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FINANCIAL MARKETS DEPARTMENT

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POLAND WEEKLY REVIEW

MACROECONOMICS AND FINANCIAL MARKETS

PREVIEW: The week of September 21st to September 27th

Indicator	Date of release	Period	BRE forecast	Con-sensus	Last	Comment
Retail sales y/y	**Sep 22**	**Aug**	**16.0%**	-	17.2%	The headline figure affected by lower sales of motor vehicles.
"Net" core inflation y/y	**Sep 22**	**Aug**	**1.2%**	1.1%	1.5%	Decline in core inflation owing to reduction of internet fees.
MPC decision on rates	**Sep 26**	**Sep**	**4.75%**	4.75%	4.75%	The Committee likely to adopt "wait and see" approach.

In Focus / Macroeconomics

Wage growth topped 10% y/y in August

Wage growth and consequently higher unit labour costs translate into higher inflation risks

In August corporate wages rose by 10.5% y/y, exceeding both market expectations (9.5% y/y) and our forecast (9.5% y/y). Crossing over the 10 per cent threshold could potentially induce some psychological effects to the market. The actual impact of the figure, however, was limited by the underlying bullish sentiment.

Such high wage dynamics may have been expected for a few months, as detailed data consistently pointed to a rising number of industry sectors in which wage growth went beyond double digits. A double digit wage growth was recorded in June in 16 sectors, rising to 21 in July. We maintain our view that corporate wages may rise even faster in the coming months. There are still no signs that demand for labour is easing off. The latest data on corporate employment even points to steadily rising dynamics. In August corporate employment rose by 4.8% compared to. 4.7% recorded in July. As the rising demand for labour usually translates into a higher wages with some lag, the workers' bargaining power may be on the rise moving forward in coming quarters.

Following the release of wage data we are more confident than ever that, in the third quarter, Unit Labour Cost dynamics could top 10% y/y vs. 9.2 recorded in Q2 and 5.6% predicted by Central Bank experts for the whole year. In addition, a record growth in the labour fund was recorded in August. Given that the tax rate cuts, implemented in July, worked to further boost households' disposable income by 3-4%, substantial growth in consumption is expected over the coming months. All of this translates into higher inflation risks. The combination of heavy competition between companies - with their excellent financial standing allowing them to (temporarily) increase wages without rising prices - and a stable price development in the external environment pose some downside risks to our baseline scenario - inflation topping 3.0% in 2008 and interest rates rising to 5.5% by mid 2008).

The Polish MPC may still be quite confused by the latest inflation reading… we do not expect it to hike the rates next week.

Turning to the effects that the higher wage figure may have on the ongoing monetary policy, we assess that the Polish MPC may still be quite confused by the latest inflation reading (an unexpected drop of the CPI inflation to 1.5% owing to one-off reduction in internet fees, according to Mr. Noga from the MPC, has made the situation "complicated") and may result to the "wait and see" approach. Consequently, we do not expect the MPC to hike rates till November. More hawkish comments are to be expected after the release of September's inflation data or as feedback to inflation projections which, according to our estimates, may show inflation breaching the upper inflation target limit in the midterm.

Industrial production still climbing

August data confirms the view we have expressed so far i.e. that industrial production enjoys sound growth

In August the industrial production index rose by 9.0% y/y and 1.1% m/m which was slightly below the market consensus (9.5% y/y) and our forecast (9.5% y/y) as well. This figure is lower than the one recorded in the previous month (10.4% y/y), however in SA terms (9.4% y/y in August vs. 8.3% y/y in July) it turns out that the actual growth was higher this month - the distortion caused by the working-day effect.

It is worth noting that in manufacturing the growth dynamics were significantly higher, reaching 10.4% y/y. A weaker performance in the whole industrial sector was due to mining, which recorded a strong production decline. This is a tendency which we have been monitoring in the last period and is now confirmed by the August data. We do not, however, believe the last industrial production figure was influenced by car sales, which in the recent months have shown no significant correlation with the overall production index.

August data confirms the view we have expressed so far i.e. that industrial production enjoys sound growth and is consistent with the last statement from the MPC which assessed the state of the real economy in a similar way. Accordingly, it is neutral for the markets. It should be stressed, however, that this year growth takes place in different circumstances from those in 2003 - when industrial production recorded equally high dynamics. Now the situation in the labour market is totally different and if the high production dynamics are to be maintained, then employment growth must follow, driving the wage dynamics (see the section above).

MEDIUM-TERM FORECATS

Indicator	2006	2007	2008
GDP y/y (%)	6.1	**6.5**	5.7
Inflation rate (%)	1.0	2.4	3.2
Current account (% of GDP)	-2.1	**-4.5**	**-5.3**
Unemployment rate (end-of-year)	14.9	**11.0**	9.8
NBP repo rate (end-of-year)	4.00	5.00	5.50

*Source: GUS, NBP, BRE Bank, **bold** change on last week*

Fixed Income

A volatile week on PLN rates

Last week after surprising CPI release market made from 20 to 25 bp down in yields. The wage figure which was published on Monday made very little reaction to the market despite the fact it came at 10.5 yoy basis beating market expectations. Next big market mover was FED decision to cut rates, which made sentiment on PLN rates again very positive, but short lived. After touching again minimal levels in rates on Wednesday morning, on Thursday we saw sharp move up (7-9 bp), especially in the short part of the curve. We still think that pay position in the mind term FRA is the best option, as curve is pricing only one hike in full with 50% risk another may come in the 1y time. CPI drop can prove to be only temporary, as it is based on category that has very little to do with demand pressure, plus it will be reversed in 6months time. Other factors remain unchanged, pointing to risk or rather more then less hikes.

RECOMMENDATION:

Pay 6x12 PLN FRA.

AUCTIONS

	next auc.	offer	avg yield last	last auction date
13 Week T-bills	-	-	4.208%	1/16/2006
26 Week T-bills	-	-	3.943%	4/24/2006
52 Week T-bills	08/10/07	-	5.084%	9/17/2007
2Y T-bond OK1209	03/10/07	-	5.327%	9/5/2007
5Y T-bond PS0412	17/10/07	-	5.480%	9/19/2007
10Y T-bond DS1017	10/10/07	-	5.658%	7/11/2007
20Y T-bond WS0922	-	-	5.796%	9/12/2007

Money Market

Very cheap week behind and probably ahead

Very cheap week due to huge surplus of the money in the system (2-3 billion PLN). We could observe short rates falling down. It was perfectly in line with successive growth of the cash re-serve in the system. On Friday central bank offered 19.5 billion PLN worth of money bills (21.3 billion PLN in cash was coming back from maturing on the same date papers). The demand for the money bills was 2,4 billion PLN smaller than supply. It made O/N and T/N rates temporary go down to 4.6%.

Inflation below market forecasts, volatile times for longer terms

Polish consumer price inflation slowed to 1,5% year-on-year in august. The figure was well be-low market expectations of 1.9% This figures shifted temporary down yield curve about 10-15 basis points.

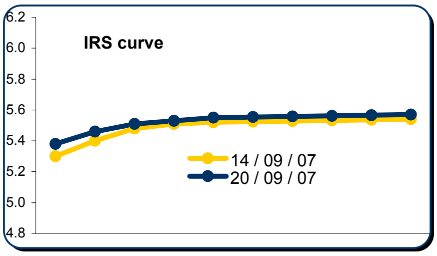
T-bills down at weekly tender.

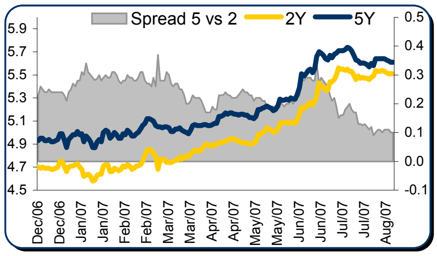
The average yield on the polish benchmark 52-week T-bill fell to 4.983% at auction Monday, from 5.084% at the previous auction September 3. The ministry sold all 500 million zlotys of 52-week paper on offer at well bid tender.

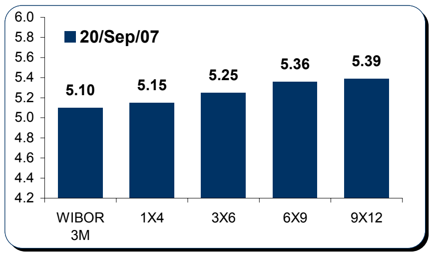
RECOMMENDATION:

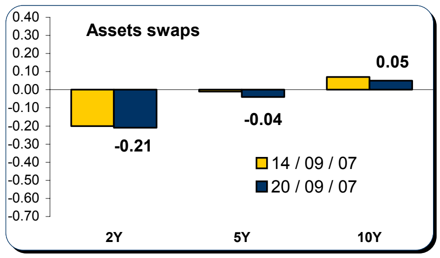
Pay 1Y OIS at current levels, sell 3S OIS.

FIXED INCOME & MONEY MARKET CHARTS









Foreign Exchange

Zloty stable

This week złoty was traded in a narrow range between 3.7660 and 3.7900 . Its is also clear that złoty is following the sentiment on USD. As dollar is getting weaker and złoty seems to be insensitive for domestic signals, EURPLN looks heading 3.7400 last lows level.

Volatility stable

EURPLN implied volatility was traded around 5.8 levels for whole curve on quiet trading. USDPLN was traded respectively 8.4 for 1M and 8.15 for 1Y.

RECOMMENDATION:

Spot:
Main supports / resistances:
EUR/PLN: 3.7400 / 3.8000
USD/PLN: 2.6400 / 2.7200

Zloty in side trend

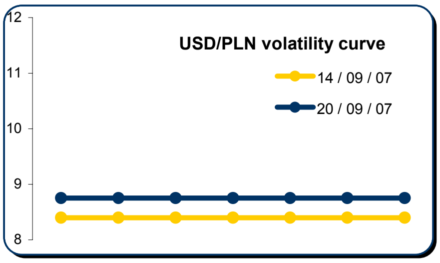
We see zloty in slow, strengthening trend with 3.7400 as test of it. We have to stay close with USD sentiment to track PLN one.

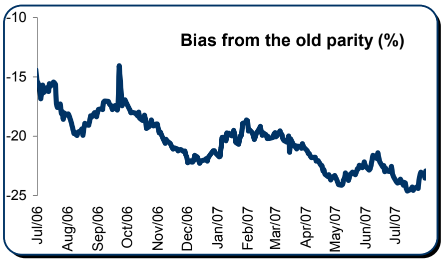
Options:

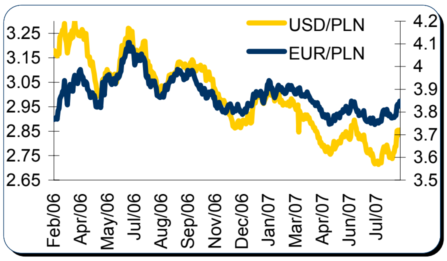
Keep short vega

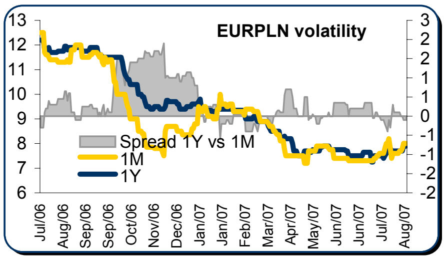
EURPLN volatility looks pretty bidded at 5.6/5.7 levels, what gives signals to close short EURPLN vega. We also advice USDPLN long gamma as it still looks relatively cheap. Buying USDPLN 1Y calls/RR looks worth considering too as 0.9 vols for RR is historical low.

FX CHARTS









MARKET PRICES UPDATE

MONEY MARKET RATES

Money market rates (Closing mid-market levels)						
date	3M		6M		1Y	
	FXSW	WIBOR	FXSW	WIBOR	FXSW	WIBOR
14/09/07	5.06%	5.08%	5.05%	5.21%	5.19%	5.45%
17/09/07	5.03%	5.07%	5.07%	5.22%	5.23%	5.44%
18/09/07	5.03%	5.09%	5.10%	5.24%	5.26%	5.45%
19/09/07	5.03%	5.09%	5.10%	5.24%	5.26%	5.45%
20/09/07	5.10%	5.10%	5.12%	5.25%	5.28%	5.45%

FRA MARKET RATES

FRA Market Rates (Closing mid-market levels)					
date	1X4	3X6	6X9	9X12	6X12
14/09/07	5.09%	5.16%	5.29%	5.33%	5.35%
17/09/07	5.10%	5.20%	5.35%	5.38%	5.40%
18/09/07	5.10%	5.21%	5.34%	5.36%	5.39%
19/09/07	5.10%	5.22%	5.32%	5.35%	5.37%
20/09/07	5.15%	5.25%	5.36%	5.39%	5.41%

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
14/09/07	5.45%	5.08%	5.57%	5.29%	5.72%	5.69%	5.73%	5.76%
17/09/07	5.44%	5.05%	5.57%	5.29%	5.71%	5.68%	5.72%	5.76%
18/09/07	5.45%	5.05%	5.57%	5.34%	5.71%	5.67%	5.71%	5.76%
19/09/07	5.45%	5.05%	5.56%	5.30%	5.71%	5.65%	5.72%	5.75%
20/09/07	5.45%	5.03%	5.56%	5.34%	5.70%	5.68%	5.70%	5.75%

PRIMARY MARKET RATES

Last Primary Market Rates	au. date	maturity	avg price	avg yield	supply	demand	sold
52W TB	07/09/17	08/09/17	95.204	4.98%	500	2600	500
OK0709	07/09/05	09/07/25	90.694	5.33%	1800	4232	1800
PS0412	07/09/19	12/04/25	97.044	5.48%	2500	5717	2500
DS1017	07/07/11	17/10/25	96.817	5.66%	1800	2997	1800

FX VOLATILITY

	USD/PLN 0-delta stradle				25-delta RR		25-delta FLY	
date	1M	3M	6M	1Y	1M	1Y	1M	1Y
14/09/07	8.30	8.20	8.20	8.15	1.00	1.00	0.30	0.35
17/09/07	8.30	8.20	8.20	8.15	1.00	1.00	0.30	0.35
18/09/07	8.30	8.20	8.20	8.15	1.00	1.00	0.30	0.35
19/09/07	8.30	8.20	8.20	8.15	1.00	1.00	0.30	0.35
20/09/07	8.30	8.20	8.20	8.15	1.00	1.00	0.30	0.35

PLN SPOT PERFORMANCE

PLN spot performance			
date	USD/PLN	EUR/PLN	bias
14/09/07	2.7254	3.7816	-24.08%
17/09/07	2.7280	3.7835	-24.03%
18/09/07	2.7315	3.7859	-23.96%
19/09/07	2.7008	3.7730	-24.47%
20/09/07	2.7706	3.6847	-24.71%

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

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