



TOP NEWS FROM THE POLISH MARKET

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MACROECONOMICS

GDP up by 7.4% in Q1, strong pick up in consumption

GDP in Q1 grew by 7.4% y/y, slightly below our forecast (7.5%, consensus=7.2%). The most important change in the structure of growth is the significant pick up in consumption to 6.9% (5.1% in Q4 2006), clearly indicating the consumption boom. In our opinion the pick up in consumption will be sustained in the coming quarters. Also the pick up in investment was significant – 29.6%, partly due to mild weather conditions and strong constructions growth. Also on the supply side a change in growth structure was observed – towards constructions (40.1%) and market services (7.4%), with industry growth at 9.1%, roughly in line with previous quarters.

MPC left interest rates unchanged, communiqué fairly dovish

As expected, the MPC kept interest rates unchanged in May. The communiqué after the meeting was fairly dovish. After a somewhat weaker industry output and retail sales April data, the MPC admitted the GDP growth rate may have reached its peak in Q1. The MPC omitted part of the communiqué stating that the growth rate above potential may lead to stronger inflationary and wage pressures, indicating that the impact of positive output gap on inflation may turn out to be weaker than had been expected recently.

The balance of risks for future inflation is still on the upside, though the MPC reckons the April hike may have diminished the upside risks.

In our opinion the key to forecast future MPC decisions is the statement that “the more comprehensive assessment of the scale of risk of inflation overshooting the inflation target will only be possible after analyzing the data to be released in the coming months.”

MPC comments: D. Filar and H. Wasilewska-Trenkner for further rate hikes

Several MPC members have given comments after the MPC meeting and GDP data.

D. Filar thinks the April hike did not resolve the CPI problem, and the next hike should be made before the summer holidays. In his opinion, the first hike was made too late and now the frequency of the coming hikes should be higher.

H. Wasilewska-Trenkner also thinks that the CPI outlook remains unfavourable, though the coming hikes needn't be rapid. The timing of the next hike will depend on the coming May data, which will allow an assessment of whether the April slowdown in wages, industry output and retail sales was temporary or not. She added that the opinions that the total scale of hikes reaching 150 bps are overestimated.

M. Pietrewicz and S. Nieckarz against

M. Pietrewicz admitted that the rate hike may prove necessary if the GDP growth rate were to be maintained in Q2, though he immediately added that the slowdown should be observed.

J. Czekaj: hike may take place, though the timing is unclear

S. Nieckarz underlined that the structure of growth remains favourable – with strong growth of investment. Moreover, in his opinion the domestic demand does not exceed the potential, which is confirmed by the fairly stable net inflation.

Finally J. Czekaj stated that the market forecasts regarding interest rates (next hike in July or October) are likely to be fulfilled.

MF forecasts CPI at 2.1% y/y, below our expectations. Rate hike in July seems unlikely

The statements by MPC members were followed by the MF CPI forecast for May – 2.1% y/y, below our earlier expectations. This leads to a lower CPI path in the latter part of the year. CPI in June will most likely remain below 2.5%. This significantly reduces the probability of the July interest rates hike we have been expecting until recently.

Budget execution in May rose to 16-17% of the limit

According to preliminary MF estimates the budget execution after May rose to 16-17% of the annual limit. This should imply a deficit of 3 b PLN in May itself, compared to 4.5 b in May 2006.

E. Suchocka-Roguska admitted that the exact income execution is still uncertain, but some spending acceleration has taken place. In our opinion the systematically lower deficit is a result of a strong income rise (mostly PIT and indirect taxes), directly connected to economic growth. At the moment, given our macro forecasts, a yearend deficit lower by 6-8 b PLN seems reasonable.

FIXED INCOME

Quiet week despite RPP meeting

Last week main event on PLN market was RPP decision on rates. The reaction after press conference was mixed. Our reading was for slightly less risk than previous month as all data printed weaker than market had expected. GDP figure hasn't changed anything in the market sentiment, despite growth and investments being at record highs. Looking back one has to admit that all the weaker data haven't change the bearish sentiment on the rates, especially in the 5y. We think that it is beginning of the bearish trend, especially with sentiment in the EUR market is weak. Our case is a little bit disturbed by lower CPI forecast for this month and this is why we recommend moving pay position into 5y now from previous 2y. We also recommend to add pay position on the dips.

RECOMMENDATION:

Pay 2Y5Y.

MONEY MARKET

Very cheap end of the reserve

Just as we were forecasting very cheap end of the reserve. The whole system located 1.6 billion PLN in the central bank for the last day and this amount best reflects how over liquid was the market. Hence, for the beginning of the week carry was nearby the deposit rate, which is 2.75%. On Thursday, as the new reserve started, shortest rates bounced back to the main rate levels. On Friday the CB offered 23,8 billion PLN of money bills - banks bought only 22,18 billion (21,7 billion during the previous auction), which should more or less square the liquidity for coming days.

The MPC left all the rates unchanged

As for longer terms the MPC left all parameters of the monetary policy unchanged, just as everyone expected. However, bullish sentiment literally exploded after conference and the MPC statement. It was not bullish itself, however it seems that it was not as hawkish as majority expected as well. This sentiment dominated the end of the week. Correction should be seen soon.

Not too hawkish statement triggered bullish sentiment

Next T-bill auction on June 4.

Finance ministry said it will offer 0,5 billion zlotys in 52-week treasury bills on June 4. The ministry cancelled the June 18 second monthly auction due to good budget performance.

RECOMMENDATION:

Sell Polonia up to 6 and 9 M on hikes.

FOREIGN EXCHANGE

Zloty stable

Last week the Zloty traded range-bound between 3.8000 and 3.8300. EUR/USD also traded stable around 1.3450. USD/PLN traded at around 2.8200.

Volatility lower

Stable EUR/PLN was the main reason for the volatilities sell-off. The 1M EUR/PLN declined from 6.8 to 6.1, whereas 1Y from 6.4 to 6.2. The USD/PLN volatility curve declined parallelly

RECOMMENDATION:**Zloty stronger****Short Gamma**

from 7.7 to 7.5 (mids).

Spot:

Main supports / resistances:

EUR/USD: 1.3400 / 1.3550

EUR/PLN: 3.7700 / 3.8100

USD/PLN: 2.8000 / 2.8400

In the following week we still may see EUR/PLN trade lower, that is why we recommend selling EUR/PLN on tops in the following week.

Options:

With realized volatility so low, and the Zloty appreciating we still recommend selling Gamma and earning the decay.

MARKET PRICES UPDATE**MONEY MARKET RATES**

Money market rates (Closing mid-market levels)						
date	3M		6M		1Y	
	FXSW	WIBOR	FXSW	WIBOR	FXSW	WIBOR
28-05-07	4.41%	4.45%	4.54%	4.62%	4.78%	4.81%
29-05-07	4.41%	4.45%	4.54%	4.62%	4.78%	4.81%
30-05-07	4.43%	4.45%	4.55%	4.62%	4.78%	4.82%
31-05-07	4.43%	4.44%	4.55%	4.62%	4.79%	4.82%
01-06-07	4.42%	4.44%	4.53%	4.61%	4.78%	4.79%

FRA MARKET RATES

FRA Market Rates (Closing mid-market levels)					
date	1X4	3X6	6X9	9X12	6X12
28-05-07	4.50%	4.64%	4.83%	5.02%	4.94%
29-05-07	4.51%	4.64%	4.84%	5.03%	4.96%
30-05-07	4.51%	4.63%	4.83%	5.03%	4.96%
31-05-07	4.50%	4.62%	4.82%	5.00%	4.95%
01-06-07	4.49%	4.63%	4.83%	5.01%	4.96%

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
28-05-07	4.81%	4.38%	5.09%	4.60%	5.28%	5.15%	5.32%	5.31%
29-05-07	4.81%	4.37%	5.09%	4.60%	5.29%	5.16%	5.33%	5.32%
30-05-07	4.82%	4.36%	5.08%	4.59%	5.28%	5.16%	5.33%	5.32%
31-05-07	4.82%	4.35%	5.09%	4.58%	5.30%	5.15%	5.34%	5.31%
01-06-07	4.79%	4.35%	5.09%	4.57%	5.29%	5.15%	5.33%	5.30%

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
28-05-07	7.75	7.75	7.75	7.75	1.20	1.30	0.35	0.60
29-05-07	7.75	7.75	7.75	7.75	1.20	1.30	0.35	0.60
30-05-07	7.75	7.75	7.75	7.75	1.20	1.30	0.35	0.60
31-05-07	7.75	7.75	7.75	7.75	1.20	1.30	0.35	0.60
01-06-07	7.75	7.75	7.75	7.75	1.20	1.30	0.35	0.60

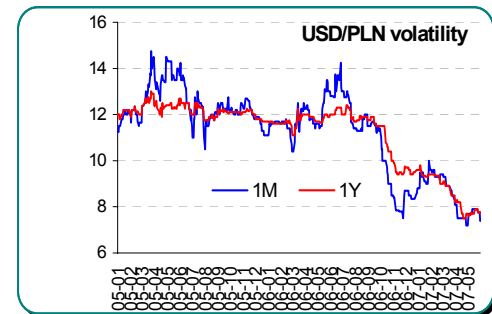
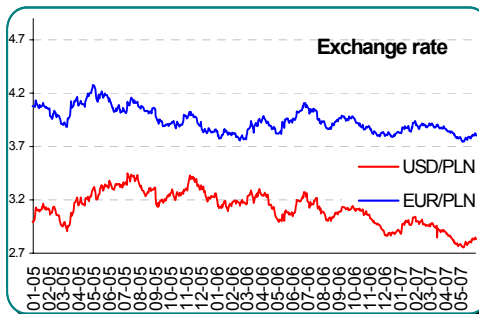
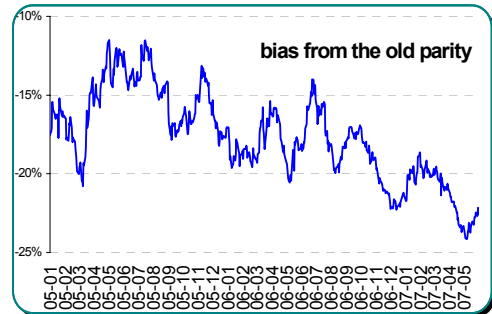
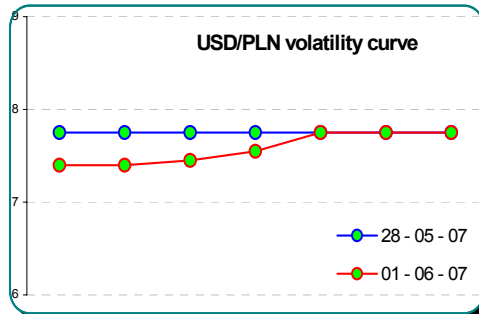
PLN SPOT PERFORMANCE

PLN spot performance			
date	USD/PLN	EUR/PLN	bias
28-05-07	2.8270	3.8040	-22.66%
29-05-07	2.8353	3.8192	-22.38%
30-05-07	2.8483	3.8252	-22.16%
31-05-07	2.8360	3.8148	-22.43%
01-06-07	2.8322	3.8040	-22.60%

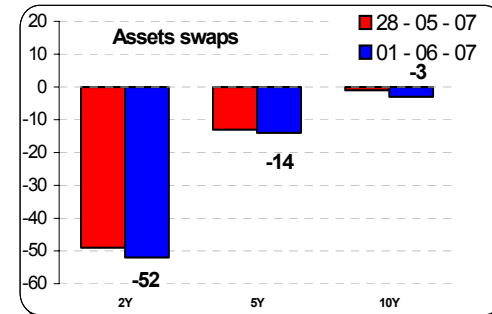
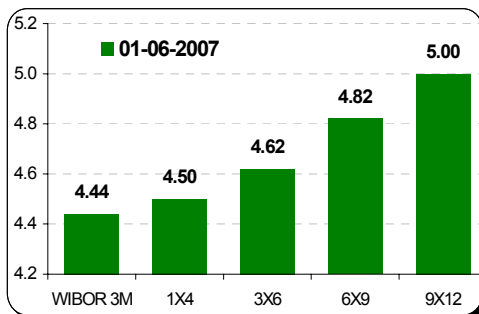
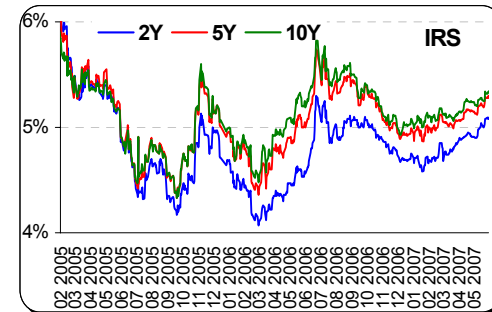
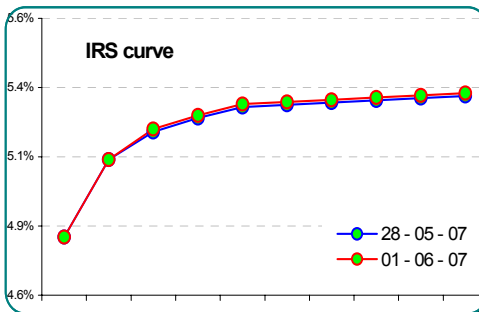
Note: parity on 11/04/00 – USD= 4.3806, EUR=4.2196, basket share 50:50
Mid-market volatility of vanilla option strategies

CHARTS

Foreign Exchange



Fixed Income



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CALENDAR

Macro

	March	April	May	Data Release	BRE Bank forecast
CPI m/m	0.5%	0.5%		13-06-07	0.4%
CPI y/y	2.5%	2.3%		13-06-07	2.2%
PPI m/m	0.5%	0.6%		20-06-07	0.1%
PPI y/y	3.3%	2.3%		20-06-07	2.1%
Industrial production growth m/m	14.7%	-8.7%		20-06-07	5.9%
Industrial production growth y/y	11.3%	12.4%		20-06-07	11.0%
Average wages in enterprise sector [PLN]	2852.7	2786.3		19-06-07	2781.7
Average wages in enterprise sector y/y	9.1%	8.4%		19-06-07	9.1%
Unemployment	14.4%	13.7%		22-06-07	13.0%
Budget realisation (%)	16.1%	6.9%		15-06-07	16.0%
Current account [EUR mn]	-539			15-06-07	-564
Balance of foreign trade in goods (transaction basis) [EUR mn]	-627			15-06-07	-554
Exports growth y/y (transaction basis)	15.8%			15-06-07	16.0%
Imports growth y/y (transaction basis)	21.7%			15-06-07	22.0%
Current account [% of GDP]	-2.2%			15-06-07	-2.2%
Money supply (M3)	492.8	498.7		14-06-07	
Money supply growth y/y	18.1%	17.8%		14-06-07	
Total PLN loans [PLN bn]	392.6	402.8		14-06-07	
Households PLN loans	203.7	209.6		14-06-07	
Corporate PLN loans	151.4	155.2		14-06-07	
Total PLN deposits [PLN bn]	410.8	414.4		14-06-07	
Households PLN deposits	227.1	225.2		14-06-07	
Corporate PLN deposits	125.4	126.7		14-06-07	
NBP intervention rate	4.00%	4.25%	4.25%	27-06-07	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	04-06-07	-	4.481%	07-05-07
2Y T-bond OK1208	04-07-07	-	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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