DANSKE RESEARCH

Danske Markets

Investment Research

19 June 2009

New Europe Weekly

Uncertainties building up in Russia

Russian financial markets have stabilised in the last four months driven by renewed risk appetite in the midst of hopes of green shoots appearing in the global and Russian economies. This led to a doubling of the value of Russian equity markets and pushed the rouble around 10% stronger against the dual currency basket as oil prices advanced. Interest rates fell steeply too as the liquidity situation improved.

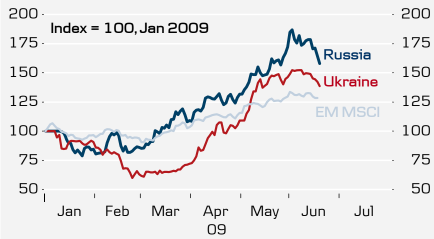
However, **the economic outlook is uncertain, which increases financial risks.** Data this week showed that Russian industrial output dropped 17.1% y/y in May, setting a new record low. Wage arrears are now affecting more than half a million workers and unemployment continues to rise. With high inflation and poor labour market dynamics the demand side of the economy has still not stabilised. Hence the outlook is rather uncertain, also taking into account large financial risks and high external repayments this year. We expect that Russian GDP to drop up to 8% in 2009, while staying relatively flat in 2010 (+ 0.5% y/y).

The economic recovery will only be gradual and if oil prices drop significantly the rouble will come under immediate pressure. A move down in oil prices towards USD 50/barrel would push the rouble towards the weak level of the trading band (basket/RUB 41) – 8-9% weaker than today's level. **Based on an strong rouble and lower interest rates we recommend hedging all short to medium term rouble risks.**

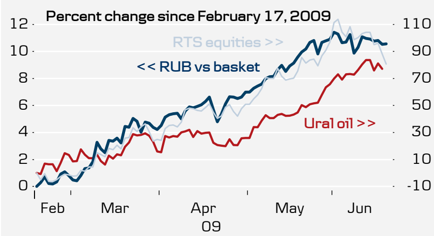
Key points for next week

- Busy week ahead in terms of rate decision meetings and economic data.
- We look for unchanged rates in Hungary (9.50%) and the Czech Republic (1.50%).
- We expect lower rates in Poland (-25bp to 3.50%) and South Africa (-50bp to 7.00%).
- Inflation data for Poland and South Africa.
- Retail sales data for Hungary, Lithuania and Poland.
- Baltic States: coordinated action in fiscal tightening.

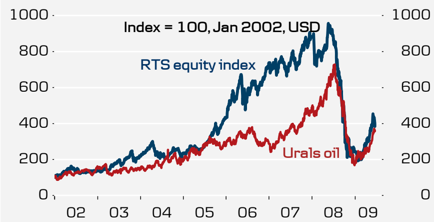
CIS equities have performed well recently



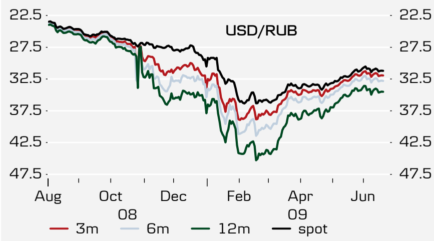
Higher oil prices support markets



High historical correlation



RUB hedging costs are lower



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Calendar

EMEA Data and Events in Week26

Monday, June 22, 2009				Period	Danske Bank	*Consensus*	Previous
EEK	8:00	Producer prices	y/y	May			0.0%
LTL	10:00	Industrial production	y/y	May	-20.0%		-25.5%
PLN	14:00	Net core inflation	y/y	May		*2.7%*	2.6%
HUF	**14:00**	**Central Bank meeting (rate decision)**			**9.50%**	***9.50%***	**9.50%**

Tuesday, June 23, 2009				Period	Danske Bank	*Consensus*	Previous
TRY	9:00	Foreign tourist arrivals	y/y	May			-6.2%

Wednesday, June 24, 2009				Period	Danske Bank	*Consensus*	Previous
CZK	-	15-year government bond auction					
PLN	**-**	**Monetary Policy Council meets**	**%**		**3.50%**	***3.50%***	**3.75%**
ZAR	**11:30**	**CPI**	**y/y**	**May**	**8.0%**	***7.9%***	**8.4%**

Thursday, June 25, 2009				Period	Danske Bank	*Consensus*	Previous
CZK	**-**	**Monetary policy meeting**	**%**		**1.50%**	***1.25%***	**1.50%**
ZAR	**-**	**Monetary Policy Council Meeting**	**%**		**7.00%**	***7.00%***	**7.50%**
HUF	9:00	Retail trade	y/y	Apr	-6.5%	*-4.4%*	-3.6%
PLN	10:00	Retail sales	y/y	May	-2.2%	*-0.1%*	1.0%
PLN	10:00	Unemployment	%	May	10.8%	*10.8%*	11.0%
ZAR	11:30	Producer prices	y/y	May	-1.8%	*-1.8%*	2.9%

Friday, June 26, 2009				Period	Danske Bank	*Consensus*	Previous
EEK	8:00	Trade balance	bn. CZK	Apr			-1.6
LTL	10:00	Retail trade	y/y	May	-25.1%		-29.7%

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

Source: Danske Research

Danske Markets

Market update

Latvian fears eased but sentiment still nervous

- Short-term fears concerning a Latvian devaluation eased at the start of this week as the Latvian parliament passed the revised 2009 budget. The IMF and EU endorsed the fiscal austerity bill afterwards – see *IMF statement* – but there is still no news about when the next tranche (EUR 1.7bn) of the international loan will be paid out to Latvia. Short-term LVL interest rates eased markedly following levels above 100% last week. However. during the week LVL short rates rose back up to the 30–40% level, driven by demand for short liquidity ahead of the next reserve maintenance period – ending 23 June.

- The overall sentiment in EMEA FX-markets turned more sour this week as global equity markets dropped during the week and EUR/USD fell more than 2%. Most CEE FX-rates are 1-2% lower against the euro. ZAR looks fragile as the C/A deficit did not improve, and TRY has been pushed a little on rising geopolitical risks. We are still waiting to hear about whether Turkey will opt for an IMF loan.

- **Notable is the underperformance of the Polish zloty** not only last week, but also during the month. Fundamentally there are no strong reasons for the zloty to underperform both HUF and RON, but it is rather market driven as PLN markets are most liquid. Hence short PLN positions are an easy way to hedge CEE exposure.

- **The Czech koruna outperformed its peers last week and month**. This week CZK is roughly 1% stronger against EUR –due to its defensive nature. Going forward we expect CZK to continue its outperformance if risk aversion creeps higher.

- **Rouble is fairly stable over the last week** despite more negative news on the economic front. Going forward RUB could weaken if oil prices drop.

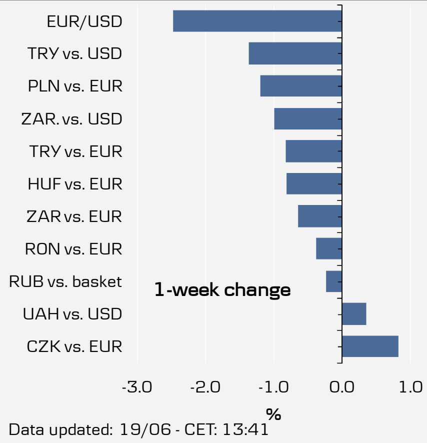
Plenty of rate decision meetings next week

- Weak Polish data this week (see *comment*) increase the chance of **a final 25bp cut in Poland**, which would bring the key rate down to 3.50% y/y. Both consensus and we expect a cut. **We do not expect that the Czech central bank (CNB) will lower its key rate** further – currently at 1.50%, but there is a small chance that CNB lowers its key rate by 25bp to 1.25% on the back of the slumping economy.

- **In Hungary the central bank (MNB) does not have any room to cut rates in the near term.** Hungary, which last fall secured an IMF loan, has to pursue a cautious rate policy, IMF officials said this week. We share this view and find it hard to justify rate cuts this year – as markets are pricing – unless Hungarian financial markets stabilise and EUR/HUF moves significantly lower. Furthermore, inflation is still rather certain. We still like betting on higher rates in Hungary.

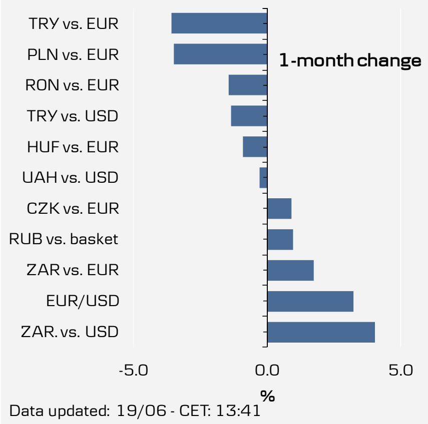
- **The South African central bank (SARB) is expected to lower its key rate by another 50bp to 7.00%** on the back of the slumping economy. The rate cut should mark the final cut in the current easing cycle. Carry-to-risk – measured as three-month interest rate differential to the US divided by implied USD/ZAR volatility indicates value in long ZAR positions. We would rather position ourselves for a sharp rise in USD/ZAR in the coming months.

EUR weakness and risk aversion



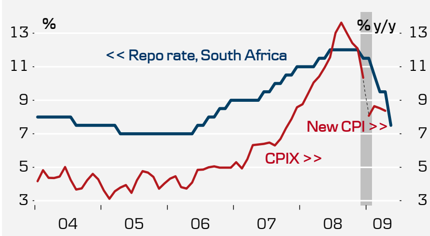
Source: Reuters Ecowin and Danske Markets

ZAR outperforms in latest month



Source: Reuters Ecowin and Danske Markets

A final cut from SARB



Source: Reuters Ecowin and Danske Markets

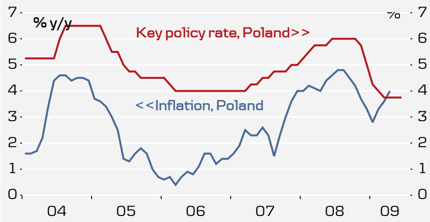
CEE: Inflation remains above target in Poland

Poland

- Inflation has come down significantly in recent months, but there are signs that it is beginning to stabilise at the current level, which means that inflation on average will be around 3.5% y/y in 2009. This has so far led to monetary easing from the Polish central bank (NBP). The NBP has cut its key policy rate by a total of 225bp since August last year. Even though the key policy rate was unchanged at the recent MPC meeting, the bank maintained an easing bias in monetary policy so the door is still open for further monetary easing.

- In addition, despite the fact that rates are likely to remain at 3.5-4.0% for some months and hence above the NBP's inflation target of 2.5% +/- 1 percentage point, a number of NBP officials have recently indicated that further monetary easing could be on the cards. Both wage growth and inflation have recently surprised on the downside further strengthening the argument for further monetary easing. We therefore now expect the NBP to cut its key policy rate by 25bp to 3.50% at next week's monetary policy council meeting, which is likely to be the last rate cut in this easing cycle.

Inflation above central bank's target



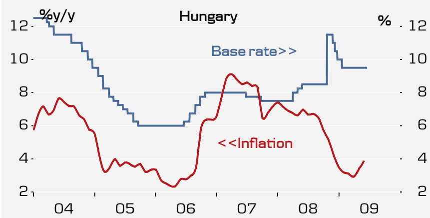
Source: EcoWin Reuters

Hungary

- After a period of decline Hungarian inflation is heading upward again. Despite the deep recession inflation rose to 3.4% y/y in April and the outlook for a significant VAT hike later in the year, we now expect average Hungarian inflation at 4.8% y/y for 2009. This effectively closes the door on further monetary easing in Hungary.

- Furthermore, the MNB is concerned that the sell-off in the forint could rattle the already fragile Hungarian financial system. Therefore we expect the MNB to continue its wait-and-see stance in monetary policy for some time and to keep its key policy rate unchanged at 9.50% at Monday's Monetary Council meeting.

Inflation is heading up

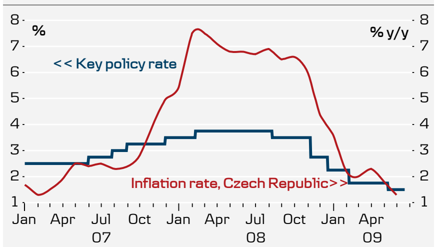


Source: EcoWin Reuters

Czech Republic

- Next week the Czech central bank (CNB) will decide whether the Czech interest rates will go down further or whether they will be kept on hold. The latest economic indicators show that the Czech economy has not stabilised yet, which leaves room for further monetary easing. The possibility of another rate cut has increased this week after CNB board member Robert Holman - who usually advocates interest rates stability - said that he may have to vote in favour of a rate cut. His comments are especially interesting as he was one of the two board members who voted for unchanged interest rates at the last monetary policy meeting in early May. It is important to mention that CNB vice-governors Mojmir Hampl and Miroslav Singer who might vote for further rate cuts will not attend the monetary policy meeting next week. To conclude, even though the chance of yet another 25bp rate increased this week and is fairly high, we stick to our forecast and expect the key policy rate to remain unchanged at 1.50% at next week's monetary setting meeting. Consensus changed this week from unchanged to 25bp rate cut.

Will the CNB cut again?



Source: EcoWin Reuters

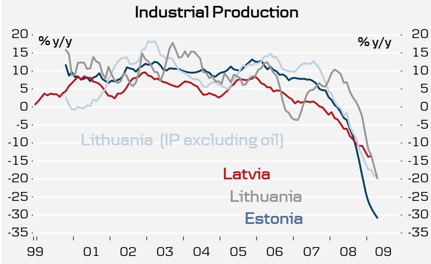
Baltic States: Coordinated action in fiscal tightening

Estonia

- Industry confidence indicators in Estonia turned positive this month. This does not indicate a sustainable improvement of Estonian economy: economic activity is still weak and industrial production continues to fall. The Estonian central bank sticks to its forecast of economic downturn of 12.3% y/y in 2009. The central bank stated that the development of the Estonian economy so far has been broadly in line with the base scenario but that "in real terms, there have not been significant improvements yet". In our base scenario we expected a 15.8% y/y decline this year. We believe that risks to our forecast are mostly balanced and depends on the external outlook.

- **Parliament in Estonia approved plan to increase VAT rate to 20%** and it is also expected to approve the raise in the excise duties of fuel and alcohol and cut sickness benefits. This will put some more upside pressure on consumer prices development but, judging from the Lithuanian experience, this will not have a long-lasting effect.

Industrial production in free fall



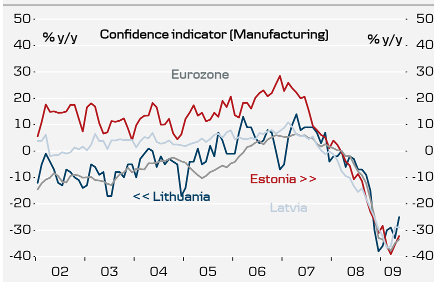
Source: Reuters Ecowin

Lithuania

- **Lithuania's industrial confidence indicator rose** to minus 25 in May from minus 33 in April, which might indicate that the decline in industrial production in May was slightly slower. Taking into account this improvement, we expect industrial production to decline to 20.0% y/y compared with a decline of 25.2% y/y in April. However, all risk is on the downside as expectations about export orders in May remained at the same level as in April and upside in employment is limited due to still high unemployment fears. Lithuanian consumer confidence improved only marginally in May and we do not expect retail trade to improve significantly in May; we forecast a decline of 25.1% (in April the drop was around 30% y/y).

- **Lithuanian Ministry of Finance lowered its economic forecast significantly**. It now predicts GDP to plunge 18.2% y/y in 2009, which is currently the most pessimistic forecast in the market. The government intends to implement more fiscal tightening by raising VAT to 21% and cutting current expenditures. Still, we stick to our previous forecast of a decline of 16% on average in 2009, but our forecast is clouded by considerable uncertainty and immediate downside risks mostly related to expected fiscal tightening and external outlook worsening.

Marginal improvement in confidence

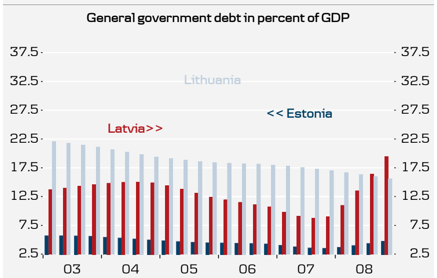


Source: Reuters Ecowin

Latvia

- Next week's Latvian economic data calendar is generally uneventful. Last week Latvia's lawmakers approved budget cuts of around EUR 720m, which was good news as it probably will open the door for the pay-out of the next installment on the IMF loan. All Baltic states implemented a significant tightening of the fiscal policy. The Baltic states finally "harmonised" indirect taxes, which is relatively good news for the retailers as it reduces tax competition. However, this is not the last hike or cut as the outlook remains weak and new discussions will be needed about a budget for next year.

Public finances are under pressure



Source: Reuters Ecowin

CIS: Flirting with OPEC

Russia

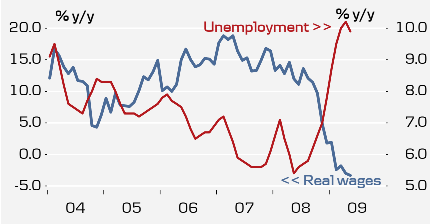
- **Russian industrial output dropped 17.1% y/y in May** (-16.9% y/y in April), setting a new record low for the second consecutive month. Hence, even though PMIs have advanced in the last quarter, industrial activity has yet to stabilise. Meanwhile data show that Russian wage arrears rose to a 3-1/2 year high in May. Wage arrears, now affecting half a million people, rose to USD 280m on 1 June. These data enforce our view that the Russian economy still has not stabilised. So even though unemployment (surprisingly) dropped to 9.9% in May, we still expect the unemployment rate to rise further in the coming months, exerting more pressure on public finances.

- Data showed that Russia's FX-reserve dropped for the first week in six weeks, shrinking USD 2.9bn as the central bank (CBR) stopped intervening to avoid a stronger rouble in the midst of rising oil prices. Russia's reserves were USD 406.6bn on 12 June.

- **Plenty of interesting statements from Russian officials this week.** Russian President Medvedev said that the world needs new reserve currencies, and that they are not happy with the existing reserve currencies, including the dollar. He then warned that the world economy does not need currency turbulence and the Kremlin was calling for a cautious approach to global currencies. Medvedev added that the world will witness the creation of a supranational currency - whatever that means.

- Russia and China agreed this week to boost the use of their national currencies, rouble and yuan, in bilateral trade. Further, high ranking officials indicated that Russia could be thinking about joining OPEC, as this could provide OPEC with more control over oil prices – Russia produces about 10% of the total world oil output.

Labour market dynamics negative



Source: Reuters Ecowin and Danske Markets

Industrial activity closer to a trough

Source: Reuters Ecowin and Danske Markets

Ukraine

- Currently discussions are held about the date for the presidential elections. It looks likely that they will be held on 17 January 2010 – despite PM Tymoshenko's allies calling for an earlier date.

- Production in basic economic sectors dropped 29.4% in May, the Ukrainian central bank (NBU) said this week. This was worse than in April when it dropped 28.5%, so the trend towards improving the index, observed in February-April, has been interrupted.

Kazakhstan

- The foreign debt of the BTA bank will be restructured as of 1 August, Finance Minister Bolat Zhamishev has said. Negotiations with the bank's foreign creditors are in progress. Once the restructuring has been completed the bank will be fully solvent, he said, and it will be offered to a strategic investor.

Danske Markets

EMEA: Political tensions in Turkey

Turkey

- On Monday the liberal Turkish daily Taraf ran a story about alleged plans by the Turkish military to destabilise the Turkish government. On Tuesday the Turkish Prime Minister Tayyip Erdogan met with army chief General Ilker Basbug to discuss the alleged military plan in an extraordinary meeting in Ankara.

- In a comment to the news reports Erdogan said: **"The printed document includes an initiative that aims to destroy democracy”**. There is no doubt that the Turkish government is taking this seriously and that political risk is once again on the rise in Turkey. Until now the Turkish markets have been relatively unaffected by the rising political tensions, but that might change in the coming weeks.

Turkish inflation continues to fall

Source: Reuters EcoWin

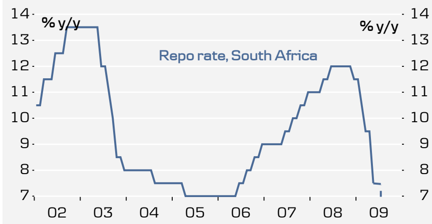
South Africa

- Interesting week ahead in South Africa with inflation first and monetary policy setting meeting the day after.

- Inflation remains stubbornly high, well above the South African central bank’s (SARB) inflation target range of 3%-6%. Inflation for May, which is due for release next week, is expected to drop, albeit only moderately. We expect May’s inflation to drop to 8.0% y/y, down from 8.4% y/y in April. Consensus sees a slightly larger decline of 7.9% y/y.

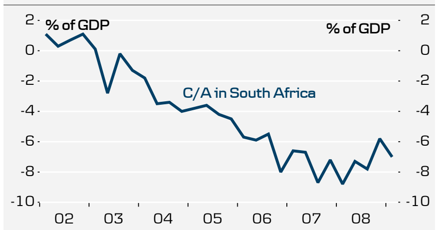
- Given the stickiness of inflation and as indicated in the last MPC statement the committee is not in the mood for further significant cuts (?). We - in line with consensus - expect a 50bp rate cut at next week’s MPC meeting, which would bring the key policy rate down to 7.00%. After that we could talk about the end of the easing cycle or perhaps one minor rate cut, but we do not expect any further aggressive monetary easing going forward, especially given the high inflation, but also given the currency risks from the large current account deficit (Q1 current account deficit came out much worse than expected at -7.0%).

SARB will continue monetary easing



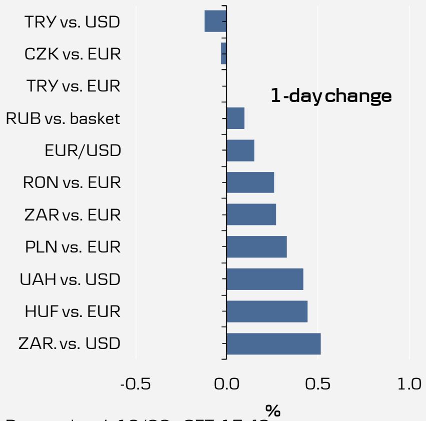
Source: Reuters EcoWin

Current account deficit widens



Source: EcoWin Reuters

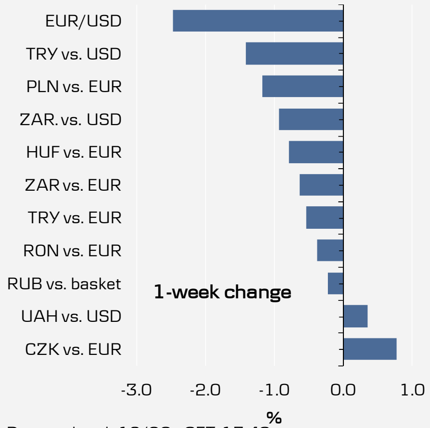
One-day FX-Performance



Data updated: 19/06 - CET: 13:42

Source: Reuters EcoWin

One-week FX-performance



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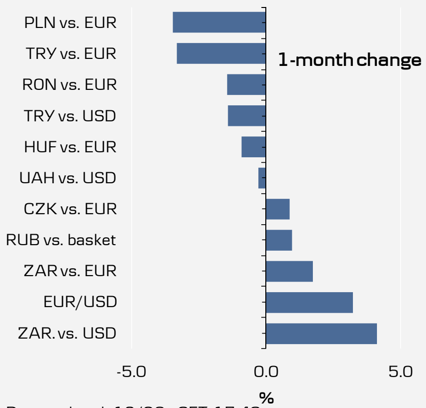
Source: Reuters EcoWin

One-month FX-performance



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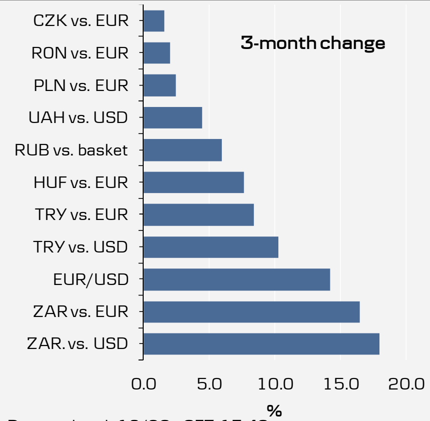
Source: Reuters EcoWin

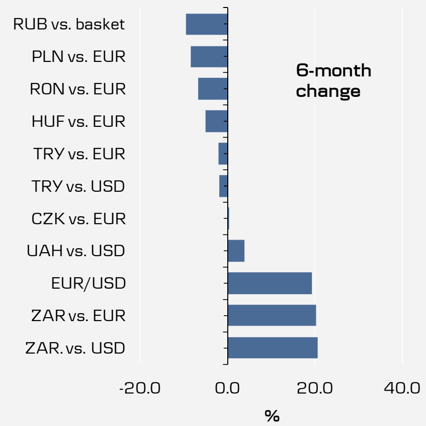
Three-month FX-performance



Data updated: 19/06 - CET: 13:42

Source: Reuters EcoWin

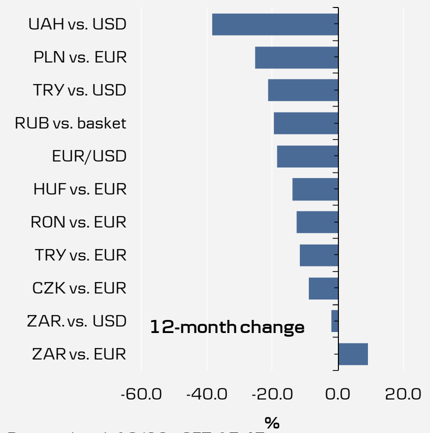
Six-month FX-performance



Data updated: 19/06 - CET: 13:43

Source: Reuters EcoWin

12-month FX-performance



Data updated: 19/06 - CET: 13:43

Source: Reuters EcoWin

FX forecasts

Currency Forecast, New Europe/EMEA

Jun - 19, 2009		EUR	USD	SEK	NOK	DKK
USD	Actual	1.39	-	785.2	638.9	534.0
	+3m	1.39	-	755	612	536
	+6m	1.44	-	708	576	517
	+12m	1.40	-	714	586	533
PLN	Actual	4.52	3.24	242.4	197.2	164.9
	+3m	4.50	3.24	233	189	166
	+6m	4.55	3.16	224	182	164
	+12m	4.60	3.29	217	178	162
HUF	Actual	280	200.6	3.91	3.19	2.66
	+3m	300	216	3.50	2.83	2.48
	+6m	305	212	3.34	2.72	2.44
	+12m	310	221	3.23	2.65	2.41
CZK	Actual	26.4	18.9	41.5	33.8	28.2
	+3m	27.0	19.4	38.9	31.5	27.6
	+6m	26.8	18.6	38.1	31.0	27.8
	+12m	26.8	19.1	37.3	30.6	27.8
EEK	Actual	15.6	11.2	70.0	56.9	47.58
	+3m	15.7	11.3	67.1	54.3	47.6
	+6m	15.7	10.9	65.2	53.0	47.6
	+12m	15.7	11.2	63.9	52.4	47.7
LVL	Actual	0.70	0.50	1570.7	1278.1	1068.3
	+3m	0.70	0.50	1500	1214	1064
	+6m	0.70	0.49	1457	1186	1064
	+12m	0.70	0.50	1429	1171	1066
LTL	Actual	3.45	2.48	317.0	257.9	215.6
	+3m	3.45	2.48	304	246	216
	+6m	3.45	2.40	296	241	216
	+12m	3.45	2.46	290	238	216
RON	Actual	4.22	3.03	259.3	211.0	176.3
	+3m	4.30	3.09	244	198	173
	+6m	4.40	3.06	232	189	169
	+12m	4.60	3.29	217	178	162
BGN	Actual	1.96	1.40	559.5	455.3	380.5
	+3m	1.96	1.41	537	435	381
	+6m	1.96	1.36	522	425	381
	+12m	1.96	1.40	512	419	382
TRY	Actual	2.17	1.56	504.9	410.8	343.4
	+3m	2.20	1.58	477	386	339
	+6m	2.25	1.56	453	369	331
	+12m	2.30	1.64	435	357	324
RUB	Actual	43.4	31.1	25.2	20.5	17.2
	+3m	46.7	33.6	22.5	18.2	16.0
	+6m	49.2	34.2	20.7	16.9	15.1
	+12m	49.8	35.6	20.1	16.5	15.0
UAH	Actual	10.58	7.59	103.5	84.2	70.4
	+3m	12.51	9.00	84	68	60
	+6m	14.40	10.00	71	58	52
	+12m	15.40	11.00	65	53	48
ZAR	Actual	11.31	8.11	96.8	78.7	65.8
	+3m	11.82	8.50	89	72	63.1
	+6m	12.96	9.00	79	64	57.5
	+12m	12.88	9.20	78	64	57.9

Source: Danske Markets

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All EM research is available on Bloomberg DDEM

Disclosure

This report has been prepared by Danske Research, which is part of Danske Markets, a division of Danske Bank. Danske Bank is under supervision by the Danish Financial Supervisory Authority. The author of the report is Lars Christensen, Chief Analyst.

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First date of publication

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