



## TOP NEWS FROM THE POLISH MARKET

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## MACROECONOMICS

**Wages increased in May by 8.9% y/y**

The annual growth rate of wages in May increased slightly to 8.9% from 8.4% y/y in April. This figure stays in line with our expectations and allows it to be concluded that the dynamics of wages stabilized on a very high level. Thus the growth of wages in several branches is in double figures.

**Industry output grew by only 8.1% below expectations**

On the other hand the industry output in May grew less than the market expected. The annual growth rate amounted to 8.1% (8.3% after seasonal adjustment, k=10.4%). It is the second month in a row in which the industry output was significantly below the trend. We think that this data has been distorted by the extraordinary long holiday in May. However despite this distortion this data shows that the industry output weakened. We believe that strong domestic demand can not be fully met by the supply, which may lead to higher inflation pressure in the medium term.

On the basis of monthly data we estimate that GDP growth rate will have dropped in Q2 to 6.0% (in June the industry output growth due to unfavourable trading day effect grew by only 7-8%). This deterioration of industry output in conjunction with strong wages growth will lead to growth of unit labour cost which is of great importance for the MPC.

**Three of five core inflation measures rose in May. Net inflation at 1.6%**

Further evidence for inflationary pressure is provided by core inflation measures for May. Three of the five measures increased, one decreased and one remained unchanged. Net inflation grew from 1.5% in April to 1.6% in May, mostly due to growing services prices. We expect that net inflation will jump to 1.7% in June and after that, due to "base effect", will drop temporarily in the summer months. By the end of year we forecast net inflation to be 1.9-2.0% y/y.

**The comments of two of the most influential MPC members indicate rates hike in the near future**

In the face of these data MPC members changed their announcements to more "hawkish" ones. Professors A. Wojtyna and A. Slawinski said that further hikes will be needed to stabilize inflation around the inflation target. Slawinski said that the value of the option of waiting with the next hike is very small. Wojtyna added that a good example for Poland is the case of the United Kingdom where the inflation was very low for a long time and after that grew rapidly. Additionally, in his opinion, the potential risk from the labour market in Poland is higher than in the UK, due to the direction of labour force flows (migration increases the supply of labour in the UK and decreases in Poland). Commenting the situation on the labour market Wojtyna said that in the face of such strong wages growths the neutralization of higher ULC by productivity growth may be very problematic.

**The minutes from meeting in May confirmed that MPC voted for the hike**

These comments are significantly more hawkish than the minutes from the MPC meeting in May. The minutes were not very informative due to the fact the all the opinions expressed in the minutes were anonymous. Thus we think that some points can be helpful for predicting the future interest rates path. Firstly MPC members wrote that in spite of weakening, GDP growth will be higher than potential growth. It means that the slight weakening of the growth which we expect can not stop the cycle of monetary policy tightening.

Secondly, during the meeting in May some members emphasized that wages dynamics in April (8.4% y/y) were lower than in March (9.1% y/y). After the data for May where wages again grew at 8.9% this argument against hikes is not longer valid.

Thirdly in May the MPC voted the interest rates hike. It contrasts with the MPC statement after the meeting in April when the MPC wrote that a hike was a preemptive strike not the beginning of the cycle.

We believe that the pressure on the hikes is stronger than the results from last two statements after the meetings. Moreover the "dovish" members have systematically lost the arguments for holding the rates unchanged.

**We expect repo rate at the end of year at 5.00% with the next hike in July**

One more argument for the tightening is the reduction of the tax wedge by 7% (3% from July and 4% from January) which has been accepted by Parliament. This reduction may invoke additional demand shock in the economy, which cannot be disregarded by the MPC.

We expect that the MPC will continue the cycle of the tightening till 5.00% at the end of 2007 and 5.50% at the end of 2008. The question is when the first hike will occur. In our opinion a hike in July is more likely than in June for two reasons: Firstly, current inflation will exceed the inflation target, which may be of importance for some members. Secondly, the new inflation projection will be published. However we can fully exclude that the hike will occur in June. We estimate the probability of a hike in July against June to be 60:40.

The result of the voting in April has been published as well. According to expectations 6 members voted for the hike and 4 against (inc. chairman S.Skrzypek). This result has no impact on our outlook for the future moves of the MPC.

## FIXED INCOME

**Curve finally started to price in some tightening**

The main event of last week was publishing of wages data, which came higher than the market had expected. We saw some heavy paying interest across the whole curve with the end of the curve flattening a little bit. Curve now is pricing 5.50% as the top of policy tightening within 2y time and some additional premium for risk, about 20 bp on the 3-5y sector. Most of the paying interest in our opinion was stop-loss related. We think that we are approaching new period of rather higher volatility, and we think that curve will trade for sometime in wide range of 5.50-5.90 in the 5y. We recommend reducing positions here, we don't have any specific view of the curve, and right now we will be playing range in the possible most volatile period which we see to be 5y. As far as fundamental story, we are still negative on the rates.

### RECOMMENDATION:

Be lazy, take profit, at least some.

## MONEY MARKET

**Stable carry, end of the reserve ahead**

**Wages woke up June expectations**

Carry still stable which is very good because we can save the energy for trading. Open market operation in line with expectation 21,6 billion pln and this was enough to square the market. Hence, next week should be good for carry except the last day of the reserve. On this day everything is possible but stabilization.

For longer terms very hectic. After high wages (8.9 vs 8.1% expected) part of the market started to play a June hike scenario. Neutral PPI and IO figures could not change it since some stop losses were triggered. The curve moved up 15 bps in 1Y and the biggest impact was in the shorter terms. 1M till 3M went crazy. In OISs 20 bps was built up in one day. Now we will wait and see till Wednesday.

### RECOMMENDATION:

Sell 6M polonia on hikes.

## FOREIGN EXCHANGE

### Zloty stable

Last week the Zloty traded range-bound between 3.7800 and 3.8100, lower comparing to a week before. EUR/USD also traded stable around 1.3420. USD/PLN traded at around 2.8350.

### Volatility lower

With EUR/PLN below 3.8000, the volatilities traded low. The 1M EUR/PLN traded at 6.1, whereas 1Y from at 6.2, both mids. The USD/PLN volatility curve traded at 7.3 (1M) and 7.5 (1Y).

### RECOMMENDATION:

### Zloty stronger

Spot:  
Main supports / resistances:  
EUR/USD: 1.3400 / 1.3500  
EUR/PLN: 3.7700 / 3.8100  
USD/PLN: 2.8000 / 2.8400

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

### Short Gamma

Options:

With realized volatility so low, and the Zloty stable 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
18-06-07	4.47%	4.47%	4.62%	4.65%	4.91%	4.86%
19-06-07	4.49%	4.48%	4.67%	4.66%	4.97%	4.90%
20-06-07	4.55%	4.48%	4.74%	4.66%	5.06%	4.90%
21-06-07	4.55%	4.48%	4.74%	4.66%	5.06%	4.90%
22-06-07	4.55%	4.48%	4.75%	4.67%	5.06%	4.79%

**FRA MARKET RATES**

FRA Market Rates (Closing mid-market levels)					
date	1X4	3X6	6X9	9X12	6X12
	18-06-07	4.58%	4.78%	4.98%	5.17%
19-06-07	4.60%	4.85%	5.08%	5.27%	5.25%
20-06-07	4.65%	4.92%	5.17%	5.34%	5.57%
21-06-07	4.68%	4.91%	5.16%	5.36%	5.55%
22-06-07	4.67%	4.89%	5.15%	5.35%	5.54%

**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
18-06-07	4.86%	4.35%	5.27%	4.65%	5.55%	5.40%	5.60%	5.51%
19-06-07	4.90%	4.35%	5.32%	4.72%	5.66%	5.48%	5.68%	5.59%
20-06-07	4.90%	4.35%	5.43%	4.81%	5.70%	5.55%	5.74%	5.65%
21-06-07	4.90%	4.35%	5.40%	4.84%	5.69%	5.54%	5.72%	5.66%
22-06-07	4.79%	4.35%	5.39%	4.81%	5.67%	5.52%	5.71%	5.64%

**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	07-06-22	12-04-25	96.925	5.48%	1000	2673	1000
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
18-06-07	7.30	7.50	7.50	7.50	0.90	1.15	0.30	0.45
19-06-07	7.30	7.50	7.50	7.50	0.90	1.15	0.30	0.45
20-06-07	7.30	7.50	7.50	7.50	0.90	1.15	0.30	0.45
21-06-07	7.30	7.50	7.50	7.50	0.90	1.15	0.30	0.45
22-06-07	7.30	7.50	7.50	7.50	0.90	1.15	0.30	0.45

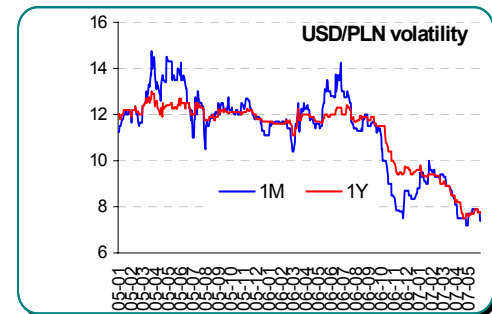
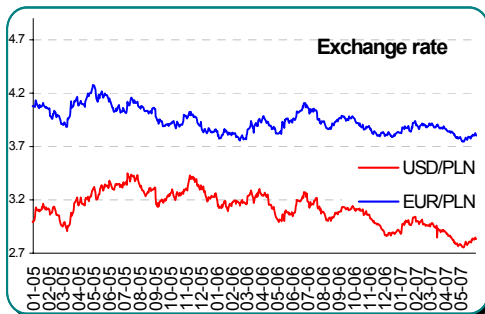
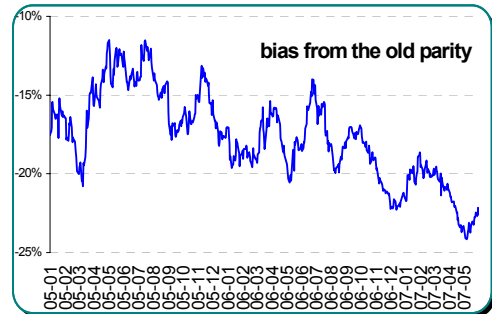
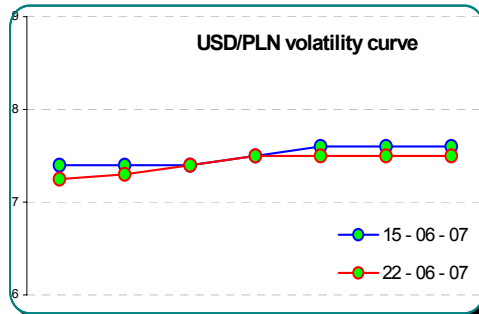
**PLN SPOT PERFORMANCE**

PLN spot performance			
date	USD/PLN	EUR/PLN	bias
18-06-07	2.8364	3.8007	-22.59%
19-06-07	2.8414	3.8066	-22.46%
20-06-07	2.8191	3.7835	-22.99%
21-06-07	2.8338	3.7935	-22.70%
22-06-07	2.8229	3.7865	-22.91%

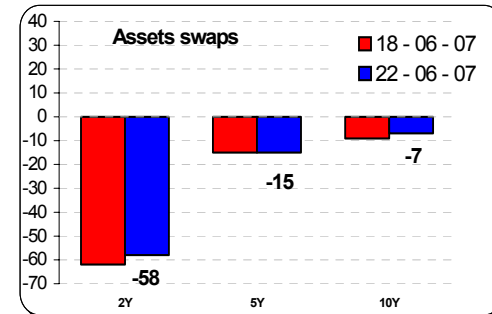
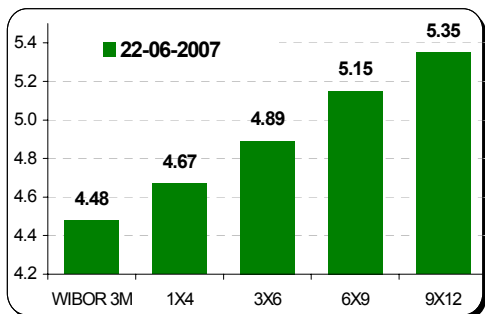
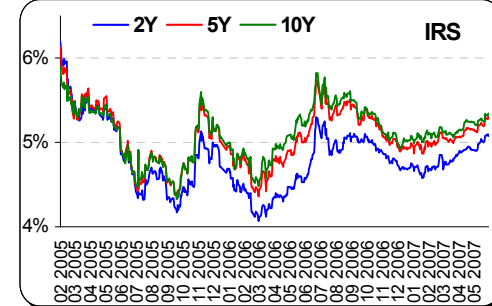
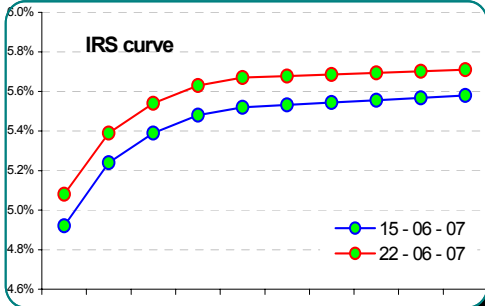
Note: parity on 11/04/00 – USD= 4.3806, EUR=4.2196, basket share 50:50  
Mid-market volatility of vanilla option strategies

**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%	0.5%	0.4%	19-07-07	
PPI y/y	3.3%	2.3%	2.2%	19-07-07	
Industrial production growth m/m	14.7%	-8.6%	3.0%	19-07-07	
Industrial production growth y/y	11.3%	12.6%	8.1%	19-07-07	
Average wages in enterprise sector [PLN]	2852.7	2786.3	2776.9	16-07-07	
Average wages in enterprise sector y/y	9.1%	8.4%	8.9%	16-07-07	
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	19-09-07	-	5.480%	20-06-07
10Y T-bond DS1017	11-07-07	-	5.244%	11-04-07
20Y T-bond WS0922	12-09-07	-	5.309%	14-03-07

## CONTACT DETAILS

### **BRE BANK SA**

**ul. Senatorska 18  
00-950 Warszawa  
P.O. Box 728  
Poland**

**Reuters Pages:  
BREX, BREY, and  
BRET**

**Bloomberg: BRE**

**SWIFT: BREXPLPW**

**[www.brebank.com.pl](http://www.brebank.com.pl)**

### **Forex (BREX) - FX Spot & Options**

Marcin Turkiewicz (+48 22 829 01 84) [Marcin.turkiewicz@brebank.com.pl](mailto:Marcin.turkiewicz@brebank.com.pl)  
Jakub Wiraszka (+48 22 829 01 73)  
Tomasz Chmielarski (+48 22 829 01 78)

### **Fixed Income (BREP) - FRA, IRS, T-Bonds, T-Bills**

Łukasz Barwicki (+48 22 829 01 93) [Lukasz.barwicki@brebank.com.pl](mailto:Lukasz.barwicki@brebank.com.pl)  
Paweł Białczyński (+48 22 829 01 86)

### **MM (BREP) - MM, FX Swaps**

Tomasz Wołosz (+48 22 829 01 74) [Tomasz.wolosz@brebank.com.pl](mailto:Tomasz.wolosz@brebank.com.pl)  
Bartłomiej Małocha (+48 22 829 01 77)

### **Structured Products (BREP)**

Jarosław Stolarczyk (+48 22 829 01 67) [Jaroslaw.stolarczyk@brebank.com.pl](mailto:Jaroslaw.stolarczyk@brebank.com.pl)  
Jacek Dereziński (+48 22 829 01 69)

### **Institutional Sales (BRES)**

Inga Gaszkowska-Gębska (+48 22 829 12 05)

### **Research**

Jacek Kołowski (+48 22 829 01 83) [Research@brebank.com.pl](mailto:Research@brebank.com.pl)  
Ernest Pytlarczyk (+48 22 829 01 66)  
Artur Ulbrich (+48 22 829 12 07)

### **Financial Markets Department**

Phone (+48 22 829 02 03)  
Fax (+48 22 829 02 45)

### **Treasury Department**

Phone (+48 22 829 02 02)  
Fax (+48 22 829 02 01)

### **Financial Institutions Department**

Phone (+48 22 829 01 20)  
Fax (+48 22 829 01 21)

### **Back Office**

Phone (+48 22 829 04 02)  
Fax (+48 22 829 04 03)

### **Custody Services**

Phone (+48 22 829 13 50)  
Fax (+48 22 829 13 49)