



TOP NEWS FROM THE POLISH MARKET

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MACROECONOMICS

Headline inflation rate down to 2.3% in April owing to high base effect

The CPI index was up by 0.5% m/m in April, which translated into an annual inflation rate of 2.3% compared to 2.5% recorded in March. This drop is mainly owing to the high base effect (higher energy prices in 2006). Core inflation, according to our estimates, dropped to 1.4 from 1.7% recorded in March. Turning to the inflation breakdown, the CSO pointed to a significant increase in prices for services (health and dental care, cosmetics and hairdresser). Moreover, a significant rise in food prices (1.0% m/m) and fuel price (3.8% m/m) has been recorded. These factors have been partially balanced by flat prices in the remaining categories.

The April data confirm our assessment of the condition of the Polish economy; on the one side services and food prices rise and on the other side prices for household appliances, clothing and footwear, i.e. tradables, decline. Items, which fall under the tradables category, may be additionally affected by the appreciating zloty in the coming months. However, the net effect of those processes will be an ultimate rise in CPI inflation. We expect an annual inflation rate to climb to 2.6% in June and to 3.0% at the end of 2007.

For another month in a row credit for households grew at 40% rate y/y

The money supply M3 amounted to 498.7 bn PLN at the end of April, i.e. 17.3% up y/y. On the deposits side no significant changes compared to the previous reading have been noted. Households' deposits were 10% up on an annual basis, while there was a 30% y/y increase in firms' deposits. Turning to credit, there has been a 19.2% y/y rise in credit for firms and an increase exceeding 40% annual growth of credit for households. For another month in a row the growth of mortgage loans exceeded 60%, but for a few months now a visible increase in consumer credit has been recorded as well.

Polish C/A gap slightly worse than expected

Polish C/A balance showed 539 Eur gap in March, i.e. 2.4% of GDP, close to our expectations. The trade gap widens to 627 Eur from the revised 201 Eur recorded in February. Imports and exports grew by 21,7% and 15,8% respectively.

The figure is not particularly bad given that the import dynamics, so the Central Bank reports, have been distorted by a one-off transaction. The crucial question is going to be whether the booming consumption and investment will cause significant deterioration of the C/A balance in the coming months. Even if this danger materialises, the widening C/A gap should be balanced by the FDI inflow. We estimate these inflows at on average above 1 bn Eur per month in 2007.

Wages grew by 8.4% in April – below our forecast, but the wages growth rate has apparently picked up

Corporate wages in April rose by 8.4% y/y. This is below our forecast (10.1%) and below growth observed in March. It is however extremely difficult to assume the pressures on the labour market have eased off in April. The wages growth rate has clearly picked up in the recent months. Given the present wage pressure, the upside risks to inflation (stemming both from pricing policies of the companies and from demand pressure) will in our opinion increase in the coming months leading to higher inflation.

S. Skrzypek: CPI under control, will remain below 3.5% until the end of 2009

NBP President S. Skrzypek repeated that the recent increase should not be considered a beginning of the increase cycle. He thinks that the CPI remains under control, stressing the outlook presented by the inflationary projection. Firstly, he points out that the central inflation path is below that of the January projection; secondly he adds that the CPI is below 3.5% throughout the projection horizon.

A fairly similar view was presented by M. Pietrewicz. He reckons the projection to be trustworthy and sees no significant reasons for forecast revision.

J. Czekaj: risk to infla-

J. Czekaj thinks the MPC addressed the CPI risks with an increase in April and for now the next

tion from labour market and growth rates, but rates unchanged in the coming months

A. Wojtyna: balance of risks to inflation still unfavourable

We stick to our view: next hike will take place in July, followed by another in the autumn

increase is not necessary. He thinks that the risk of rapid inflation acceleration is moderate, which is also indicated by the April CPI data. Major risks to CPI are the growth rate and the labour market. He sees the present wages growth as high, but still it should not lead to excessive price pressure. In particular, the relation of wages growth and productivity remains favourable for now.

A similar statement was made by S. Owsiak, in whose opinion interest rates may remain unchanged for the next 6 months. He thinks a rate hike may be necessary in the yearend, should CPI exceed 2.5%. As other MPC members, he sees the major risk to inflation coming from the labour market, but at the same time sees the CPI path presented in the inflationary projection as accurate.

A. Wojtyna thinks the balance of risks for future inflation remains unfavourable and as a result, another interest rate increase may take place this year. The drop in April inflation may have been temporary and inflationary outlook is still risky. Prof. Wojtyna adds that the MPC cannot rest comfortably with growth rates above potential; moreover, the available information does not indicate that the MPC has the comfort of 2-3 months of pause before the next increase.

Our comment:

We stick to our view on NBP interest rates. We expect the next increase to take place in July. In our opinion, the majority of the MPC members is aware that the April inflationary projection may turn out overly optimistic. Moreover, majority MPC will (in our opinion) aim at keeping inflation close to 2.5%, rather than within the target band (as was suggested by the NBP President). Risks to that target are clearly on the upside – stemming from tight labour market, consumption boom, and output above potential. With stable GDP growth rates in the coming quarters we expect the MPC to continue increasing after July as well (increasing cycle may in our opinion end at 5.50% by the mid 2008)

FIXED INCOME

Have you got your raise already

RECOMMENDATION:

Last week we saw some bits of volatility. The two main events on the market were PS0412 1.5 bio auction, and wages figure for the month of April. From our perspective demand on the auction was weak, so we were quite surprised with the bid coming above secondary market and demand being almost 6 fold the auction. First reaction was bonds positive, but as figure was closing, we saw even better offers than the auction bid. Figure came at lower than expected level, which triggered buying in the bonds, and some receiving interest in the 2y IRS. Thursday we saw continuation of the bullish move which was supported by dovish statement by CB governor Skrzypek. All in all the high of the week was 2y paid at 5.07 and PS0412 trading down at 98.25. Bonds are trading very rich in ASW at -10bp, curve is also flattening a lot in the 5y10y sector from 8 to 4 in a week, we see also good buying interest in WS0922. We think that it is big mistake to judge last wages figure as low, and we think that it is even bigger mistake to follow Skrzypek's view as far as the future path of interest rates. We see rates climbing much higher and still faster than market expects. We recommend paying on dips 2 and 5y IRS, we also see 6x9 and 9x12 spread to low at current 13 bp. Good Luck!

Pay on dips 2y IRS

MONEY MARKET**Increased supply of the money bills****Slightly better figures released some pressure****RECOMMENDATION:**

Relatively expensive week and the situation does not look any better. Increased supply of the money bills sucks the cash from the system. Participants are still likely to buy those papers even though the carry off sets any profits. Deficit is growing as far as reserve requirements are concerned. Anything can happen but one thing is certain, the end of the reserve will be very nervous.

As for longer terms sentiment is slightly better. CPI in line with expectations, lower wages growth but still high (8.4% vs 8.8% expected). Our best guess wd be next 25 bps rates hike in July. Low budget deficit so far makes the MinFin restrict the Treasuries supply. First sign is cancellation of the T-bills auction next week.

Buy long sell short.

FOREIGN EXCHANGE**Zloty stable**

Last week the Zloty traded most of the time in the vicinity of 3.7900 with a maximum of 3.8080 traded on an illiquid market. Despite the widespread expectations of a deeper correction, the EUR/PLN remained stable and traded range-bound.

We also saw a correction of the EUR appreciating trend versus USD – where the EUR/USD traded back down to 1.3470. Most of the week the EUR/USD traded, however, mostly at about 1.3530, hence the USD/PLN traded at around 2.8000.

Volatility stable

Implied volatilities remained at their previous week's levels. The 1M EUR/PLN traded at 6.8, the rest of the curve (till 1Y) at 6.4 to 6.5 (6M paid at 6.5), whereas longer-dated options were being sold (2Y given at 6.25). USD/PLN traded at about 7.6-7.7 along the curve.

RECOMMENDATION:**Zloty stronger**

Spot:
Main supports / resistances:
EUR/USD: 1.3450 / 1.3600
EUR/PLN: 3.7400 / 3.7800
USD/PLN: 2.7600 / 2.7900

In the following week we still may see EUR/PLN trade lower – towards 3.7400. We recommend selling EUR/PLN on tops this week. The USD/PLN should follow suit, especially if the EUR/USD appreciating trend comes back. Look at 2.7600 as a support.

Short Gamma

Options:

With Zloty trading range-bound or slowly appreciating as it might happen the following week, we recommend short Gamma positions which should help to earn some decay. Also, for those with long-term view on options we still suggest to sell Vega at around 6.5 vols

MARKET PRICES UPDATE**MONEY MARKET RATES**

Money market rates (Closing mid-market levels)						
date	3M		6M		1Y	
	FXSW	WIBOR	FXSW	WIBOR	FXSW	WIBOR
14-05-07	4.39%	4.43%	4.52%	4.55%	4.74%	4.75%
15-05-07	4.39%	4.43%	4.52%	4.55%	4.74%	4.75%
16-05-07	4.41%	4.44%	4.54%	4.57%	4.77%	4.77%
17-05-07	4.41%	4.44%	4.54%	4.58%	4.77%	4.77%
18-05-07	4.41%	4.44%	4.55%	4.58%	4.77%	4.77%

FRA MARKET RATES

FRA Market Rates (Closing mid-market levels)					
date	1X4	3X6	6X9	9X12	6X12
	14-05-07	4.47%	4.61%	4.83%	4.94%
15-05-07	4.47%	4.62%	4.82%	4.95%	4.92%
16-05-07	4.48%	4.64%	4.84%	4.96%	4.93%
17-05-07	4.49%	4.64%	4.84%	4.96%	4.93%
18-05-07	4.46%	4.63%	4.83%	4.95%	4.91%

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
14-05-07	4.75%	4.46%	5.00%	4.57%	5.21%	5.13%	5.27%	5.32%
15-05-07	4.75%	4.46%	5.01%	4.56%	5.22%	5.14%	5.28%	5.32%
16-05-07	4.77%	4.46%	5.04%	4.55%	5.23%	5.13%	5.28%	5.31%
17-05-07	4.77%	4.45%	5.03%	4.58%	5.22%	5.13%	5.28%	5.31%
18-05-07	4.77%	4.43%	5.02%	4.55%	5.21%	5.11%	5.26%	5.27%

PRIMARY MARKET RATES

Last Primary Market Rates							
	au. date	maturity	avg price	avg yield	supply	demand	sold
52W TB	07-05-07	08-05-07	95.665	4.48%	900	1342	900
OK0709	07-04-04	09-07-25	89.970	4.69%	1000	2463	1000
PS0412	07-05-16	12-04-25	98.360	5.13%	1500	8541	1500
DS1017	07-04-11	17-10-25	99.976	5.24%	1800	3473	1800

FX VOLATILITY

date	USD/PLN 0-delta stradle				25-delta RR		25-delta FLY	
	1M	3M	6M	1Y	1M	1Y	1M	1Y
14-05-07	7.90	7.80	7.75	7.70	1.20	1.30	0.35	0.60
15-05-07	7.90	7.80	7.75	7.70	1.20	1.30	0.35	0.60
16-05-07	7.90	7.85	7.85	7.85	1.20	1.30	0.35	0.60
17-05-07	7.90	7.85	7.85	7.85	1.20	1.30	0.35	0.60
18-05-07	7.90	7.80	7.80	7.90	1.20	1.30	0.35	0.60

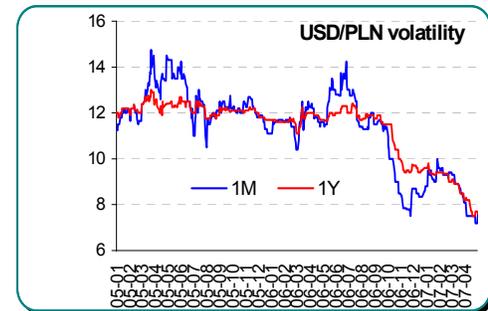
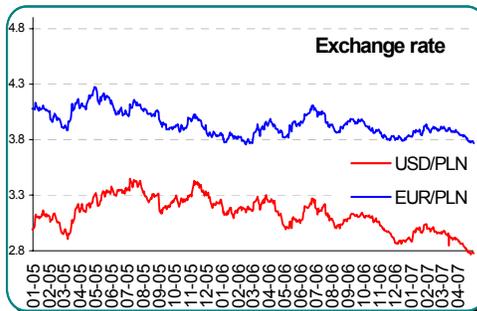
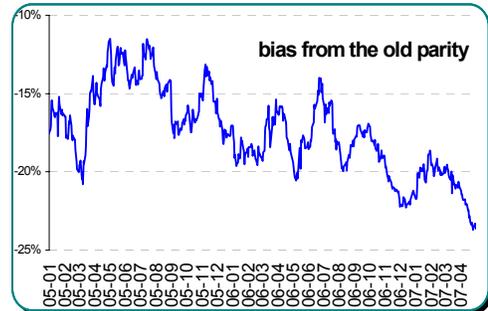
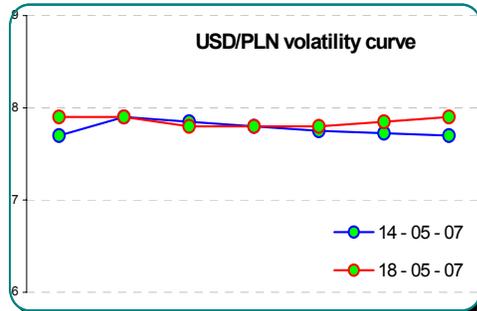
PLN SPOT PERFORMANCE

PLN spot performance			
date	USD/PLN	EUR/PLN	bias
14-05-07	2.7773	3.7610	-23.73%
15-05-07	2.7887	3.7786	-23.40%
16-05-07	2.7934	3.7909	-23.20%
17-05-07	2.7996	3.7897	-23.14%
18-05-07	2.8081	3.7909	-23.03%

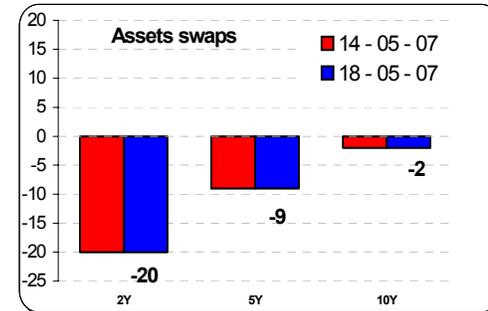
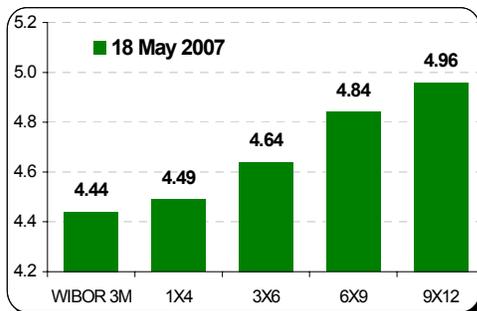
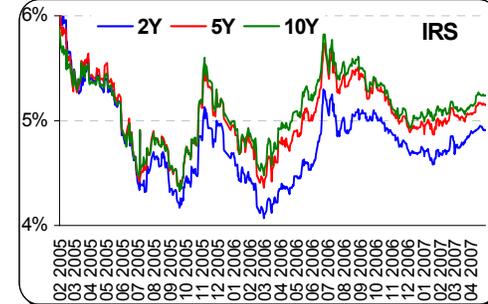
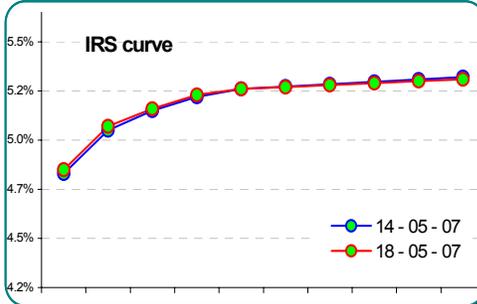
Note: parity on 11/04/00 – USD= 4.3806, EUR=4.2196, basket share 50:50
Mid-market volatility of vanilla option strategies

CHARTS

Foreign Exchange



Fixed Income



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CALENDAR

Macro

	February	March	April	Data Release	BRE Bank forecast
CPI m/m	0.3%	0.5%	0.5%	13-06-07	
CPI y/y	1.9%	2.5%	2.3%	13-06-07	
PPI m/m	0.3%	0.5%		21-05-07	0.4%
PPI y/y	3.5%	3.3%		21-05-07	2.1%
Industrial production growth m/m	-2.1%	14.7%		21-05-07	-6.3%
Industrial production growth y/y	13.0%	11.3%		21-05-07	15.1%
Average wages in enterprise sector [PLN]	2687.5	2852.7	2786.3	19-06-07	
Average wages in enterprise sector y/y	6.5%	9.1%	8.4%	19-06-07	
Unemployment	14.9%	14.4%		25-05-07	13.7%
Budget realisation (%)	10.1%	16.1%	6.9%	15-06-07	
Current account [EUR mn]	-561	-539		15-06-07	
Balance of foreign trade in goods (transaction basis) [EUR mn]	-201	-627		15-06-07	
Exports growth y/y (transaction basis)	13.1%	15.8%		15-06-07	
Imports growth y/y (transaction basis)	12.3%	21.7%		15-06-07	
Current account [% of GDP]	-2.2%	-2.2%		15-06-07	
Money supply (M3)	490.6	492.8	498.7	14-06-07	
Money supply growth y/y	17.9%	18.1%	17.8%	14-06-07	
Total PLN loans [PLN bn]	383.6	392.6	402.8	14-06-07	
Households PLN loans	197.1	203.7	209.6	14-06-07	
Corporate PLN loans	148.2	151.4	155.2	14-06-07	
Total PLN deposits [PLN bn]	410.7	410.8	414.4	14-06-07	
Households PLN deposits	228.6	227.1	225.2	14-06-07	
Corporate PLN deposits	126.1	125.4	126.7	14-06-07	
NBP intervention rate	4.00%	4.00%	4.25%	30-05-07	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	21-05-07	-	4.481%	07-05-07
2Y T-bond OK1208	06-06-07	-	4.694%	04-04-07
5Y T-bond PS0412	20-06-07	-	5.127%	16-05-07
10Y T-bond DS1017	11-07-07	-	5.244%	11-04-07
20Y T-bond WS0922	12-09-07	-	5.309%	14-03-07

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