

# EMERGING MARKETS WEEKLY PERSPECTIVE

March 03, 2010

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## Global Economic Research

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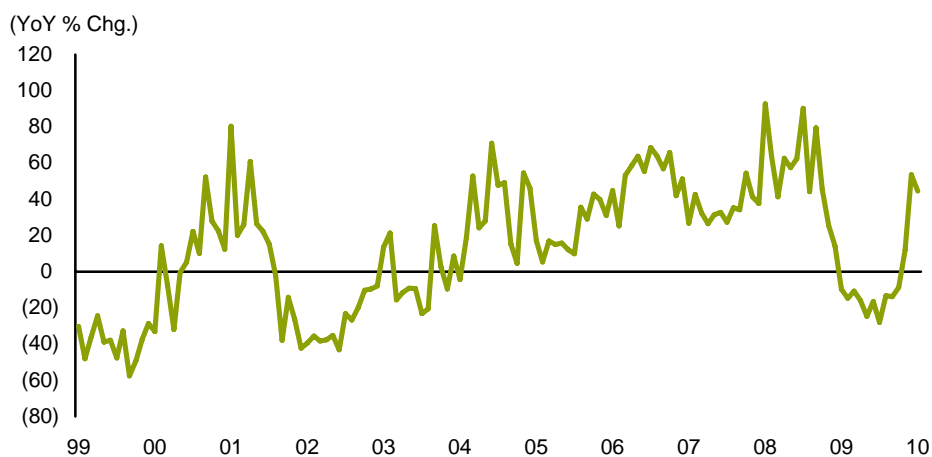
	Moody's / S&P <sup>1</sup> Rating	Expected Rating Trend	Foreign Currency Debt Rating
<b>LATIN AMERICA</b> <sup>1</sup> (POS) = Pos Outlook; (NEG) = Neg Outlook			
Argentina	B3 / B-	↔	Market Weight
Brazil	Baa3(POS) / BBB-	↑	Overweight
Chile	A1(POS) / A+	↑	Market Weight
Colombia	Ba1 / BBB-	↔	Market Weight
Costa Rica	Ba1(POS) / BB+	↔	Market Weight
Dominican Republic	B2 / B	↑	Overweight
Ecuador	Caa3 / CCC+	↔	Market Weight
El Salvador	Ba1(NEG) / BB	↓	Overweight
Jamaica	B3 / B-	↑	Overweight
Mexico	Baa1 / BBB	↓	Underweight
Panama	Ba1*+ / BB+(POS)	↔	Market Weight
Peru	Baa3 / BBB-	↔	Market Weight
Uruguay	Ba3 / BB	↑	Market Weight
Venezuela	B2 / BB-	↔	Overweight
<b>ASIA</b>			
China	A1(POS) / A+	↑	Market Weight
India	Baa2 / BBB-(NEG)	↔	Market Weight
Indonesia	Ba3 / BB-(POS)	↑	Overweight
Korea	A2 / A	↔	Market Weight
Malaysia	A3 / A-	↔	Market Weight
Pakistan	B3 / B-	↔	Underweight
Philippines	B1 / BB-	↔	Market Weight
Sri Lanka	NR / B(POS)	↑	Market Weight
Vietnam	Ba3(NEG) / BB(NEG)	↓	Market Weight
<b>EMERGING EUROPE, MIDDLE EAST &amp; AFRICA (EEMEA)</b>			
Bulgaria	Baa3(POS) / BBB	↓	Market Weight
Egypt	Ba1 / BB+	↔	Market Weight
Gabon	NR / BB-	↔	Market Weight
Georgia	NR / B	↔	Market Weight
Ghana	NR / B+(NEG)	↔	Market Weight
Hungary	Baa1(NEG) / BBB-	↔	Market Weight
Kazakhstan	Baa1(NEG) / BBB-	↔	Overweight
Lebanon	B2(POS) / B(POS)	↑	Underweight
Lithuania	Baa1(NEG) / BBB	↔	Overweight
Poland	A2 / A-	↔	Market Weight
Russia	Baa1 / BBB	↔	Overweight
Serbia	NR / BB-(NEG)	↑	Market Weight
South Africa	A3 / BBB+(NEG)	↔	Market Weight
Tunisia	Baa2 / BBB	↔	Market Weight
Turkey	Ba2 / BB(POS)	↔	Underweight
Ukraine	B2(NEG) / CCC+	↔	Overweight

**Argentina: Reserves Raid.** The president signed two separate decrees designed to end-run both the courts and Congress and use \$6.6B in dollar reserves to pay debt amortizations. It is doubtful that opposition politicians or the courts will be able to muster significant opposition to the move, and the new central bank president was put into office precisely to enable maneuvers like this. Markets responded quietly, presumably of the view that short-term financing needs were now going to be easily addressed. While that is true, it is also true that along the spectrum of financing options, Argentina is now beginning to scrape the bottom of the barrel. In addition to this grab, central bank profits will be tapped. If needed, we expect the government to twist arms in the local banks to accept a short-term bond as well. That will get the country to the 2011 elections, where it is presumed that the Kirchners will be beaten by someone more market friendly. We share that view, but we fear that the new president will inherit a bare cupboard, and that will beget a crisis unless global financial conditions are quite benign.

**Colombia Chooses Correctly.** We think the Colombian courts did the country a favor by rejecting the possibility of a third term for President Uribe, though he has been a superlative president. Bending the rules once as was done four years ago is one thing, but doing so a second time would have been a negative for democracy in the country in our view. The likely winner of the vote, which is coming in a few short weeks on May 30, is former defense minister Juan Santos. He will likely hew closely to Uribe policies. Markets did not react to the news, which had already been pretty well telegraphed, and that in itself was another sign of political maturity for the country.

**Brazil: Looks Like March** In this week's central bank survey inflation expectations for 2010 rose to 4.91%, up from 4.62% four weeks ago and now getting well above the target of 4.5%. Late last week, central bank governor Meirelles was quoted in the press as taking a somewhat hawkish stance and suggesting that politics would have nothing to do with the rate cycle (given that the presidential election is in October). This week, he repeated the same message in a slightly different context. To us, it seems clear that Meirelles is setting the market up for a March start to the rate hiking cycle—this would be extremely consistent with the history of the central bank under his command. At the same time, the market has priced in 400bps of hikes through the first part of 2011, which we think is close to 200bps too excessive. So once the rate hiking cycle commences, Meirelles will slowly begin to define how long we can expect it to continue, and at that point we expect to see rates rally.

### Display: Brazil's Robust Consumer



Source: Banco Central do Brasil and Haver Analytics

**Dominican Republic: IMF Letter of Intent for 2010 Policies.** DR's Minister of Economy reported that the new IMF letter of intent for 2010 policies should be submitted by the end of this week. Most important will be the strategy to reform the electricity sector – the government is targeting in 2010 an aggressive reduction in the electricity subsidy as one of the flagship components in the IMF program. Structural inefficiencies in electricity generation & collection have been sizeable issues over DR's history – a weakness that rose to recent prominence over the 2008 spike in energy prices. The IMF seems to have confidence in the plan they are about to layout. Should the program in fact result in meaningful improvements to the sector over the medium-term – that would be significant to DR's long-term credit standing. However, a negative repercussion will be that the government deficit is likely to remain wide in 2010 given the public/electricity sector reforms and capital spending plans. We have the consolidated deficit remaining above 4% in 2010 before easing to 2% in 2011.

**Jamaica: S&P and Moody's Upgrades.** S&P and Moody's raised their long-term foreign- and local-currency sovereign ratings on Jamaica this week following completion of the Jamaica Debt Exchange (JDX). S&P upgraded its rating to 'B-' from 'SD', outlook 'Stable'; Moody's changed its rating to 'B3' from 'Caa1', outlook 'Stable'. The ratings decisions on Jamaica reflect the significant improvements in the country's liquidity position and fiscal path balanced against Jamaica's still-high public debt levels (136% of GDP) and implementation risks over the IMF program. The JDX operation closed last Wednesday with participation above 99%, resulting in an IMF agreement and broad-based multilateral inflows.

**El Salvador: Mixed Fiscal News in December.** Dec-09 tax revenues showed a -4.2% y/y contraction, an improvement from November's -16.1%. El Salvador's Activity Index in December was down -1.3% y/y, the best result since prior to the crisis. However, current expenditures rose in tandem, increasing 18.7% y/y in December. We think the fiscal deficits will remain wide in 2010 as the government begins to implement its anti-crisis spending plan with projections of a 5.5% deficit in 2009 followed by 5.7% in 2010.

**China's February PMI.** Including this year, four out of six readings of China's official Purchasing Managers' Index (PMI) during Chinese New Year showed a deceleration from previous month. However, this year's decline to 52 from January's 55.8 was more pronounced than thought, which may be exacerbated by the unusual bad weather condition in 2010. All the PMI components fell in February and the 7.4 points decline in input prices to 61.1 was a big surprise which, in our view, reflects the seasonal distortion (or lack of seasonal adjustment in the series) rather than any fundamental changes.

The important point here is that China's economic growth has ramped up remarkably in sequential terms from the low during the global crisis, and the reason for policy exit is to normalize growth to prevent overheating. At 52, the PMI suggests solid but less overheating pace of recovery momentum and this is what we and policymakers should be aiming for. A few more data points are needed to check the trend post-Chinese New Year, so it is premature to think that the February easing immediately suggests less aggressive policy tightening by Beijing.

Separately, the CLSA-Markit PMI for China declined less than the official series, down 1.6 points to 55.8. This series has performed better than the official one over the past few months, which may be due to the fact that it is less SOE-dominated in the survey and, thus, less affected by domestic tightening but more supported by the improvement in external demand.

**India's 4Q/09 GDP and FY2010/11 Budget.** It was quite a surprise that India's 4Q/09 GDP growth did not outperform expectation the same way as most of its regional peers. Growth in y/y terms came in at a relatively weak 6% (consensus 6.9%) after expanding 7.9% in 3Q. However, much of the weakness was caused by the impact of severe drought which resulted in a -2.8% y/y contraction in agriculture output (vs. +0.9% in 3Q). Slower public spending has also caused growth in community/social services swinging to -2.2% y/y from +12.7% y/y in 3Q. The positive signs are that manufacturing output improved to 14.3% y/y (from 9%) and construction stayed robust at 7.8% y/y. With agricultural production set to normalize in the current quarter, plus continued positive outlook for manufacturing production, we expect the economy will resume to a faster pace of growth in 2010. We stick to our GDP forecast of 7.8% for this year compared to 6% in 2009.

The budget for FY2010/11 planned for a reduction in fiscal deficit to 5.5% of GDP from the previous year's 6.9%. The fiscal plan will only be mildly contractionary but the hike in fuel prices and excises and duties will immediately exacerbate cost-push inflationary pressure in the economy. Fuel subsidies – a key policy issue - were left untouched but are reported to be reviewed by the government in the next few weeks. Overall, the effect of the budget will increase pressure on the Reserve Bank of India to stay ahead of the tightening curve. We expect the central bank will further raise cash reserve requirement and start hiking repo rate by 25-50bp in the next policy meeting on April 29.

**Indonesia's Fiscal Policy.** The government has decided to forestall fuel price and electricity tariff hikes. As a result, spending on energy subsidies is planned to increase by 35% and, including fertilizer and food subsidies, the total state subsidy bill is expected to increase by 28% in 2010. This will widen 2010's fiscal deficit to 2.1% of GDP from initially programmed 1.6%. The wider deficit will be funded by IDR1.2 trillion (US\$128 million) of new borrowing as well as money carry forward from last year's budget.

Although the size of fiscal deficit does not look too alarming (in absolute terms and relative to other BB-rated sovereigns) but the holding back of fiscal reform is negative to Indonesia's sovereign assessment. This is particular be the case if, as widely suggested, the price cap is the result of political pressure on President SBY over the Bank Century case. The event, in our view, could act as headwind for our expectation that Indonesia's credit spreads will trade through its Philippine counterparts in the near term.

In addition, the absence of price reform implies less imminent pressure on headline inflation, but more subsidies should mean more spending and increase the risk of longer-term inflationary pressure. The bottomline is that the still accommodative fiscal stance will increase pressure on Bank Indonesia to respond preemptively should current inflation – which has so far been quite well behaved - surprise on the upside.

**Ukraine: Successful No Confidence Vote Will Likely Improve Policy Coherence.** The successful no confidence vote by parliament in Prime Minister Timoshenko's government is likely to improve economic policy coherence since the next prime minister and president are likely to be more closely aligned. This vote also substantially reduces the risk of early parliamentary elections. The three candidates for Prime Minister nominated by Yanukovich are all good choices, and the no confidence vote would not likely have passed without some sort of power sharing deal among the major parties in parliament. Thus, the risks of a new coalition failing are low by Ukrainian standards, though the fragmented composition of parliament means some risk of infighting always exists. Once the next government is formed, the new leadership will likely reengage with the IMF and negotiate new program terms. A one and a half year window now exists to implement reforms—a substantial period of time by Ukrainian political standards—before the next parliamentary elections, which need be held by October 2011.

**EEMEA: Strong February PMI Data.** Composite manufacturing purchasers' manufacturing indices (PMI) for EEMEA rose again in February to 52.1 from 51.8 in January. The composite PMI is now at the highest level since January 2008. Four out of six countries posted gains: South Africa (60.4 from 53.6), Hungary (55.9 from 53.5), Czech Republic (54.3 from 53.1) and Poland (52.4 from 51.0). Two countries posted declines: Russia (50.2 from 50.8) and Turkey (50.9 from 53.0). PMI data can be volatile on a monthly basis. The overall trends remains strong.

**Turkey: CPI Increased Above Expectations As Political Risks Mount.** CPI rose by more than expected to 10.1% year-over-year in February from 8.2% in January and a low of 5.1% in October 2009. Inflation is now well above the year-end target of 6.5%. All price categories rose month-over-month terms by more than historical averages, meaning that the current pace of price increases in food, energy and core is tracking higher than in the past. Core ex food and energy is now 8.3% y/y. The central bank has argued that the increase is temporary and core and headline inflation will fall back toward the target by year-end as base effects from energy price rises and excise tax increases roll off. Our view is different. The increase in inflation now reflects the rolling off of positive base effects last year from tax cuts and lower energy prices. The central bank is taking a very big risk with such a loose monetary policy stance since inflation expectations continue to rise, financial conditions are very loose and the recovery is well advanced. We reiterate our view that both the currency and bond yields are at risk of a rise in Turkey's risk premium.

Separately, Prime Minister Erdogan, the President and the military's leadership have tried to diffuse heightened tensions surrounding the arrests of senior military staff. We do not see any long-term economic fallout at this point from political issues, but tensions are likely to remain high in the coming months. The prime minister said that the government is preparing constitutional reforms to be introduced before end-March. They will likely include some attempt at reforming the secular judiciary and possibly on removing the headscarf ban in public institutions. These reforms are likely to be contentious, and may add to market volatility.

**Poland: Strong Q4 GDP.** According to national statistics data, real GDP grew by 1.2% quarter-over-quarter, seasonally adjusted (q/q sa) from 0.6% in Q3, bringing year-over-year growth to 3.1%. This performance is broadly in line with our estimate based on calendar year growth. The Q4 detail showed that net exports and public expenditures drove the growth acceleration. Private consumption was softer at 0.2% q/q sa, but calendar year private consumption fell less than most other EEMEA countries. We expect Poland's GDP to grow by 3.9% in 2010 from 1.7% in 2009, and that the mix of growth will shift toward private investment and consumption as labor markets improve and lending accelerates.

**South Africa: Stable CPI and Favorable ESKOM Price Hike Are Positive For Rates.** January CPI remained stable at 6.2% y/y from 6.3% in December, as a big decline in core inflation and food prices offset a large rise in energy prices due to base effects. As important, the energy regulator granted the electricity company ESKOM a 24.8% utility hike for fiscal year 2011 (25.8% and 25.9% increases for the following two fiscal years). The fiscal year 2011 increase is lower than the 35% increase sought by ESKOM, but in line with the central bank's 25% assumption. This announcement removes a key near-term supply side risk to our inflation outlook, and supports our view that inflation will remain just below the 6% exchange rate target ceiling for most of this year. Thus, we continue to expect the central bank to hike rates only toward the end of the year as the economic recovery gains strength and is reflected in domestic demand and labor markets.

The return of president Yar'Adua to Nigeria after being outside of the country for four months raises risks of a top level political power struggle, which could result in early presidential elections, a resumption of guerilla violence or, in an extreme scenario, a military takeover of the government. Vice president Goodluck has been elevated to acting president and in the most likely of scenarios will serve out the president's remaining term. The nature of his appointment by congress, and his religious and regional affiliations will undermine any attempts to pass controversial government appointments or policy initiatives. This is particularly unsettling due to the administration's involvement in amnesty and resources sharing talks with the Niger Delta's militia group, MEND, who has recently ended a truce and resumed terrorizing the state's oil resources threatening production.