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FINANCIAL MARKETS DEPARTMENT

PAGES: 8

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POLAND WEEKLY REVIEW

MACROECONOMICS AND FINANCIAL MARKETS

PREVIEW: The week of February 1st to February 7th

Indicator	Date of release	Period	BRE fore-cast	Consen-sus	Last	Comment
MinFin's CPI forecast	**Feb 01**	**Jan**	**4.1% (final reading)**	4.2%	4.0%	Upward pressure is exerted by food prices whereas the cost of fuels works in the opposite direction. We expect the core inflation to remain at December's level.

In Focus / Macroeconomics

The MPC delivered what it was supposed to, now it is time for assessment of risks

The MPC decision has come as expected: 7-day minimal intervention stands now at 5.25%. The statement was hawkish enough to justify the hike. However, the comments released just after the meeting by the Committee members add to the lower rates view by expressing concerns on economic growth and possibility of widening divergence between Polish and EMU rates.

The statement was mainly focused on domestic factors: rising state-controlled prices, GDP growth running above potential, mounting wage pressure (including the public sector) and elevated food prices. Mentioned factors were this time amplified by acknowledging the risk of second round effects. Added uncertainty factors concerning the disguised links between global slowdown, Polish GDP growth deceleration and resulting ease of inflationary pressure should be treated as a sample of concerns within the MPC – likely to be more bluntly voiced in separate comments soon. Basing on the statement alone, it would have been reasonable to think the cycle is not over.

The sample of some dovish attitudes has been given already this morning. J. **Czeka**j expressed concerns on economic growth and lower ECB rates which may impose appreciation pressure on the zloty (by the way, appreciation is not regarded now as an ally with fighting inflation but rather as an obstacle to exports). His forecasts assume inflation peaking in March and then decline; it is then hardly a surprise that softer real figures for January will make him to put no further hikes scenario on his agenda. Softer growth is also seen by H. **Wasilewska-Trenkner**, however, it does not fall short of her earlier estimates of about 5,5% in 2008. The argumentation for lower growth is basing on statistical effects and supply constraints of domestic enterprises faced in the labor market – the culprits lie essentially in the domestic market, not the global one. Quite the most hawkish commentary was given, not surprisingly, by D. **Filar**. In his opinion the pro-inflationary domestic factors (along with permanently elevated food prices) played the prominent role in recent decision (the conclusion that can be drawn form the statement alone). However, he also touched issues concerning the spread between EMU and Polish rates as those that "complicate the decision process".

January data are going to play into the hands of dovish MPC members.

January data are going to play into the hands of dovish MPC members. First of all, we may see inflation figures not necessarily much higher than those recorded in December. January core "net" inflation growth may also work towards the climate of subsiding inflationary threats. Quite the same impression may be given by industrial output, being under the heavy pressure of base effects and faced with lower volume of orders. On the other hand, wage figures are not going to disappoint in January – the growth rate close to recent trend may be slightly upped also by a rise in the minimum wage. It is then highly probable that more "growth oriented" MPC members will declare to put the tightening cycle to a halt. However, we advise to stick to the scenario of quite a robust growth reaching 5.5% in 2008 (mainly driven by domestic demand) despite signals of deeper slowdown which we are likely to be seen in the first months. That is why we think the inflation pressure is not going to fade – first sign (although largely anticipated and stemming mainly from increases in state-controlled prices) will come already in March with higher core inflation. We believe it will be still driven upwards by the wage and demand pressure, additionally amplified by numerous pro-cyclical fiscal stimuli. Owing to "negative impressions" gave by the weaker data we expect the hike to take place no sooner than in March or April. We also expect the hike expectations to subside further. We think the February projection will fail to be hawkish enough to trigger an earlier hike. That is why we also anticipate the hike expectations to subside further. In the mid term, however, we continuously see mounting inflationary risks with inflation stabilizing at about 4%, i.e. above the upper tolerance band, at the end of 2008.

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	11,4	9,8
NBP repo rate (end-of-year)	4,00	5,00	**6,00**

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

Fixed Income

Volatile week

We have hit a quite volatile period on IR market. Looking at levels of market closes it may look like not much is happening, but daily moves tend to exceed 10 bp. Still the main trend is for steeper curve, and lower rates. Some confusion on the market was caused by more hawkish than expected MPC comment following the decision, and very dovish statements from Mr Czekaj, who is perceived as a moderate member. All in all, market sentiment is very fragile, moves are sharp and driven by random flows. As far as recommendation we don't have conviction strong enough to recommend any directional trade, we think curve will stay in range, until amplitude of daily moves will settle down, we recommend trading range on 0412 between 95.90-96.50 from a buyer perspective, we don't recommend going short bonds. No relevant data in the week ahead.

RECOMMENDATION:

Trade range on 0412 between 95.90-96.50 from a buyer perspective. Do not go short bonds.

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	2008-02-11	-	5,740%	2007-12-03
2Y T-bond OK0709	2008-04-04	-	6,189%	2008-01-02
5Y T-bond PS0413	2008-02-06	-	5,943%	2007-11-21
10Y T-bond DS1017	2008-02-13	-	5,699%	2007-10-25
20Y T-bond WS0922	2008-05-14	-	5,794%	2008-01-09

Money Market

Cheap end of the reserve

The MPC hiked all the rates

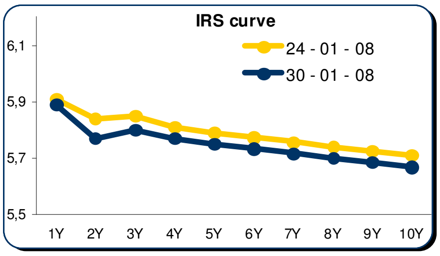
As we were expecting, the end of the reserve was very cheap. System lend over 5 billion pln to central bank having no better opportunity. New reserve will stabilise the carry fore coming two maybe 3 weeks nearby the main market rate.

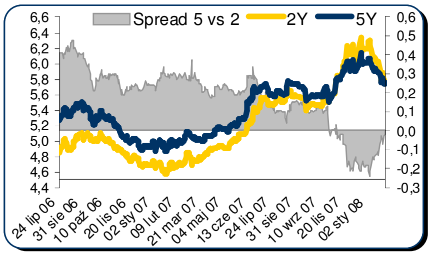
Despite of the bullish local figures, aggressively falling interest rates in the USA, probability that ECB will respond in the similar way, the MPC decided to hike all the rates. The new rates are as follow: the main market rate 5.25%, deposit rate 3.75%, Lombard rate 6.75% and rarely used rediscount rate 5.5%. Because of this decision, probability of further wait and see bias is very likely. We think that the MPC will pause next month or maybe longer just to see what happens with local economic trends and global sentiment.

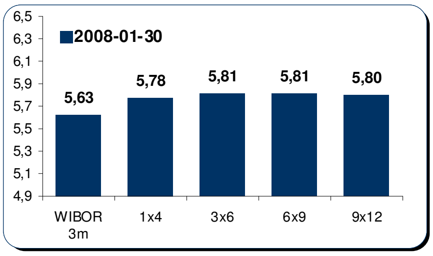
RECOMMENDATION:

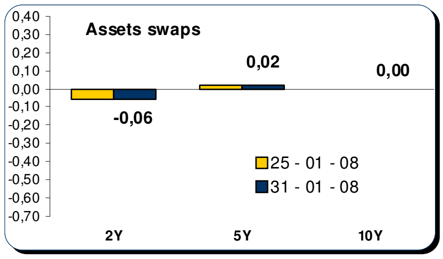
Sell 3M Polonia.

FIXED INCOME & MONEY MARKET CHARTS









Foreign Exchange

Zloty stable

This week the zloty was traded between 3.6060 and 3.6300. Range trading took place before and after Fed and NBP decisions. Slightly lower expectations for rate hikes in Poland and US recession threat caused banks actions hadn't affect market in a significant way.

Volatility curve stays at the same levels

Without zloty's clear trend set, curve remains untouched with 1M traded around 6.7 and 1Y around 6.0 levels.

RECOMMENDATION:

Spot:
Main supports / resistances:
EUR/PLN: 3.5800 / 3.6600
USD/PLN: 2.3600 / 2.5100

Sell on upticks

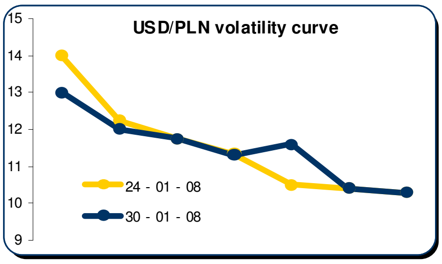
Although market reactions doesn't provide clear signals for traders, we believe that combination of growing interest rate parity and good fundamentals of Polish economy with quieting actions from Fed opens way to further PLN strengthening. Our idea is to sell on upticks up to 3.6600 with S/L at 3.6900 and P/T at 3.5900.

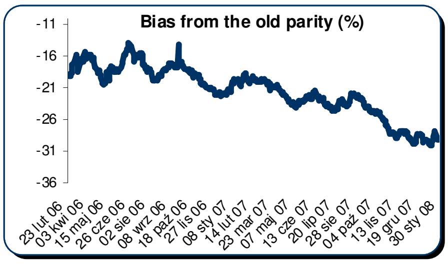
Options:

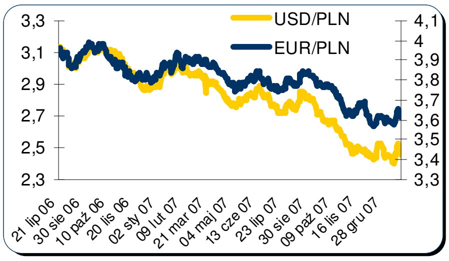
Short EURPLN gamma/Short USDPLN vega

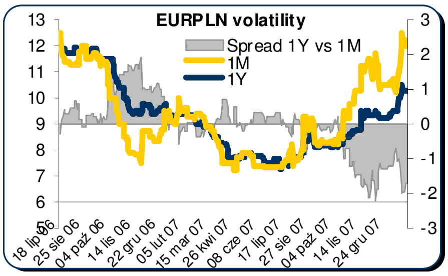
We advice to trade small amounts of short EURPLN gamma. We see 11.0 for 6M and 10.50 for 1Y as good entry level in short USDPLN vega position.

FX CHARTS


USD/PLN volatility curve
24 - 01 - 08
30 - 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
24-01-08	5,54%	5,55%	5,76%	5,75%	5,96%	5,94%
25-01-08	5,52%	5,54%	5,72%	5,75%	5,90%	5,94%
28-01-08	5,52%	5,53%	5,77%	5,76%	5,92%	5,93%
29-01-08	5,51%	5,54%	5,76%	5,74%	5,91%	5,93%
30-01-08	5,45%	5,53%	5,55%	5,74%	5,75%	5,91%

FRA MARKET RATES

FRA Market Rates (Closing mid-market levels)

date	1X4	3X6	6X9	9X12	6X12
24-01-08	5,77%	5,86%	5,86%	5,85%	5,89%
25-01-08	5,75%	5,90%	5,91%	5,89%	5,93%
28-01-08	5,72%	5,81%	5,82%	5,81%	5,85%
29-01-08	5,74%	5,79%	5,78%	5,76%	5,81%
30-01-08	5,78%	5,81%	5,81%	5,80%	5,83%

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
24-01-08	5,94%	5,08%	5,57%	5,29%	5,72%	5,69%	5,73%	5,76%
25-01-08	5,94%	5,05%	5,57%	5,29%	5,71%	5,68%	5,72%	5,76%
28-01-08	5,93%	5,05%	5,57%	5,34%	5,71%	5,67%	5,71%	5,76%
29-01-08	5,93%	5,05%	5,56%	5,30%	5,71%	5,65%	5,72%	5,75%
30-01-08	5,91%	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
24-01-08	12,25	11,35	10,50	10,30	0,75	0,85	0,30	0,35
25-01-08	12,25	11,35	10,50	10,30	0,75	0,85	0,30	0,35
28-01-08	12,25	11,35	10,50	10,30	0,75	0,85	0,30	0,35
29-01-08	12,25	11,35	10,50	10,30	0,75	0,85	0,30	0,35
30-01-08	12,25	11,35	10,50	10,30	0,75	0,85	0,30	0,35

PLN SPOT PERFORMANCE

PLN spot performance

date	USD/PLN	EUR/PLN	bias
24-01-08	2,4784	3,6225	-28,79%
25-01-08	2,4542	3,6135	-29,17%
28-01-08	2,4665	3,6245	-28,90%
29-01-08	2,4501	3,6185	-29,16%
30-01-08	2,4503	3,6218	-29,12%

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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