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FINANCIAL MARKETS DEPARTMENT

PAGES: 8

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POLAND WEEKLY REVIEW

MACROECONOMICS AND FINANCIAL MARKETS

PREVIEW: The week of March 28th to April 3rd

Indicator	Date of release	Period	BRE forecast	Consensus	Last	Comment
FinMin's iflation forecast	**Apr 1**	Mar	**4.1% y/y (final figure)**	-	4.2%	Annual inflation rate to moderate temporarily in March (no state-controlled price hikes this month, moderate food prices, higher fuel prices). 'Net' core inflation up a notch to 2.6% from 2.5% recorded in February. Headline inflation as well as core measures are set to rise again starting in April (next stage of controlled prices deregulation).

In Focus / Macroeconomics

Retail sales soaring at 23.8% annual pace

Retail sales beat market consensus situated at 20.0% y/y, growing at the highest pace since the pre-accession period in 2004. The reading was driven by the sales of durable goods (cars, press, electronics and "other" category) and the sales of food as well. The former categories confirm well established consumer confidence and eagerness to spend money, leading straight to buoyant consumption growth in Q1 and relatively strong GDP expansion of 6% y/y.

Along with the release of the retail sales figure we recalculated the corresponding deflators. So, the retail sales deflator amounted to 4.6% y/y, slightly lower than a month ago but in line with the underlying trend. The deflator covering the demand categories (excluding food and fuels) remained almost flat at 0.3% y/y. We do not expect this trend to be altered abruptly, however, rising overall level of prices may fuel additional wage demands (second round effects), leading in short-term to elevated demand and additional rise of retail prices.

The price-trend pictured above finds support in core inflation measures. Net core inflation (calculated excluding food and fuels) rose in January and February to 1.9% y/y and 2.5% y/y respectively. Readings are pushed mainly by rising state-regulated prices, although to the reasons enumerated above we expect price rises to slowly spill over other consumption categories.

MPC raised repo rate for a third time in a row

Polish MPC hiked the rates this week by 25 bps to 5.75%, in line with market expectations. The third consecutive hike has been motivated by rising inflationary pressure, stemming mainly from the tight labor market and elevated mid-term inflation path resulting from supply shocks and rising controlled prices. All this can be directly gleaned from the after-meeting statement.

Although the Council referred directly to deteriorating economic outlook for the euro area and the US as well, it stressed that the short term perspectives for the Polish economy remained favorable. According to the statement and comments that followed, GDP is set to surpass the potential output in the first half of 2008. In addition, the private consumption is to accelerate from the rates recorded in the previous year. In MPC's opinion, incremental idiosyncratic (demand) shocks should allow for a temporary decoupling of the Polish economy, opening door for a more restrictive monetary policy. Indeed, outstanding figures from the real sphere accompanied with a record high corporate wage dynamics were probably the main factors behind the March's decision.

The statement list the factors that may limit the inflation rise in the future as well. It includes globalization and favorable financial standing of companies. Quite interestingly, prof. Wojtyna, a moderate MPC member, detached himself from thoughts presented by some MPC members on the zloty appreciation. In his opinion, rising rate disparity and strengthening of the zloty only back the effectiveness of monetary policy and should not be assessed negatively.

As for the new insights, the issue of anti-inflationary effects of recent hikes has once again come back on the agenda (last time it popped up was in October statement). Linking this information with 6% level of repo rate preferred by ultimately hawkish D. Filar leads us to the conclusion that costs of credit have reached a level close to the upper limit tolerated by the other rate-setters.

We still think the MPC will continue the course of fast rate hikes; the labor market data may speak for a hike already in April. From the MPC viewpoint, such a strategy minimizes the risk of hiking in times of softer growth rate (to come in H2 according to the inflation projection). After the hike in April, the MPC will embark on wait-and-see strategy lasting at least to June (new inflation projection, exact figures for Q1 GDP growth). The MPC is going to have a hard nut to crack in early Autumn when we expect inflation to accelerate above 5% and growth rate of wages still to stay at double-digit levels. Such a configuration of data may wipe out any expectations on ending the tightening cycle. We thus sustain our earlier forecast that the reference rate will exceed substantially the 6% level.

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	**>6.0**

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

Fixed Income

Another hike. And more to come.

The MPC hiked rates again by 25bp. Moreover, Council members quite clearly suggested that if currently observed trends in economy continue, they will deliver further tightening. Yet the market reaction was quite limited. What really amazes us, is that market is already trying to price in end of the cycle. We think it's definitely too early to say tightening would stop at 6% and we'll see rate cuts early next year. FRA curve currently implies that in 6 month time, when inflation reading will reach this year around 5%, 3x6 would trade below spot Wibor, which makes no sense at all. We stick to our view, that rates are too low and potential risks are definitely underpriced, therefore there is much value in the front end of the curve. We also carefully observe 5y5y forward spread to euro, which continues to tighten recently, we think we are might soon come close to level where there is no room for further convergence, but a lot of room to diverge if anything goes wrong…

RECOMMENDATION:

Pay 1y3s.

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	2008-04-14	-	6,230%	2008-03-10
2Y T-bond OK0709	2008-04-04	-	6,189%	2008-01-02
5Y T-bond PS0413	2008-05-07	-	6,167%	2008-03-05
10Y T-bond DS1017	2008-04-09	-	5,785%	2008-02-13
20Y T-bond WS0922	2008-05-14	-	5,794%	2008-01-09

Money Market

Still a chance for cheap carry tomorrow

Carry above the main market rate and liquidity shrinking so just the opposite scenario to what we were forecasting. No reasonable explanation why market bought all money bills (14.7 billion pln) knowing that it was too much. Tomorrow's operation will be the key whether the end of the reserve will be cheap or not. Logic tells us that demand for the bills or the offer itself should be low and shortest rates will drop down for the weekend.

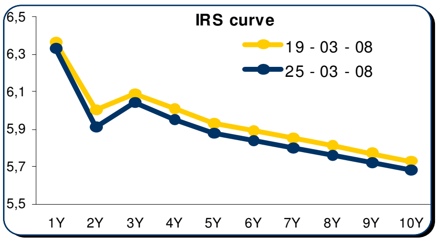
25 bps hike and hawkish conference triggered further expectations for fast hikes

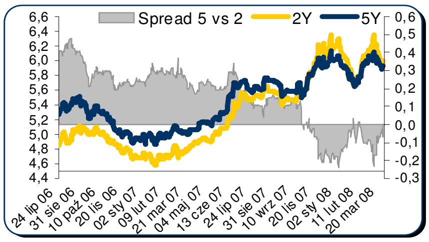
Core inflation slightly lower then expected (2.5 vs 2.7%), however continuous growth m/m sustained. Retail sales much higher then expected (23.8 vs 19.0%) and another 25 bps rates hike by the MPC. The main rate now is 5.75%, Lombard rate at 7.25%, deposit rate 4.25% and rarely used discount rate at 6%. Hawkish statement after the decision pointed out that growing wages and core inflation are more important factors then headline CPI which just for the record is falling down a bit (probably only for transition period). Hence, one can not exclude another hike in April and the whole cycle is not very likely to finish soon.

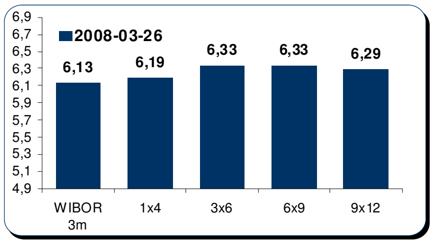
RECOMMENDATION:

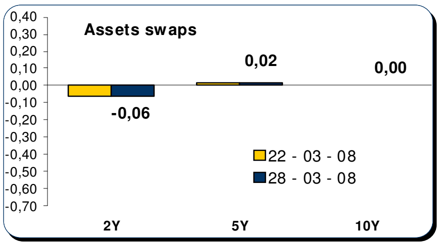
Still pay synthetic 9*12 OIS.

FIXED INCOME & MONEY MARKET CHARTS









Foreign Exchange

Zloty slightly stronger

Since Friday the zloty was traded between 3.5370 and 3.5190. This week, PLN was driven mostly with inner signals as outer, like global sentiment, stayed steady. Zloty touched bottom of this range on increasing expectations for rate hikes.

Volatility curve slightly lower

Narrow trading range and stronger zloty lowered curve a little bit with 1M traded at 6.7 and 1Y 6.0-6.1.

RECOMMENDATION:

Spot:
Main supports / resistances:
EUR/PLN: 3.5100 / 3.5600
USD/PLN: 2.2000 / 2.3200

Sell on upticks

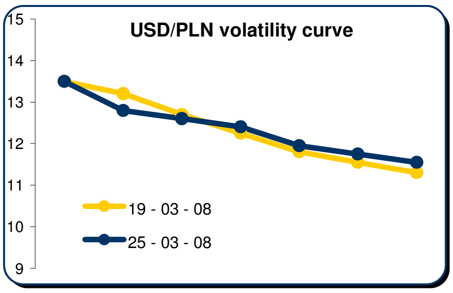
We still suggest to sell on upticks with in this case close watching of interest rates market as main trend setter.

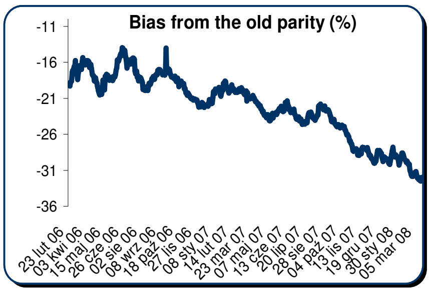
Options:

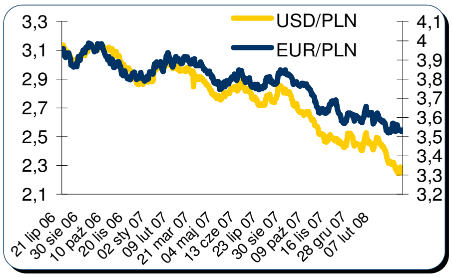
Short EURPLN gamma

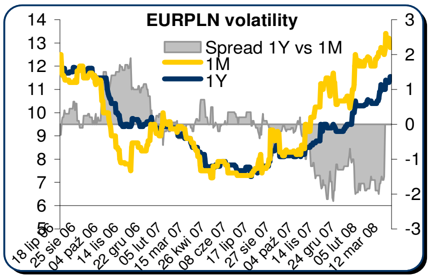
We advice to trade short EURPLN gamma as spot market is likely to still trade in narrow range.

FX CHARTS






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
19-03-08	5,98%	5,94%	6,30%	6,25%	6,43%	6,38%
20-03-08	5,98%	5,94%	6,20%	6,24%	6,43%	6,38%
21-03-08	5,97%	5,95%	6,23%	6,24%	6,36%	6,38%
25-03-08	5,97%	5,95%	6,23%	6,25%	6,36%	6,40%
26-03-08	5,98%	5,96%	6,32%	6,28%	6,41%	6,42%

FRA MARKET RATES

FRA Market Rates (Closing mid-market levels)					
date	1X4	3X6	6X9	9X12	6X12
19-03-08	6,16%	6,27%	6,28%	6,24%	6,33%
20-03-08	6,16%	6,27%	6,28%	6,25%	6,30%
21-03-08	6,19%	6,26%	6,27%	6,24%	6,30%
25-03-08	6,19%	6,26%	6,27%	6,24%	6,30%
26-03-08	6,16%	6,25%	6,26%	6,22%	6,30%

FIXED INCOME MARKET RATES

Fixed Income Market Rates (Closing mid-market levels)							
date	1Y		2Y		5Y		
	WIBOR	TB	IRS	OK0709	IRS	PS0511	IRS
19-03-08	6,38%	5,08%	5,57%	5,29%	5,72%	5,69%	5,73%
20-03-08	6,38%	5,05%	5,57%	5,29%	5,71%	5,68%	5,72%
21-03-08	6,38%	5,05%	5,57%	5,34%	5,71%	5,67%	5,71%
25-03-08	6,40%	5,05%	5,56%	5,30%	5,71%	5,65%	5,72%
26-03-08	6,42%	5,03%	5,56%	5,34%	5,70%	5,68%	5,70%

PRIMARY MARKET RATES

Last Primary Market Rates							
	au. date	maturity	avg price	avg yield	supply	demand	sold
52W TB	08-03-10	09-03-10	94,074	6,23%	1000	296132	10000
OK0710	08-01-02	09-07-25	85,730	6,19%	1800	2047	1654
PS0413	08-03-05	13-04-25	95,950	6,17%	1500	2019	1500
DS1017	08-02-13	17-10-25	96,048	5,79%	2000	2785	2000

FX VOLATILITY

	USD/PLN 0-delta stradle				25-delta RR		25-de
date	1M	3M	6M	1Y	1M	1Y	1M
19-03-08	13,20	12,25	11,50	11,30	0,75	0,90	0,30
20-03-08	13,20	12,25	11,50	11,30	0,75	0,90	0,30
21-03-08	13,20	12,25	11,80	11,30	0,75	0,90	0,30
25-03-08	13,00	12,30	11,80	11,40	0,75	0,90	0,30
26-03-08	12,80	12,40	11,95	11,55	0,75	0,90	0,30

PLN SPOT PERFORMANCE

PLN spot performance			
date	USD/PLN	EUR/PLN	bias
19-03-08	2,2841	3,5333	-32,06%
20-03-08	2,2882	3,5336	-32,01%
21-03-08	2,2688	3,5280	-32,30%
25-03-08	2,2489	3,5346	-32,45%
26-03-08	2,2356	3,5260	-32,70%

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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