



POLAND WEEKLY REVIEW

MACROECONOMICS AND FINANCIAL MARKETS

**IN FOCUS /
MACROECONOMICS**

- Speculations surrounding the new inflation projection may trigger the change of moods in the MPC • pages 2-3
- Coming data are relevant to the extent they give more insight into ULC and food prices

FIXED INCOME

**FI
RECOMMENDATION**

- Very low volumes and volatility on the market • page 3
- Pay 4x7 FRA

MONEY MARKET

**MM
RECOMMENDATION**

- CPI forecast by MinFin did not ruin good sentiment • pages 3-4
- Will the MPC make use of the insurance policy?
- Sell 2M Polonia above 4.8, 2M Wibor above 4.9 and 2M deposits nearby 5%

FOREIGN EXCHANGE

**FX
RECOMMENDATION**

- Zloty stable • pages 4-5
- Volatility lower
- Zloty in range trading
- Long USD/PLN vega

MARKET PRICES
CONTACT LIST
DISCLAIMER

- page 6
- page 7
- page 8

PREVIEW: The week of October 4th to October 11th

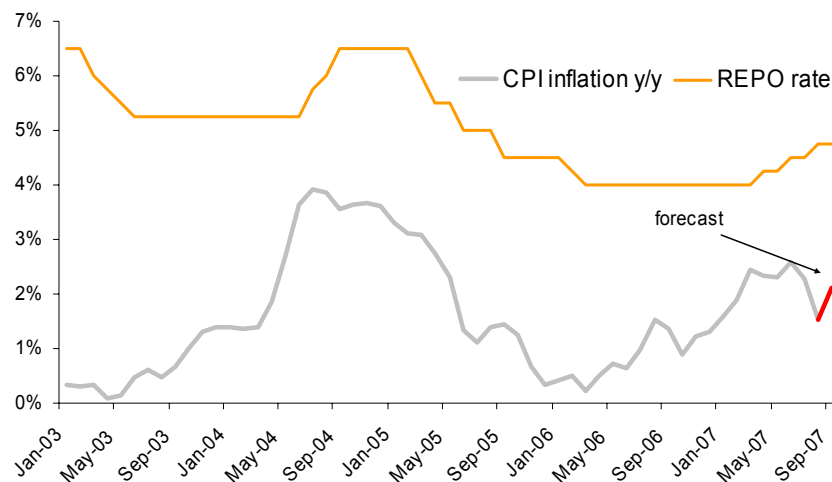
Indicator	Date of release	Period	BRE forecast	Con-sensus	Last	Comment
No releases of relevant Polish data						

In Focus / Macroeconomics

Coming data are relevant to the extent they give more insight into ULC and food prices

Speculations surrounding the new inflation projection may trigger the change of moods in the MPC

There were no official macroeconomic figures published last week. However, the Ministry of Finance announced its (usually accurate) inflation forecast at 2.0% y/y and 0.5% m/m. The acceleration of price growth is nearly consistent with our estimates placing the headline CPI at 2.1%, but far above market consensus of 1.6%. It seems then that inflation dip recorded in August was temporarily, connected mainly with one-off effects and unusually high drops recorded in vegetables, dairy and bakery products. We expect CPI inflation to slowly accelerate till the end of the year, with base measure heading towards 1.7-2.0% y/y. Short-term risks to inflation are slightly on the upside and stem mainly from the prices of food. Medium-term perspectives are balanced, with recent sharp rise of ULC driving the prices upwards and low EUR/PLN exchange rate which is making imports cheaper and thereby keeping inflation in check.



In MPC member Slawinski's opinion, recent hikes gave the MPC enough time to take a "wait and see" position.

The announcement of inflation forecast prepared by the Ministry of Finance triggered some comments from the MPC members. Noga said the released figures were consistent with his own estimates and he expected one more hike this year and two more in 2008. What is most surprising, the MPC member pointed the possibility to ease monetary policy in late 2008. On the other hand, M. Pietrewicz presented definitely "dovish" view: in his assessment, the inflation projection prepared in October will show lower inflation path than the one released in July (does he know the inflation projection or only speculate?). Dovish judgments were presented also by the head of MPC, Skrzypek. In his opinion, headline inflation will be close to the target at the end of the year (but prices of food and oil remain to be an upside risk); what is more, wage pressures are not passing through to producer prices. Quite the contrary, our calculations based on the official central bank's inflation model (ECMOD) point out that the price growth in medium-term presented in inflation projection might be higher owing to the rise of ULC observed in Q2 and Q3, which had not been taken into account while the older projection was prepared. Another MPC member, A. Slawinski, presented the most balanced view. In his opinion, recent hikes gave the MPC enough time to take a "wait and see" position. However, he confirmed the MPC's last statement that the probability of inflation staying below the target is lower than the one concerning the opposite scenario. The judgment is somehow confirmed by September's inflation estimates.

Taking into account the aforementioned information, the MPC decision seems to remain unclear. The CPI inflation will be gradually rising, but there are some factors which keep the prices in check. Nevertheless, the Monetary Committee takes into account also the Polish growth prospects. They may suffer from a slowdown in EU, which in turn depends on the situation in the U.S. experiencing the housing slump. We shall wait and see if falling house prices depress consumers wealth as much as to encourage them to sharply limit their expenditures. More insight to the

MPC decision will be given as soon as the new data are released. So far, the outcome of MPC voting depends mainly on new inflation projection – flatter price growth path (not our baseline scenario!) will certainly cool “hawkish” expectations for a few months.

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

Very low volumes and volatility on the market

Last week was very calm on the market. The only thing worth mentioning was Ministry of Finance CPI forecast for September at 2.0%, much higher than market expectations. Currently curve is not pricing hikes this year (first hike is priced in in January) with end of the cycle at 5.25 sometime in second part of 2008. We still remain slightly more bearish on the curve, as all the indicators (apart from CPI) show economy is still very strong. We actually think Polish MPC can hike this month, which makes us payers on the FRA curve. Best choice is 4x7 FRA which fixes after January meeting, pricing currently only one hike. We think that it is very cheap bet.

RECOMMENDATION:

Pay 4x7 FRA

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	07-11-07	-	5,284%	2007-10-03
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

CPI forecast by MinFin did not ruin good sentiment

Will the MPC make use of the insurance policy?

After very cheap end of the reserve the cost of carry again leveled off to the main market rate. This situation will remain constant for at least two weeks, regardless of any up or downturns in the supply and demand considering money bills. Next auction is to be held tomorrow and the estimated size is between 18 and 20 billion pln.

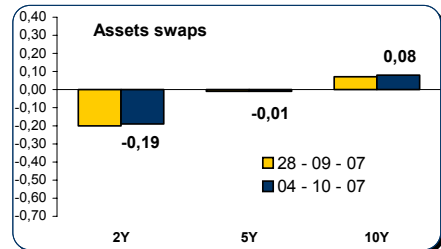
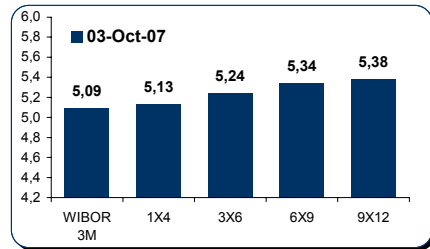
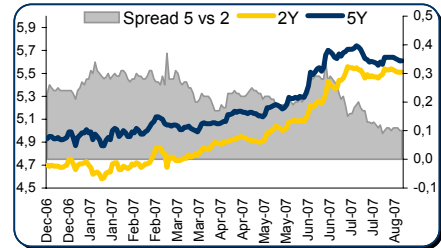
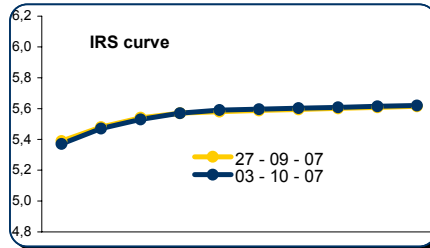
For the MM trading CPI forecast by MinFin was the highlight of the passing week. 2% was slightly above the market expectations and substantially higher comparing to last month's 1.5%. Nonetheless, market took it quite easy supported by some dovish comments of the few MPC members.

It seems that majority of them feels comfortable with three last rates hikes and thinks that they bought some time for further economy observations. We bet on another 25 hike in November.

RECOMMENDATION:

Sell 2M Polonia above 4.8, 2M Wibor above 4.9 and 2M deposits nearby 5%.

FIXED INCOME & MONEY MARKET CHARTS



Foreign Exchange

Zloty stable

This week zloty was traded between 3.7630 and 3.7765. Such a narrow range, traded on really low turnover, was owing to low volatility on EURUSD. So, without breaking of EURUSD's 1.4000/1.4250, breaking of 3.74/3.80 EURPLN range, at least before elections, is unlikely.

Volatility lower

EURPLN implied volatility stepped down around 0.2 vols for whole tenors and was traded at 5.55 and 5.6 for respectively 1M and 1Y.

RECOMMENDATION:

Zloty in range trading

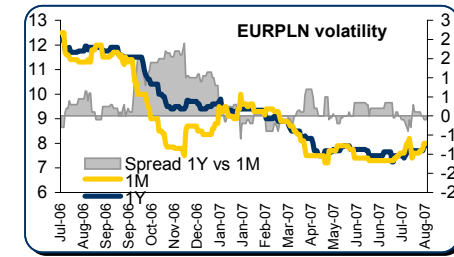
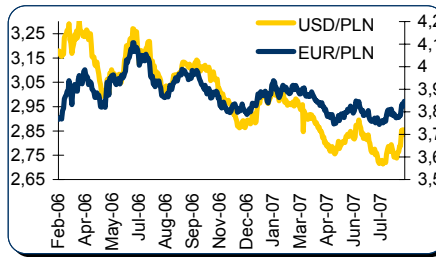
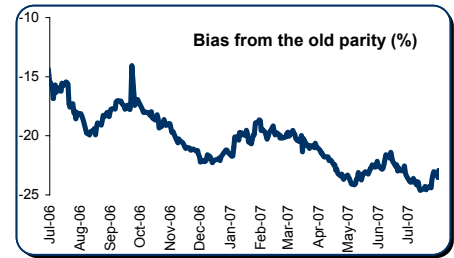
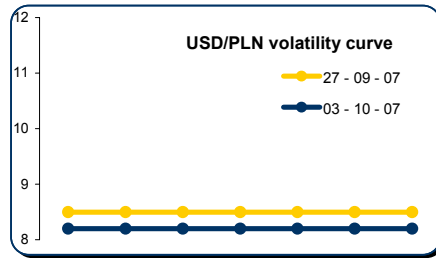
Spot:
Main supports / resistances:
EUR/PLN: 3.7400 / 3.8000
USD/PLN: 2.6300 / 2.7100

Last week we saw zloty in trapped in low turnover, side trend with 3.8000 as good selling EURPLN level for 3.7400 as positive sentiment test, and nothing had change it.

Long USD/PLN vega

Options:
Keep neutral/short EURPLN gamma. Buy USDPLN 6M-1Y vega.

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
27-09-07	5,07%	5,10%	5,06%	5,24%	5,24%	5,45%
30-09-07	5,05%	5,10%	5,04%	5,25%	5,20%	5,45%
01-10-07	5,05%	5,10%	5,04%	5,25%	5,20%	5,45%
02-10-07	5,05%	5,10%	5,04%	5,25%	5,20%	5,45%
03-10-07	5,07%	5,09%	5,06%	5,24%	5,21%	5,45%

FRA MARKET RATES

FRA Market Rates (Closing mid-market levels)					
date	1X4	3X6	6X9	9X12	6X12
27-09-07	5,14%	5,27%	5,36%	5,38%	5,40%
30-09-07	5,13%	5,24%	5,33%	5,35%	5,38%
01-10-07	5,14%	5,26%	5,34%	5,36%	5,39%
02-10-07	5,13%	5,25%	5,33%	5,36%	5,38%
03-10-07	5,13%	5,24%	5,34%	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
27-09-07	5,45%	5,08%	5,57%	5,29%	5,72%	5,69%	5,73%	5,76%
30-09-07	5,45%	5,05%	5,57%	5,29%	5,71%	5,68%	5,72%	5,76%
01-10-07	5,45%	5,05%	5,57%	5,34%	5,71%	5,67%	5,71%	5,76%
02-10-07	5,45%	5,05%	5,56%	5,30%	5,71%	5,65%	5,72%	5,75%
03-10-07	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	07-10-03	09-07-25	91,123	5,28%	1800	3571	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
27-09-07	8,35	8,20	8,20	8,10	1,00	1,00	0,30	0,35
30-09-07	8,30	8,20	8,20	8,10	1,00	1,00	0,30	0,35
01-10-07	8,30	8,20	8,20	8,10	0,90	0,90	0,30	0,35
02-10-07	8,20	8,20	8,20	8,10	0,90	0,90	0,30	0,35
03-10-07	8,20	8,20	8,20	8,20	0,90	0,90	0,30	0,35

PLN SPOT PERFORMANCE

PLN spot performance			
date	USD/PLN	EUR/PLN	bias
27-09-07	2,6726	3,7780	-24,73%
30-09-07	2,6647	3,7775	-24,82%
01-10-07	2,6483	3,7680	-25,12%
02-10-07	2,6543	3,7685	-25,05%
03-10-07	2,6610	3,7690	-24,97%

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

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.pl

Forex (BREX) - FX Spot & Options

Marcin Turkiewicz (+48 22 829 01 84) Marcin.turkiewicz@brebank.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.pl
Paweł Białczyński (+48 22 829 01 86)

MM (BREP) - MM, FX Swaps

Bartłomiej Małocha (+48 22 829 01 77) Bartlomiej.malocha@brebank.pl
Tomasz Wołosz (+48 22 829 01 74)

Structured Products (BREX)

Jarosław Stolarczyk (+48 22 829 01 67) Jaroslaw.stolarczyk@brebank.pl
Jacek Dereziński (+48 22 829 01 69)

Institutional Sales (BRES)

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

Research

Ernest Pytlarczyk (+48 22 829 01 66) Research@brebank.pl
Marcin Mazurek (+48 22 829 0183)
Radosław Cholewiński (+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

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