



TOP NEWS FROM THE POLISH MARKET

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MACROECONOMICS

Poland's CPI inflation came in above forecasts in May

The short term outlook for the Polish official rates had been largely affected by May inflation data and the Central Banker's comments that followed.

Poland's CPI inflation came in above forecasts in May and amounted to 2.3% y/y (0.5% m/m); while both the consensus and the MinFin's forecast stood at 2.1%. This upside surprise was mainly due to higher food prices. In addition, a significant rise in the following categories was recorded: hotels, restaurants and accommodation. All this fits well with our intuition that prices of non-tradables rise more significantly while prices in remaining categories remain flat.

Because of the rise in the annual inflation rate in May our short term inflation forecasts have been revised upwards. For now, the likelihood that the inflation rate will top 2.5% in June has increased. As the 2.5% level seems to be a key psychological level for some MPC members, the likelihood of a rise in interest rates soon increased as well.

The comments made by the MPC members seem to support our conclusion.

After the release of the data on inflation, a usually hawkish member of the central bank's monetary policy committee, Dariusz Filar, stated that the figures were another argument in favour of further monetary policy tightening. He further stressed that interest rate hikes should not be overly spread out over time because wage pressures and inflation in the services sector were on the rise.

A similar opinion has been expressed by, M. Noga, who in addition envisaged Polish inflation breaching 2.5% this year and 3.5% in 2008.

A more comprehensive comment was made by J. Czekaj, a median voter, who in our opinion may shift the balance in the committee towards a prompt rate hike. Although Czekaj is not very bearish on inflation, he expects the rate to be hiked in 2007 and 2008 as well. He conditions the exact timing of the hikes on monthly data due to be released this week. Czekaj explicitly stated that he would especially focus on the wages data, which we expect to overshoot expectations.

A more dovish comment was made by NBP Governor Skrzypek. He played down the chances of an overshoot of the CPI target, but could not rule out the need for further interest rate hikes this year, as concerns about accelerating wages deepen. In his opinion June inflation could possibly exceed the Central Bank target level of 2.5%, mostly due to the negative base effect of inflation last year, but it would still be on the safe side, since inflation was driven by supply shocks.

Wages are key for the Polish rates in the short term

Our comment: Wages are key for the Polish rates in the short term. We still expect the risks to lie on the upside.

Money supply (M3) was up 0.9% m/m in May

Money supply (M3) was up 0.9% m/m in May, which translated into 16.1% y/y, down from 17.3% recorded in April. The credit for households was up by 3.6% m/m and by 38.4% y/y, while credit for enterprises expanded by only 1.0% m/m. On the deposits side a 1.1% m/m drop in households deposits was recorded while deposits of enterprises expanded at 1.6% m/m.

Interestingly, a significant rise in deposits of local communities has been recorded, which fits well with the data on the general government deficit released last week by the MinFin. That data confirm a superior financial condition (8 bn PLN budget surplus) of these entities in the first quarter of 2007. In our opinion the data on M3 confirm the economic tendencies we observed in the last few months. Credit to households continues to expand at a high pace but there is an indication that saving rate may drop in the future.

2008 budget outline to be revised in September

Last week, the Polish government accepted the 2008 budget outline. The budget deficit is to amount 30 bn PLN next year, i.e. it will stay at the same level as in 2007. Given that the Polish economy is on the recovery path one may conclude that the fiscal policy will be too expansionary next year. The estimates of budget revenues and spending (12.8% and 11.2% up compared to the plan for 2007) are, for the time being, quite conservative, provided that the revenues are

Budget deficit for Jan-May came in at 14.2% of the government's 2007 plan

likely to overshoot this year and thus a more favourable base for the next year will be established. On the spending side, the MinFin did not account for all spending put forward by the ruling coalition. We see, however, these assumptions as a good starting point for fierce negotiations within the coalition (the budget gap has been intentionally overestimated to limit the demands for higher spending) and expect the 2008 budget outline to be revised in September, which has already been confirmed by MinFin's officials.

The budget deficit for Jan-May came in at 14.2% of the government's 2007 plan and was slightly below the earlier estimates of the MinFin (we expanded on this point last week). Thus, we uphold our view that the whole year deficit figure may undershoot the target by 6-8 bn PLN.

FIXED INCOME

Should MPC worry?

The two main events of last week were the 30y bond auction and release of CPI figure. Sentiment on the market was rather poor as rates in core markets rose quite significantly. The auction was no surprise with probably one buyer taking the most of the stake, but CPI came at 2.3 versus 2.1 expected by the market. Next days we saw major curve flattening with very short end of the FRA curve moving 10 to 12 bps. We think that MPC is starting to get quite worried about possible CPI acceleration, especially that there is little risk that hikes will slow down growth in coming quarters. Ministry of Finance on the other hand is trying to boost local demand by lowering pension fee and promising special allowance for every child in the family. We maintain our view that rates will push higher, and it will be definitely faster than market expects, we are payers of dips we start to like 2y pay position most.

RECOMMENDATION:

Pay 2 Y.

MONEY MARKET

Stable carry next week

Quite week for carry with Polonia rates around the main market rate. It seems that next week will be pretty similar. Open market operation squared the market with a tender of 22.2 billion pln. Hence, the carry will remain stable at similar levels.

Crucial figure on Tuesday

Breaking through week for longer terms. If anyone had any doubts as for further rates hikes, the CPI figure made them disappear. Market moved 10-20 bps up depending on the term and now is waiting for the wages figure. In our opinion it will support the bears.

RECOMMENDATION:

Pay 6m wibor ois.

FOREIGN EXCHANGE

Zloty stable

Last week the Zloty traded range-bound between 3.8000 and 3.8200, only on Friday has it declined below 3.8000, what may signal an end of the correction. EUR/USD also traded stable

Volatility lower

RECOMMENDATION:

Zloty stronger

Short Gamma

around 1.3320. USD/PLN traded at around 2.8650.

With EUR/PLN below 3.8000, the volatilities declined. The 1M EUR/PLN declined from 6.5 to 6.1, whereas 1Y from 6.4 to 6.2. The USD/PLN volatility curve declined paralelly from 7.6 to 7.3 (mids).

Spot:
Main supports / resistances:
EUR/USD: 1.3350 / 1.3450
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
11-06-07	4.44%	4.47%	4.58%	4.62%	4.86%	4.83%
12-06-07	4.44%	4.47%	4.58%	4.62%	4.86%	4.83%
13-06-07	4.44%	4.47%	4.57%	4.63%	4.84%	4.85%
14-06-07	4.45%	4.47%	4.61%	4.64%	4.88%	4.85%
15-06-07	4.46%	4.47%	4.61%	4.64%	4.88%	4.79%

FRA MARKET RATES

FRA Market Rates (Closing mid-market levels)					
date	1X4	3X6	6X9	9X12	6X12
11-06-07	4.52%	4.68%	4.90%	5.12%	5.04%
12-06-07	4.53%	4.68%	4.87%	5.10%	5.03%
13-06-07	4.53%	4.67%	4.91%	5.12%	5.04%
14-06-07	4.56%	4.75%	4.97%	5.16%	5.12%
15-06-07	4.57%	4.75%	4.97%	5.15%	5.11%

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
11-06-07	4.83%	4.40%	5.21%	4.62%	5.49%	5.34%	5.53%	5.46%
12-06-07	4.83%	4.38%	5.22%	4.62%	5.51%	5.38%	5.55%	5.49%
13-06-07	4.85%	4.33%	5.25%	4.63%	5.54%	5.40%	5.59%	5.51%
14-06-07	4.85%	4.35%	5.26%	4.67%	5.55%	5.41%	5.60%	5.52%
15-06-07	4.79%	4.35%	5.24%	4.68%	5.52%	5.39%	5.58%	5.50%

PRIMARY MARKET RATES

Last Primary Market Rates							
	au. date	maturity	avg price	avg yield	supply	demand	sold
52W TB	07-06-04	08-06-04	95.759	4.38%	500	1931	500
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
11-06-07	7.40	7.55	7.75	7.75	1.20	1.30	0.35	0.45
12-06-07	7.40	7.50	7.70	7.70	1.20	1.30	0.30	0.45
13-06-07	7.40	7.50	7.70	7.70	1.20	1.30	0.30	0.45
14-06-07	7.40	7.50	7.60	7.60	1.20	1.30	0.30	0.45
15-06-07	7.30	7.50	7.50	7.50	0.90	1.15	0.30	0.45

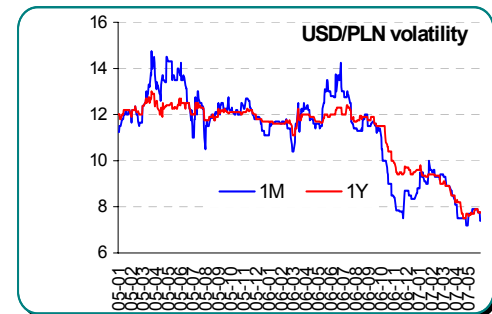
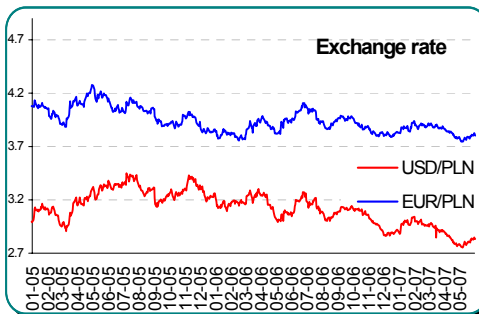
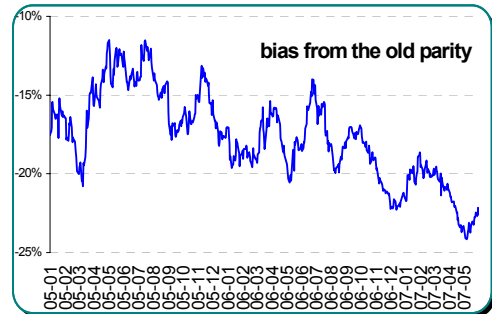
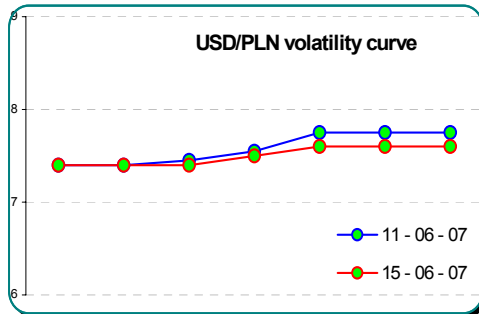
PLN SPOT PERFORMANCE

PLN spot performance			
date	USD/PLN	EUR/PLN	bias
11-06-07	2.8746	3.8365	-21.73%
12-06-07	2.8685	3.8278	-21.90%
13-06-07	2.8953	3.8451	-21.39%
14-06-07	2.8744	3.8230	-21.89%
15-06-07	2.8625	3.8120	-22.16%

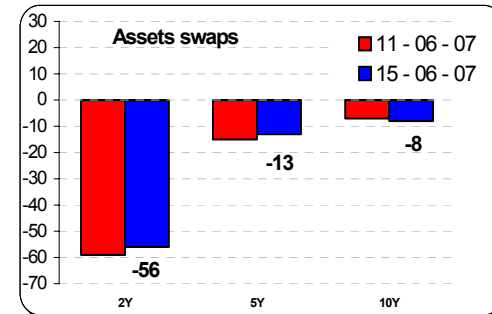
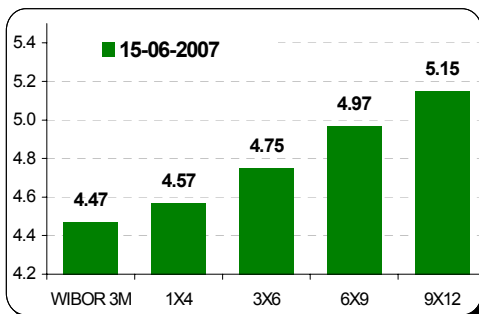
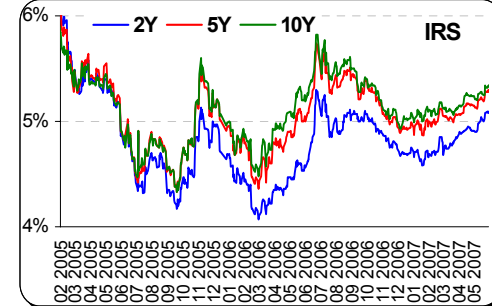
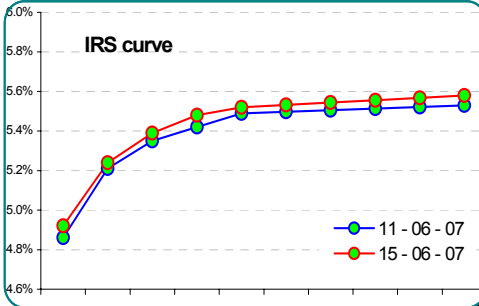
Note: parity on 11/04/00 – USD= 4.3806, EUR=4.2196, basket share 50:50
Mid-market volatility of vanilla option strategies

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%	0.5%	13-07-07	
CPI y/y	2.5%	2.3%	2.3%	13-07-07	
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%	13.0%	24-07-07	
Budget realisation (%)	16.1%	6.9%	14.2%	13-07-07	
Current account [EUR mn]	-539	-678		13-07-07	
Balance of foreign trade in goods (transaction basis) [EUR mn]	-627	-779		13-07-07	
Exports growth y/y (transaction basis)	15.8%	15.7%		13-07-07	
Imports growth y/y (transaction basis)	21.7%	24.9%		13-07-07	
Current account [% of GDP]	-2.2%	-2.2%		13-07-07	
Money supply (M3)	492.8	498.4	502.9	13-07-07	
Money supply growth y/y	18.1%	17.8%	16.1%	13-07-07	
Total PLN loans [PLN bn]	392.6	402.6	412.5	13-07-07	
Households PLN loans	203.7	209.4	216.9	13-07-07	
Corporate PLN loans	151.4	155.3	156.9	13-07-07	
Total PLN deposits [PLN bn]	410.8	414.0	417.2	13-07-07	
Households PLN deposits	227.1	225.0	222.7	13-07-07	
Corporate PLN deposits	125.4	126.7	129.1	13-07-07	
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	09-07-07	-	4.380%	04-06-07
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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