



POLAND WEEKLY REVIEW

MACROECONOMICS AND FINANCIAL MARKETS

**IN FOCUS /
MACROECONOMICS**

- Inflation in April a notch lower
- Real sphere of the economy – is the turning point in sight?

• pages 2-3

FIXED INCOME

- Rates reaching this year highs

• page 3

**FI
RECOMMENDATION**

- Play range

MONEY MARKET

- Extremely small demand for money bills pushed the carry down
- I/O and retail sales crucial for the MPC

• page 3-4

**MM
RECOMMENDATION**

- Pay 6,9M Polonia if rates go down again (6.13 and 6.19% respectively).

FOREIGN EXCHANGE

- Zloty stronger/traded in side trend
- Volatility curve slightly steepened

• pages 4-5

**FX
RECOMMENDATION**

- Stay aside/Buy on dips
- Stay aside/Short EURPLN gamma

**MARKET PRICES
CONTACT LIST
DISCLAIMER**

• page 6

• page 7

• page 8

PREVIEW: The week of May 16th to May 23rd

Indicator	Date of release	Period	BRE fore-cast	Consen-sus	Last	Comment
Employment	May 19	Apr	4.7% y/y	4.8%	4.8%	Business indicators point to an overall but gradual cooling of employment dynamics (large drops in manufacturing only partially offset by better results in services).
Wages	May 19	Apr	11.4% y/y	11.5%	10.2%	Growth rate in trend. Last reading probably distorted downwards by the lower number of working days and softer industrial output (analysis of historical time series point to a significant correlation between I/O and wages).
Industrial Out-put	May 21	Apr	11.0% y/y	14.2%	0.9%	Softer business confidence indicators (lower new export orders, less investment starts). Two working days more in comparison with the last month and a corresponding period of the last year.
PPI	May 21	Apr	2.3% y/y	2.7%	2.9%	Monthly drops in manufacturing and mining stemming from current and lagging effects of copper and oil prices and exchange rate developments. The risk skewed to the upside owing to alterations in energy tariffs (rising fixed cost and lower variable rate).

In Focus / Macroeconomics

Inflation in April a notch lower

CPI figures for April were slightly lower than market consensus (+4.1% y/y) reaching 4.0% annually and 0.4% m/m - in line with our expectations. The main upward contribution came from food prices (0.8%), restaurants and hotels (0.6%) and "other" category (0.6%). The impact of gas price hikes, which came into force in late April, appears to be negligible (the broader category "energy" remained unchanged on a monthly basis) - its full influence will be visible in next month's figure, driving the broad "housing" category by 1-1.2 pp. upwards. We estimate the core inflation right in the middle of 2.8-2.9 interval - the official figure to be released by the National Bank of Poland will rely much upon rounding. The publication confirms our view of slowly mounting spillovers from initially higher energy prices; demand pressures are visible as well.

The drop of inflation will be temporary. Next month's reading is set to be substantially higher owing to regulated prices and food (4.3% y/y). The rise in headline figure will be accompanied by accelerating core measure (3.3% y/y). We expect inflation to peak in August/September when the annual headline figure is likely to exceed 5%; then we may see a gradual decline of price growth towards 4% (it applies for headline and core measure as well).

The April's MPC decision on rates is not a "close call" and may prove heavily data-dependent. This month it is real sphere though which is to be of greatest importance for the voting outcome. The upcoming data releases (wages, retail sales) should boost rate hike expectations. On the other side, the most recent comments of MPC members – mostly declared hawks – point rather to postponing the rate hike until June (release of GDP data and central bank inflation projection). Some members (Slawinski among others) implicitly point to the strengthening zloty and the undesirable effect the soon rate hike may have on the rate expectations and FX market. Hawkish Filar contributed to the discussion on a presumably lower long end of inflation projection and much weaker real sphere figures to be released in June (working days effects) admitting that these factors would not restrain the Committee from hiking the rates in June.

Real sphere of the economy – is the turning point in sight?

Unexpected deceleration of industrial output in March posed some significant questions on condition of the real sphere of the economy. Last time we wrote about possible explanation of the observed phenomenon (also in case of retail sales). This time we scrutinize business indicators (published by the Statistical Office, National Bank of Poland and PMI surveys) to sketch the trend for coming quarters.

It seems we are going to witness a softer growth for some time. The first phase of business activity deterioration is visible in manufacturing sector. Strong zloty, solid growth of labor costs and inputs contribute increasingly to the impaired competitiveness of Polish goods. On the other hand, rising inflation and borrowing costs are likely to hamper private consumption. However, the full impact of this effect is unlikely to be revealed fast – there are still fundamental factors (mainly large growth of wages) which efficiently support the real purchasing power. What is more, perspectives on softening demand (first foreign and then domestic) and expected lower profits of exchange-quoted companies are likely to discourage investment activity. Thus, the growth of gross fixed investment may be substantially lower in coming quarters; short of previously noted results and market consensus as well.

The GDP growth rate is likely to remain above 5% in H1, however, it may be even slightly softer in the rest of the year. As for the GDP components, we may expect lower dynamics of gross fixed investment (the growth may slide below 10% in late 2008, though additional boost from EU funds is going to smooth the cyclical path of investment) accompanied by relatively high growth of consumption, which is likely to exceed the dynamics of the headline GDP figure.

MEDIUM-TERM FORECATS	Indicator	2006	2007	2008
	GDP y/y (%)	6.1	6.5	5.3
	Inflation rate (%)	1.0	2.4	4.5
	Current account (% of GDP)	-2.1	-4.5	-4.6
	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

Rates reaching this year highs

The sentiment on the fixed income market has worsened and yields kept moving higher, reaching this year highest levels on 2Y and close to previous tops on 5Y. 15-year bond auction was another one, showing there isn't much appetite for the risk on the market. It seems that locally current yield levels are quite attractive to receive and we should see the market pulling back a bit or even staying in some range before we go higher from current levels. Next week data - wages, industrial output and PPI should be rather negative for the rates, confirming the trend on wages and also negating previous low production figure, as one-time event. However, with a holiday on Thursday and therefore only half of the week of regular trading, we expect volatility to decrease. We reduced our pay positions in short end, especially in 2Y sector, expecting some rebound from current levels.

RECOMMENDATION:

Play range.

AUCTIONS

	next auc.	offer	avg yield last	last auction date
13 Week T-bills	-	-	6.061%	4/14/2008
26 Week T-bills	-	-	6.220%	4/14/2008
52 Week T-bills	5/26/2008	-	6.340%	5/5/2008
2Y T-bond OK0709	7/2/2008	-	6.193%	4/2/2008
5Y T-bond PS0413	6/4/2008	-	6.155%	5/7/2008
10Y T-bond DS1017	7/9/2008	-	6.054%	4/9/2008
20Y T-bond WS0922	9/12/2008	-	6.080%	5/14/2008

Money Market

Extremely small demand for money bills pushed the carry down

Very cheap week behind. People must have been really tired with expensive carry persisting for too long without any good reason. Only 5 billion pln of money bills have been absorbed and short cash dropped around 50 bps down. The bills offer was not too large anyway (9 billion pln), however to get a substantial release something more than that was necessary. And that is what happened. Tomorrow some more room for the OMO (12 billion pln), but the question is whether the demand will be there. If yes, carry will go up to 5,85-5.9%, if not 5.5% is more likely, for the coming week.

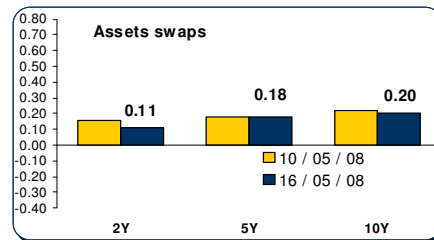
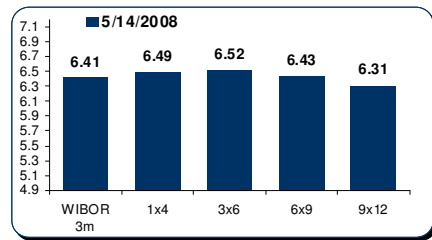
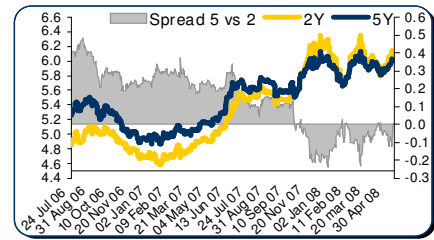
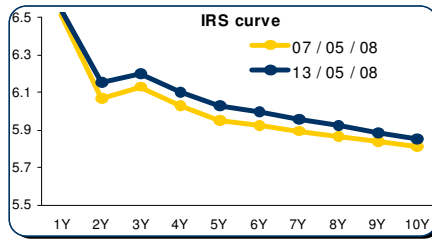
IO and retail sales crucial for the MPC

Not too much action for trading. CPI in line with expectations and wages will not be the surprise either. Industrial output and retail sales are the figures we are waiting for. Still much bigger probability that the next rates hike will be done in June than May. Good thing is that this strange curve shape (up till 9M and then down) ceased to exist and now we are facing upward sloping curve, which is more logical in our opinion. Flattening possible after next hike in 6-12M sector.

RECOMMENDATION:

Pay 6,9M Polonia if rates go down again (6.13 and 6.19% respectively).

FIXED INCOME & MONEY MARKET CHARTS



Foreign Exchange

Zloty stronger/traded in side trend

Since Friday the zloty was traded between 3.3801 and 3.4050. Zloty was stopped by option barrier placed at 3.3800, were we observed lower demand for PLN.

Volatility curve slightly steepened

Breaking through 3.4000 made market slightly short in gamma what caused buying interests on short end, 1M moved to 6.6 form 6.3.

RECOMMENDATION:

Spot:
Main supports / resistances:
EUR/PLN: 3.3500 / 3.4500
USD/PLN: 2.1300 / 2.2700

Stay aside/Buy on dips

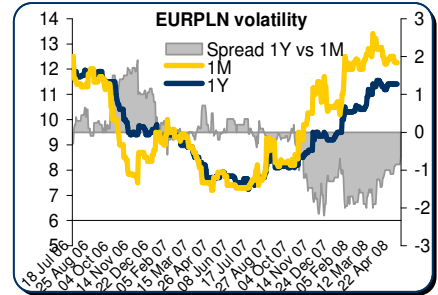
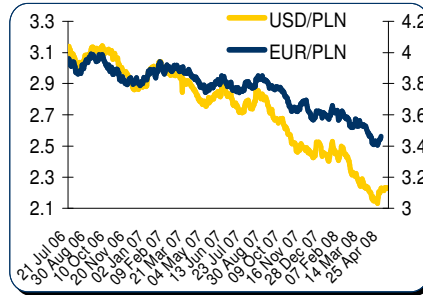
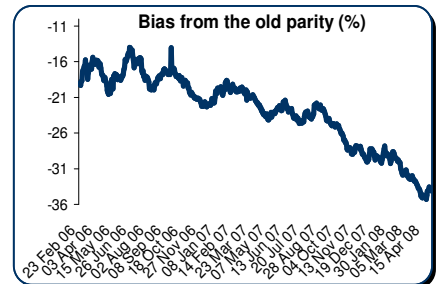
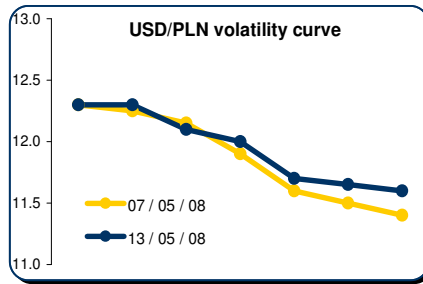
Decreasing PLN demand and improving USD sentiment makes us looking for opportunities to buy EURPLN. Key will be market belief that FOMC is likely to hike in future. We see buying at 3.3800 with short S/L or at 3.3500 as good idea.

Options:

Stay aside/Short EURPLN gamma

Till PLN sentiment won't clarify we see keeping small amounts of short EURPLN gamma as best idea, but our second-best thought is to buy strikes above 3.4100.

FX CHARTS



MARKET PRICES UPDATE**MONEY MARKET RATES**

Money market rates (Closing mid-market levels)						
date	3M		6M		1Y	
	FXSW	WIBOR	FXSW	WIBOR	FXSW	WIBOR
07/05/08	6.30%	6.29%	6.42%	6.42%	6.54%	6.54%
08/05/08	6.31%	6.29%	6.43%	6.43%	6.55%	6.54%
09/05/08	6.30%	6.30%	6.42%	6.41%	6.54%	6.54%
12/05/08	6.32%	6.30%	6.41%	6.42%	6.54%	6.54%
13/05/08	6.31%	6.30%	6.44%	6.43%	6.55%	6.54%

FRA MARKET RATES

FRA Market Rates (Closing mid-market levels)					
date	1X4	3X6	6X9	9X12	6X12
07/05/08	6.42%	6.47%	6.38%	6.22%	6.34%
08/05/08	6.44%	6.45%	6.37%	6.21%	6.37%
09/05/08	6.44%	6.48%	6.39%	6.23%	6.36%
12/05/08	6.44%	6.48%	6.39%	6.24%	6.36%
13/05/08	6.44%	6.51%	6.43%	6.28%	6.40%

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
07/05/08	6.54%	5.08%	5.57%	5.29%	5.72%	5.69%	5.73%	5.76%
08/05/08	6.54%	5.05%	5.57%	5.29%	5.71%	5.68%	5.72%	5.76%
09/05/08	6.54%	5.05%	5.57%	5.34%	5.71%	5.67%	5.71%	5.76%
12/05/08	6.54%	5.05%	5.56%	5.30%	5.71%	5.65%	5.72%	5.75%
13/05/08	6.54%	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	08/05/05	09/05/05	93.941	6.34%	2500	4123	2787
OK0710	08/01/02	09/07/25	85.730	6.19%	1800	2047	1654
PS0413	08/04/07	13/04/25	96.211	6.16%	1800	3129	1800
DS1017	08/02/13	17/10/25	96.048	5.79%	2000	2785	2000

FX VOLATILITY

date	USD/PLN 0-delta stradle				25-delta RR		25-delta FLY	
	1M	3M	6M	1Y	1M	1Y	1M	1Y
07/05/08	12.25	11.90	11.60	11.40	0.70	0.85	0.30	0.35
08/05/08	12.25	11.90	11.60	11.40	0.70	0.85	0.30	0.35
09/05/08	12.25	11.90	11.60	11.40	0.70	0.85	0.30	0.35
12/05/08	12.25	11.90	11.60	11.40	0.70	0.85	0.30	0.35
13/05/08	12.25	12.00	11.70	11.60	0.70	0.85	0.30	0.35

PLN SPOT PERFORMANCE

PLN spot performance			
date	USD/PLN	EUR/PLN	bias
07/05/08	2.2303	3.4217	-34.00%
08/05/08	2.2006	3.4054	-34.53%
09/05/08	2.1995	3.3946	-34.67%
12/05/08	2.1861	3.3846	-34.94%
13/05/08	2.2010	3.3934	-34.67%

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)

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

The review note is based on the information available to the public. This review note is provided to you for information purposes only and is not intended as advice on any particular matter or as recommendation, offer or solicitation for purchase or sale of any financial instrument and should not be taken as such. BRE Bank SA, its directors, officers, executives, managers, servants or agents expressly disclaim all liability to any person in respect of anything, and in respect of the consequences of anything, done or omitted to be done, wholly or partly, in reliance upon the whole or any part of the contents of this review note. The opinions and estimates contained herein reflect the current judgment of the author(s) on the date of this document and are subject to change without notice. The opinions pointed in review do not necessarily correspond to the opinions of BRE Bank SA. The past performance of financial instruments is not indicative of future results. No assurance can be given that any financial instrument or issuer described herein would yield favourable investment results. No client or other reader should act or refrain from acting on the basis on any matter contained in it without taking specific independent professional advice on the particular facts and circumstances in issue. Copyright protection exists in this publication and it may not be, even partially, reproduced or distributed without the prior written agreement with BRE Bank SA.