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FINANCIAL MARKETS DEPARTMENT

PAGES: 8

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POLAND WEEKLY REVIEW

MACROECONOMICS AND FINANCIAL MARKETS

PREVIEW: The week of January 24th to January 31st

Indicator	Date of release	Period	BRE fore-cast	Consen-sus	Last	Comment
MPC decision	**Jan 30**	**-**	**5.25%**	5.25%	5.0%	We still expect the MPC to hike, addressing internal problems. Then we will probably see the widening of two-month cycle on the back of rising negative assessment of global uncertainties.

In Focus / Macroeconomics

Softer real data and no hard proofs of inflation pressure in sight may force the Polish MPC to think "global"

Growing core inflation and its underlying causes may still speak for a rate hike in January (and we still expect the MPC to follow this scenario)…

Global economy perturbations and a series of weak data from the Polish economy have considerably changed the basis for the rate decisions, at least in the eyes of investors. Subsiding interest rate hikes expectations have been recently also backed by disappointing retail sales figures. Growing core inflation and its underlying causes may still speak for a rate hike in January but the other ones are not likely to follow soon; it seems the growing uncertainty will take the upper hand for some time and the "dovish" MPC bias will jump into the foreground.

According to the most "hawkish" members of the MPC (namely D. Filar) the fallout from the global economy is likely to hit the Polish economy with the lag of at least some quarters. Even then, the impact on the growth rate will be rather limited. Having this in mind it is advisable to address the contemporary tension arising in the economy (soaring wages and gloomy perspectives for core inflation) before the adjustment costs become too high.

…but…

After the unprecedented Fed easing, a slight flip towards less pronounced hikes was presented by H. Wasilewska-Trenkner who treats global processes as "those which may affect economic growth". However, after the publication of core "net" inflation figures she backed her earlier view that the January hike is needed.

Quite the most "dovish" speech was delivered by A. Wojtyna (one of the so-called key voters). According to his most optimistic scenario, one additional hike may be enough to halt inflationary pressures. However, he does not forget about the wage-spiral, still dangerous for inflation prospects. As a counterbalancing factor he cites the negative effects the US recession may impose on Polish exports and, what seems more important, increased financial markets volatility which may encourage firms to trim their investment plans. The latter factor seems for him more important as it is highly volatile investment component which explains sudden GDP contractions.

…the other hikes are not likely to follow soon; it seems the growing uncertainty will take the upper hand for some time and the "dovish" MPC bias will jump into the foreground.

We still see the recently issued data as mainly driven by one-off factors (it regards also the retail sales, dragged down by the sales of food – the demand for durable goods was sustained, reflecting rising affluence and confidence of households). It is still worth to note that the MPC focus has visibly shifted towards monitoring core measures of inflation (headline CPI has gone a way above the target, driven by factors of exogenous origin). Due to a change in CPI basket the publication of core inflation for January and February will be, however, postponed to March. That is why, we may expect the MPC and market focus stay shifted to global factors in the coming weeks.

We do not share an opinion, that the recession in the US (if really occurs – we only address uncertainty at the moment) will considerably weigh on Polish GDP growth. It is internal demand which will drive the economy through 2008. Its impact on overall price level will become visible in the coming months of the year. First "shocker" will pop into daylight along with publication of the "net inflation" figures (in March), which will be hard to ignore, as the reading at the level of 2.5% is expected. We continuously see that there is room for more effects of the demand tension to reveal and to drive the core inflation path further beyond 3%.

On balance, we still expect the MPC to hike in January. Then, the anticipated "awaiting" period will begin – global factors and growing uncertainty will force the MPC to break the timing of the cycle to buy some time for analysis of the data – it is then possible that another rate hike takes place no sooner than in April and then another one late in the summer on the back of higher core inflation data.

MEDIUM-TERM FORECATS

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

Hike expectations flatten to 5.50%

It's been an interesting week on the fixed income market. Already positive sentiment was strongly supported by Fed's decision, bringing rates to this year's lows, especially on short end of the curve. Also retail sales data surprised on the downside - another data after softer than expected industrial output, that will support dovish wing of the MPC. Market currently prices in two 25bp hikes and rates peaking at 5.50%. At current levels we do not see much value in the curve either way. Further unpricing of rate hikes seems unlikely at the moment, looking at inflation level, also there isn't much potential to the upside, as we do not see anything that could seriously change the sentiment. We decided to take some profit on our steepener trades, and tend to stay flat in terms of risk at the moment. If rates move lower from this current levels, we will probably consider it as an opportunity to pay.

RECOMMENDATION:

Stay flat. Reduce steepeners.

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

All about bullish

Is the optimistic scenario realistic?

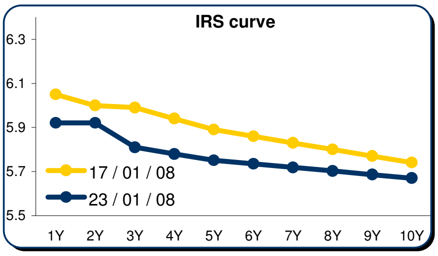
Cheap end of the reserve very likely.

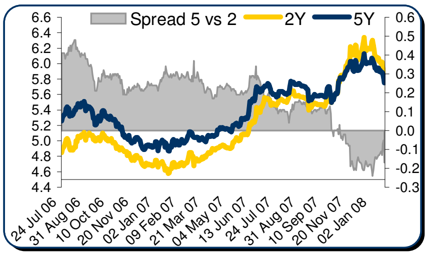
The simplest summary of last week would be: all about bullish. All the figures plus external incentives were against bearish perspectives for the nearest monetary policy. Lower industrial output (6.2 vs 8.6% expected), PPI 2.5% against 2.8% expected, retail sales even more surprising 12.4 versus 20.8% expected! If we add 75 bps rates cut in the USA, no wonder that 1Y OIS dropped by 25 bps (5.85 before 5.6% now). Moreover the entire curve was massively sold and now we can only see expectations for 2 more hikes in this cycle. So 6-6.5% cup moved down to 5.5%. The question remains is Polish economy so fragile and dependant on what we can observe in USA. Our answer is no. We think that next figures will not confirm the trend and we will be back with higher inflation sooner or later, hence 5.5% can be overreacted overoptimistic scenario. However rates hikes may come a bit later (February instead of January) and will be less time-concentrated that was assumed previously.
As far as liquidity is concerned still stable, but one should be prepared for cheap end of the reserve. Two arguments for it: next OMO will give the yield without possible rates hike calculation (players may be less likely to buy all the bills) plus over 5 billion pln in T-bills matures on the last day of the reserve.

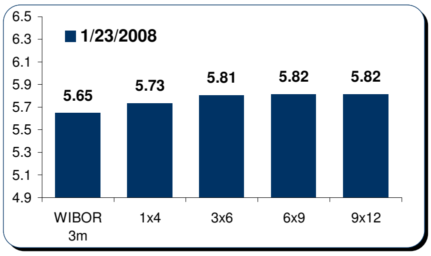
RECOMMENDATION:

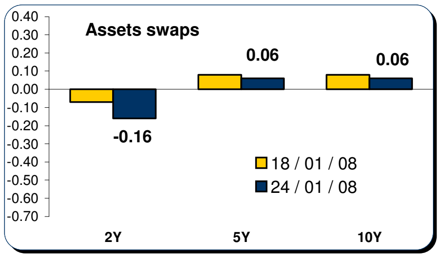
Buy 1y Polonia nearby 5.6%.

FIXED INCOME & MONEY MARKET CHARTS









Foreign Exchange

Zloty volatile

This week the zloty was traded between 3.6100 and 3.6740. Top of the range was hit on Tuesday as stocks had been sold-off on global recession threats, low was reached at end of week as reaction for 75pts Fed rate cut with improving global sentiment. Zloty have been traded with almost 100% correlation with EURJPY cross these days.

Volatility curve steepened

Volatile trading on spot market made PLN curve more steepened with 1M trade at 7.5 and 1Y 6.3 on Tuesday. Further zloty gains made it back to 6.7 for 1M and 6 for 1Y.

RECOMMENDATION:

Spot:
Main supports / resistances:
EUR/PLN: 3.5900 / 3.6600
USD/PLN: 2.4300 / 2.5200

Stay aside/watch core markets

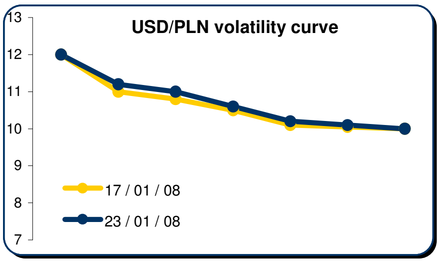
After Fed's 75pts rate cut investors awaits next 'significant decisions' both from Fed and ECB what makes core markets wavering and so PLN does. High correlation with EURJPY is likely to last.

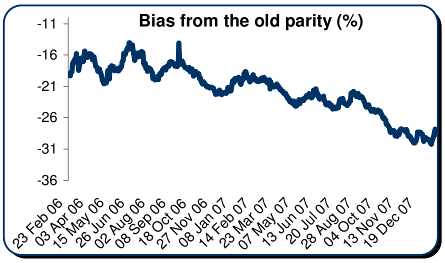
Options:

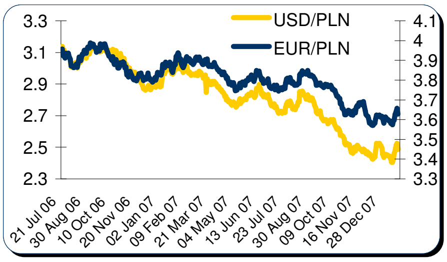
Sell USD vega/slightly short EURPLN gamma

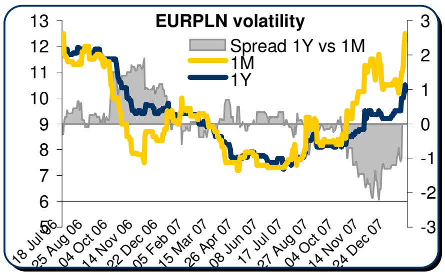
We advise to trade small amounts of short EURPLN gamma/selling USDPLN vega at present levels.

FX CHARTS


USD/PLN volatility curve
17 / 01 / 08
23 / 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
17/01/08	5.52%	5.56%	5.83%	5.85%	6.03%	6.08%
18/01/08	5.53%	5.56%	5.81%	5.85%	6.00%	6.08%
21/01/08	5.50%	5.55%	5.74%	5.86%	5.96%	6.08%
22/01/08	5.54%	5.56%	5.84%	5.86%	6.00%	6.07%
23/01/08	5.56%	5.56%	5.62%	5.86%	5.80%	6.05%

FRA MARKET RATES

FRA Market Rates (Closing mid-market levels)

date	1X4	3X6	6X9	9X12	6X12
17/01/08	5.79%	5.98%	6.02%	6.03%	6.10%
18/01/08	5.79%	5.97%	6.05%	6.04%	6.11%
21/01/08	5.79%	5.95%	5.99%	6.00%	6.05%
22/01/08	5.77%	5.86%	5.86%	5.86%	5.90%
23/01/08	5.73%	5.81%	5.82%	5.82%	5.86%

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
17/01/08	6.08%	5.08%	5.57%	5.29%	5.72%	5.69%	5.73%	5.76%
18/01/08	6.08%	5.05%	5.57%	5.29%	5.71%	5.68%	5.72%	5.76%
21/01/08	6.08%	5.05%	5.57%	5.34%	5.71%	5.67%	5.71%	5.76%
22/01/08	6.07%	5.05%	5.56%	5.30%	5.71%	5.65%	5.72%	5.75%
23/01/08	6.05%	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
17/01/08	11.00	10.50	10.10	10.00	0.75	0.85	0.30	0.35
18/01/08	11.20	10.60	10.20	10.00	0.75	0.85	0.30	0.35
21/01/08	12.00	11.00	10.60	10.20	0.75	0.85	0.30	0.35
22/01/08	12.50	11.20	10.70	10.50	0.75	0.85	0.30	0.35
23/01/08	12.25	11.00	10.50	10.30	0.75	0.85	0.30	0.35

PLN SPOT PERFORMANCE

PLN spot performance

date	USD/PLN	EUR/PLN	bias
17/01/08	2.4606	3.5977	-29.28%
18/01/08	2.4782	3.6250	-28.76%
21/01/08	2.5112	3.6395	-28.21%
22/01/08	2.5263	3.6577	-27.82%
23/01/08	2.4861	3.6280	-28.63%

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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