



POLAND WEEKLY REVIEW

MACROECONOMICS AND FINANCIAL MARKETS

**IN FOCUS /
MACROECONOMICS**

- Polish MPC kept the rates unchanged. Statement and comments clearly affected by the latest inflation reading. • pages 2-3
- Retail sales beats expectations

FIXED INCOME

- Market reached equilibrium levels • pages 3-4
- Volatility to stay low

**FI
RECOMMENDATION**

- Stay flat. Play range.

MONEY MARKET

- No monetary policy change • pages 4-5
- Offer long ends of the deposit and OIS curves at current levels

**MM
RECOMMENDATION**

- Finance positions with short deposits up to 1S
- Sell 12 months in OIS at current levels.

FOREIGN EXCHANGE

- Zloty slightly weaker • pages 5-6
- Volatility stable

**FX
RECOMMENDATION**

- Zloty in range trading
- Long USD/PLN vega

**MARKET PRICES
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PREVIEW: The week of September 28th to October 4th

Indicator	Date of release	Period	BRE forecast	Con-sensus	Last	Comment
FinMin releases its forecast of August inflation	Oct 1	Sep	1.8% y/y	-	1.5%	Inflation to go slightly up owing to higher food prices

In Focus / Macroeconomics

Polish MPC hold the rates. Statement and comments clearly affected by the latest inflation reading.

In line with market expectations, Polish MPC left the rates unchanged in September, with the base rate at 4.75%. In its statement the Committee noted that inflation drop in August, which was deeper than expected, may prove to be only temporary. Moreover, the Committee expects the annual inflation to top the Central Bank target in the fourth quarter of 2008. As usual, the Committee pointed to mid-term inflation risks resulting from sustainable economic recovery, rising wage pressure and expansionary fiscal policy. The latter argument was introduced first in August. Although the MPC still envisages the risk of inflation crossing the upper boundary of the target as higher than such that inflation will moderate, it noted that the already implemented interest rate hikes may reduce the upshooting risk (very similar passage has been also included in the July statement consequently softening the message). In September, the Committee added two more factors that softened the statement: it pointed to the economic slowdown in the global economy as well as to the spillovers from monetary tightening abroad.

The comments of the MPC members that followed the decision were, in our opinion a bit more hawkish, with the exception of that made by Wasileska-Trenkner, than the official statement itself. Noga pointed to imbalances in the Polish economy, Filar stressed that the Committee is disappointed about the increasingly expansive fiscal policy and Czekaj noted that the labor market data are the most important for the coming decisions. Wasileska-Trenkner, seen as a hawk, noted however that she might currently see less space for rate hikes than a month ago. In her opinion, the situation on the global financial markets was an important factor that influenced the Committee's decision. Wasilewska-Trenkner also stated that the Committee should act more carefully at the moment so as not to hurt the economic recovery. In her opinion, inflation projection of the Central Bank, which will be released in October, and in particular the discrepancies between the new and old inflation forecast, will be of highest interest for the Polish MPC.

We do not think that there is an ongoing mood swing in the Committee, though we admit that the Committee may be surprised by the latest inflation reading and therefore it will increasingly rely on the coming inflation data. We also expect that new inflation projection will have a potential to trigger a change in Polish monetary policy or cause a return to the tightening bias again. According to our estimates, the central bank projection will show, despite the temporarily drop recorded in summer, inflation crossing the upper boundary of the target (3.5%) in the mid term. Furthermore, the coming data, production, retail sales, as well as wage data, will, in our opinion, continuously point to mounting inflationary pressures. Nevertheless, the committee is rather unlikely to hike the rates by November; in October the Committee will see the September inflation data with the headline figure probably below 2%. This may prove to be a psychological barrier and hinder the justification of the interest rate hike to the wider audience.

Importantly, in the next few months we envisage a gradual but systematic rise of CPI inflation and core inflation owing to, at least, statistical base effects. We also uphold our view that inflation will go up in the mid-term and interest rates will be hiked to 5.5% by mid 2008.

Retail sales beats expectations

After a very good figure in July (17.1% y/y) retail sales dynamics accelerated last month to 17.4% y/y. In m/m terms it translates into a 2.0% growth. Former went fairly beyond market consensus (16.5% y/y).

Such a strong growth was mainly due to food and beverages which sales grew in August by 17.2% y/y (in July 11.8% y/y respectively). Moreover since food prices declined last month significantly the overall deflator sank in comparison with July by 0.8 pct. to 1.3% y/y. A higher sales dynamics in this category has strengthened deflationary effects.

We would like to emphasize that the dynamics of car sales (37.2% y/y) or household equipment sales (18.3% y/y), which used to be the main growth driver recently, eased in August, however these figures remain still strong. That supports our view that the domestic demand is strong and a decline in the consumption growth in Q2 to 5.1% y/y was rather temporary. We expect latter to rise in Q3 to 6-7% y/y and to remain on this level over next quarters.

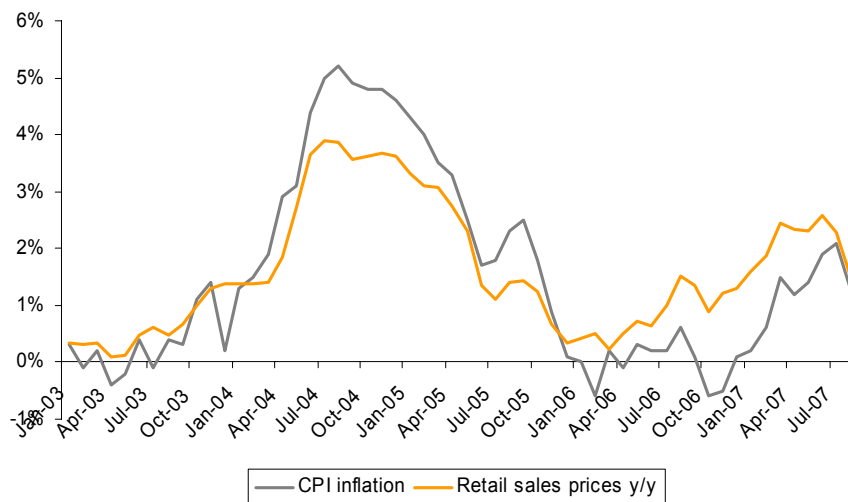
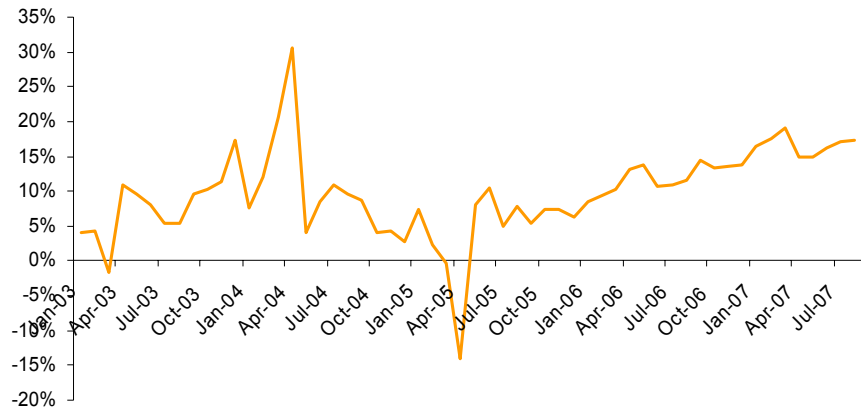
It is worth noting the consequences of the last retail sales figure for the trade gap. A higher food and beverage sales dynamics will not translate into a significant import growth as the share of

The Committee will increasingly rely on the coming inflation data and October inflation projection

A strong growth in retail sales was mainly due to food and beverages

these goods in the Polish import amounts only to a 5.5%. However a constant sales growth in other categories will contribute to a high import dynamics having negative influence on the trade balance. Thus we foresee the current account to record in August a similarly deep deficit as in the last months. The worsening CA balance is one of the factors on the list of the Polish MPC that the committee decided to watch more carefully over the next months.

Retail sales y/y



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

Market reached equilibrium levels

The market seems to have reached some equilibrium point and therefore has definitely quieted down. The MPC's decision, to leave the rates unchanged was followed by a quite neutral comment - still pointing out to possible inflationary pressure on one hand, but on the other hand low current readings give the council to put off any further tightening. In such circumstances, another

Volatility to stay low

two rate hikes priced in the curve seem fair. That also changes our bias from bearish to neutral - until some new data or new events change the picture, we do not see any good reason for a significant move in any direction, at least for the front end of the curve. The long end of the curve is likely to follow sentiment on core markets. We don't recommend any directional position here, rather concentrate on range trading.

RECOMMENDATION:

Stay flat. Play range.

AUCTIONS

	next auc.	offer	avg yield last	last auction date
13 Week T-bills	-	-	4,208%	2006-01-16
26 Week T-bills	-	-	3,943%	2006-04-24
52 Week T-bills	08-10-07	-	5,084%	2007-09-17
2Y T-bond OK1209	03-10-07	-	5,327%	2007-09-05
5Y T-bond PS0412	17-10-07	-	5,480%	2007-09-19
10Y T-bond DS1017	10-10-07	-	5,658%	2007-07-11
20Y T-bond WS0922	-	-	5,796%	2007-09-12

Money Market*Huge surplus of the money in the system*

Very, very cheap week behind us and extremely cheap end of the reserve ahead, as a result of lower demand for the money bills. The CB offered 21.6 PLN bn of money bills, market covered 20.4 PLN bn .

Very cheap carry ahead

All this because lack of trust in amounts of money bills being issued by the CB.

No monetary policy change, market ignores CB rate verdict no change

As for other last week's events we had the MPC meeting and decision exactly in line with market expectations. Poland's central bank held all interest rates unchanged on Wednesday, waiting for more evidence of subsiding price pressures.

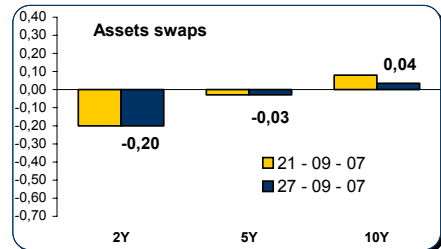
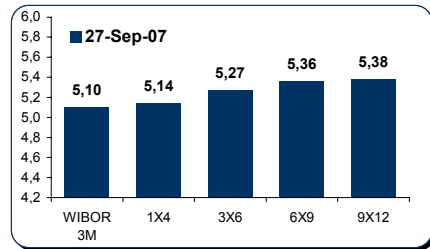
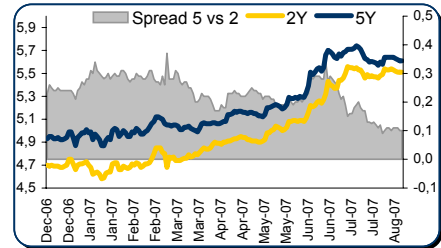
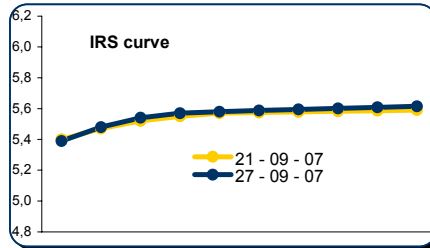
No T-bills auction last week.

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RECOMMENDATION:

Sell 12 months in OIS at current levels.

FIXED INCOME & MONEY MARKET CHARTS



Foreign Exchange

Zloty slightly weaker

This week zloty opened 3.7580 and was traded at 3.7840 as Wednesday top. Such small correction move convinced us that short term sentiment is relatively good. Although market looks little bit long PLN, we see chance to test once again 3,7400 support level.

Volatility stable

EUR/PLN implied volatility was traded around 5.8 levels for whole curve on quiet trading. USDPLN was traded respectively 8.3-8.4 for 1M and 8.15-8.2 for 1Y.

RECOMMENDATION:

Zloty in range trading

Spot:
Main supports / resistances:
EUR/PLN: 3.7400 / 3.8000
USD/PLN: 2.6300 / 2.7100

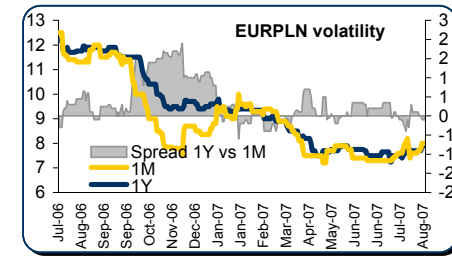
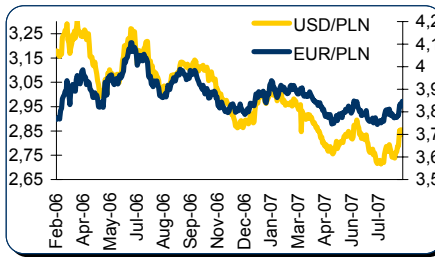
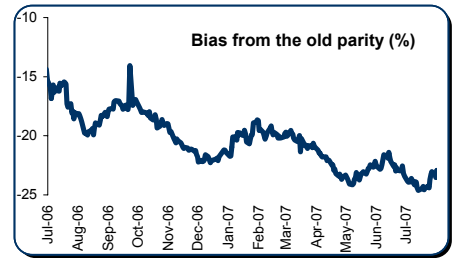
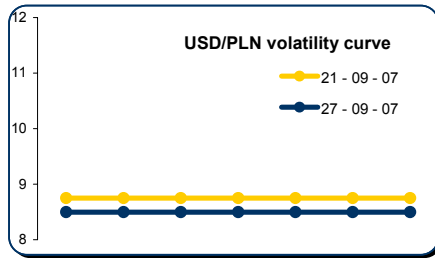
We see zloty in trapped in low turnover, side trend with 3.8000 as good selling EUR/PLN level for 3.7400 as positive sentiment test.

Options:

Long USD/PLN vega

Keep neutral/short EUR/PLN gamma. Buy USD/PLN 6M-1Y vega. USD/PLN 1Y RR looks worth buying at 0.9.

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
21-09-07	5,10%	5,10%	5,12%	5,25%	5,28%	5,45%
24-09-07	5,03%	5,10%	5,09%	5,25%	5,24%	5,45%
25-09-07	5,03%	5,10%	5,09%	5,25%	5,24%	5,45%
26-09-07	5,02%	5,09%	5,04%	5,23%	5,22%	5,44%
27-09-07	5,07%	5,10%	5,06%	5,24%	5,24%	5,45%

FRA MARKET RATES

FRA Market Rates (Closing mid-market levels)					
date	1X4	3X6	6X9	9X12	6X12
21-09-07	5,15%	5,26%	5,36%	5,40%	5,41%
24-09-07	5,14%	5,26%	5,36%	5,38%	5,41%
25-09-07	5,14%	5,27%	5,37%	5,40%	5,42%
26-09-07	5,14%	5,28%	5,37%	5,40%	5,41%
27-09-07	5,14%	5,27%	5,36%	5,38%	5,40%

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
21-09-07	5,45%	5,08%	5,57%	5,29%	5,72%	5,69%	5,73%	5,76%
24-09-07	5,45%	5,05%	5,57%	5,29%	5,71%	5,68%	5,72%	5,76%
25-09-07	5,45%	5,05%	5,57%	5,34%	5,71%	5,67%	5,71%	5,76%
26-09-07	5,44%	5,05%	5,56%	5,30%	5,71%	5,65%	5,72%	5,75%
27-09-07	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

date	USD/PLN 0-delta stradle				25-delta RR		25-delta FLY	
	1M	3M	6M	1Y	1M	1Y	1M	1Y
21-09-07	8,30	8,20	8,20	8,15	1,00	1,00	0,30	0,35
24-09-07	8,30	8,30	8,25	8,20	1,00	1,00	0,30	0,35
25-09-07	8,30	8,30	8,25	8,20	1,00	1,00	0,30	0,35
26-09-07	8,30	8,30	8,25	8,20	1,00	1,00	0,30	0,35
27-09-07	8,35	8,20	8,20	8,10	1,00	1,00	0,30	0,35

PLN SPOT PERFORMANCE

PLN spot performance			
date	USD/PLN	EUR/PLN	bias
21-09-07	2,6763	3,7666	-24,82%
24-09-07	2,6675	3,7627	-24,97%
25-09-07	2,6742	3,7680	-24,83%
26-09-07	2,6761	3,7788	-24,68%
27-09-07	2,6726	3,7780	-24,73%

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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