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FINANCIAL MARKETS DEPARTMENT

PAGES: 8

WARSAW, APRIL 4, 2008

POLAND WEEKLY REVIEW

MACROECONOMICS AND FINANCIAL MARKETS

PREVIEW: The week of April 3rd to April 9th

Indicator	Date of release	Period	BRE fore-cast	Consen-sus	Last	Comment
No significant releases						

In Focus / Macroeconomics

Inflation drops but only temporarily

At the beginning of the month the Ministry of Finance released its inflation forecast (publication is closely monitored by market participants as its accuracy is relatively high, although slightly lower in recent months). According to the forecast, inflation in March decelerated to 4.1% y/y from 4.2% y/y in February – exact figures will be published on April 15. In our opinion, the slight relaxation of inflation processes is only temporary and the price growth is set to accelerate slowly towards 5% in summer time.

Temporary slowdown of the price growth stands in-line with our forecast. The moderation stems mainly from slightly lower growth of food prices, as measured in monthly terms. We estimate thereby the "net" core inflation (the measure excluding the prices of food and fuels) to reach 2.6% y/y.

Next months will bring a gradual rise of inflation. We expect the headline inflation to reach 4.4% level in April and then 4.7% in May. Increasing headline measure will be accompanied by gradual rise of core inflation – the latter is going to surpass 3% level already in April and then jump again on another round of deregulation phase (it is May when some electricity providers are going to lift prices again). In late summer, inflation is likely to reach alarming level of 5% or even slightly surpass it. The table below presents our complete inflation path for 2008.

	Inflation	**Core „net" inflation**
January	**104,0**	101,9
February	**104,2**	102,5
March	**104,1**	102,6
April	**104,4**	103,1
May	**104,7**	103,4
June	**104,7**	103,5
July	**104,8**	103,6
August	**105,5**	104,2
September	**105,3**	104,3
October	**105,0**	104,3
November	**104,6**	104,2
December	**104,4**	104,2

We expect the MPC to lift the rates again in April and then to cease fire and become highly data dependent until late summer. There are some tenable contentions in favor of such a behavior. First of all, the reference rate at 6% may be the upper limit (for the time being) for the majority of rate-setters (recall that even the ultimate hawk D. Filar mentioned that level several time as the one he prefers; it is also the highest level supported by H. Wasilewska-Trenkner, not mentioning the "dovish" wing of the Council probably feeling guilty for the present credit costs levels). The second argument connects logically to the level of the reference rate. The MPC is likely to wait for effects of earlier hikes and, at the same time, try to assess their growth fallout. Slowly rising inflation (easily explained by state-controlled prices) enables the rate-setters to enter wait-and-see mode (it is inflation projection in June and Q1 GDP growth in May which will be decisive for the MPC mood regarding future movements). Moreover, the uncertainty surrounding the euro zone, U.S. and the global economy as well is likely to be at least partially resolved until the late second part of the year.

Taking into consideration our inflation path (mainly the core figures) it is unlikely that the MPC will ignore such a price growth should it occurs. We expect then a return to the tightening cycle in the late summer. Hike-deterrent scenario includes sharp slowdown of GDP growth which, in our opinion, remains for the time being quite unlikely.

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

Something different.

The biggest change that we see on the IR market it is fact that market is increasingly illiquid and less transparent. The actual liquidity of market is very shallow, and levels at which you can either close or open position are quite far away broker's market. Interbank spread is getting wider, and the number of market makers is declining, as well as sizes you can trade on the direct market. Other thing we noticed was squeeze on the money market. The open market operation took place on Friday, with Monday 31st being the first day of the new reserve period, and that was enough for local banks to apply for Lombard Credit. Let's imagine what will happen over half year or even worse in December. The structural change and Basel II agreement will push Wibor rates higher than in the past, and that phenomenon seems to be neglected in current pricing of the FRA curve. On the macro field, we updated our CPI path which shows yearly index easily breaking 5%, wages still in a rising trend. We remain bearish, we see FRA curve as low and attractive to pay. High money market rates will also hurt bond holders. We think asset-swap spreads will stay wide for some time, and such inverted curve cannot last for long.

RECOMMENDATION:

Pay FRA curve.

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 OK0710	2008-07-02	-	6,193%	2008-04-03
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

Shrinking credit lines give extra liquidity risk

Quite cheap end of the reserve, but not as cheap as deposit in the central bank would suggest. Market was long in almost 4 billion PLN of excess cash; however Polonia index was fixed only 25 bps below the main market rate. It was quite unusual and no reasonable explanation in our minds. Open market operation was confusing since the central bank wanted to absorb 16 billion pln, which would be way too much. Players bought 12.5 billion PLN, which in turn was far too little, hence such a big amount deposited in the central bank at the end of the day. All this should be at least alarming. Something strange is going on as far as PLN liquidity is concerned. There still is surplus of the cash in the system (around 15 billion PLN) but shrinking credit lines are new environment for the regulator and all this added together gives extra liquidity risk, since redistribution of it is much more difficult then we got used to.

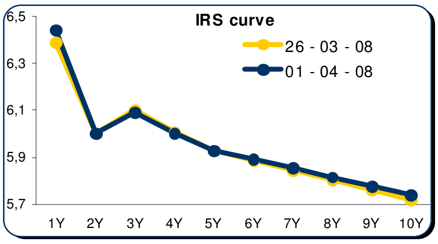
More hikes possible in the second half of the year

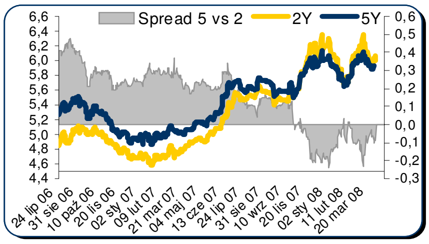
As for longer terms bearish sentiment still dominates and slightly better then expected CPI forecast did not change a thing. April hike makes sense for more and more players and this is what the curve reflects. Then pause till June's CPI long term projection and another hikes possible since we are not too optimistic for summer figures. This is not built in and we still see huge potential in pay positions.

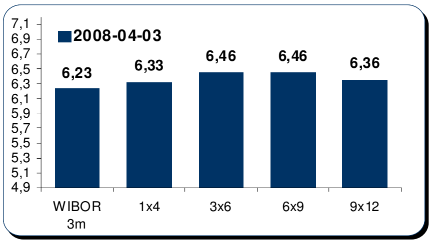
RECOMMENDATION:

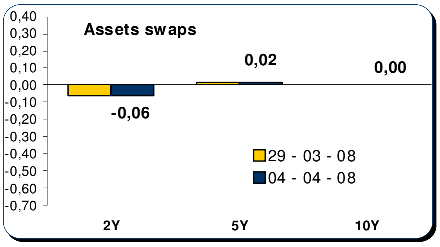
Stay pay.

FIXED INCOME & MONEY MARKET CHARTS









Foreign Exchange

Zloty stronger

Since Friday zloty was traded between 3.5300 and 3.4750. Improving global sentiment drove market to options barriers placed at 3.5000 and below what worked with breaking them.

Volatility curve flattened

Relatively quiet strengthening of zloty made curve almost flat with 1M traded at 6.4 and 1Y at 6.0.

RECOMMENDATION:

Spot:
Main supports / resistances:
EUR/PLN: 3.4500 / 3.5400
USD/PLN: 2.2000 / 2.2800

Sell on upticks

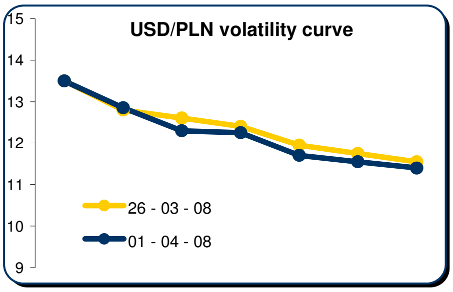
As market seems little bit option driven we suggest waiting for levels well above 3.50 to enter short EURPLN.

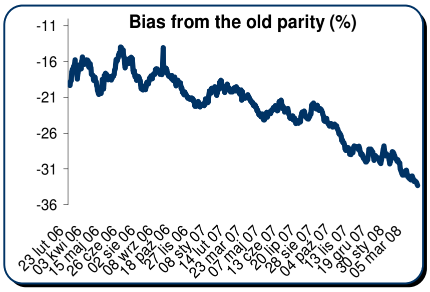
Options:

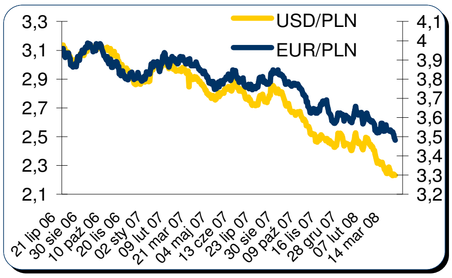
Short EURPLN gamma

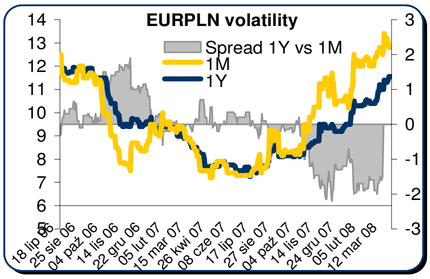
We advice to trade short EURPLN gamma as spot market is likely to still trade quiet.

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
27-03-08	6,02%	6,03%	6,28%	6,30%	6,48%	6,47%
28-03-08	6,16%	6,04%	6,40%	6,30%	6,60%	6,49%
31-03-08	6,06%	6,05%	6,15%	6,31%	6,30%	6,50%
01-04-08	6,17%	6,08%	6,45%	6,33%	6,65%	6,51%
02-04-08	6,16%	6,11%	6,46%	6,34%	6,66%	6,51%

FRA MARKET RATES

FRA Market Rates (Closing mid-market levels)

date	1X4	3X6	6X9	9X12	6X12
27-03-08	6,24%	6,34%	6,35%	6,30%	6,38%
28-03-08	6,26%	6,38%	6,38%	6,33%	6,43%
31-03-08	6,27%	6,38%	6,38%	6,32%	6,45%
01-04-08	6,25%	6,37%	6,38%	6,28%	6,38%
02-04-08	6,27%	6,42%	6,42%	6,32%	6,45%

FIXED INCOME MARKET RATES

Fixed Income Market Rates (Closing mid-market levels)

date	1Y		2Y		5Y		
	WIBOR	TB	IRS	OK0709	IRS	PS0511	IRS
27-03-08	6,47%	5,08%	5,57%	5,29%	5,72%	5,69%	5,73%
28-03-08	6,49%	5,05%	5,57%	5,29%	5,71%	5,68%	5,72%
31-03-08	6,50%	5,05%	5,57%	5,34%	5,71%	5,67%	5,71%
01-04-08	6,51%	5,05%	5,56%	5,30%	5,71%	5,65%	5,72%
02-04-08	6,51%	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	08-04-02	09-07-25	87,000	6,19%	2700	4925	2700
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-d
date	1M	3M	6M	1Y	1M	1Y	1M
27-03-08	12,80	12,40	11,95	11,55	0,75	0,90	0,30
28-03-08	12,80	12,40	11,95	11,55	0,75	0,90	0,30
31-03-08	12,80	12,40	11,95	11,55	0,75	0,80	0,30
01-04-08	12,80	12,30	11,80	11,50	0,65	0,80	0,30
02-04-08	12,85	12,25	11,70	11,40	0,65	0,70	0,30

PLN SPOT PERFORMANCE

PLN spot performance

date	USD/PLN	EUR/PLN	bias
27-03-08	2,2363	3,5270	-32,68%
28-03-08	2,2305	3,5258	-32,76%
31-03-08	2,2390	3,5110	-32,84%
01-04-08	2,2350	3,4949	-33,08%
02-04-08	2,2315	3,4815	-33,28%

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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