

New Europe Weekly

06-10 April, 2009

Investment research

Key events in the coming week

- *Update on Polish government stance regarding ERM2 entry (see page 3).*
- *Czech statistical office is due to publish CPI inflation for March. We also give an update on the Czech political situation (see page 3).*
- *We focus on the inflation outlook for CEE countries (see page 4).*
- *We focus on inflation and the public budget situation in Baltics (see page 5).*
- *Current account deteriorates further in Russia, but improvement in sight in 2009. The World Bank and OECD have revised the GDP forecast for the Russian economy for this year in a more negative direction (see page 6).*
- *We give an update on Turkish politics following the general elections and progress in agreement with the IMF regarding the loan package (see page 7).*
- *We have adjusted our PLN, RON, CZK, HUF, ZAR and TRY forecasts in a more positive direction on the back of the G20 meeting (see FX update on page 8).*
- *Limited room for rate cuts in Hungary in the current climate (see Fixed income update on page 9).*

A helping hand from G20

The result of the G20 meeting was a welcome surprise for emerging markets and we have seen most emerging markets rise on the back of the news coming out of the G20 meeting.

We think that three factors in particular are helpful for emerging markets in general and for Central and Eastern Europe in particular:

- 1) The G20 have agreed to quadruple the IMF's financial capacity with a USD1trn commitment.
- 2) International trade should get a boost from new funds to trade finance and trade credits.
- 3) The G20 leaders want revive the Doha trade rounds.

Most important - at least in the short term - is the extra funds for the IMF. This is particularly positive for the Central and Eastern European economies, where a number of countries are struggling with serious funding problems. In our view, a lot of the new IMF funds will be spent in CEE. That said, new funds for the IMF also mean more countries are likely to show an interest in securing loans from the IMF - especially if these funds can be attained with 'softer' conditions than the IMF would normally demand.

Even though the G20 in general is positive for the CEE economies, the extra funds do not change the fact that we are likely to see a very sharp further correction in growth in the region to adjust the major external imbalances. Extra IMF funds will not help avoid a major correction in external imbalances in the region and the IMF will still demand significant fiscal adjustments to provide loans to the CEE countries. However, IMF funds should help to avoid a major funding crisis in the region.

Overall we think that the G20 meeting is good news for the CEE/EMEA in general and we therefore have adjusted our PLN, RON, CZK, HUF, ZAR and TRY forecasts in a slightly more positive direction as a direct consequence of the result of the G20 meeting.

Calendar – week 15

EMEA Data and Events in Week15

Monday, April 6, 2009

			Period	Danske Bank	Consensus	Previous
CZK	9:00	Trade balance	bn. CZK	Feb	5.0	3.5

Tuesday, April 7, 2009

				Period	Danske Bank	Consensus	Previous
RUB	-	CPI	y/y	Mar	14.1%	14.1%	13.9%
EEK	8:00	CPI	y/y	Mar	2.6%		3.4%
HUF	9:00	Industrial production	y/y	Feb			-21.0%
LTL	10:00	PPI	y/y	Mar			-9.3%

Wednesday, April 8, 2009

				Period	Danske Bank	Consensus	Previous
HUF	9:00	Trade balance (preliminary)	m. EUR	Feb			-194.1
RON	9:00	Industrial production	y/y	Feb			-12.1%
TRY	9:00	Industrial production	y/y	Feb		-20.8%	-21.3%
LTL	10:00	CPI	y/y	Mar	8.2%		8.7%
LVL	12:00	CPI	y/y	Mar	8.4%		9.6%
ZAR	13:00	Manufacturing production nsa	y/y	Feb	-12.9%		-11.1%

Thursday, April 9, 2009

				Period	Danske Bank	Consensus	Previous
CZK	9:00	CPI	y/y	Mar	2.1%	2.1%	2.0%
CZK	9:00	Unemployment rate	%	Mar	7.7%	7.6%	7.4%
SKK	9:00	Industrial production	y/y	Feb			-27.0%
SKK	9:00	Trade balance	bn. EUR	Feb			-279.5
LTL	10:00	Trade balance	bn. LTL	Feb			-0.08
LVL	12:00	Trade balance	m. LVL	Feb			-147.3

Friday, April 10, 2009

				Period	Danske Bank	Consensus	Previous
TRY	-	Current account	bn. USD	Feb		1.1	0.3
HUF	9:00	CPI	y/y	Mar	2.9%		3.0%
RON	9:00	CPI	y/y	Mar	6.8%		6.9%
RON	9:00	Retail sales	y/y	Feb			-0.9%

The editors do not guarantee the accurateness of figures, hours or dates stated above
Note that all releases are CET.

Danske Bank

CEE

Polish government softens stance on swift ERM2 entry

Poland

- This week the Polish deputy Finance Minister Kotecki, in an interview on Polish radio, said that Poland should not join the ERM2 at the present time due to the high uncertainty in global markets. Until this announcement, the government had been quite adamant in saying that Poland would join ERM2 in June this year. Kotecki's comments could be seen as the first indication that the Polish government is softening its stance on swift ERM2 entry (and euro adoption).
- We have long been critical of the government's outspoken ambition to join ERM2 this year, as we don't think it has support from the ECB and the European Commission. Therefore, Kotecki's statement this week could simply be seen as a more realistic assessment of the situation, and we therefore don't believe his comments have changed the (realistic) outlook for the timing of Poland's entry to ERM2. We view this new-found realism as positive.

Czech Republic

- An interesting week in terms of economic data is ahead of us. The Czech Statistical Office is scheduled to publish inflation figures for March; we forecast inflation to inch up slightly, from February's 2.0% y/y to 2.1% y/y in March - number in line with the consensus forecast. The Czech central bank (CNB) forecasts further drop to 1.4% y/y. Looking ahead, we still expect inflation to decline further. Given the inflation outlook and the likelihood that CNB will revise down this year's GDP forecast next month, it is highly probable in our view that CNB will loosen the monetary policy further, though not drastically.
- A lot of Czech news flows this week has focused on a potential resolution of the political vacuum that was created after the government lost a no-confidence vote and was ousted from power last week. To begin with everything pointed to fairly rapid action from the politicians in breaking the political stalemate at the beginning of this week. However, at the end of the week the ex-Prime Minister Topolánek questioned the agreement made with the opposition's Social Democrats over the creation of a provisional government of experts to govern the country until early elections. But the obvious question is whether the Civic Democratic party and the opposition's Social Democrats can agree on the people who should form the caretaker government.



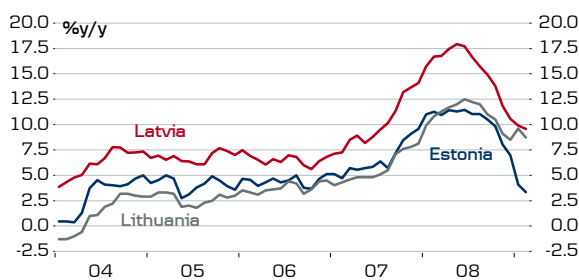
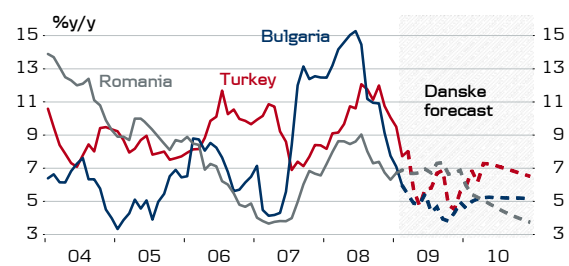
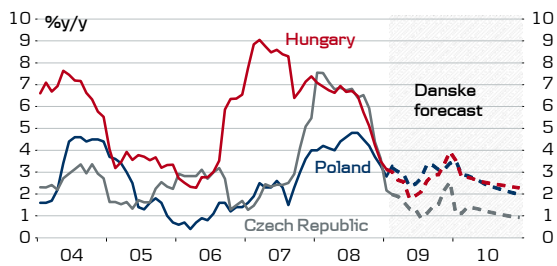
Source: EcoWin, Reuters

CEE – part II

Downtrend in inflation continues

CEE inflation

- In the coming weeks, March inflation figures for most CEE economies will be released. Below we present an updated outlook on CEE inflation.
- The massive fall in production which has led to a growth crisis in the region has driven down inflation over the last few months, with base effects from the declining oil price contributing to this trend. On the other hand, the significant weakening of the currencies since the beginning of the year has limited downside for inflation.
- In Poland and Romania inflation looks set to stabilise around the current level, implying an average inflation rate in 2009 of around 3.0% y/y in Poland and 6.9% y/y in Romania. The same goes for the Czech Republic and Hungary where inflation could continue on a mild downtrend in the next couple of months and then stabilise, resulting in average inflation of 1.7% y/y in the Czech Republic and 2.7% y/y in Hungary.
- In other CEE countries, inflation has not bottomed yet. In Turkey and Bulgaria we should see inflation continuing down throughout the year, resulting in average inflation in 2009 of 6.3% y/y in Turkey and 5.0% y/y in Bulgaria. In Russia and the Baltic countries we are expecting the same trend through 2009. However average inflation is likely to remain in double digit territory in the coming few years in both Russia and Ukraine.



Inflation year-average (% y/y)			
	2008	2009	2010
Bulgaria	12.4	5.0	5.1
Czech Republic	6.4	1.7	1.1
Estonia	10.4	1.5	0.8
Hungary	6.1	2.7	2.6
Latvia	15.5	6.3	5.0
Lithuania	10.9	5.8	6.0

Inflation year-average (% y/y)			
	2008	2009	2010
Poland	4.4	3.0	2.5
Romania	7.9	6.9	4.6
Russia	14.1	12.6	10.1
Turkey	10.4	6.3	6.8
Ukraine	25.3	16.1	12.1

Source: EcoWin, Reuters, Danske Markets

Baltic States

Inflationary pressures ease while fiscal pressures increases

Estonia

- Estonian inflation has been decreasing at a faster pace than that of its Baltic peers. We expect Estonian inflation in March to drop further to 2.6% from 3.4% in February. The risk that the Estonian economy will be hit by deflationary pressure has increased significantly. According to our new scenario, consumer price growth will probably drop to an average of 1.5% this year.
- However, looking forward we see some upside risks to our inflation forecast, mainly related to indirect tax rises. The budget deficit criterion currently is one of the key challenges, especially taking into account a plan to speed up euro adoption to 2011. If GDP drops 9-10% y/y, the budget deficit in Estonia could reach 6% of GDP this year. Following the experience in other Baltic countries, this could lead to a rise in the VAT rate or excise duties. Current proposals on the table are to abolish some income tax rebates and introduce a car tax. However, this may not be enough to keep the budget deficit within the 3 % of GDP limit.

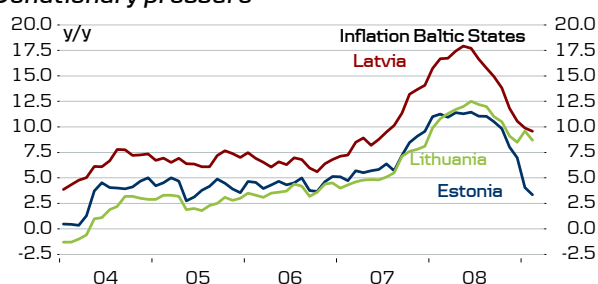
Lithuania

- In Lithuania, easing inflationary pressure was offset somewhat by the rise in excise duties on tobacco products and increase in public transportation costs. Thus, we expect Lithuanian inflation to decelerate to 8.2% y/y in March from 8.7% y/y in February. We expect Lithuania average inflation to drop to 5.8% in 2009 from 10.9% y/y 2008.
- According to preliminary estimates, the public deficit in Lithuania widened to 3.2 % of GDP last year from 1.2% of GDP in 2007. Technically, the conditions for entering the euro area have therefore been breached. However, this year even more pressure will be on the budget. In order to avoid an unsustainably high budget deficit, there could be further public budget cut reaching up to 4 % of GDP.

Latvia

- The consumer price falls in Latvia are likely to be steeper in the coming months on the back of the ongoing downturn. We expect consumer prices in March to have decelerated further to 8.4% y/y from 9.6% y/y in February. In 2009, average inflation in Latvia could drop to a single digit figure of around 6.0%. There is downside risk to this inflation projection: if a more pessimistic scenario materializes, inflation could decline to an average of 3-4%.
- Latvia is missing a payment from IMF in March because of its failure to implement new fiscal measures. Thus a significant fiscal tightening should be implemented as soon as possible in order to be compliant with the previously-agreed deficit of no more than 5% of GDP.

Deflationary pressure



Source: Reuters EcoWin

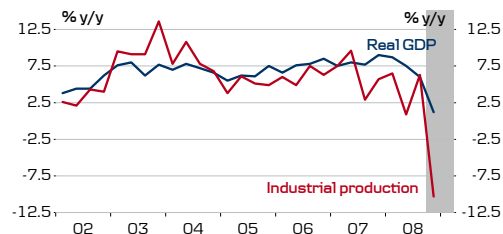
CIS

Tentative signs of stabilisation in the manufacturing sector

Russia

- This week the Russian central bank (CBR) announced a large drop in the C/A surplus in Q4 08 to USD 8.6bn (the lowest in five years), down from USD 29.5bn in the previous quarter. This was not unexpected as the market was anticipating a fall in the surplus in Q4 on the back of sharply lower oil prices. For the whole of 2008, the C/A surplus was USD 102.3bn.
- Net portfolio investment was USD 21bn in Q4 as foreigners reduced asset holdings in Russia. Further, net other investments (including changes in holdings in loans, bank accounts, and currencies) were USD 115.4bn, as Russian companies reduced foreign liabilities. In fact, Russian Finance Minister Kudrin said last week that Russian banks had reduced their foreign liabilities by as much as USD 50bn Q4. The large capital deficit helps to explain the USD130bn drop in FX reserves during Q4.
- Russian domestic demand contracted sharply in Q1, and we expect imports to drop roughly USD 30bn in Q1 09 from Q4 08, and therefore expect a C/A surplus of roughly USD 20bn in Q1. For the whole of 2009 we expect a C/A surplus of USD 60bn in our baseline scenario based on an average oil price of USD52/bbl. However, we expect net capital outflows to hover around USD 150bn in 2009, as the Russian private sector further reduces foreign liabilities and direct and portfolio inflows remain weak throughout the year. Overall that will draw down Russian FX reserves during 2009 to some USD 330bn by year-end from current levels of USD 388bn.
- This week provided a good a bit of good news for the manufacturing sector. The overall PMI manufacturing index rose for a third consecutive month to 42.0 in March from 40.6 in February and an all-time low of 33.8 in December 2008 - all numbers are seasonally adjusted. Most subcomponents moved higher. Most notable was the improvement in new export orders following weak activity during the peak of the gas dispute with Ukraine around New Year. The output component moved up to 43.9 in March from a low of 28.5; meanwhile stocks of finished goods dropped. Overall, the surveys indicate that manufacturing activity is set to bottom in Q1 2009.
- Russia's GDP growth slowed to 1.2% y/y in Q4 08, down from a revised 6.0% y/y in Q3 08, the Federal Statistics Service announced on Thursday. Russian officials expect GDP to drop 7% y/y in Q1 y/y. The World Bank this week lowered its GDP forecast for 2009 to -4.5% y/y. A more down-beat report on Russia from the OECD suggests "a deep recession is underway", and it lowered its GDP projection for 2009 to -5.6% y/y. Our forecast for 2009 is -3.0% y/y, but we will probably adjust it lower when we next update our forecasts for Russia.

Lacklustre activity in Q4 (GDP, 1.2% y/y)



Some recovery in manufacturing in Feb-Mar



Source: EcoWin, Reuters

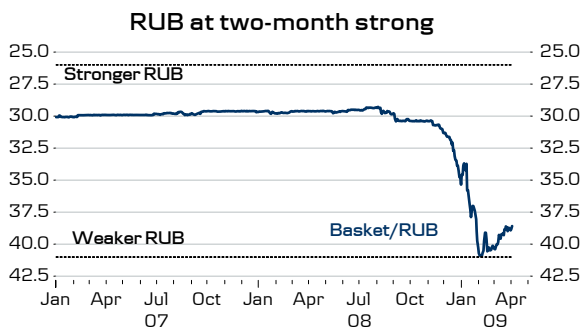
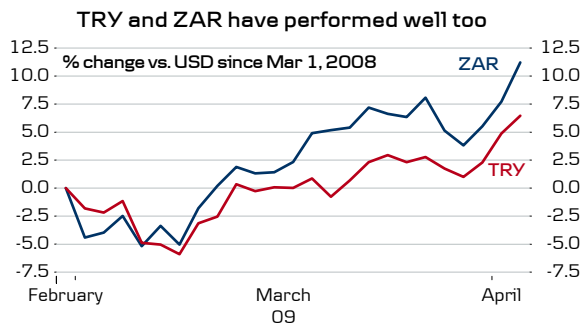
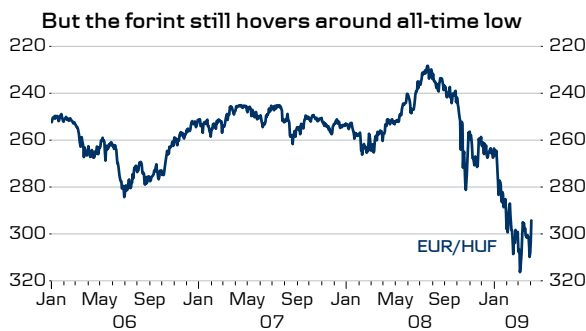
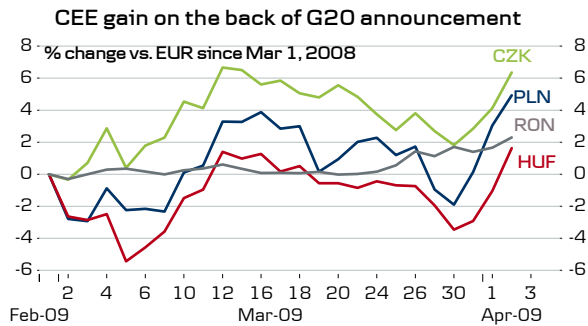
EMEA

Support for AK Party down, but election victory should secure IMF deal

Turkey

- Most political parties would have been very happy with the level of support that Turkey's ruling party, the Islamist oriented AKParty, received in Sunday's local election. However, we are pretty sure that Prime Minister Recep Tayyip Erdogan is secretly disappointed with the figure of 39%, as opinion polls were indicating close to 50% support for AKP.
- The "disappointing" showing in the local elections by AKP can be attributed to a number of factors, but in our view the sharp drop in economic activity has played a key role. Furthermore, it is clear that the weak performance in especially Ankara and Istanbul where local factors undoubtedly played a role, was another major factor.
- We think that the election results should be seen as a "warning" to AKP that the Turkish voters are worried about the state of the economy and that the government should focus on economic issues more than other issues. Therefore, we don't think the election results make it less likely that Turkey will reach an agreement with the IMF about a loan package. In fact, the result could turn out to be positive for such an agreement, if the AKP is "forced" to focus more on economic issues.

FX update



Source: Ecwin, Reuters - updated 19 March 2009

G20 communiqué is good news for emerging markets

As written in the editorial on the first page, the result of the G20 meeting was a positive surprise for emerging markets. We have seen most emerging markets rise on the back of the news coming out of the G20 meeting. Overall we think that the G20 brought good news for the CEE/EMEA in general and we therefore have adjusted our PLN, RON, CZK, HUF, ZAR and TRY forecasts in a slightly more positive direction as a direct consequence of the result of the G20 meeting - see our updated FX forecasts on page 10.

CEE

We adjust our FX forecasts for the region such that they still reflect our relative story for the region. We expect that the Czech koruna will outperform its peers. We are still looking for some nervousness regarding the Polish zloty, but downside is probably being limited by potentially easier access to credit via the IMF. We are still fairly bearish on the Hungarian forint and the Romanian leu. Both countries struggle with large financial distress, and the presence of the IMF is no guarantee that the currencies will not weaken further. Market participants are wary about more downgrades and rising supply of government bonds.

MEA

TRY and ZAR have had a fairly good run over the past three to four weeks, and that trend could have further to go if global risk appetite improves further. We see most downside risk for the South African rand, while the Turkish lira could stabilise on the back of an expectation of a new IMF package. Some market participants speculate that the South African central bank (SARB) could actually start to intervene to weaken the rand at USD/ZAR 9.00. We are not fully convinced about this prediction; however, SARB could be interested in building up FX reserves.

CIS

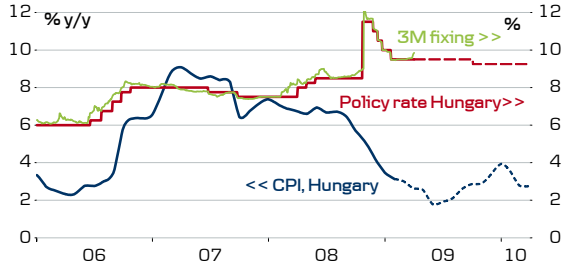
The rouble is trading at strongest levels against the basket since the end of January on higher oil prices and improved risk appetite (RUB/basket at 38.50).

We see limited short-term risks for the rouble, but the CBR might continue to stave off RUB appreciation by selling rouble in the FX market and thus build up FX reserves. We are currently considering adjusting our rouble forecast in a less negative direction.

Fixed income update

Hungary

No room for cutting despite better inflation outlook



Costly downgrade, as investors fears junk bond status
Hungarian swap rates

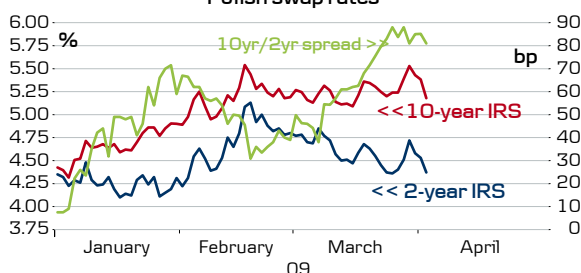


Is the Hungarian swap curve in for a steepener?
Hungarian swap curve



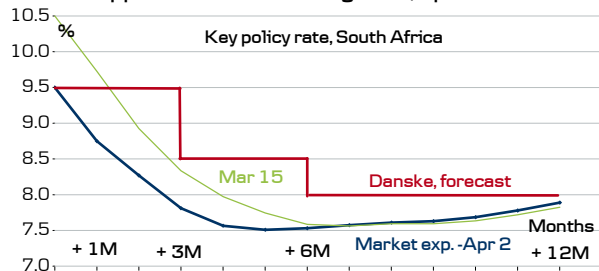
Poland

Polish swap curve steepened in recent weeks
Polish swap rates



South Africa

FRAs dropped in short-term segment, up to 6 months



Source: Ecwin, Reuters - updated 02 April 2009

Hungarian markets troubled by downgrade

This week the Standard & Poor's rating agency lowered Hungary's long-term foreign and local currency issuer credit rating to 'BBB-' from 'BBB' - see [Flash Comment - Hungary: S&P downgrades Hungary - outlook negative](#), 30 March. Hence Hungary's rating is now only one notch from junk status. The S&P kept a negative outlook citing concerns over the fiscal outlook in the midst of expectations of a very sharp recession in 2009.

The downgrade was not unexpected, even though most watchers had not expected it to be delivered before the appointment of a new government. Hence, in this light, higher swap rates seems like a fair market reaction. Market participants are becoming increasingly worried about the outlook that Hungarian government credit will be attached 'junk' status. Going forward the rating agency's decision should effectively close the door for further monetary easing from the Hungarian central bank (MNB) in the coming months despite a much improved inflationary outlook. The MNB will have to tread carefully with local markets being rattled about the economic outlook. The IMF would most likely support a tight monetary stance too. We are looking for a 50bps cut to be delivered in the early autumn. We expect the Hungarian swap curve could steepen somewhat, driven by higher long-term rates amid more stable short-term rates.

Downside for Polish rates limited by the ECB

ECB disappointed the markets yesterday by only cutting the refi rate 25bp to 1.25%, keeping the door open for a final cut. That lifted European rates and yields amid lower rates in Poland on the back of the G20 communiqué. Hence Polish/European swap spreads narrowed. Going forward we see limited downside for two-year polish swap rates, and we expect to 10-year rates to follow the long end of the Euroland curve. It is increasingly our conviction that European bond yields are in a bottoming phase and will be heading higher over the next 3-6 months as economic indicators improve.

Short rates are priced for aggressive cuts, SA

Over recent weeks short-term rates have moved lower in South Africa. Market pricing currently suggests 200bp worth of rate cuts within the next six months. This is 50bp more than we expect. In 6-12 months FRAs factor in some risk of the cutting cycle being reversed.

FX forecasts

Currency Forecast, New Europe/EMEA						
Apr - 3, 2009		EUR	USD	SEK	NOK	DKK
USD	Actual	1.34	-	806.1	658.2	555.0
	+3m	1.24	-	887	694	601
	+6m	1.20	-	883	692	621
	+12m	1.22	-	803	672	611
PLN	Actual	4.41	3.28	245.5	200.4	169.0
	+3m	4.65	3.75	237	185	160
	+6m	4.70	3.92	226	177	159
	+12m	4.70	3.85	209	174	159
HUF	Actual	295.4	220.1	3.66	2.99	2.52
	+3m	310	250	3.55	2.77	2.40
	+6m	320	267	3.31	2.59	2.33
	+12m	325	266	3.02	2.52	2.30
CZK	Actual	26.5	19.7	40.8	33.4	28.1
	+3m	27.2	21.9	40.4	31.6	27.4
	+6m	27.3	22.8	38.8	30.4	27.3
	+12m	27.4	22.5	35.8	29.9	27.2
EEK	Actual	15.6	11.7	69.1	56.5	47.60
	+3m	15.7	12.6	70.3	55.0	47.6
	+6m	15.7	13.0	67.7	53.0	47.6
	+12m	15.7	12.8	62.6	52.4	47.7
LVL	Actual	0.71	0.53	1524.8	1245.1	1049.8
	+3m	0.70	0.56	1571	1229	1064
	+6m	0.70	0.58	1514	1186	1064
	+12m	0.70	0.57	1400	1171	1066
LTL	Actual	3.45	2.57	313.3	255.8	215.7
	+3m	3.45	2.78	319	249	216
	+6m	3.45	2.88	307	241	216
	+12m	3.45	2.83	284	238	216
RON	Actual	4.20	3.13	257.5	210.3	177.3
	+3m	4.60	3.71	239	187	162
	+6m	4.70	3.92	226	177	159
	+12m	4.80	3.93	204	171	155
BGN	Actual	1.96	1.46	553.9	452.3	381.4
	+3m	1.96	1.58	563	440	381
	+6m	1.96	1.63	542	425	381
	+12m	1.96	1.60	501	419	382
TRY	Actual	2.14	1.59	506.0	413.2	348.4
	+3m	2.20	1.77	500	391	339
	+6m	2.30	1.92	461	361	324
	+12m	2.35	1.93	417	349	317
RUB	Actual	44.9	33.4	24.1	19.7	16.6
	+3m	50.3	40.6	21.8	17.1	14.8
	+6m	50.9	42.4	20.8	16.3	14.6
	+12m	53.7	44.0	18.3	15.3	13.9
UAH	Actual	10.80	8.05	100.1	81.8	68.9
	+3m	11.78	9.50	93	73	63
	+6m	12.00	10.00	88	69	62
	+12m	12.20	10.00	80	67	61
ZAR	Actual	12.22	9.10	88.5	72.3	61.0
	+3m	12.15	9.80	91	71	61.3
	+6m	12.24	10.20	87	68	60.9
	+12m	12.44	10.20	79	66	59.9

Source: Bloomberg and Danske research forecasts

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