future.

The moderate and very influential MPC member Professor Wojtyna quite explicitly expressed his view on the chances of rate hikes by saying: *"the chances are rising of an increase in Polish interest rates in the first half of 2007"* and *"the monetary tightening would be moderate and that does not necessarily mean that it would come in the single move"*. He also said that markets had incorrectly interpreted the council's statement in February as non-hawkish.

In further parts of the interview he was more dovish and pointed to rising productivity and savings of households which may limit the inflationary pressure. Professor Woityna also upheld his view that while negotiating the wage contracts trade unions are nowadays aware that higher wages may force the employers to reduce employment in the future.

Last week's interview with Professor Wojtyna led us to the following conclusions:

Some MPC members feel uncomfortable with the market not pricing any hikes this year. However the question whether hawkish statements will immediately translate into an interest hike remains open. For the moment the phrase *"increase in Polish interest rates in the first half of*

C/A deficit of 678 m EUR in January, 2.2% of GDP; high trade gap on lower exports

Deficit execution of 10.1% after February, budget income remains strong

2007" may be read as an announcement of an interest rate hike in April, i.e. the month when the new Central Bank's inflationary projection will be released. In April the MPC will also see a higher inflation rate for March, due to food and fuel prices. We still assess the chances for the rate hike in April as slightly below 50% but believe that Wojtyna's intention was to draw analysts' attention to the MPC's communiqué. Hence, if the MPC truly intend to hike the rates in April, it will state it almost explicitly in the March communiqué (in a very similar manner to the ECB). On the other hand a dovish communiqué may be read as a lack of consensus in the MPC regarding the interest rate hikes in the first half of 2007.

C/A deficit amounted to 678 m EUR in January, above our forecast (-136) and the market consensus (-300). This would imply a rise of C/A to GDP to 2.2%. For the second month in a row, the high C/A deficit results from the trade gap (-387 m EUR), and traditionally the income balance was negative (-771 m). The weak trade balance is the outcome of lower exports growth (15.5%), whereas imports dynamics remained fairly stable compared to previous months (21.5%). The balance of EU transfers in January was positive, reaching 116 m EUR. In our opinion in the coming months we may see the current pace of imports growth maintained. High domestic demand (including a high share of imports in investment) combined with lower (but still sound) exports growth should lead to gradual deterioration in trade balance and C/A.

The deficit execution after February reached 10.1% of the annual limit (3 b of 30 b PLN). In February itself the deficit amounted to 6.1 b, which should be considered a very modest rise given high seasonal spending in February (higher EU membership fee and education subsidy). Budget income since the beginning of the year has been executed at a high pace, in all tax categories the advancement in income compared to the plan is higher than last year (e.g. indirect tax income at over 20% of the limit). The data also indicate some savings being made – total spending reached 15.9% of the annual limit (17.1% a year ago). The budget was able to reduce subsidies, social security funds and domestic debt servicing costs. The overall data on budget only confirm that there should be no problems in executing the schedule presented at the beginning of the month.

FIXED INCOME

There are hawks in the MPC...

RECOMMENDATION:

Last week most important issue were the hawkish comment made by MPC Wojtyna on Thursday. As he pointed out, that the market wrongly takes the Council statements as dovish and that there is a possibility of hikes already in first half of the year, the curve reaction was immediate with short end going up by some 5-7bp and 2y-10y spread narrowing by some 5bp. We think this tendency should continue. Short end, which doesn't fully price in a hike sooner than in September seems too low, also rest of the curve has still some potential to flatten. We recommend paying on dips, preferably in 1y and 2y sectors.

Pay dips, pay short end.

MONEY MARKET

Too many money bills on Friday

Another week in the row the CB offered too many money bills (19.8 vs 19 billion pln expected), even though their weekly liquidity forecast shows shortage of the money in the system (now its about 1 billion pln). Is the CB again trying to limit the reduction ratio by squeezing the market? It

Bearish sentiment and waiting for another figures

RECOMMENDATION:

is a possibility, but we all know that it is not going to work even in short term not to mention strong market habit which is overbidding just in case. However its worth considering whether to hedge the carry by buying short OISs before the end of the reserve or not.

Not too much action for longer terms (CPI in line with expectations and wages close enough), however bearish sentiment occurred after the MPC member Wojtyna was quite hawkish in his comments. Market moved the spread in the right and more and more people expects the hikes soon. PPI and IO on Monday and these figures will be crucial for the sentiment in coming days.

Buy short OISs to protect the carry.

FOREIGN EXCHANGE

Zloty stronger

For the most of last week, the EUR/PLN, traded range bound (3.8500/ 3.9000). Only on Friday afternoon has it strengthened on the news of 8.5% revaluation of Slovakia's ERM II band by the ECB (current lower n upper limits of EUR/SKK are 30.12604 and 40.12604). On Monday open the EUR/PLN traded at the low of 3.8635.

Volatility stable

As a result of Zloty's abrupt appreciation, the volatilities have been bid in short tenors. On Monday open the 1m EURPLN traded at 7.3 (versus 6.9 on Friday close and one week earlier), whereas 1m USD/PLN at 9.0 (vs 8.7 week ago). 1y ATM traded respectively at 7.1 and 9.0.

RECOMMENDATION:

Zloty stable

Spot:
Main supports / resistances:
EUR/USD: 1.3170 / 1.3430
EUR/PLN: 3.8500 / 3.9000
USD/PLN: 2.8900 / 2.9500

In the following week we may see Zloty trade within a range. That is why we do not recommend any directional positions.

Short Gamma

Options:

Given that EUR/PLN remains within a range and that, plausibly, in the coming month 1mth historical volatility will remain close to 4.5-6.5, we recommend shorting Gamma. Also, we recommend selling Vega through ATMs at levels above 7.0.

MARKET PRICES UPDATE**MONEY MARKET RATES**

Money market rates (Closing mid-market levels)						
date	3M		6M		1Y	
	FXSW	WIBOR	FXSW	WIBOR	FXSW	WIBOR
12-03-07	4.13%	4.20%	4.23%	4.34%	4.46%	4.54%
13-03-07	4.13%	4.20%	4.25%	4.34%	4.47%	4.54%
14-03-07	4.13%	4.20%	4.25%	4.34%	4.47%	4.54%
15-03-07	4.15%	4.20%	4.30%	4.34%	4.51%	4.54%
16-03-07	4.14%	4.20%	4.30%	4.36%	4.52%	4.58%

FRA MARKET RATES

FRA Market Rates (Closing mid-market levels)					
date	1X4	3X6	6X9	9X12	6X12
	12-03-07	4.26%	4.37%	4.56%	4.69%
13-03-07	4.26%	4.39%	4.57%	4.70%	4.67%
14-03-07	4.27%	4.40%	4.58%	4.71%	4.68%
15-03-07	4.27%	4.43%	4.63%	4.75%	4.71%
16-03-07	4.27%	4.45%	4.65%	4.78%	4.72%

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
12-03-07	4.54%	4.20%	4.74%	4.47%	5.01%	4.97%	5.10%	5.19%
13-03-07	4.54%	4.20%	4.75%	4.46%	5.01%	4.97%	5.10%	5.19%
14-03-07	4.54%	4.20%	4.76%	4.47%	5.03%	4.97%	5.12%	5.20%
15-03-07	4.54%	4.21%	4.76%	4.53%	5.03%	4.99%	5.11%	5.19%
16-03-07	4.58%	4.22%	4.79%	4.53%	5.04%	5.00%	5.11%	5.21%

PRIMARY MARKET RATES

Last Primary Market Rates							
	au. date	maturity	avg price	avg yield	supply	demand	sold
52W TB	07-03-05	08-03-07	95.926	4.20%	900	1329	900
OK0709	07-03-07	09-07-25	89.923	4.56%	1000	3819	1000
PS0412	07-02-21	12-04-25	98.899	4.99%	1500	5205	1500
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
12-03-07	8.90	8.90	8.90	8.90	1.30	1.35	0.40	0.65
13-03-07	8.90	8.90	8.90	8.90	1.30	1.35	0.40	0.65
14-03-07	8.90	8.90	8.90	8.90	1.30	1.35	0.40	0.65
15-03-07	8.90	8.90	8.90	8.90	1.30	1.35	0.40	0.65
16-03-07	8.90	8.90	8.90	8.90	1.30	1.35	0.40	0.65

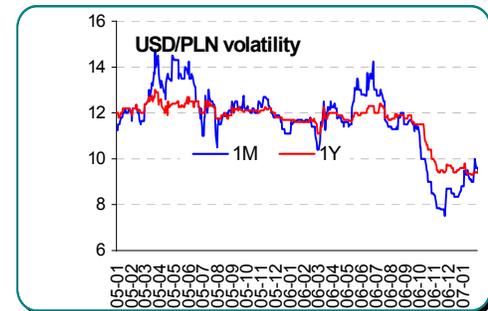
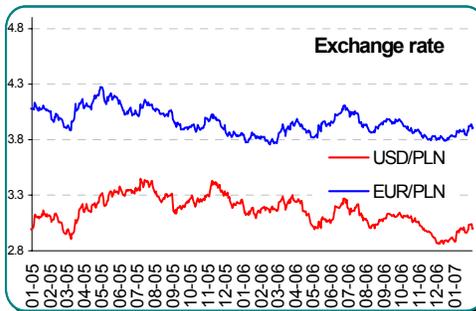
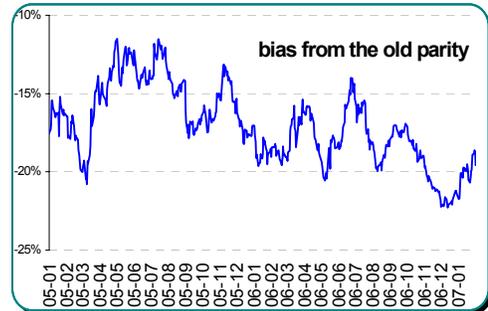
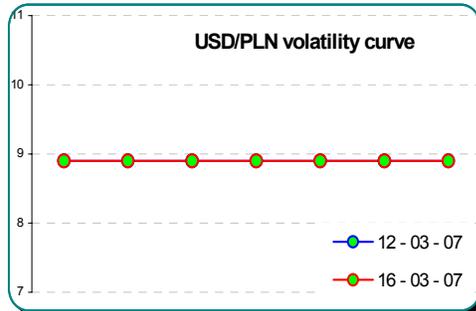
PLN SPOT PERFORMANCE

PLN spot performance			
date	USD/PLN	EUR/PLN	bias
12-03-07	2.9380	3.8795	-20.50%
13-03-07	2.9521	3.8853	-20.27%
14-03-07	2.9583	3.9031	-19.98%
15-03-07	2.8469	3.8938	-21.37%
16-03-07	2.9330	3.9065	-20.23%

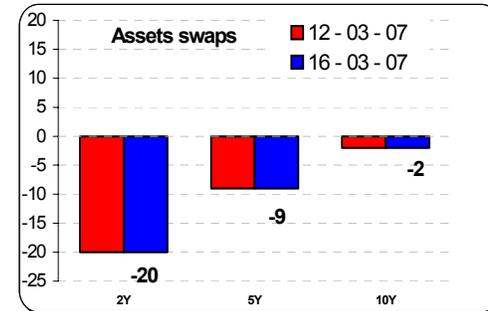
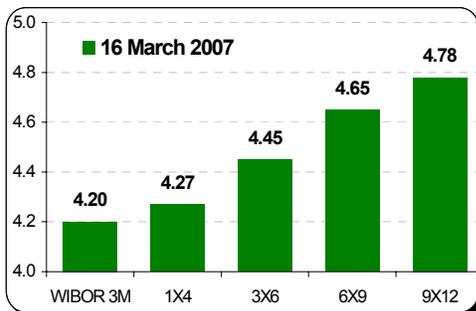
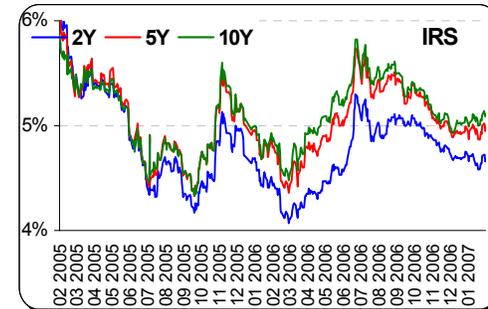
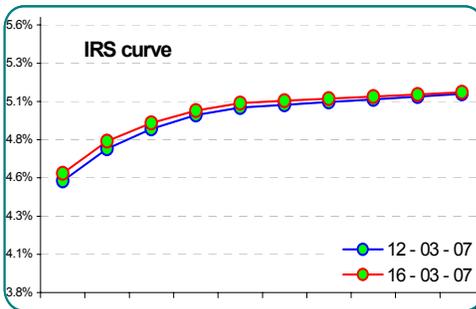
Note: parity on 11/04/00 – USD= 4.3806, EUR=4.2196, basket share 50:50
Mid-market volatility of vanilla option strategies

CHARTS

Foreign Exchange



Fixed Income



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CALENDAR

Macro

	December	January	February	Data Release	BRE Bank forecast
CPI m/m	-0.2%	0.4%	0.3%	13-04-07	
CPI y/y	1.4%	1.6%	1.9%	13-04-07	
PPI m/m	-0.5%	0.5%		19-03-07	0.2%
PPI y/y	2.6%	2.9%		19-03-07	3.4%
Industrial production growth m/m	-6.7%	0.4%		19-03-07	-0.3%
Industrial production growth y/y	5.9%	15.6%		19-03-07	13.9%
Average wages in enterprise sector [PLN]	3027.5	2663.6	2687.5	17-04-07	
Average wages in enterprise sector y/y	8.5%	7.8%	6.5%	17-04-07	
Unemployment	14.9%	15.1%		23-03-07	15.0%
Budget realisation (%)	82.3%	-10.3%	10.1%	15-04-07	
Current account [EUR mn]	-915	-678		13-04-07	
Balance of foreign trade in goods (transaction basis) [EUR mn]	-1080	-387		13-04-07	
Exports growth y/y (transaction basis)	8.3%	15.5%		13-04-07	
Imports growth y/y (transaction basis)	17.0%	21.3%		13-04-07	
Current account [% of GDP]	-2.1%	-2.2%		13-04-07	
Money supply (M3)	477.0	485.3	490.5	13-04-07	
Money supply growth y/y	15.7%	19.3%	17.9%	13-04-07	
Total PLN loans [PLN bn]	367.3	376.6	383.6	13-04-07	
Households PLN loans	188.5	194.2	197.0	13-04-07	
Corporate PLN loans	143.3	144.4	148.3	13-04-07	
Total PLN deposits [PLN bn]	397.2	404.7	410.7	13-04-07	
Households PLN deposits	223.1	226.3	228.6	13-04-07	
Corporate PLN deposits	125.2	124.1	126.1	13-04-07	
NBP intervention rate	4.00%	4.00%	4.00%	28-03-07	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	19-03-07	-	4.201%	19-02-07
2Y T-bond OK1208	04-04-07	-	4.562%	07-02-07
5Y T-bond PS0412	21-03-07	-	4.988%	21-02-07
10Y T-bond DS1017	11-04-07	-	5.240%	11-10-06
20Y T-bond WS0922	12-09-07	-	5.309%	14-03-07

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