ALLIANCEBERNSTEIN

Global Economic Research

EMERGING MARKETS WEEKLY PERSPECTIVE

February 03, 2010

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Global Economic Research

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	Moody's / S&P[1] Rating	Expected Rating Trend	Foreign Currency Debt Rating
LATIN AMERICA	[1](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	Caa1 / SD	↑	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
ASIA			
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
EMERGING EUROPE, MIDDLE EAST & AFRICA (EEMEA)			
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(STA)	↔	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-	↔	Underweight
Ukraine	B2(NEG) / CCC+	↔	Overweight

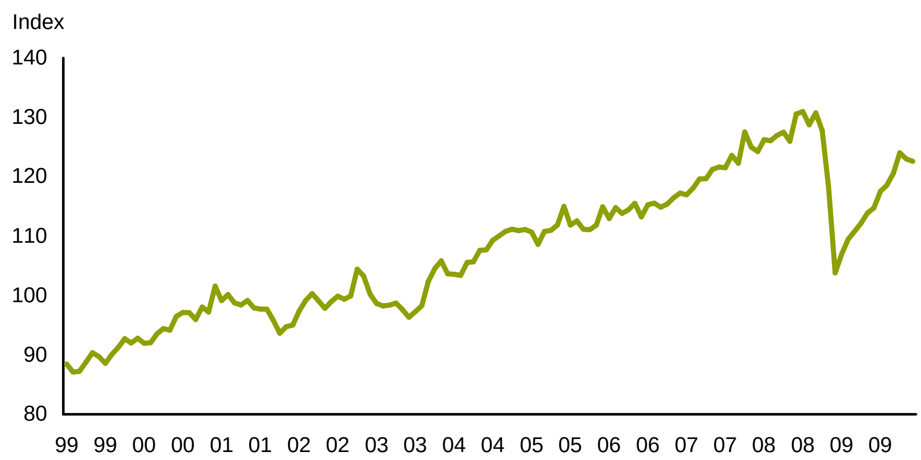
LATIN AMERICA (James Barrineau and Dennis Shen)

Mexico's New Peso Regime. The new head of the central bank in Mexico has announced a policy of dollar reserve accumulation. This represents a significant break in policy. Under the leadership of the recently retired Guillermo Ortiz, the central bank never saw much need for reserve accumulation, and in fact early in the past decade initiated a policy to sell oil dollars into the FX market on a daily basis. Unfortunately, that policy became suspect during the recent turmoil when it became clear that the more reserves a sovereign EM had, the better off they were. But the more subtle change, we think, is an implicit acknowledgement that Mexico is no better off than other emerging market countries in times of stress—Mexico needs the insurance just as much as Brazil, or Russia, or any other peer. Secondly, we think this implies a shift towards a softer peso policy. This not only makes sense in a time of declining oil production, but also as a backdoor way to maintain competitiveness in the US market. Thus we do not see a tremendous peso rally, which many analysts have been calling for based on its under-performance in the rally of the past six months. Instead we see the peso range-bound from about 12.60-13.25. Above 13 we would be buyers, but we would not be holders if the peso rallied toward the more appreciated ends of the range given the implications of this policy shift.

Argentina's Central Bank Shift. The head of the central bank resigned last Friday, hopefully taking a big step towards putting the controversy of his continued employment behind the country. More importantly for the medium term, the government is proposing a change to the central bank charter that would allow more easily the use of reserves for things like paying the debt. This was the original issue that led to the central bank head's refusal to release reserves and refusal to resign. However, this being Argentina, we have worries that a change in the charter will bring more substantial government control than on the narrow issue of reserves. We suspect that the government will welcome some inflation this year in order to make it easier to boost tax revenues, and a charter change could speed up this process. The rate of growth in the monetary base has already risen. This strategy is risky, because it is likely to make it more difficult to keep the currency steady. Greater currency volatility will lead to locals preferring dollars over pesos, which will lead to lower dollar reserves, thus putting a crimp into one of the only unambiguously positive features of the macro framework in 2009

Brazil's Central Bank Tough Talk. Earlier this week governor Meirelles gave a speech in which he said that retail sales, lending, and wages were all running above long-term growth rates. At the same time, though, industrial production for December was down a bit from November, a second consecutive month of decline after a sharp rise. In this context, we think that Meirelles is being consistent with the operating pattern of the bank during his tenure—laying out the groundwork carefully for changes in interest rates in advance of an actual move so that expectations converge towards what the bank is planning before it occurs. That points us to a hike at the April meeting, with March's meeting serving as a final opportunity to get the market fully onboard. Some analysts have been predicting rate hikes only beginning in June, and those forecasts will almost certainly be changed as Meirelles shapes expectations in the weeks ahead.

Display: Brazil: Industrial Production Stalls a Bit in Q4

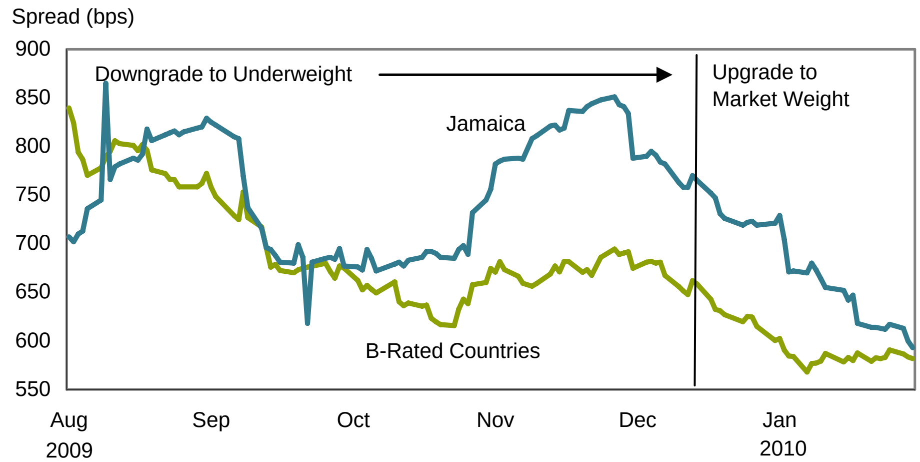


Source: Fundação Instituto Brasileiro de Geografia e Estatística and Haver Analytics

LATIN AMERICA (James Barrineau and Dennis Shen)

Jamaica: Upgrade to Overweight. We upgrade our foreign currency recommendation on Jamaica to 'Overweight' from 'Market Weight'. Furthermore, we revise our expected ratings trend to 'Positive' to reflect near-term ratings upgrades. On December 18th, we upgraded Jamaica to 'Market Weight' on the pending IMF agreement and its contingent debt liability program. Despite recent appreciation, Jamaica valuations remain competitive (**Display**). Today, having bridged ratings risks tied to the liability program announcement, we think that steady fundamental improvements and declining uncertainty justify further spread tightening over the medium-term. As Jamaica prepares to execute its landmark debt exchange and enter the IMF phase of its history, we believe the post-restructuring risk/return profile to be in-line with an 'Overweight' view.

Display: Jamaica Valuations Remain Competitive
Jamaica Sovereign Spreads vs. B-Rated Index Peers



Source: JP Morgan

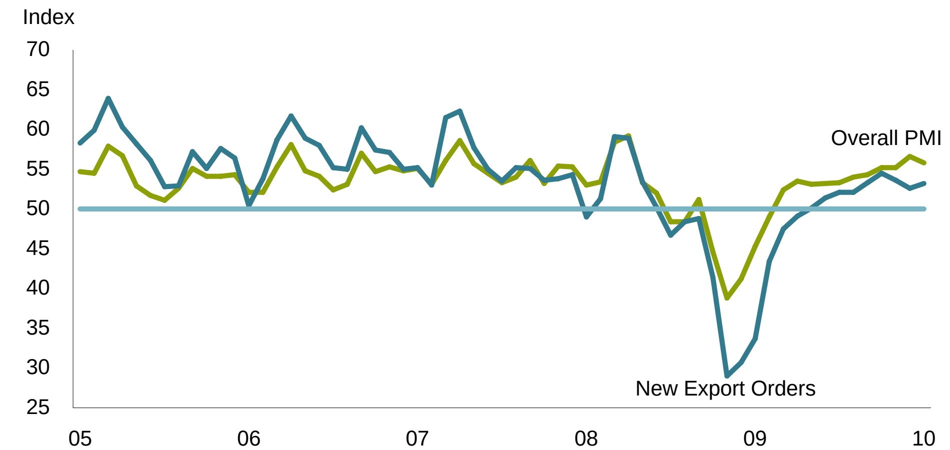
ASIA (Anthony Chan and Dennis Shen)

China's preemptive tightening has raised market worry of a hard economic landing, but this week's releases of strong Purchasing Managers' Index (PMI) in China and other major Asian countries, as well as signs of a sustained export recovery across the region should reinforce the strong growth message. Meanwhile, inflation has picked up steadily in many countries as widely anticipated, and the bounces have not translated into a shock to policymakers.

PMIs. China's official PMI eased 0.8 point to 55.8 in January, but it is important to note that it remained well above the expansionary threshold level of 50 and was the second highest level since April 2008 (**Display**). By contrast, the private-sector Markit PMI rose by a further 1.3 points to 57.4. Arguably, this survey captures more of the smaller and non-state firms which are more sensitive to improved external demand, whereas state companies dominate the official survey which is more directly affected by policy tightening as well as the recent slowdown in fixed asset investment. Importantly, new export orders in China's PMI have revived, which reflects improving western demand for its exports.

Display: Recovery Momentun Remains Strong

China's Official PMI



Source: CEIC Data

More encouragingly, India's PMI jumped 2 points to a cyclical high of 57.6 last month and, again, with export orders increasing by some 5 points to close to a reading of 60. Similarly, Korea's PMI picked up by another 2.8 points to 55.6, with sizable increases in the output and new export orders components.

Inflation. The price components of all Asia's PMIs have further picked up in January, with input costs rising noticeably due to higher food and commodity products. However, this week's releases of January's consumer price inflation (CPI) numbers for Korea, Indonesia and Thailand, while headline inflation has picked up, core inflation seemed to be reasonably well-behaved. The bottomline is that the inflation trends per se have not affected our expectation for the timing of interest-rate hike in these countries, and the specifics are as follows:

Korea – January CPI came in in line at 3.1% y/y (0.4% m/m) while core inflation remained stable at 2.1% y/y. The CPI is rising steadily to the Bank of Korea's target zone of 3-4%, together with continued strong activity, we stick to our call for the central bank to start raising policy rate before the end of the first quarter.

Indonesia - Inflation has been softer than thought over the past few months, but January CPI was a touch stronger at 3.7% y/y (0.8% m/m) versus December's 2.8%. Core CPI picked up mildly to 4.4% y/y from 4.3%, but still well below the underlying trend of 7-8% seen in the pre-Lehman collapse period. That said, we expect that the turn in food and commodity cycles is likely to push CPI to 7-8% by the second quarter and, as such, the balance of risk is that Bank Indonesia may hike policy rate before the end of the current quarter.

ASIA (Anthony Chan and Dennis Shen)

Thailand - The swing from deflation to inflation has been quite rapid over the past few months due to the bounce in food and commodity prices. Headline CPI increased to 4.1% y/y in January (from 3.5% in December) but core remained tame at 0.6% y/y. With the economic recovery lagging its regional peers and core CPI still well behaved within the Bank of Thailand's core inflation target at 0.5-3.0%, we think a rate hike is unlikely to occur until the second quarter.

EEMEA (Alexander Moseley and Kenneth Colangelo)

EEMEA: Real Economic Data Are Strong, While Credit Remains Weak. PMI data posted strong gains in January, rising to a composite of 51.8 from an average of 50.3 for the previous four months. PMI data are now at the highest level since February 2008, and above the expansionary level of 50 in all six major economies: South Africa (53.6), Hungary (53.5), Czech (53.1), Turkey (53.0), Poland (51.0) and Russia (50.8). The month-to-month non-linear recovery in PMI data is similar to 2002-2003. Overall, the data remain consistent with a rebound in growth, led by exports and loose policy mixes.

Domestic credit growth slowed in November and December of 2009, in contrast to the notable improvement in real economic activity. This pattern suggests that banks continue to shrink their balance sheets as growth recovers. A lag in credit growth is consistent with previous emerging market cycles, when absolute credit growth generally recovers with a lag of one or two years. Composite monthly credit growth slowed to 0.4% month-over-month in November from 1.1% in October, led by Turkey (+2.3%). In December, however, credit contracted in four out of five reporting economies (Russia still not available). Again, Turkey is the outlier with strong growth of 1.3% month-over-month.

Russia: Implied Real GDP Growth Very Strong in Q4. 2009 annual GDP contracted by -7.9% versus 2008, which was better than our stronger-than-consensus estimate of -8.4%. As expected, the decline was driven by fixed investment (-18.2%), private consumption (-8.1%) and inventory liquidation, while government consumption (+1.9%) and net exports (+58%) were both positive. The calendar year figure implies that GDP grew by 5.25% quarter-over-quarter seasonally adjusted in Q4, which is consistent with high frequency monthly indicators. Real GDP has now recovered by 7.9% since Q2 following a -11.2% contraction during the prior three quarters. If the numbers are statistically correct, the strong Q4 means that if Russia records 0% quarterly growth in all of 2010, then calendar year growth will be 5.4%, which is well above the consensus forecast of 4.1%. We will look to raise our above-consensus 2010 forecast of 5.4% once the quarterly figures are confirmed.

Turkey: Inflation Increase Will Eventually Prompt Rate Hikes. CPI rose by more than expected in January to 8.2% year-over-year from 6.5% in December, due to higher food, energy and core prices on the back of excise tax hikes. This increase reduces Turkey’s real policy rate to -1.6% from an average of +6% since 2002. Core inflation ex-food and energy also increased to 8.2% year-over-year from a low of 3.5% in May 2009 and an average of 7.9% since 2004. Complacency about Turkey remains very high, and rates and the currency remain at risk due to a potential rise in the risk premium because of the central bank’s dovish stance.

Many analysts are arguing that this data release is positive, since the rise in inflation is less than the Istanbul price rise reported on Monday and because one of the central bank’s key measures of core inflation, the "I" index which excludes food, non-alcoholic beverages, tobacco and gold (about 32% of the CPI index), fell by -0.5% month-over-month and is low at 3.8%. However, there are numerous problems with this interpretation. First, inflation has risen much faster than the central bank or market expected several months ago. Second, as a result, inflation expectations are rising rapidly. Consensus expectations for 2010 rose last month to 8.1% from 6.7%, which is a very large move for one month. Third, increases in energy prices mean that the “I” index will rise sharply in the coming months. Fourth, the central bank officially targets headline inflation of 6.5%, not core inflation. Its reference last month to informally targeting core inflation will face the test of rising inflation expectations and missing its official target. Finally, negative real interest rates are incompatible with low inflation given the pickup in lending (+14% in nominal terms since April), rise in inflation expectations, and history of high inflation.

Hungary: Central Bank Cut Rates as Expected. The central bank’s decision last week to reduce its policy rate by 25 bps to 6.00% from 6.25%, rather than 50 bps as some expected, was based on its cautious stance toward global risk appetite. As was the case in previous months, the central bank suggested that the domestic growth and inflation outlook warrant deeper cuts in interest rates. Our view remains that the central bank will continue to cut interest rates gradually to 5.25% this year, and not further, since uncertainty over Greece is likely to persist.

EEMEA (Alexander Moseley and Kenneth Colangelo)

South Africa: Central Bank Leaves Rates on Hold at 7.0% as Expected. The central bank's decision to leave rates on hold reflects its ongoing view that inflation is likely to fall within the 3% to 6% target range over the next year. Currently, inflation is 6.3%. This view is based on rand strength and the negative output gap offsetting upside risks to inflation from electricity and oil prices and wage growth. Weak employment led some rate setting members to vote for a cut. However, we do not view a cut as likely given that the central bank has acknowledged that employment is likely to lag GDP. We maintain our view that higher-than-anticipated growth and inflation from supply side factors will prompt a first rate cut in Q4 2009.

Separately, governor Marcus did not comment on a change in central bank mandate, since the National Treasury's is responsible for such an announcement. We believe that the mandate is likely to be expanded to include growth and employment in addition to inflation, similar to the Fed, but will not increase the inflation target level, as occurred in Turkey. In practice, this change is not likely to alter materially the conduct of monetary policy.

Israel: Inflation is set to Decline. Israel's central bank is likely to slow the pace of interest rate hikes since headline inflation is expected to decline to within the target range. Two supply-side factors are likely to drive inflation lower in the near-term. First, the government announced a 50 bps cut in the maximum VAT rate to 16.0% from 16.5%. This is a partial reversal from last July's increase of 100 bps made in order to raise revenue. The government originally had planned to remove the entire increase by the end of the year but has begun earlier than expected. Last month the central bank kept interest rates stable at 1.25% despite December inflation of 4.0% year-over-year, which is above the target band of 1-3%. The bank had estimated that 1.2 percentage points of inflation is attributed to VAT increases. Second, the Public Utilities Authority announced that electricity prices would be cut by 8% to 16% in February due to lower production costs.