30 October 2009

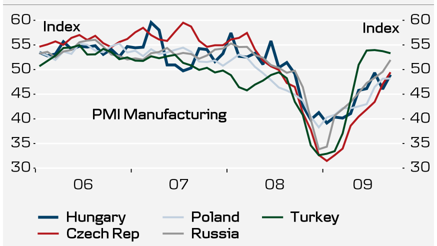
New Europe Weekly

On a knife-edge for the EMEA markets

PMI inches up across the region, but who cares?

Next week will see PMI data for October for most countries across central and eastern Europe (CEE). In the recent month the PMI has rebounded across the region in line with the general global trend. We expect the PMI to have increased further from September to October in most countries in the region and in most countries the PMI will now have moved back to around or even above 50, indicating expanding economic activity in the CEE manufacturing sector. This is good news, but we doubt that this will get much attention in the CEE markets as other issues – primarily the ongoing market correction in CEE markets will dominate market sentiment going into next week.

PMI to inch higher



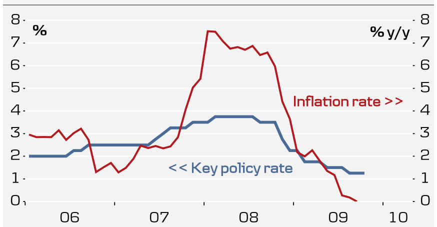
Source: Reuters Ecowin and Danske Markets

Inflation to drop in Turkey and Russia

Turkish October inflation data could attract some attention. Lacklustre economic activity and strong base effects will push inflation to a new record-low of 4.3% y/y. However, according to our models inflation will bottom out in October and then gradually rise to around 6% in Q2 09. Hence we see limited room for more rate cuts.

In Russia, we expect inflation to move down to single-digit territory, as we expect October inflation to drop to 9.7% y/y. The inflation outlook turned more benign and we see room for more rate cuts from the Russian central bank in the coming months.

CNB to cut rates



Source: Reuters Ecowin and Danske Markets

Fixed income outlook

As the calendar looks fairly thin in the coming week, FX markets are likely to be the key driver for fixed income markets next week. Turkish October inflation could attract some attention.

FX outlook

Our EMEA FX scorecard continues to send the most negative signals for the Hungarian forint and the South African rand, we continue to see the largest risks in these two currencies.

If the negative correction continues into next week it will likely hit all currencies in the region and it is unlikely that there will be any real safe havens. That said the scores for both the Polish zloty and the Czech koruna have moved back into more neutral territory in our EMEA FX scorecard, which indicates that these two currencies will outperform HUF and ZAR going into next week.

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Calendar

EMEA Data and Events in Week45

Monday, November 2, 2009				Period	Danske Bank	Consensus	Previous
HUF	-	PMI	Index	Oct	49.5		49.0
CZK	-	Budget balance	bln. CZK	Oct			-87.3
PLN	-	PMI	Index	Oct	49.3		48.2
RUB	6:30	PMI	Index	Oct	53.0		52.0
TRY	9:00	PMI	Index	Oct			
CZK	9:30	PMI	Index	Oct	50.0		49.5
ZAR	10:00	PMI	Index	Oct	48.5		48.0

Tuesday, November 3, 2009				Period	Danske Bank	Consensus	Previous
RUB	**-**	**CPI**	**y/y**	**Oct**	**9.7%**		**10.7%**
RON	**-**	**Central bank meeting (rate decision)**	**%**		**8.00%**	***8.00%***	**8.00%**
ZAR	10:00	Naamsa vehicle sales	y/y	Oct			-22.4%
LVL	12:00	Industrial production	y/y	Sep	-15.5%		-12.5%
TRY	**16:00**	**CPI**	**y/y**	**Oct**	**4.3%**	***4.6%***	**5.3%**
TRY	16:00	PPI	y/y	Oct	1.1%	*1.0%*	0.5%

Wednesday, November 4, 2009				Period	Danske Bank	Consensus	Previous
HUF	**14:00**	**Central bank releases Minutes from monetary policy meeting**					

Thursday, November 5, 2009				Period	Danske Bank	Consensus	Previous
CZK	**-**	**Monetary policy meeting (rate announcement)**	**%**		**1.00%**	***1.25%***	**1.25%**
HUF	9:00	Industrial production (flash estimate)	y/y	Sep			-19.8%
HUF	17:00	Budget balance	bln. HUF	Oct			-145.7

Friday, November 6, 2009				Period	Danske Bank	Consensus	Previous
EEK	**8:00**	**CPI**	**y/y**	**Oct**	**-2.0%**		**-1.6%**
CZK	9:00	Trade balance	bln. CZK	Sep			10.6
HUF	9:00	Trade balance	m. EUR	Sep			254.3
LTL	10:00	PPI	y/y	Oct			-19.4%

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

Danske Markets

Source: Danske Markets

Fixed income market update

Review: FX sell-off pushes yields up

The sell-off in EMEA currency markets this week caused some significant pressure on market rates in the region. This has been notable in **Hungarian markets**, where rates and yields are up roughly 30bp across the curve. After the movements this week markets are now priced less aggressively for Hungarian rate cuts (see charts next page). Where the pricing one week ago suggested that the Hungarian central bank (MNB) would cut its key rate at least another 100bp to below 6%, the terminal rate is now expected to be around 6.4-6.5%, which in our view is a fairer judgement of the outlook. We expect the cutting cycle to stop at 6.75%. In **Turkey** rates have risen even more sharply during the week, despite a stable currency. We judge that continued worries over withholding tax and worries over public debt roll-over in the coming quarters weighed on sentiment. Market pricing is now beginning to factor in that the Turkish central bank could begin to hike its key rate within the next six to 12 months. **In Czech and Polish markets rates are up roughly 10-15bp across the curves.** Overall market pricing of rate expectations in EMEA has, in our view, turned fairer over the past week, but we still believe especially Hungarian rates and yields are too low.

EMEA swap rate performance

2Y IRS	Mid level	1W chg - bp
CZK	2.43	16
HUF	6.76	33
PLN	4.99	13
RUB	8.60	5
TRY	8.90	40
ZAR	7.73	-10
5Y IRS	**Mid level**	**1W chg - bp**
CZK	3.17	13
HUF	6.81	29
PLN	5.59	13
RUB	8.95	-20
TRY	10.16	51
ZAR	8.61	-7

Source: Reuters Ecowin and Danske Markets

Russia still has room for lower rates

This week the Russian central bank once again cut its refinancing rates by another 50 basis points. The rate reduction was identical across all the regulator's instruments – both those designed to provide liquidity (repo, loans secured by non-tradable assets, overnight loans) and absorb it (deposits in the CBR). Even though we did not know the exact timing of this cut it comes as no surprise to us that the CBR carries on with the easing cycle. The currency has been stable since Q1 09 and economic activity shows no inflation pressure. Hence the inflation outlook turned more benign and meanwhile we expect to see quite large base effects around the new year, which could push inflation down to 7-8% by end Q1 10. Hence we see room for a further reduction in Russian rates in the coming months.

Policy rate outlook

	Spot	+3M	+6M	+12M
EUR	1.00	1.00	1.00	1.50
PLN	3.50	3.50	3.50	3.50
CZK	1.25	1.00	1.00	1.00
HUF	7.00	6.75	6.75	6.75
TRY	6.75	6.50	6.50	6.50
ZAR	7.00	7.00	7.00	7.50
RUB	9.50	9.00	8.50	8.50

Source: Reuters Ecowin and Danske Markets

Preview: FX markets in the driver's seats

As the calendar looks fairly thin in the coming week, FX markets are likely to be the key driver for fixed income markets next week too. However, the Turkish October inflation data could attract some attention. Lacklustre economic activity and strong base effects will push inflation to a new record-low of 4.3% y/y. However, according to our models inflation will bottom out in October and then gradually rise to around 6% in Q2 09. Hence we see limited room for more rate cuts.

Czech central to cut rates?

The outcome of the next week's monetary policy setting meeting in the Czech Republic remains highly uncertain. Contrary to the consensus expectations, which see interest rates on hold next week, we expect the Czech central bank to deliver another 25bp rate cut. Nonetheless, we must admit that risks that the CNB would keep interest rates on hold increased considerably over the past few weeks, as the correction of the CZK (it lost almost 2% in one week and over 4% over the past month) reduces pressure on the CNB to ease monetary conditions further. Despite a correction in CZK, CNB's inflation target of 3% will be undershot significantly this year. Furthermore, there is no real inflationary pressure going forward and we expect only a sluggish economic recovery next year. Hence we see room for further monetary easing. Decisive for the rate decision will be the new revised inflation and GDP forecast, which the CNB board will have available at the meeting. In our view, inflation for this year will be revised significantly down but also we expect GDP growth for both this and next year CNB to be revised in a more negative direction. In that respect a cut next week remains possible.

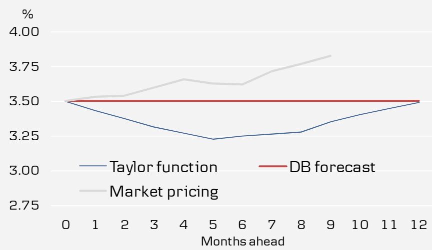
Fixed Income market update – II

Poland

Polish inflation outlook

Source: Reuters Ecowin and Danske Markets

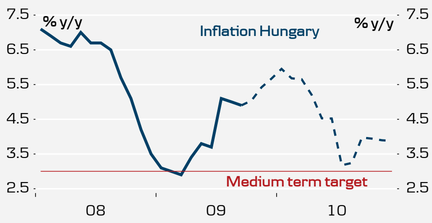
Policy rate outlook and pricing



Source: Reuters Ecowin and Danske Markets

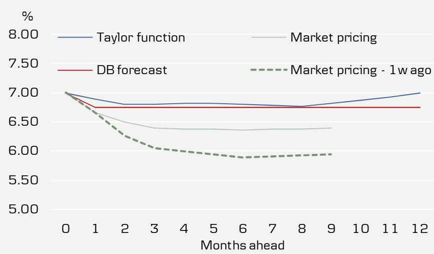
Hungary

Hungarian inflation outlook



Source: Reuters Ecowin and Danske Markets

Policy rate outlook and pricing



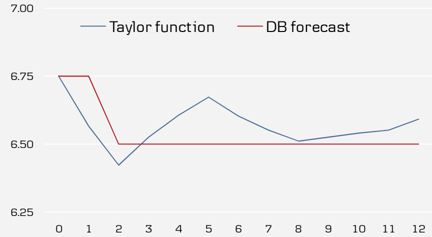
Source: Reuters Ecowin and Danske Markets

Turkey

Turkish inflation outlook

Source: Reuters Ecowin and Danske Markets

Policy rate outlook



Source: Reuters Ecowin and Danske Markets

FX market update

Review: Correction time

In last week's edition of *New Europe Weekly* we warned that the "carry protection" to a large extent had disappeared for most of the EMEA currencies and this was one of the main reasons why our EMEA FX scorecard on Tuesday turned negative on most currencies covered. As a consequence, on Tuesday, we published the comment *Correction time.* The warning has turned out to be correct, as we have subsequently seen a relatively sharp sell-off in most EMEA currencies.

To us the reasons for the negative correction are pretty clear. First, as mentioned, the carry on long positions in the EMEA has, to a large extent, disappeared and thereby reduced the attractiveness of the EMEA currencies. Second, most of the EMEA currencies have this week broken the key technical level. Third, the global financial and economic environment has worsened recently as stock markets have softened.

Hardest hit have been the Hungarian forint and the South African rand – both currencies have seen significant carry erosion and is normally quite sensitive to worsened global conditions.

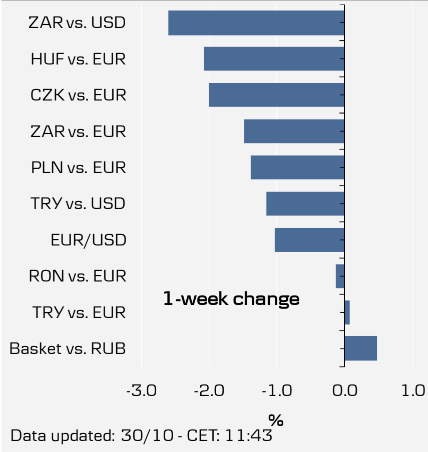
Preview: Still fragile EMEA markets

Toward the end of the week stronger than expected US GDP numbers for Q3 have brought a bit of stabilisation, but judging from our EMEA FX scorecard it might not be the end of the correction in EMEA FX markets and the correction could continue into next week – and might even accelerate if the we get more bad news out of some of the region's 'trouble spots', such as Latvia, Romania or the Ukraine, where the worries over the IMF deals threaten to send shock waves through the markets.

Our EMEA FX scorecard continues to send the most negative signals for the Hungarian forint and the South African rand – we continue to see the largest risks in these two currencies.

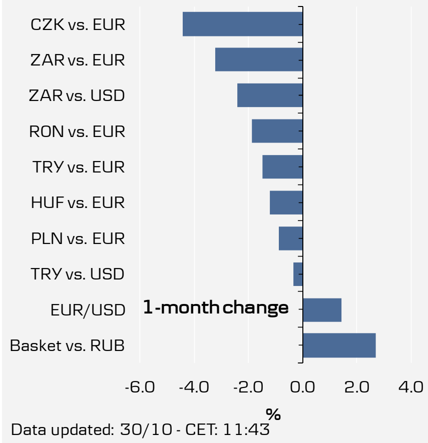
If the negative correction continues into next week it will likely hit all currencies in region and it is unlikely that there will be any real safe havens. That said the scores of both the Polish zloty and the Czech koruna have moved back into more neutral territory in our EMEA FX scorecard, which indicates that these two currencies will outperform HUF and ZAR going into next week.

FX performance – one-week



Source: Reuters Ecowin

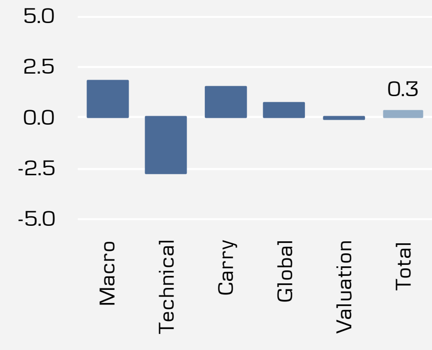
FX performance – one-month



Source: Reuters Ecowin

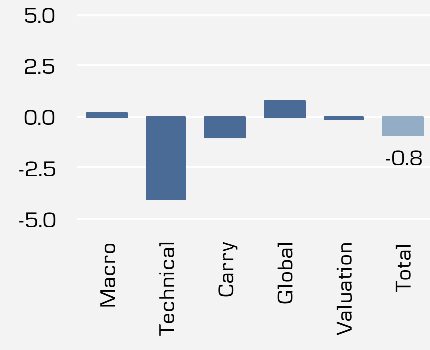
FX Score Card overview

Score – PLN



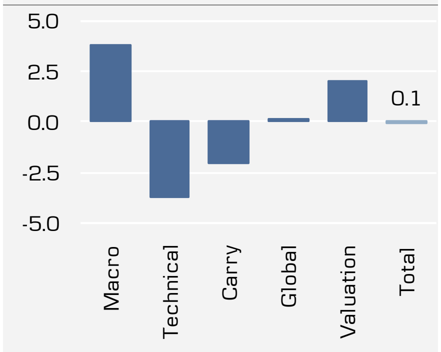
Danske Markets calculations

Score – HUF



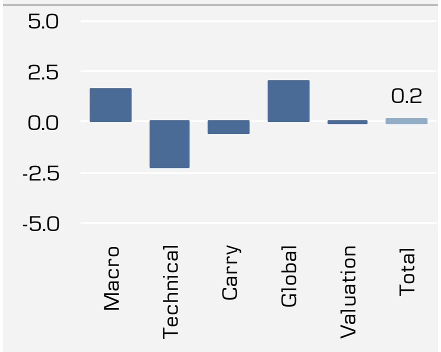
Danske Markets calculations

Score – CZK



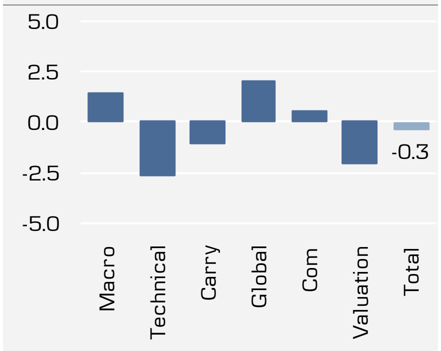
Danske Markets calculations

Score – TRY



Danske Markets calculations

Score – ZAR



Danske Markets calculations

EMEA FX scorecard outline

- All scores are computed so they score from +5 to -5. The score measures how far from a mean point the indicator is measured in standard deviation. A score is combined of different sub-scores.
- **Macro:** Calculates the growth momentum in different monthly macro indicators.
- **Technical:** Calculates the momentum in different volatility measures, short- and longer term moving averages and the level of relative strength index.
- **Carry:** Calculates the momentum in local three-month rates, carry-to-risk, spread against EUR or USD three-month rates and spread against peers.
- **Global:** Consists of a global growth score based on leading global indicators and hard macro data, a liquidity score based on the momentum in G3 real rates, a sentiment score based on performance in the global equity market and traditional funding currencies.
- **Valuation:** Calculates whether currencies are over/under valued compared with the long-term trend in the real effective exchange rate (REER). The trend is adjusted for external imbalances – i.e. an imbalance-adjusted REER. The scores are calibrated to reflect short-term impact of the valuation on the FX.

EM FX trading performance

Performance sheet

Danske EM FX Trading Recommendations

Open	Start date	Level	Now	Target	Stop	P/L (incl carry)	Comment
Recently closed	Start date	Level	Exit date	Level	P/L (incl carry)		
Buy EUR/HUF	*27/10/09*	*268.75*	*29/10/09*	*272.00*	*1.17%*		29/10 - stop raised to 272
Buy USD/ZAR	*27/10/09*	*7.58*	*29/10/09*	*7.72*	*1.81%*		29/10 - stop raised to 7.72
Hist. Performance							
# of trades since 2007		30	# of trades in 2009			6	
- average net gain		0.58%	- average net gain			-0.05%	
- batting average		0.60	- batting average			0.50	

Source: Danske Markets

Currency forecast, EMEA

Currency Forecast, New Europe/EMEA						
Oct 30.2009		EUR	USD	SEK	NOK	DKK
USD	Actual	1.48	-	700	565	502
	+3m	1.55	-	652	529	481
	+6m	1.50	-	653	540	497
	+12m	1.45	-	662	552	514
PLN	Actual	4.24	2.86	245	198	176
	+3m	4.10	2.65	246	200	182
	+6m	4.05	2.70	242	200	184
	+12m	4.00	2.76	240	200	187
HUF	Actual	273	184	3.81	3.07	2.73
	+3m	275	177	3.67	2.98	2.71
	+6m	280	187	3.50	2.89	2.66
	+12m	280	193	3.43	2.86	2.66
CZK	Actual	26.4	17.8	39.3	31.7	28.2
	+3m	26.2	16.9	38.5	31.3	28.4
	+6m	25.7	17.1	38.1	31.5	29.0
	+12m	25.4	17.5	37.8	31.5	29.4
EEK	Actual	15.6	10.5	66.3	53.5	47.6
	+3m	15.7	10.1	64.5	52.4	47.6
	+6m	15.7	10.4	62.6	51.8	47.6
	+12m	15.7	10.8	61.3	51.1	47.7
LVL	Actual	0.71	0.48	1465	1182	1051
	+3m	0.70	0.45	1443	1171	1064
	+6m	0.70	0.47	1400	1157	1064
	+12m	0.70	0.48	1371	1143	1066
LTL	Actual	3.45	2.33	300	242	216
	+3m	3.45	2.23	293	238	216
	+6m	3.45	2.30	284	235	216
	+12m	3.45	2.38	278	232	216
RON	Actual	4.30	2.90	241	195	173
	+3m	4.35	2.81	232	189	171
	+6m	4.45	2.97	220	182	167
	+12m	4.60	3.17	209	174	162
BGN	Actual	1.96	1.32	530	428	381
	+3m	1.96	1.26	517	419	381
	+6m	1.96	1.30	501	414	381
	+12m	1.96	1.35	491	409	382
TRY	Actual	2.21	1.49	469	379	337
	+3m	2.20	1.42	459	373	339
	+6m	2.15	1.43	456	377	347
	+12m	2.10	1.45	457	381	355
RUB	Actual	43.1	29.1	24.1	19.4	17.3
	+3m	45.3	29.2	22.3	18.1	16.5
	+6m	45.5	30.3	21.6	17.8	16.4
	+12m	46.7	32.2	20.6	17.1	16.0
UAH	Actual	12.0	8.08	86.6	69.9	62.1
	+3m	14.0	9.00	72.4	58.8	53.4
	+6m	15.0	10.00	65.3	54.0	49.7
	+12m	16.0	11.00	60.2	50.2	46.8
ZAR	Actual	11.5	7.73	90.5	73.1	64.9
	+3m	11.6	7.50	86.9	70.5	64.1
	+6m	11.7	7.80	83.8	69.2	63.7
	+12m	11.6	8.00	82.8	69.0	64.3

Source: Reuters Ecowin and Danske Markets

Macro Forecast, EMEA

Macro forecast, EMEA

	Year	Gdp(1)	Private. cons(1)	Fixed Inv(1)	Export(1), (4)	Import(1), (4)	Trade Balance(2), (4)	Current acc.(2), (4)	Industrial prod.(1)	Unem-ploym(3)	Infla-tion(1)
Czech Republic	2008	2.6	3.4	-1.0	0.2	1.0	2.1	-4.1	-1.5	5.9	6.4
	2009	-4.4	1.5	-8.2	-14.9	-19.4	5.1	-1.1	-14.1	9.2	1.0
	2010	0.1	1.0	-1.0	4.2	1.8	6.4	0.2	1.1	10.7	0.2
Estonia	2008	-3.6	-4.8	-12.1	-0.7	-8.7	-11.7	-10.1	-1.4	4.7	10.4
	2009	-15.0	-18.0	-30.0	-15.0	-28.0	-	3.0	-	15.0	-0.2
	2010	-2.7	-1.3	0.1	2.4	3.1	-	1.0	-	18.0	0.7
Hungary	2008	0.7	-0.4	-2.8	7.6	7.4	-0.1	-7.7	-0.6	8.4	6.1
	2009	-6.5	-5.9	-6.3	-18.7	-26.6	6.1	-4.1	-20.9	10.3	4.3
	2010	-2.0	-0.9	-5.1	5.8	3.3	7.8	-4.1	-5.1	11.1	4.4
Latvia	2008	-4.2	-11.0	-13.2	-1.3	-13.6	-17.6	-12.6	-3.7	7.0	15.4
	2009	-19.0	-20.0	-39.0	-22.0	-30.0	-	3.0	-	16.0	3.0
	2010	-6.0	-7.0	-3.8	-0.8	0.7	-	4.5	-	20.0	-0.9
Lithuania	2008	3.0	4.7	-6.1	113.0	10.0	-11.2	-12.2	7.1	5.8	11.1
	2009	-19.0	-20.0	-38.0	-19.0	-27.0	-	0.7	-	15.0	4.0
	2010	-6.0	-6.4	-5.8	-0.7	0.3	-	1.0	-	20.0	-0.8
Poland	2008	5.0	5.4	9.6	14.9	18.2	-4.9	-5.0	3.0	9.5	4.2
	2009	0.2	2.3	-3.1	-21.0	-27.5	-1.7	-1.5	-5.3	12.0	3.5
	2010	0.4	2.9	-7.2	0.1	4.7	-3.0	-2.7	3.4	13.8	2.6
Russia	2008	6.0	10.5	9.0	33.1	31.0	36.7	6.2	2.0	7.7	14.1
	2009	-8.0	-7.0	-13.0	-36.9	-33.3	-42.9	3.7	-8.0	7.5	11.9
	2010	1.5	2.0	-1.0	14.3	18.8	5.9	2.7	1.0	7.4	7.8
Turkey	2008	1.1	0.3	-6.5	25.7	21.3	-9.5	-7.7	-0.6	-	10.4
	2009	-6.9	-1.4	-22.6	-24.7	-29.7	-6.4	-3.2	-10.2	-	6.0
	2010	2.9	3.8	-0.4	1.8	13.0	-7.7	-5.9	6.8	-	5.7

1) Average % y/y 2) % of GDP 3) % of total work force 4) Export and import prices, USD

Source: Reuters Ecowin and Danske Markets

Macro Monitors

Macro Monitor: Poland, Oct 12

Macro Monitor: Hungary, Oct 12

Macro Monitor: Czech Republic, Oct 15

Macro Monitor: Turkey, Oct 19

Source: Danske Markets

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