BRE BANK SA

THE BEST FINANCIAL INSTITUTION FOR DEMANDING CUSTOMERS

FINANCIAL MARKETS DEPARTMENT

PAGES: 8

WARSAW, JANUARY 17, 2008

POLAND WEEKLY REVIEW

MACROECONOMICS AND FINANCIAL MARKETS

PREVIEW: The week of January 18th to January 24th

Indicator	Date of release	Period	BRE forecast	Consensus	Last	Comment
C/A balance	**Jan 16**	**Nov**	**-1.15 bn EUR**	-950 mn EUR	-1.3 bn EUR	Narrowing deficit stems from elevated EU inflows. Trade deficit driven by lower exports.
Core inflation	**Jan 22**	**Dec**	**1.7% y/y**	1.6% y/y	1.5% y/y	The rise was triggered by the categories like house maintenance, health, hotels and restaurants. State-controlled prices and base effects alone are going to lift the measure towards 2.5% in Q1 and fundamental factor will push the figure beyond in the course of the year

In Focus / Macroeconomics

Rising inflation and pretty moderate wage growth in December

CPI inflation came out at expected level, however, there are signs that engines of growth have changed from food and fuel items to core measures. Pretty market-disastrous wage figures should be rather taken in cold blood – it seems the figure was downward-driven by bonuses in mining – we see to find a confirmation to that thesis in the detailed data on January 30. We expect the MPC to give us impression that it will stuck to the scenario of only 2-3 hikes this year and textbook data dependence. We envisage the check point for both the market as well as the MPC to come in the second quarter of 2008.

We continuously expect that the rising bargaining power of employees as well as elevated inflationary expectations affected by booming food prices may hit the vast majority of CPI categories…

In line with analysts' expectations December CPI inflation rose to 4.0% y/y, up from 3.6% recorded in November. The annual figure was mainly driven by statistical low base effect related to extraordinary low fuel prices in the last quarter of 2006. In m/m terms, however, the CPI index has been boosted by increases in core items amid very limited growth of food and fuel prices (the effects of globally elevated prices of milk, wheat etc. were much more pronounced in previous months than now).

Going into more details, significant price increases have been recorded in health care, house maintenance as well as in a category encompassing restaurants and hotels. On balance, we estimate that, contrary to previous market expectations, the net core inflation rose in December to 1.7% up from 1.5% recorded in November. This trend is set to continue in the coming months and quarters which may prove crucial for the monetary policy prospects. In their most recent comments, the MPC members indicated that amid rising headline inflation the focus has shifted to monitoring the core measures and net core inflation in particular. The latter is, on the back of rising regulated prices, set to breach 2.0% in January and top 3% by the mid 2008.

…however…

We continuously expect that the rising bargaining power of employees as well as elevated inflationary expectations affected by booming food prices may hit the vast majority of CPI categories. We do not change our assessment after the labor market data release; the corporate wage dynamics slowed markedly to 7.2% y/y in December, down from 12.0% recorded in November. In our opinion December reading has been skewed downwards by one off factors such as earlier payment of bonuses in mining industry, which had actually boosted the November figure. This notwithstanding, we assess the trend growth rate of corporate wages at 9-10% y/y which ultimately translates into higher Unit Labor Costs and will likely result in higher inflationary pressure.

…MPC to give us impression that it will stuck to the scenario of only 2-3 hikes this year and text-book data dependence. We envisage the check point for both the market as well as the MPC to come in the second quarter of 2008…

Recent comments from the MPC members (H. Wasilewska-Trenkner, A. Sławiński) suggest the labor market tensions are not going to ease in 2008. Wasilewska-Trenkner thinks the labour market tightness may cast shadow over the other sectors of the economy, mainly the public sphere where wage demands are becoming much more pronounced and aggressively articulated. A. Slawiński argues that rising public sector wages are neutral for ULC (they may constitute an upside risk in case when the labor unions were so strong as to negotiate wage rises in other, private sectors of the economy; in fact they are neither strong nor widespread what limits their influence) but directly dangerous for inflation through consumption demand channel.

MEDIUM-TERM FORECASTS

Indicator	2006	2007	2008
GDP y/y (%)	6.1	6.5	5.6
Inflation rate (%)	1.0	2.4	4.0
Current account (% of GDP)	-2.1	-4.5	-5.3
Unemployment rate (end-of-year)	14.9	11.3	9.8
NBP repo rate (end-of-year)	4.00	5.00	>6.0

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

Fixed Income

Busy week on the FI

Curve drops some 7-8 bp

Last week was quite interesting on the FI market. The release of CPI figure was no surprise as it came out at expected 4%. What was interesting was market reaction which moved some 3-4 bp down in yield. The biggest market mover was wages figure which came at 7.2 versus double digit expectations. Market rallied another 3-4 bp especially in the front end of the curve. Curve is currently pricing main rate at 5.75 with risk it can be lower. It seems from market expectations that CPI is likely to fall into MPC target in second part of the year. We maintain our main view that CPI is likely to rise much more than expected and MPC is likely to fall behind the curve, so we recommend steepening trades, especially in 2y10y and 2y5y sectors. We also favor asset swaps with current levels, are it is quite likely that cash market will stay low and MinFin is going to decrease supply in medium term, as the alternative we recommend getting long in floater WZ0118 at current levels, new coupon is likely to fix at 5.95 is area.

RECOMMENDATION:

Steepening trades in 2y10y and 2y5y / get long in floater WZ0118 at current levels

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	2/11/2008	-	5.740%	12/3/2007
2Y T-bond OK0709	4/4/2008	-	6.189%	1/2/2008
5Y T-bond PS0413	2/6/2008	-	5.943%	11/21/2007
10Y T-bond DS1017	2/13/2008	-	5.699%	10/25/2007
20Y T-bond WS0922	5/14/2008	-	5.794%	1/9/2008

Money Market

Dovish comments from the MPC side

CPI in line with expecta-tions

Extremely bullish wages

Cheaper carry since the market bought 3 billion PLN less money bills then was on the offer side (10.6 vs 13.5 billion pln). Liquidity situation looks optimistic also for the next week and as of now cheap end of the reserve is much more likely then a squeeze.

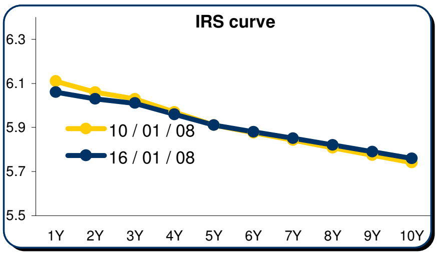
Longer terms bullish. Dovish comments from the MPC side plus CPI in line with expectations (4% and a faith that this CPI increase is only temporary) pushed the rates a little bit down. But it was just appetizer before the wages figure. Market consensus was nearby 11%, real figure 7.2%. This was quite a trigger for those still believing that the next rates hikes will be fast and time concentrated. Today's scenario is one maybe two hikes this quarter and then wait and see whether last figures were just an exception or maybe a new trend helping to fight the inflation back.

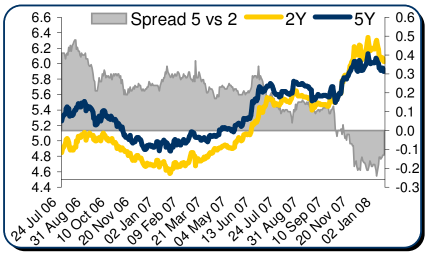
RECOMMENDATION:

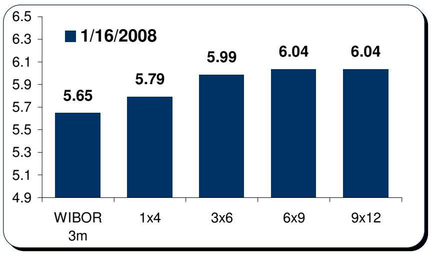
Sell 6M polonia nearby 5.55%.

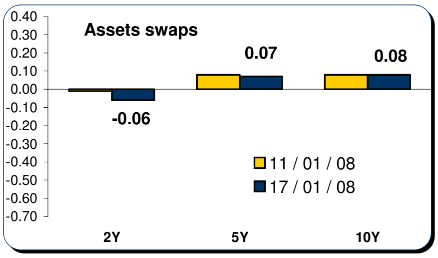
FIXED INCOME &

MONEY MARKET CHARTS









Foreign Exchange

Zloty weaker

This week złoty was traded between 3.5700 and 3.6050. Hopes for 50 pts rate cut by Fed form week beginning and weakening of global sentiment due to weak stocks performance in mid-week made PLN hitting both bands. Fed decision still appears as main market indicator.

Volatility curve steepened

Wednesday EURPLN moves from 3.5800 to 3.6050 caused curve's short end to be traded 0.2 vol higher than Monday's opening for 1M with 1Y still priced at 5.9. Such weak reaction on both, spot and option market, for global tensions is strictly related with increasing number of customers (exporters) hedging their positions and balancing market demand.

RECOMMENDATION:

RECOMMENDATION:

Stay aside – watch core markets

Spot:
Main supports / resistances:
EUR/PLN: 3.5700 / 3.6400
USD/PLN: 2.4000 / 2.5000

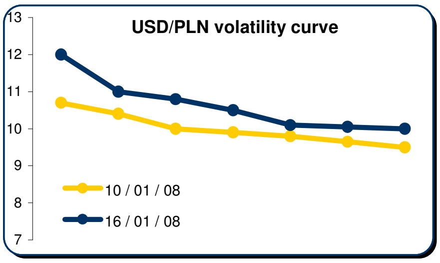
With markets awaiting outer signals we advice to stay aside or trade PLN as cross weighted with major currencies view, 3.6400 provides good entry level for opening short EURPLN position.

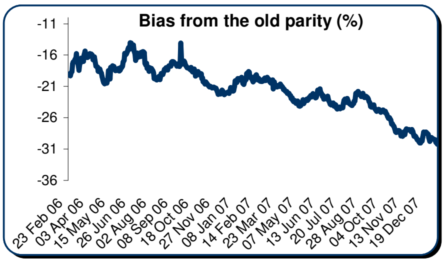
Options:

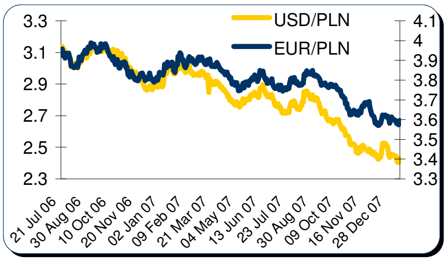
Sell USD vega/slightly short EURPLN gamma

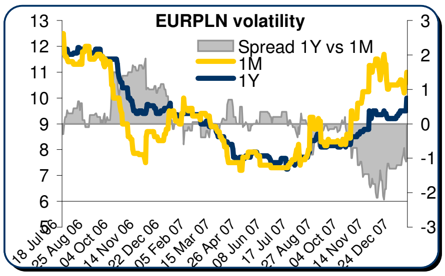
We advice to open small amounts of short EURPLN gamma or selling USDPLN vega at present currency spread levels.

FX CHARTS


USD/PLN volatility curve
10 / 01 / 08
16 / 01 / 08


Bias from the old parity (%)


USD/PLN
EUR/PLN


EURPLN volatility
Spread 1Y vs 1M
1M
1Y

MARKET PRICES UPDATE

MONEY MARKET RATES

Money market rates (Closing mid-market levels)						
date	3M		6M		1Y	
	FXSW	WIBOR	FXSW	WIBOR	FXSW	WIBOR
10/01/08	5.56%	5.56%	5.85%	5.89%	6.14%	6.10%
11/01/08	5.58%	5.55%	5.88%	5.89%	6.15%	6.10%
14/01/08	5.53%	5.55%	5.86%	5.89%	6.13%	6.10%
15/01/08	5.51%	5.55%	5.80%	5.90%	6.07%	6.10%
16/01/08	5.50%	5.55%	5.70%	5.87%	6.00%	6.09%

FRA MARKET RATES

FRA Market Rates (Closing mid-market levels)					
date	1X4	3X6	6X9	9X12	6X12
10/01/08	5.83%	6.03%	6.13%	6.13%	6.15%
11/01/08	5.82%	6.03%	6.14%	6.14%	6.18%
14/01/08	5.81%	6.02%	6.12%	6.12%	6.17%
15/01/08	5.81%	6.00%	6.08%	6.08%	6.10%
16/01/08	5.79%	5.99%	6.04%	6.04%	6.08%

FIXED INCOME MARKET RATES

Fixed Income Market Rates (Closing mid-market levels)								
date	1Y		2Y		5Y		10Y	
	WIBOR	TB	IRS	OK0709	IRS	PS0511	IRS	DS1017
10/01/08	6.10%	5.08%	5.57%	5.29%	5.72%	5.69%	5.73%	5.76%
11/01/08	6.10%	5.05%	5.57%	5.29%	5.71%	5.68%	5.72%	5.76%
14/01/08	6.10%	5.05%	5.57%	5.34%	5.71%	5.67%	5.71%	5.76%
15/01/08	6.10%	5.05%	5.56%	5.30%	5.71%	5.65%	5.72%	5.75%
16/01/08	6.09%	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	07/12/03	08/12/03	95.415	5.74%	2000	33116	2000
OK0710	08/01/02	09/07/25	85.730	6.19%	1800	2047	1654
PS0413	07/11/21	13/04/25	96.810	5.94%	2200	2611	2200
DS1017	07/10/10	17/10/25	96.607	5.70%	1800	5061	1800

FX VOLATILITY

	USD/PLN 0-delta stradle				25-delta RR		25-delta FLY	
date	1M	3M	6M	1Y	1M	1Y	1M	1Y
10/01/08	10.40	9.90	9.80	9.50	0.70	0.75	0.30	0.35
11/01/08	10.20	9.80	9.70	9.50	0.70	0.75	0.30	0.35
14/01/08	10.50	10.00	9.70	9.50	0.70	0.75	0.30	0.35
15/01/08	10.60	10.20	9.80	9.50	0.70	0.75	0.30	0.35
16/01/08	11.00	10.50	10.10	10.00	0.70	0.75	0.30	0.35

PLN SPOT PERFORMANCE

PLN spot performance			
date	USD/PLN	EUR/PLN	bias
10/01/08	2.4450	3.5930	-29.52%
11/01/08	2.4220	3.5810	-29.92%
14/01/08	2.4055	3.5825	-30.09%
15/01/08	2.4052	3.5735	-30.20%
16/01/08	2.4272	3.5950	-29.70%

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)

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

Disclaimer

Distribution and use of this publication