

IMF's busy travel itinerary

The outlook for the Emerging Markets in a deleveraging world

Lars Christensen

Chief Analyst, Head of Emerging Markets Research

+ 45 45 12 85 30 (direct)

+ 45 40 74 49 51 (mobile)

larch@danskebank.dk

Lars Tranberg Rasmussen

Analyst

+ 45 45 12 85 34 (direct)

+ 45 20 55 27 98 (mobile)

laras@danskebank.dk

October 2008

Danske Research, Danske Bank

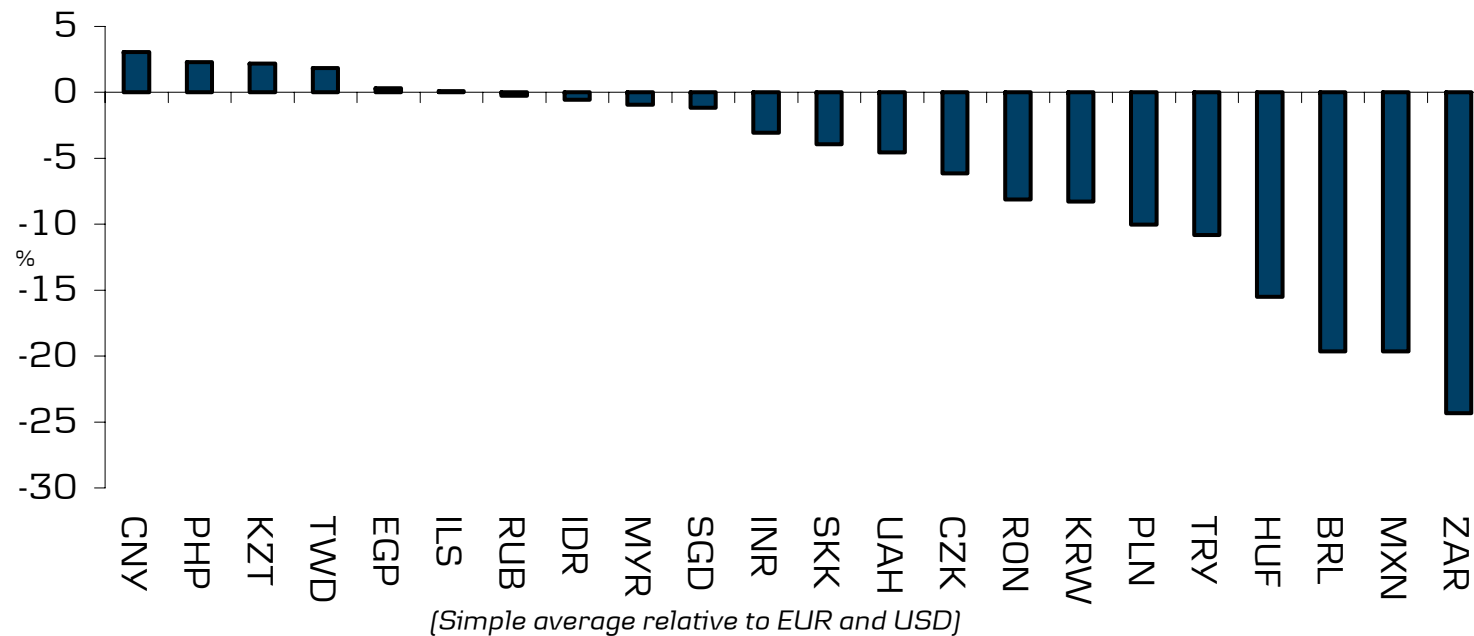
www.danskebank.com/research

Agenda

- Markets status
- It all started in Reykjavik
 - Travel itinerary for the IMF – a look at credit default swaps
- Regional outlook
 - EMEA
 - CEE/Baltics
 - CIS
 - LATAM
 - ASIA

Market status - FX rates in last month

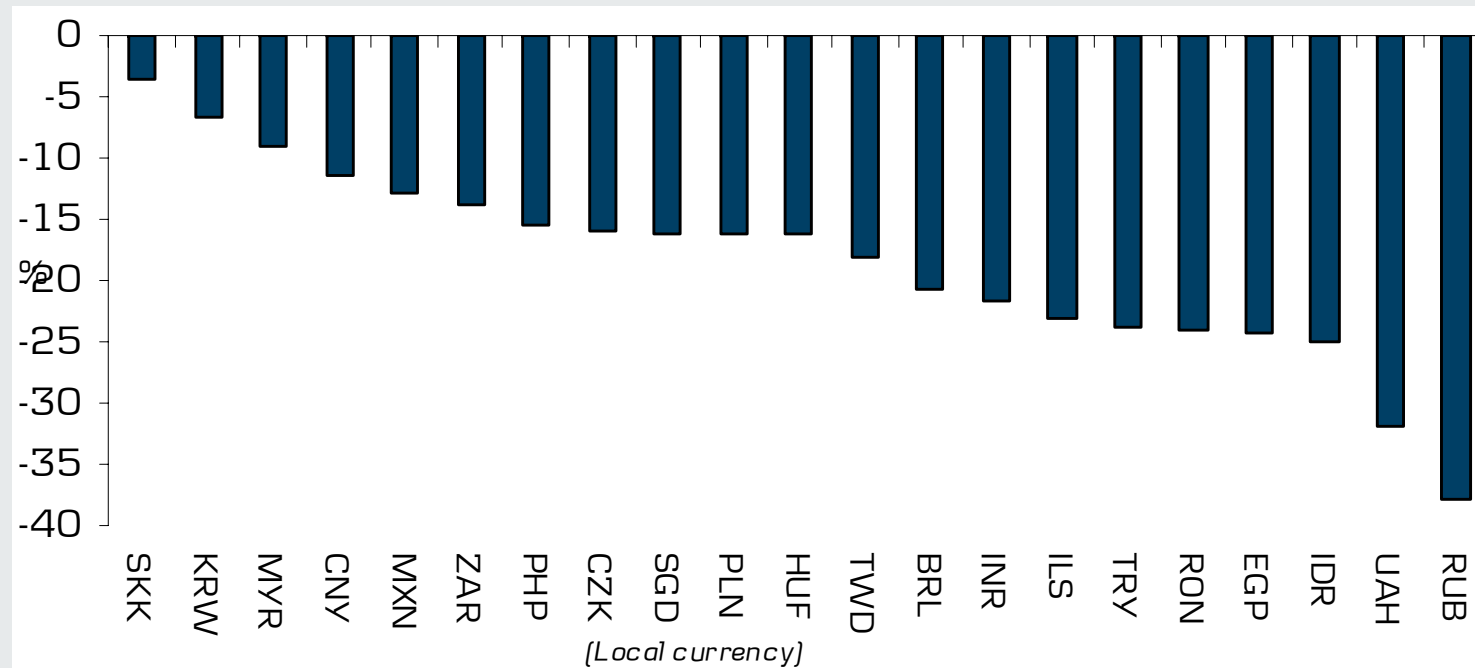
FX change against EUR and USD



Source: Ecwin

Market status – equity markets

Stock market performance



Source: Ecwin

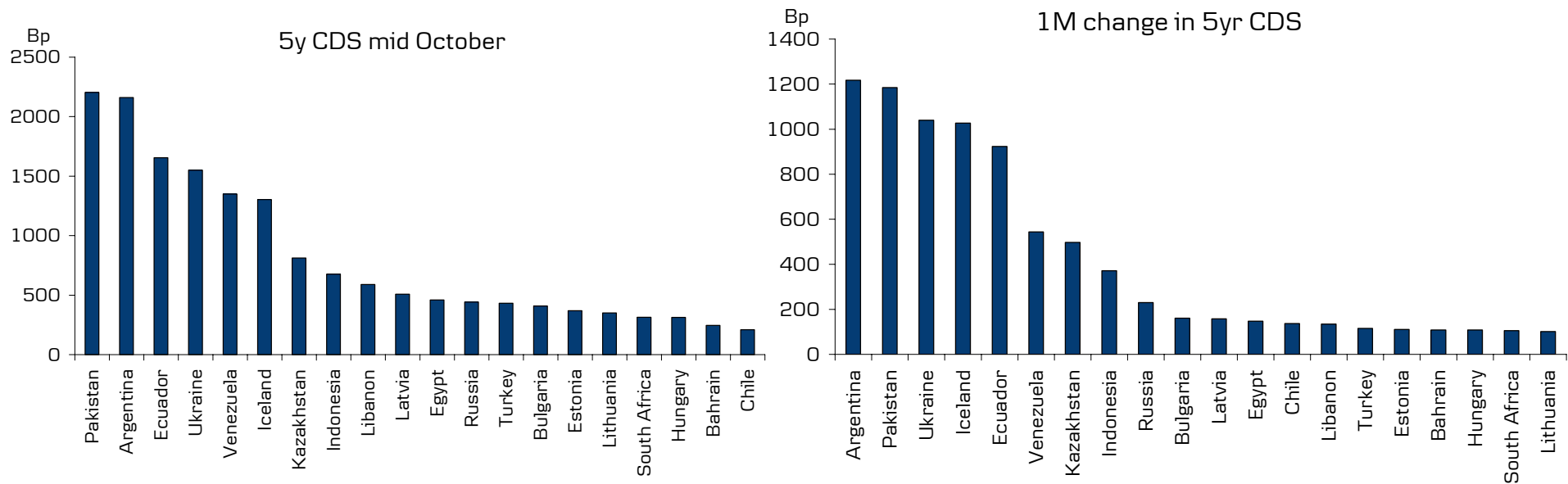
The Icelandic canary

- Status on Iceland:
 - We are in a total economic and financial meltdown on Iceland.
 - Crisis management has been very bad – both from the central bank and the government (latest policy mistake today: a 350bp rate cut).
 - Our worst fears have been realised.
 - The banking sector has *de facto* been nationalised.
 - Inflation is likely to rise to at least 50% y/y, but maybe as much as to 100% y/y in the coming months.
 - GDP is likely to drop significantly – our earlier forecast of a drop of 5-10% is probably far too optimistic.

What now for Iceland?

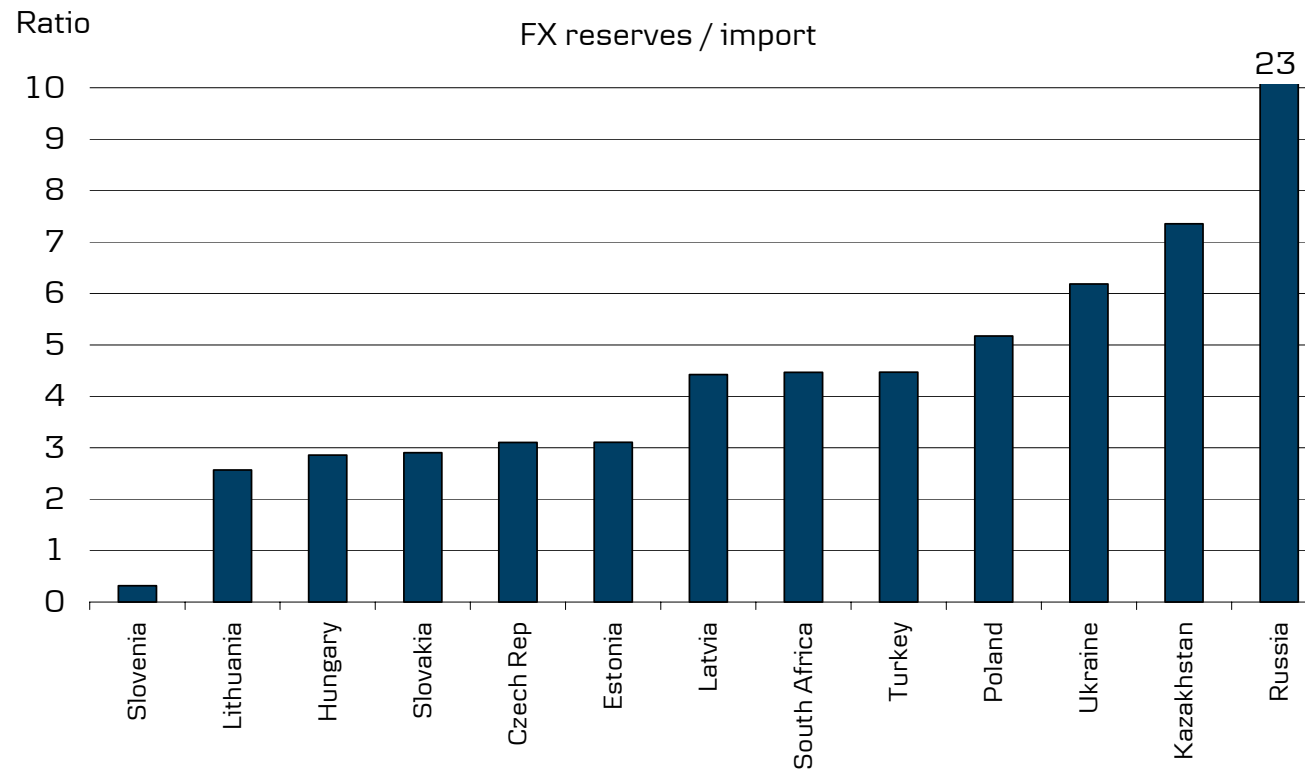
- An international rescue package is badly needed.
 - A loan from Russia is not a serious option in our view.
 - The most likely outcome is an IMF package with some support from the Nordic governments and central banks.

Take a look at credit default swaps - IMF's travelling schedule



Source: Bloomberg

Take a look at FX reserves to imports ratio



Source: IMF

Busy, busy... IMF on tour

- IMF has already offered "financial and technical" assistance to:
 - Iceland
 - Ukraine
 - Hungary
- More countries - especially in EMEA are likely to give the IMF a call.

Regional outlook

CEE/Baltics

- The credit crunch has arrived in CEE:
 - Most at risk are the “usual” suspects: The Baltic States, Hungary, Bulgaria and Romania that all run large current account deficits, have large external funding needs and have large amounts of outstanding foreign currency loans.
 - We have long warned about the risks in CEE and the Baltic States and we continue to see serious risk to financial and economic stability in the region.
 - In general we recommend hedging all FX exposure to the region – we forecast all the (floating) currencies in the region to underperform the forward over the next three months

CIS – no more easy money

- Years of easy fiscal and monetary policies in combination with rising commodity and soft commodity prices brought high growth, rising inflation and rich liquidity.
- However, things have changed markedly in recent months. Financial markets have come under severe pressures, with equities dropping sharply, FX rates coming under pressure and the cost of liquidity rising sharply.
- Russia:
 - The Russian government and the CBR have implemented measures to support liquidity and improve solvency in the banking system. Today the Russian central bank (CBR) cut reserve requirements to free RUB100bn of liquidity -> markets reaction higher yields and lower equity markets. This reflects current market uncertainties.
 - While the government has large buffers to help relieve pressure on markets under stress, the growth outlook is deteriorating.
- Ukraine:
 - Inconsistent policy and increased political uncertainty ahead of snap parliamentary elections represent a dangerous combination given tensions in global liquidity markets.
 - The Ukraine's economy minister, said that the country is seeking systematic support from the IMF to help limit liquidity strains. In our view the IMF could provide a much needed external anchor given the current difficult economic and political climate.

LATAM – the good times are over

- The Latin American economies have to a large extent benefitted from rising commodity prices.
- However, few countries have used good times to save for bad times.
- Most at risk as a result of the credit crisis are:
 - Argentina
 - Venezuela
- Brazil and Mexico, however, now look much stronger today than in earlier crises, as both countries have large FX reserves and have reduced external debt levels.

Asia is less sensitive to the credit crunch

- **Direct impact from the credit crunch is less**
 - Only modest increase in financial leverage.
 - Capital controls still widespread.
 - Strong external liquidity position (big FX reserves, only little short term debt and current account surplus).
- **Main event risk in Asia in the short run**
 - **Pakistan** might default on its foreign debt – FX reserves running dangerously low, see Research – “Pakistan: Badly in need of foreign assistance”.
 - **South Korea** – Debt leverage has increased and domestic banks are dependent on foreign short-term funding.
 - **Vietnam** – Overheating and sharp increase in current account surplus combined with inadequate FX reserves.

Q&A session



This report has been prepared by Danske Research, which is part of Danske Markets, a division of Danske Bank. Danske Bank A/S is authorized by the Danish Financial Supervisory Authority and subject to limited regulation by the Financial Services Authority (UK). Details on the extent of our regulation by the Financial Services Authority are available from us on request.

Danske Bank has established procedures to prevent conflicts of interest and to ensure the provision of high quality research based on research objectivity and independence. These procedures are documented in the Danske Bank Research Policy. Employees within the Danske Bank Research Departments have been instructed that any request that might impair the objectivity and independence of research shall be referred to Research Management and to the Compliance Officer. Danske Bank Research departments are organised independently from and do not report to other Danske Bank business areas. Research analysts are remunerated in part based on the over-all profitability of Danske Bank, which includes investment banking revenues, but do not receive bonuses or other remuneration linked to specific corporate finance or debt capital transactions.

Danske Bank research reports are prepared in accordance with the Danish Society of Investment Professionals' Ethical rules and the Recommendations of the Danish and Norwegian Securities Dealers Associations.

Financial models and/or methodology used in this report

Calculations and presentations in this report are based on standard econometric tools and methodology. Documentation can be obtained from the above named authors upon request.

Risk warning

Major risks connected with recommendations or opinions in this report, including a sensitivity analysis of relevant assumptions, are stated throughout the text.

First date of publication

Please see the front page of this research report.

Disclaimer

This publication has been prepared by Danske Markets for information purposes only. It is not an offer or solicitation of any offer to purchase or sell any financial instrument. Whilst reasonable care has been taken to ensure that its contents are not untrue or misleading, no representation is made as to its accuracy or completeness and no liability is accepted for any loss arising from reliance on it. Danske Bank, its affiliates or staff, may perform services for, solicit business from, hold long or short positions in, or otherwise be interested in the investments (including derivatives), of any issuer mentioned herein. The Equity and Corporate Bonds analysts are not permitted to invest in securities under coverage in their research sector. This publication is not intended for retail customers in the UK or any person in the US. Danske Markets is a division of Danske Bank A/S. Danske Bank A/S is authorized by the Danish Financial Supervisory Authority and subject to limited regulation by the Financial Services Authority (UK). Details on the extent of our regulation by the Financial Services Authority are available from us on request. Copyright (C) Danske Bank A/S. All rights reserved. This publication is protected by copyright and may not be reproduced in whole or in part without permission.