



TOP NEWS FROM THE POLISH MARKET

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MACROECONOMICS

In our opinion the MPC statement may indicate a 25 bps interest rate hike in April

The hike will be implemented as a pre-emptive measure and there is no commitment in the MPC to raise the rates aggressively

S&P upgraded Poland's ratings, citing strong economic fundamentals

Deficit execution of 18% after March, below level from the budget schedule

In line with our expectations, the Polish MPC kept its interest rates on hold in March. We have noted, however, a significant change in the way the Council communicates with the market. It seems that following the ECB transparency policy the Polish MPC may more directly announce the potential interest rate hikes in the future.

Hence, the MPC removed wording published in its previous two statements that indicated that the current interest rates could be sufficient to keep inflation on target. It also modified the subsequent sentence indicating that "stabilizing inflation around the 2.5% target and thus creating conditions for long-term economic growth may require a tightening of monetary policy in the near future".

In our opinion the phrase "may require a tightening of monetary policy in the near future" here is crucial and may be interpreted in a similar way as "vigilance" used by the ECB in its statement when the interest rate hike is scheduled for the future. Thus, we ascribe a very high likelihood to a 25 bps interest rate hike in April, when the central bank's inflationary projection is to be released. In the statement a sentence indicating that there is no commitment to aggressive monetary tightening also appeared. The Council simply stated that the scale of the hikes to come would depend on the data to be released. For now, it is very likely that the expected interest rate hike in April will be implemented as a pre-emptive measure and the subsequent hikes will be data dependent. In our opinion the Council may decide to hike rates in July but it is the autumn 2007 which may bring a turnaround in the inflationary processes and the monetary policy perspectives.

Also the comments made by the MPC members following the meeting, in our opinion, clearly indicate that the council is committed to hiking the rates. J. Czekaj, a moderate MPC member, noted that the hikes are to be expected within months not quarters. M. Noga urged the rates to be hiked immediately.

S&P raised Poland's long-term foreign debt rating to A- from BBB+ and the local rating from A- to A (for the long-term debt) and A2 to A1 (short-term). The rating outlook remains stable. The S&P decision has been long awaited, particularly after the rating upgrade by Fitch (in January). Considering excellent economic fundamentals in Poland the upgrade is by no means justified, especially as Poland's ratings were equal to Hungary's (despite a huge budget deficit in Hungary) and lower than in Slovakia or the Czech Rep.

Also S&P's communiqué refers to strong fundamentals. The agency indicates that the upgrade reflects strong and well-balanced economic growth, despite political turmoil. S&P also points to economic diversification and dropping foreign debt.

The decision to upgrade the ratings had a marginal effect on the fixed income market – on the one hand the decision is hardly a surprise, secondly the market expects interest rates to go up soon. Also Poland's foreign debt prices included a high possibility of ratings upgrade.

Preliminary estimates by the MF indicate that the deficit execution after March reached 18% of the annual limit (ca. 5.5 b of 30 b PLN), vs. 22% forecasted in the budget execution schedule. The better execution results from lower spending in March, though the deputy minister E. Suchocka-Roguska stated that this is more likely due to a shift in time rather than fixed savings. The MF kept to its forecast of the April deficit (ca. 25%).

The low deficit dynamics and thus lower supplies of domestic debt are clearly factors allowing for relatively stable long-term yields. The high pace of the domestic demand allows for high tax income, so the budget execution remains under no threat this year. The exact level of yearend deficit depends largely on whether social security contributions are reduced in July – if the tax wedge is not lowered this year, the yearend deficit will surely be well below the limit of 30 b.

FIXED INCOME**Council members becoming more hawkish**

Last week rates fluctuated within narrow range amid low activity. Uncertainty connected with MPC's decision pushed the market up by few points at the beginning of the week, and after no-hike decision market eased again. This week main event was probably the MinFin prediction of the March CPI at 2.4% y/y. Considering recent hawkish comments made by Council members about possible rate hike within next couple of month, such data makes the April hike an likely outcome. We expect this week to be quiet one, with no data releases and upcoming Easter holiday. However later this month we expect economic data releases supporting the hike scenario, therefore we recommend pay position in short sector of the curve, as the hike doesn't seem to be priced in yet.

RECOMMENDATION:

Quiet week ahead. Pay 1Y

MONEY MARKET**Volatile end of the reserve****High carry next week****April hike more and more probable**

Very cheap last week just as we were forecasting in our last report plus extremely volatile end of the reserve. Overnight deposit bids on Friday ranged over 2 figures (5% after auction, 2.5% at the end of the day). This huge volatility was mainly driven by open market operation (22.2 billion pln vs 19.5 billion pln). The amount of the bills was too high as for the last day of the reserve due to inefficient settlement system and credit line problems between players, hence squeeze and then after everything was cleared carry dropped to deposit rate in the CB. Next week relatively expensive since OMO was too high even as far as new reserve is concerned (according to the CB's liquidity projection). Question is why the CB bank offered so many money bills and furthermore why the system absorbed it? We can not reply any of those...

As for longer terms the MPC did not change the rates but the statement was more bearish then last time. Probability of hike in April is rising and the market considers it to be almost certain. MM curves see 50 bps hikes this year. April and then June/July. It seems to be quite reasonable bet.

RECOMMENDATION:

Sell Polonia on hikes.

FOREIGN EXCHANGE**Zloty stronger**

For most of last week the EUR/PLN traded range bound (technically 3.8500/ 3.9000). On average EUR/PLN traded at 3.8700-3.8750 levels. On Thursday, the S&P rating agency unexpectedly upgraded the Polish rating to A- and the abrupt EUR/PLN sell off followed – we saw a low of 3.8620 on that day. Later in the day we saw some importers buying Euros and the spot recovered to 3.8700 levels.

USD/PLN, due to relatively stable EUR/USD, traded close to 2.9000 throughout the week.

Volatility lower

As a result of the appreciating Zloty, we saw another sell-off of volatilities last week. The volatilities have been offered in all tenors: 1Y EUR/PLN declined from 6.75 to 6.3 (mid) on Friday

RECOMMENDATION:**Zloty stable/bullish****Short Gamma**

close, 1Y USD/PLN from 8.5 to 8.2. 1M EUR/PLN dropped from 6.7 to 6.3, whereas 1M USD/PLN from 8.5 to 8.0. In general, the volatility curves declined almost in parallel by 1.0% within the space of 2 weeks – a significant move, especially in longer tenors.

Spot:

Main supports / resistances:

EUR/USD: 1.3200 / 1.3370

EUR/PLN: 3.8400 / 3.8800

USD/PLN: 2.8900 / 2.9500

In the following week we still may see Zloty trade within a range, however due to recent developments in the region (lowering of EUR/SKK FX band, upgrade of S&P rating for Poland) we may see EUR/PLN testing the lower (that is 3.8500) band in the following week. 3.8500 is a very strong support, we do not believe it could be broken and that is why we do not recommend any directional positions.

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.

MARKET PRICES UPDATE**MONEY MARKET RATES**

Money market rates (Closing mid-market levels)						
date	3M		6M		1Y	
	FXSW	WIBOR	FXSW	WIBOR	FXSW	WIBOR
26-03-07	4.20%	4.23%	4.34%	4.41%	4.56%	4.61%
27-03-07	4.20%	4.23%	4.34%	4.41%	4.56%	4.61%
28-03-07	4.21%	4.24%	4.34%	4.41%	4.56%	4.61%
29-03-07	4.21%	4.24%	4.34%	4.41%	4.56%	4.61%
30-03-07	4.18%	4.24%	4.33%	4.44%	4.57%	4.64%

FRA MARKET RATES

FRA Market Rates (Closing mid-market levels)					
date	1X4	3X6	6X9	9X12	6X12
	26-03-07	4.40%	4.53%	4.73%	4.84%
27-03-07	4.40%	4.53%	4.74%	4.83%	4.81%
28-03-07	4.40%	4.52%	4.70%	4.80%	4.79%
29-03-07	4.40%	4.52%	4.70%	4.80%	4.79%
30-03-07	4.41%	4.53%	4.71%	4.82%	4.81%

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
26-03-07	4.61%	4.30%	4.83%	4.51%	5.06%	4.98%	5.11%	5.19%
27-03-07	4.61%	4.30%	4.85%	4.52%	5.07%	5.00%	5.12%	5.20%
28-03-07	4.61%	4.30%	4.84%	4.54%	5.06%	5.00%	5.11%	5.20%
29-03-07	4.61%	4.30%	4.84%	4.54%	5.06%	4.99%	5.13%	5.18%
30-03-07	4.64%	4.32%	4.85%	4.54%	5.06%	5.00%	5.12%	5.19%

PRIMARY MARKET RATES

Last Primary Market Rates							
	au. date	maturity	avg price	avg yield	supply	demand	sold
52W TB	07-03-19	08-03-21	95.869	4.26%	1000	1432	1000
OK0709	07-03-07	09-07-25	89.923	4.56%	1000	3819	1000
PS0412	07-03-21	12-04-25	99.009	4.97%	1800	4979	1800
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
26-03-07	8.90	8.90	8.90	8.90	1.30	1.35	0.40	0.65
27-03-07	8.90	8.90	8.90	8.90	1.30	1.35	0.40	0.65
28-03-07	8.90	8.90	8.90	8.90	1.30	1.35	0.40	0.65
29-03-07	8.90	8.90	8.90	8.90	1.30	1.35	0.40	0.65
30-03-07	8.90	8.90	8.90	8.90	1.30	1.35	0.40	0.65

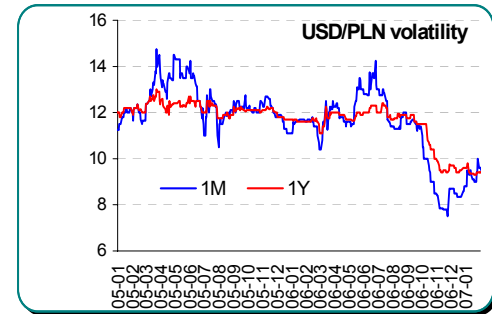
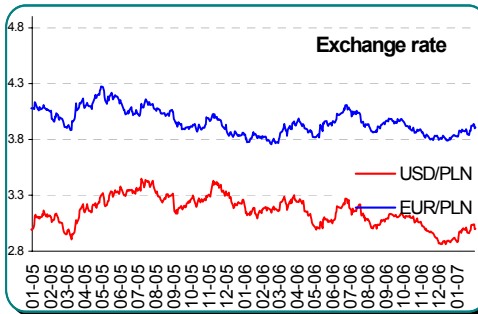
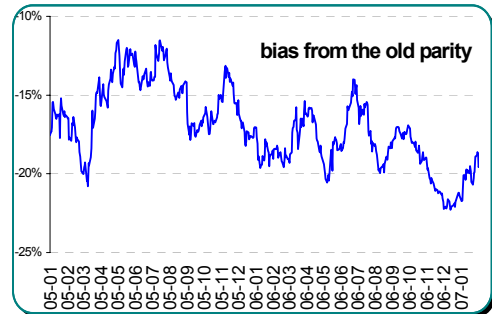
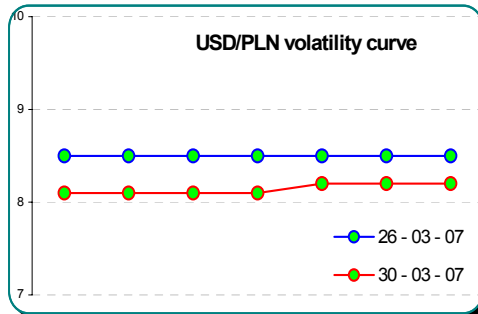
PLN SPOT PERFORMANCE

PLN spot performance			
date	USD/PLN	EUR/PLN	bias
26-03-07	2.9171	3.8683	-20.87%
27-03-07	2.9011	3.8718	-21.01%
28-03-07	2.9163	3.8890	-20.63%
29-03-07	2.9070	3.8789	-20.86%
30-03-07	2.9058	3.8695	-20.98%

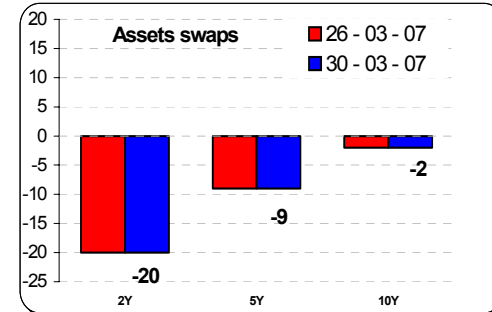
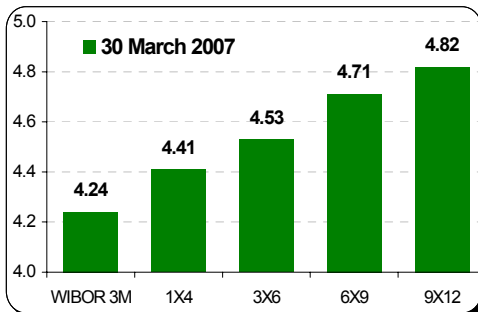
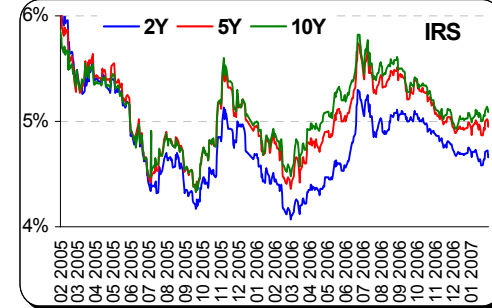
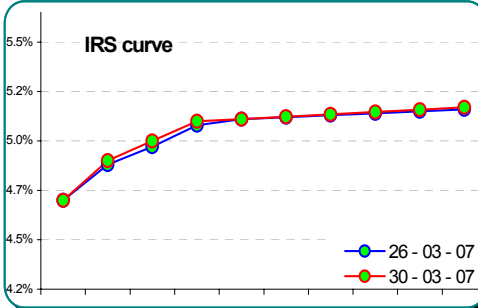
Note: parity on 11/04/00 – USD= 4.3806, EUR=4.2196, basket share 50:50
Mid-market volatility of vanilla option strategies

CHARTS

Foreign Exchange



Fixed Income



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CALENDAR

Macro

	January	February	March	Data Release	BRE Bank forecast
CPI m/m	0.4%	0.3%		13-04-07	0.3%
CPI y/y	1.6%	1.9%		13-04-07	2.3%
PPI m/m	0.6%	0.3%		20-04-07	0.7%
PPI y/y	3.1%	3.6%		20-04-07	3.5%
Industrial production growth m/m	0.2%	-2.1%		20-04-07	15.3%
Industrial production growth y/y	15.4%	12.9%		20-04-07	11.8%
Average wages in enterprise sector [PLN]	2663.6	2687.5		17-04-07	2791.0
Average wages in enterprise sector y/y	7.8%	6.5%		17-04-07	6.8%
Unemployment	15.1%	14.9%		24-04-07	14.6%
Budget realisation (%)	-10.3%	10.1%		15-04-07	18.0%
Current account [EUR mn]	-678			13-04-07	-725
Balance of foreign trade in goods (transaction basis) [EUR mn]	-387			13-04-07	-585
Exports growth y/y (transaction basis)	15.5%			13-04-07	14.8%
Imports growth y/y (transaction basis)	21.3%			13-04-07	19.3%
Current account [% of GDP]	-2.1%	-2.2%		13-04-07	-2.2%
Money supply (M3)	485.3	490.5		13-04-07	498.7
Money supply growth y/y	19.3%	17.9%		13-04-07	19.5%
Total PLN loans [PLN bn]	376.6	383.6		13-04-07	
Households PLN loans	194.2	197.0		13-04-07	
Corporate PLN loans	144.4	148.3		13-04-07	
Total PLN deposits [PLN bn]	404.7	410.7		13-04-07	
Households PLN deposits	226.3	228.6		13-04-07	
Corporate PLN deposits	124.1	126.1		13-04-07	
NBP intervention rate	4.00%	4.00%	4.00%	30-04-07	4.25%

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	02-04-07	-	4.261%	19-03-07
2Y T-bond OK1208	04-04-07	-	4.562%	07-03-07
5Y T-bond PS0412	18-04-07	-	4.967%	21-03-07
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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