OCTOBER 2011

EM Outlook

Glass Half Full or Half Empty?

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Summary Table: GDP and CPI Forecasts (% y/y)

	Real GDP					CPI[1]				
	2009	2010	2011 [2]	2012 [2]	2013 [2]	2009	2010	2011 [2]	2012 [2]	2013 [2]
Asia Pacific										
China	9.2	10.3	9.4	8.5	8.3	-0.7	3.3	5.3	3.6	4.0
India	7.0	8.9	7.5	6.7	8.6	2.4	9.6	9.4	6.8	5.7
South Korea	0.3	6.2	3.3	3.4	4.8	2.8	3.0	4.5	3.5	3.3
Taiwan	-1.9	10.9	4.3	2.5	5.2	-0.9	1.0	1.4	0.7	0.7
Hong Kong	-2.7	7.0	5.1	3.5	6.2	0.6	2.3	5.0	3.9	4.4
Indonesia	4.6	6.1	6.5	6.8	7.0	4.8	5.1	5.8	5.6	6.2
Thailand	-2.3	7.8	4.0	5.3	6.1	-0.8	3.3	3.8	3.0	3.9
Malaysia	-1.6	7.2	4.5	5.7	7.0	0.6	1.7	3.3	2.8	3.3
Philippines	1.1	7.6	4.3	5.7	6.3	3.3	3.8	4.7	3.4	4.6
Singapore	-0.8	14.5	4.9	5.6	7.2	0.6	2.8	4.7	2.4	2.5
Vietnam	5.3	6.8	6.0	7.0	7.5	7.0	9.2	18.0	6.5	9.0
CEEMEA										
Poland	1.6	3.8	3.7	2.3	2.9	3.5	2.6	4.2	2.3	2.2
Czech Republic	-4.0	2.2	2.0	1.2	3.2	1.1	1.5	1.7	2.0	1.4
Hungary	-6.7	1.2	1.2	0.7	2.6	4.3	4.9	4.0	3.8	2.9
Romania	-7.1	-1.3	1.4	1.5	2.0	5.6	6.1	6.7	3.9	3.2
Bulgaria	-5.4	-0.1	0.8	1.6	2.7	2.3	2.7	4.9	2.8	3.7
Turkey	-4.7	8.9	7.1	2.5	4.6	6.3	8.6	6.0	6.6	6.1
South Africa	-1.7	2.8	3.0	2.7	3.5	7.1	4.3	4.9	5.1	5.5
Israel	0.8	4.8	4.6	2.8	4.8	3.3	2.7	3.7	2.9	2.8
Egypt	4.7	5.1	0.7	1.6	3.7	11.7	11.6	10.6	11.8	11.2
Saudi Arabia	0.2	3.8	6.9	4.1	4.4	5.5	5.2	4.7	4.6	4.9
United Arab Emirates	-3.2	3.2	4.9	3.6	3.9	1.6	0.9	0.0	1.4	3.3
Qatar	12.0	16.6	19.3	7.3	4.4	-4.7	-2.4	2.3	3.9	5.3
CIS										
Russia	-7.9	4.0	4.3	4.7	4.8	11.8	6.9	8.8	7.2	7.2
Ukraine	-15.0	4.2	5.0	4.5	4.5	16.0	9.4	9.0	9.4	7.3
Kazakhstan	1.1	7.0	6.7	6.5	7.0	7.3	7.1	8.4	7.0	6.6
Belarus	0.2	7.6	4.8	3.0	6.5	13.0	7.7	42.0	36.5	7.5
Latam										
Brazil	-0.6	7.5	3.5	2.5	4.1	4.9	5.0	6.7	6.3	6.1
Mexico	-6.1	5.4	3.5	2.7	3.2	5.7	4.2	3.5	3.8	3.8
Chile	-1.5	5.2	6.5	4.0	4.5	0.4	1.4	3.2	3.1	3.0
Argentina	0.9	9.2	8.5	3.5	3.5	6.3	10.5	9.8	11.5	13.0
Colombia	1.5	4.3	4.9	4.1	4.4	4.2	2.3	3.4	3.7	3.5
Venezuela	-3.2	-1.5	3.3	1.4	0.5	30.5	28.7	27.4	34.2	29.2
Peru	0.9	8.8	6.1	5.4	6.8	2.3	1.7	3.2	3.2	2.6
Main Regions										
World [3]	-0.6	5.1	3.9	3.4	4.1	1.8	3.5	4.6	3.6	3.5
Advanced [3]	-3.7	3.1	1.4	1.2	2.2	0.1	1.6	2.7	1.8	1.9
US	-3.5	3.0	1.3	0.9	2.3	-0.4	1.6	3.1	2.0	2.2
Eurozone	-4.2	1.7	1.5	0.7	1.2	0.3	1.6	2.6	1.8	1.7
Japan	-6.3	4.0	-0.6	1.3	1.1	-1.4	-0.7	-0.3	-0.3	-0.1
Emerging & Developing [3]	2.7	7.3	6.6	5.9	6.2	3.8	5.6	6.6	5.6	5.4
Asia ex Japan [3]	6.3	9.3	7.7	7.1	7.7	0.6	4.5	5.8	4.2	4.3
CEE inc Russia [3]	-5.8	4.5	4.4	3.5	4.2	8.4	6.3	6.9	5.9	5.6
Latam [3]	-1.9	6.3	4.4	2.9	3.7	6.5	6.3	6.8	7.4	7.1

(1) HICP where available, India WPI (2) Forecast (3) BNPP estimates based on weights calculated using PPP valuation of GDP in IMF WEO September 2011

Source: BNP Paribas

Summary: Glass Half Full or Half Empty?

Is the emerging markets glass half full or half empty? Until a few weeks ago, it was looking decidedly half full, with growth holding up reasonably well, though with some inevitable knock-on effects on exports from the slowing in western markets. Crucially though, financial flows into emerging markets had held up relatively well (these are traditionally seen as a good indicator of the extent of any spillover). They turned sour in September, with the escalation of the eurozone fiscal crisis causing risk appetite to shift and EM currencies to soften.

That clearly has the potential to adversely affect assets, for the following reasons:

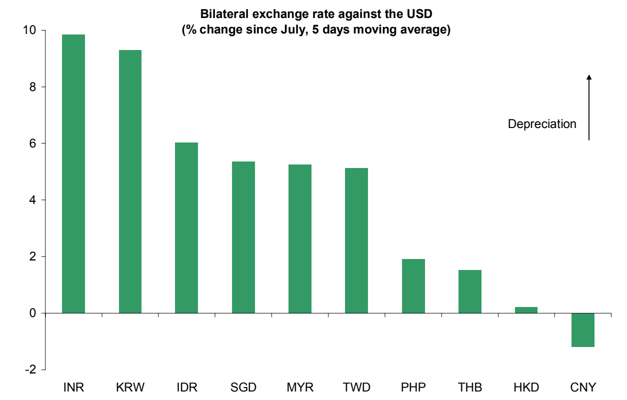
- Higher risk aversion hurts EM assets directly;
- Investors fear currency falls will continue once they start; and
- Currency falls can lead to higher inflation and higher-than-otherwise interest rates.

All in all, this is not the best possible recipe for emerging market assets and we have seen risk reduction strategies, particularly from leveraged accounts.

How long will this situation continue? The main influences will be how the crisis in the eurozone evolves, how western monetary policy develops, and how growth dynamics in the advanced countries and emerging markets shake down.

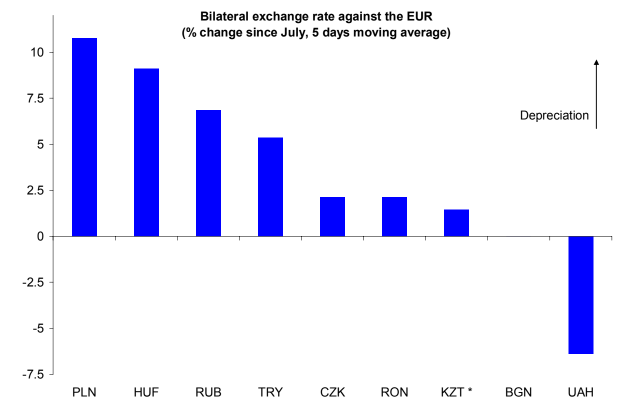
The degree of tension we have seen in the eurozone in recent weeks has been very high. Our view is that if the system remains under such strain, then in the end something will break. The costs of this would be huge, so logic and common sense dictate policy action to stabilise markets. At the time of writing, that looks to be the route the authorities are taking. The EFSF has just been passed by the Bundestag and will, hopefully, also be cleared by the Slovak parliament by mid-October. Leveraging the EFSF looks increasingly likely and moves to support bank capital if needed have supported markets. There are issues with the Greek programme and some governments have unhelpfully suggested a revisiting of PSI haircuts of 21%. Hopefully, the Troika will have seen evidence that enough progress has been made in implementing measures in Greece that they can allow the release of the sixth tranche of the first programme, which will roll us forward for three months. The market still remains sceptical whether deeper haircuts can be avoided forever, but our feeling is that these will not come unless and until more adequate firewalls are in place to protect the financial system, avoid contagion to other countries, and facilitate the funding of other governments' deficits.

Chart 1: Asian Currencies Against USD



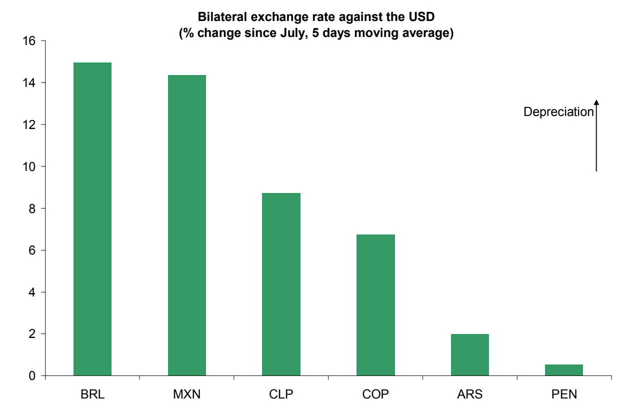
Source: Bloomberg, BNP Paribas

Chart 2: CEEMEA Currencies Against EUR (ex-KZT, USD)



Source: Bloomberg, BNP Paribas

Chart 3: Latam Currencies Against USD



Source: Bloomberg, BNP Paribas

When it comes to the last of these, suggestions that more leverage might be introduced into the rescue mechanism, by one means or another, are sensible and welcome. The ECB will, by our judgement, cut rates by 50bp by the end of the year and will also extend the LTRO to 12 months at a fixed rate. The ECB may also start to purchase covered bonds.

These would all be welcome innovations that would contribute to reducing the stress in the eurozone and therefore help to turn investors in emerging markets back towards 'risk on'.

We would love to see full-scale QE (in the region of EUR 500bn to EUR 1trn) in the eurozone, on the basis that monetary growth is feeble, but we doubt we will get it. However, leveraged purchases of govvie bonds by one or other institutions (EFSF and ESM) or a larger SMP by the ECB go down that road and so should help to relieve tensions.

In our most recent *Global Outlook* we envisaged further Fed easing, with QE3 pencilled in for November. Since then we have become less certain about the timing of further Fed easing, for the following reasons:

- Some of the US data (claims, durable goods orders, some retail reports, consumer confidence) have held up better than we might have expected;
- We have become more worried that November is too soon for the Fed to admit Operation Twist has failed;
- It looks like the November meeting will be one at which the Fed will set down more clearly its framework for deciding future action (jobs targets and inflation aspirations), rather than being a meeting for action itself; and
- The adverse trend in core inflation may go further than we had expected, and this may bolster opposition to QE within the FOMC and in Congress until the evidence for it becomes more compelling.

The disappointment with Operation Twist in risk markets is palpable and this has undoubtedly been one of the factors that have put EM currencies under pressure against the greenback.

QE3 may be delayed beyond our forecast, but we doubt it will be cancelled because we continue to expect recession in the US with a fall in payrolls looking likely. With headline inflation likely to fall next year and with unemployment certain to rise, further easing looks probable. The idea of more 'Twist' looks twisted, so QE3 is what we expect. When that comes, it should help to change the mood in EMs significantly.

In terms of the global cycle, our view continues to be that GDP will contract in both the US and the eurozone in Q4 this year, with that quarter or the succeeding one likely to be the weakest for global growth.

Whether this prediction holds up or not depends, above all, on the uncertainty stemming from the eurozone fiscal crisis. Uncertainty corrodes economic activity, with investment, big-ticket consumer purchases and hiring decisions all being delayed. At the same time, a rising risk premium on stocks pushes equity markets down.

When periods of uncertainty end, there can be a strong bounce back as delays are unwound. That said, in the credit-constrained advanced economies, we think such a rise would probably be modest.

Were the uncertainty in the eurozone to intensify or to continue at current levels, then longer-lasting damage would be done to growth, with back-to-back quarters of contraction possible in both the US and the eurozone. Global manufacturing activity would continue to be suppressed and there would be more chance we would see the kind of disruptions to trade finance that were so damaging in 2008 and 2009. The global shortage of dollars that has been an important driver of EM exchange rates in recent weeks would intensify, upping EM inflation and crimping confidence.

This is not our main scenario, however. Even if it were to transpire that the Europeans take longer than expected to get their act together, the emerging markets are not going to sit there passively and take whatever the global system throws at them. Fortunately, there is a lot of ammunition in policymakers' reserves in emerging markets. There is room to ease monetary policy and to stimulate growth through fiscal policy should exports' contribution to growth turn out to be weaker than expected. It is our judgement that, in many economies, both these barrels would be fired.

One of our themes for the coming months is that we will see monetary policy eased across a range of economies. The fact that currencies are softening against the greenback means that there will be concerns inside central banks about inflation. However, our forecasts are that we are at the top of the inflation cycle. Given softer oil prices and a reduction in some food prices, we should see world inflation decelerate significantly next year, by around 1 percentage point compared with 2010.

The softening of currencies over recent weeks may prolong the peak in inflation, but does it change the basic profile? No, especially as the bad news on currencies has meant better news in terms of lower oil and commodity prices. Interest rate easing will therefore be the order of the day in many emerging market economies as policymakers look through the current inflation readings to expect more-comforting numbers in the future as a result of slower growth and lower energy prices.

Our Asian growth forecasts for 2011 and 2012 have been lowered. Asia ex-Japan GDP growth is now seen at 7.7% in 2011 (it was 8.0%) and 7.1% in 2012 (it was 7.9%) – a soft landing in aggregate. The low point in terms of growth momentum is around the turn of the year. Growth is expected to firm in 2012 and into 2013. There is a dichotomy between North Asia, typically more exposed to western demand trends, and the less-exposed ASEAN economies.

Led by China, regional inflation pressures are still expected to ease significantly over coming months. The growth outlook is souring more rapidly and downside risks are more acute than a quarter ago so that several economies (e.g. South Korea, Taiwan and Australia) are moving relatively quickly from rate hikes to rate cuts, though policy will be eased much less than in 2008. Additional policy support in China and South Korea will probably be skewed more heavily towards fiscal measures. Indian rate cuts look unlikely until H2 2012, given inflation trends.

As we predicted in July, recent months have been disappointing for Central European economies, with a broad-based downturn in activity already apparent and leading indicators pointing to further softening. Our 2011 GDP forecast for the region is virtually unchanged at 2¾%; for next year we have cut our growth forecast by 1 percentage point to only 1.7% y/y.

Weaker growth and the easing of global food and energy prices will lead to lower inflation. However, in the near term, the disinflation trend will remain fairly choppy, for example, Polish and Hungarian currency depreciations and indirect tax hikes in Hungary.

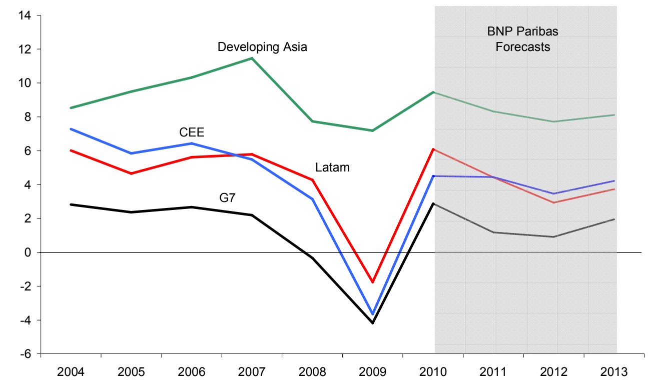
Unfortunately, Central European policymakers can do little to offset the impact of the global slowdown and rising risk aversion. Fiscal policies will have to be tightened further, with the peripheral crisis in the eurozone providing stimulus for fiscal consolidation. Thus softer monetary policy will be used to cushion the slowdown.

Real GDP growth in Latin America rebounded from -2% in 2009 to 6% last year. We estimate it at 4% this year, below 3% in 2012 and close to 4% in 2013. Our long-standing, below-consensus view on Brazil foresees growth below 3% in 2012. Mexico has been the clear laggard in the post-2009 recovery, and is unlikely to do well if the US economy falls into recession. The largest expected growth downshift in 2012 takes place in Argentina, where a booming economy will give way to much tamer expansion next year. By contrast, Colombia's deceleration next year would be fairly muted, while Peru would prove the fastest growing economy in the region next year.

Headline CPI inflation in Latin America has risen in 2011 from cyclical lows in 2010. We foresee inflation finishing 2011 above target mid-points in every inflation-targeting economy we cover. In Brazil, inflation has already exceeded the tolerance ceiling.

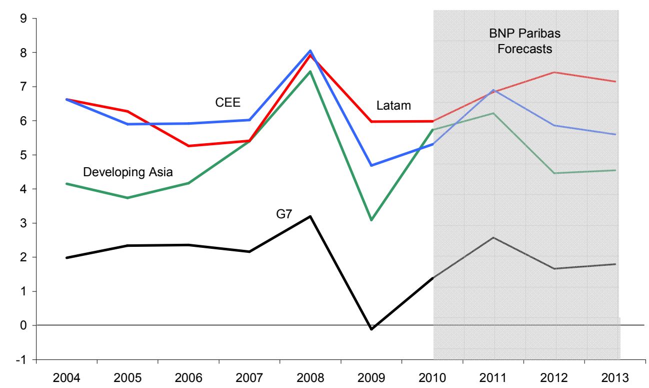
Despite above target inflation, global growth worries and their local impact will lead policymakers to ease. Some countries, such as Peru, are ready to spend more and cut rates. Others, like Brazil, plan to focus on monetary – not fiscal – easing. Across most economies, central banks will cut rates. Brazil took the lead, switching from rate hikes to cuts after a month. There is plenty of easing in the pipeline.

Chart 4: Real GDP (% y/y)



Source: IMF, BNP Paribas Forecasts

Chart 5: CPI (% y/y)



Source: IMF, BNP Paribas Forecasts

Table 1: Emerging Market Economies' Capital Flows (USD bn)

	2009	2010	2011(f)	2012(f)	2013(f)
Capital Inflows					
Total Inflows, Net	691	1078	991	1086	1193
Private Inflows, Net	623	1008	955	1045	1155
Equity Investment, Net	472	533	475	555	660
Direct Investment, Net	348	359	370	410	440
Portfolio Investment, Net	124	174	95	135	200
Private Creditors, Net	151	475	480	490	495
Commercial Banks, Net	0	162	180	180	195
Nonbanks, Net	151	313	300	310	300
Official Inflows, Net	68	70	36	41	38
International Financial Institutions	47	32	21	13	13
Bilateral Creditors	21	38	15	28	25
Capital Outflows					
Total Outflows, Net	-1050	-1453	-1350	-1459	-1536
Private Outflows, Net	-430	-645	-480	-670	-620
Equity Investment Abroad, Net	-259	-259	-220	-350	-320
Resident Lending/Other, Net	-171	-386	-260	-320	-300
Reserves (- = increase)	-620	-808	-870	-789	-916
Memo Item:					
Current Account Balance	*359*	*374*	*359*	*373*	*343*

Source: IIF (past data) , BNP Paribas (forecasts)

Asia: The Long March

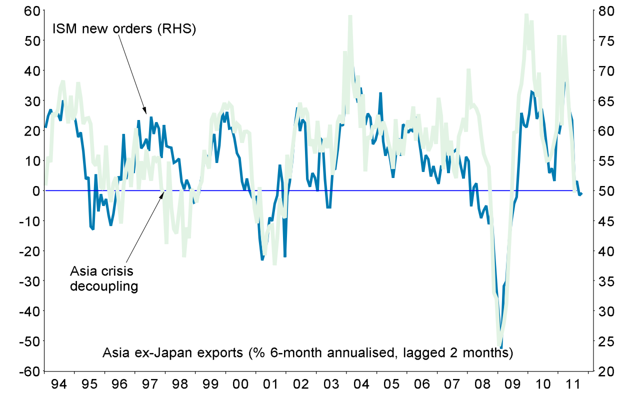
■ Still a soft landing

Our last *EM Outlook* highlighted that the regional policy tightening cycle, led by China, was well advanced. Accordingly, we felt the region was rapidly approaching a turning point. We expected to see the region's tightening cycle draw to a gradual close, because of tighter financial conditions, their corollary, slower growth, and at least a temporary retreat in headline inflation rates as food and energy shocks faded. China was expected to be the first to switch from inflation control to growth preservation and begin selective easing by end-Q3, helping ensure a soft landing for the region. India, where inflation was expected to prove stickier, was identified as the laggard and a target for a harder landing.

The intensification of the eurozone debt crisis and the rapid deterioration of the growth outlook for the US and Europe have accelerated these cyclical dynamics. US and European demand for Asian exports will be weaker than previously expected. Already stuttering, the region's exports are likely to suffer a shallow recession through Q4 and Q1 when the US and Europe are at their weakest (Chart 1). While financial markets were initially resilient, volatility has inevitably begun to infect Asia. Equity markets are down sharply and exchange rates have finally plummeted versus the USD as global USD liquidity has once again shrivelled. Lower exchange rates, which, apart from the CNY, typically fell by around 10% versus the USD in September, will provide some succour for exporters. But, in aggregate, financial conditions have tightened.

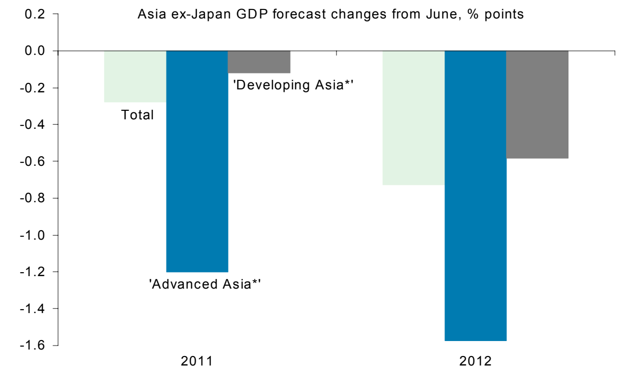
Our regional growth forecasts for both 2011 and 2012 have therefore been lowered. Asia ex-Japan GDP growth is now seen at 7.7% in 2011 (it was 8.0%) and 7.1% in 2012 (it was 7.9%). That would still be a soft landing in aggregate for the region but harder than foreseen three months ago. The low point in terms of growth momentum is, as with the export cycle, around the turn of the year. Growth momentum is then typically seen to be firming throughout 2012 and into 2013 as European tensions fade and the expected arrival of QE3 provides a fresh policy thrust for global growth. There is a clear dichotomy between North Asia, typically more exposed to Western demand trends, and the less-exposed ASEAN economies. Our GDP forecasts for the IMF's 'developed Asia' aggregate – the original 'tigers' of Hong Kong, South Korea, Taiwan and Singapore – have been cut more aggressively than the rest of the region, reflecting both their high direct trade exposure to the US and Europe, and also the importance of financial services in these economies (Chart 2). Led by China, regional inflation pressures

Chart 1: Export Slowdown



Source: BNP Paribas estimates, Reuters EcoWin Pro

Chart 2: GDP Forecast Revisions



Source: BNP Paribas, Reuters EcoWin Pro. * IMF definitions

are still expected to ease significantly over the next six to nine months, albeit from higher levels than expected a quarter ago, especially for China. The regional policy cycle has been further truncated because the growth outlook is souring more rapidly and downside risks are more acute than a quarter ago. Economies such as South Korea, Taiwan and Australia are moving from the brink of further rate cuts to expected, albeit modest, rate cuts in the space of just a few months. But the overall scope, prospects (and requirement) for aggressive easing of monetary policy is far less than in 2008. Additional policy support in China and Korea will probably be skewed more heavily towards fiscal measures. And despite India's expected harder landing, rate cuts there look unlikely until H2 2012, given inflation trends. In the more insulated ASEAN economies, the interruption of rate-hiking cycles while policy rates are still typically below normal and recent drops in exchange rates will both significantly support growth.

■ China – muddling through

Tight financial conditions had already cooled the economy from strong above-trend growth in Q4 2010 to a more trend-like annualised rate of 8.5% in Q2.

Domestic liquidity is tight, with annualised growth in the money supply below 16% and the authorities' decision to expand the deposit base covered by reserve requirements. This factor, along with the slowdown in exports, means the economy is expected to gradually lose further momentum in H2 2011. Its low point is expected in Q1 2012, with growth of sub-8% annualised. Our forecast for GDP in 2012 has been cut to 8.5% (from 9.2%). Even slower growth is expected in 2013 and 2014 as structural constraints – an unsustainably high investment share and fading demographic support – increasingly erode potential growth. As growth risks move to the downside, so too do inflation risks. CPI inflation is expected to slide from 6.2%, to 4.5% by Q4, and could be as low as 3% by mid-2012, reflecting slower growth and helpful base effects. Our 2012 CPI forecast has been cut to 3.6% (from 4%) The expected drop in inflation leaves the authorities with ample space to ward off a harder landing for the economy. Some selective policy easing is still expected to shore up growth, but next year's political transition and recognition that 2008's aggressive policy easing has increased systemic risks imply greater policy conservatism. No major policy stimulus should be expected in China unless growth falls below 7% as authorities implicitly embrace the economy's worsened trade-off between growth and inflation as structural constraints increasingly bite.

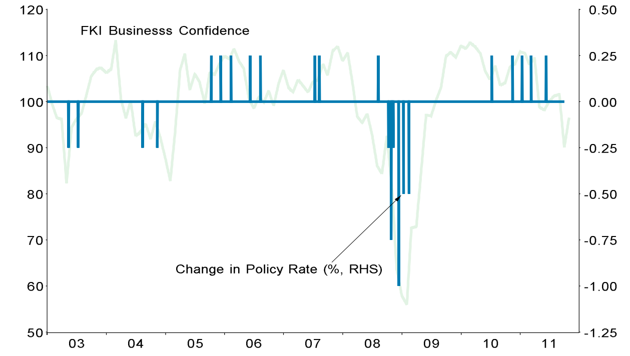
■ North versus South

North Asian economies, being more exposed to the US and Europe, have been hit hardest in our forecast revisions and it is here where the turn in the policy cycle is expected to be most abrupt. Taiwan – exposed to the more sluggish performance of China as well as the US and Europe – is forecast to experience a technical recession. It has one of the lowest inflation rates in the region so policy rates still being some 50-90bp below normal is no impediment to a cut in rates around the turn of the year.

South Korea has been operating above capacity, at least on the industrial side in H1 2011, and has above-target inflation and wobbling inflation expectations. It is expected to reverse policy abruptly as the economy flirts with, but avoids, recession around the turn of the year. Our forecast for GDP in 2012 has been cut to 3.4% (from 4.6%). Despite CPI inflation remaining above 4% y/y until early 2012 and policy rates, at 3.25%, still some 75-100bp below neutral, 50bp of rate cuts around the turn of the year are targeted. Business surveys have already dropped to rate-cutting territory (Chart 3). The KRW's recent plunge, especially versus the JPY, will also provide support. As with China, there is ample room for an easing of fiscal policy, which is likely to be pursued aggressively if recession risks intensify.

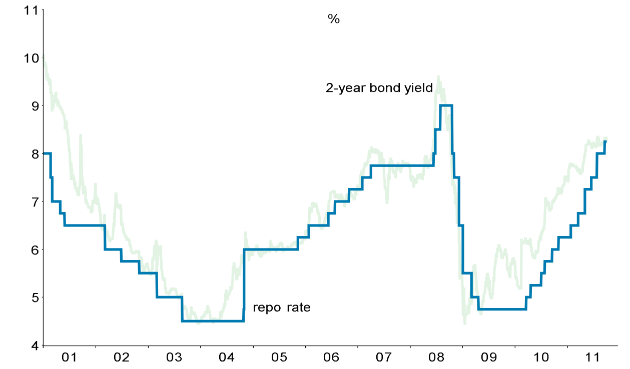
Most ASEAN economies, however, are much less exposed to a downturn in the US and Europe. Indonesia, which, along with India, has the lowest direct trade exposure to the US and Europe, is expected to remain resilient, with steady GDP growth above 6% in both 2011 and 2012, and inflation holding below 6% in both years. Policy is seen on hold until well into 2012, with the lower IDR providing support in the short term. Thailand's central bank has been one of the most proactive in normalising policy, with eight successive rate hikes up to August, but it is also seen holding policy rates given its relatively high export exposure to the US and the new government's planned fiscal expansion.

Chart 3: South Korea – Policy U-Turn?



Source: BNP Paribas estimates, Reuters EcoWin Pro

Chart 4: India – Policy Peak



Source: BNP Paribas estimates, Reuters EcoWin Pro

■ India – diminishing returns

Like Indonesia, Indian growth remains essentially about domestic demand. However, we have trimmed our already below consensus growth forecasts, reflecting weaker external developments and the RBI's continued more hawkish stance, which saw the central bank implement a final rate hike in September (Chart 4). FY 2012 GDP growth is now seen at 7.2% (it was 7.6%) and 7.1% for FY 2013 (it was 7.3%), which we characterise as a hardish landing given probable trend growth of around 8%. WPI inflation is likely to continue running at close to double-digit rates in coming months and leave little scope for policy easing until the second half of 2012. As with China, policymakers must tacitly accept a worse trade-off between growth and inflation.

Central Europe: It's a Hard Life

■ Intra-regional divergence

Although Central European economies share the same business cycle, largely driven by Germany, the region is far from homogeneous. Structural differences between the countries lead to diverse developments in their real economies – and different policy reactions. This provides opportunities for intra-regional relative value trades.

The Czech Republic remains a safe haven for the region and probably beyond. In the absence of significant fiscal or external imbalances, this situation is unlikely to change soon. In Poland, the adjustment of fiscal and current account deficits has not really started – yet. Wide imbalances increase the risk of a harder landing, especially if external demand does not quickly recover next year. Moreover, a heavy reliance on foreign financial inflows between Q2 2009 and Q2 2011 has made Poland particularly vulnerable to swings in global market sentiment. Greek banks' relatively high exposure to the Bulgarian and Romanian banking sectors is a potential risk factor for these two economies. But Hungary appears to be the most endangered economy in the region. Controversial policy measures implemented by the government have fuelled the rise in its risk premium at a time when Hungary does not have any ready-to-use external safety net, such as the IMF's Flexible Credit Line for Poland and its precautionary Stand-By Arrangement for Romania.

■ A significant slowdown is under way

As we predicted in July's edition of *EM Outlook*, this summer has been quite disappointing for Central European economies. A broad-based downturn in activity started to materialise and reliable leading indicators point to a further deceleration in growth in the remainder of the year. Our downwardly revised forecast for the global economy and rising stress in the financial markets are consistent with very soft GDP numbers across Central Europe in 2012. While we have reduced the 2011 GDP growth forecast for the region only slightly, from 2.8% y/y to 2.7%, next year we are now looking for only 1.7% y/y versus our previous call of 2.7%. Despite weaker external demand, we expect net exports to remain the main growth factor in 2012-2013.

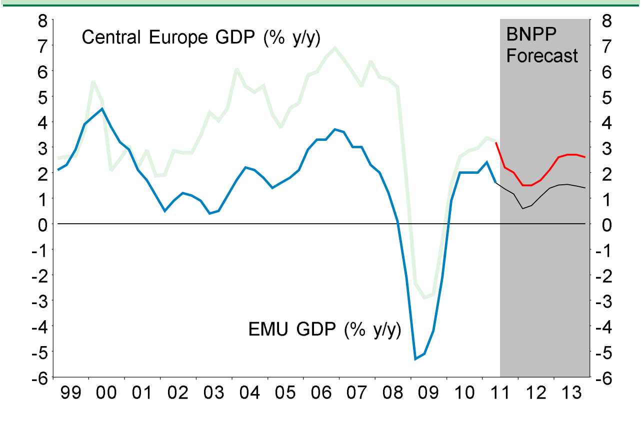
Unfortunately, Central European policymakers can do little to offset the impact of the global slowdown and rising risk aversion. Fiscal policies will have to be – and, in our view, will be – tightened further. We believe the crisis in the eurozone's peripheral economies will add impetus to the consolidation of public finances across Central Europe. Thus the only

Table 1: GDP Forecasts (% y/y)

	2009	2010	2011	2012	2013	2011		2012	
						Q3	Q4	Q1	Q2
Bulgaria	-5.4	-0.1	0.8	1.6	2.7	-0.4	0.0	0.5	2.1
Czech R.	-4.0	2.2	2.0	1.2	3.2	1.8	1.4	0.7	0.8
Hungary	-6.7	1.2	1.2	0.7	2.6	0.9	0.0	0.2	0.5
Poland	1.6	3.8	3.7	2.3	2.9	3.3	2.8	2.3	2.2
Romania	-7.1	-1.3	1.4	1.5	2.0	1.4	1.1	1.7	1.4
CE-5	-2.2	2.3	2.7	1.7	2.6	2.2	2.0	1.5	1.5

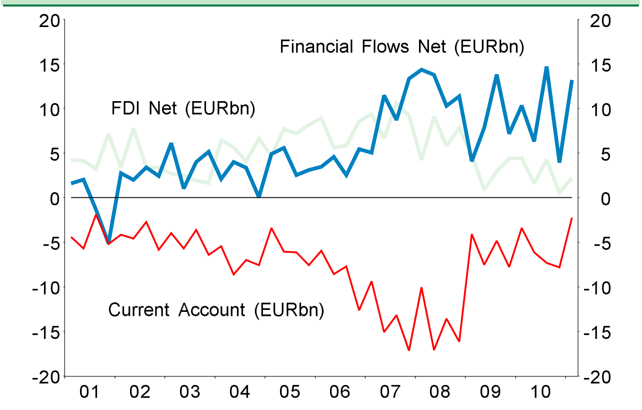
Source: BNP Paribas

Chart 1: Growth Cycle Convergence



Source: Reuters EcoWin Pro, BNP Paribas

Chart 2: Central Europe's External Balances



Source: Reuters EcoWin Pro, BNP Paribas

tool available to cushion the slowdown will be softer monetary policy. On a more positive note, external imbalances in Central Europe (with the notable exception of Poland) were reduced sharply in 2009-2010. This development significantly lowers the risk of a double-dip recession in our base-case scenario.

■ Choppy disinflation ahead

Weaker growth and the easing of pressures from global food and energy prices will lead to lower inflation over the next several quarters. However, in the near term, the disinflation trend will remain fairly choppy. The recent sharp currency depreciations in Poland and Hungary will prevent a faster decline of inflation in these economies, especially since the pass-through from exchange rates to inflation is rather strong. Planned indirect tax hikes in Hungary are a particular upside risk, especially when coupled with forint weakness, potentially boosting inflation expectations again. We are less worried about disinflation prospects in other Central European economies, where there has been much less currency weakness, if any. The harmonisation of VAT rates may temporarily add to CPI inflation in the Czech Republic next year, but given the absence of underlying pressures, inflation will remain contained.

Overall, we expect headline inflation in the region to slow from above 4% y/y in 2011 to below 3% by mid-2012, and further to around 2.5% in 2013, increasingly driven down by a renewed widening of output gaps.

■ Monetary easing in 2012, except for Hungary

Weaker growth and a lower inflation outlook call for softer monetary policy. With the exception of Hungary, we expect central banks in inflation-targeting economies to start cutting interest rates soon.

In Hungary, a rising risk premium will keep the forint under pressure, even though the NBH announced it would use its reserves to absorb hard currency outflows once banks close their positions due to the early repayment of FX mortgages. In addition, indirect tax hikes will boost the near-term inflation profile so we do not expect the NBH to be able to cut interest rates next year, despite very weak growth. On the contrary, the risk of emergency rate hikes in Hungary has increased markedly, especially if forint weakness were to prove greater or longer-lasting.

Given the recent weakness of the zloty, which may slow down disinflation in Poland, we have shifted our call for the start of the easing cycle from Q4 2011 to Q1 2012. But we still forecast 100bp in monetary easing next year, in line with the approach of the Monetary Policy Council, which depends more on current economic growth than current inflation data. On the FX front, the latest coordinated intervention by the Finance Ministry and NBP suggests policymakers will be acting to prevent a further slump in the zloty. On a positive note, they have sufficient resources to do so. We expect the zloty to regain more ground before year-end, as the government will convert all remaining euros from EU funds.

We also expect softer monetary policy in the Czech Republic; the latest dovish comments by Governor Singer clearly point in that direction. Obviously, with a base rate of merely 0.75%, the CNB cannot cut interest rates by much. But at the least we see a symbolic 25bp move in Q1 2012, and eventually non-conventional measures such as FX intervention, if growth continues to decelerate while the koruna retains its strength.

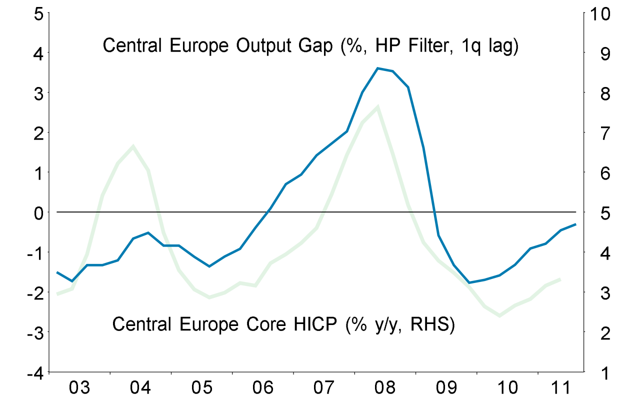
Lower inflation and a further setback in growth will support monetary easing in Romania, too, assuming fiscal tightening remains on track. ECB rate cuts of 50bp, which we forecast in Q4 2011, will provide an additional argument in favour of looser monetary policy in Central Europe, especially once the inflation scare dissipates and growth concerns become central bankers' main focus in the region.

Table 1: CPI Forecasts (% y/y)

	2009	2010	2011	2012	2013	2011		2012	
						Q3	Q4	Q1	Q2
Bulgaria	2.3	2.7	4.9	2.8	3.7	4.9	4.2	3.3	2.7
Czech R.	1.1	1.5	1.7	2.0	1.4	1.7	1.6	2.5	2.2
Hungary	4.3	4.9	4.0	3.8	2.9	4.2	3.8	3.8	3.8
Poland	3.5	2.6	4.2	2.3	2.2	4.4	3.9	3.1	2.4
Romania	5.6	6.1	6.7	3.9	3.2	5.7	5.2	4.9	4.0
CE-5	3.4	3.3	4.1	2.8	2.4	4.1	3.7	3.4	2.8

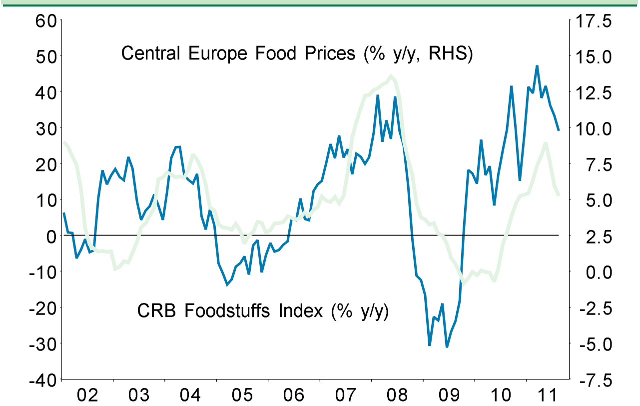
Source: BNP Paribas

Chart 3: Core Inflation and Output Gap



Source: Reuters EcoWin Pro, BNP Paribas

Chart 4: Food Inflation and Global Prices



Source: Reuters EcoWin Pro, BNP Paribas

Russia & CIS: Still Above Average

■ Growing above average

In 2009, Russia and the CIS region had shown themselves to be quite vulnerable to global financial turmoil and fell into a deeper recession, mainly due to a sharp drop in commodity prices and massive capital outflows. In contrast, in H2 2011, the wave of uncertainty associated with a global slowdown has not seriously affected commodity prices. Russia and the other CIS countries are likely to expand by more than the global average. (The severe financial crisis in Belarus has internal causes separate from the global story.) With the Urals oil forecast to average USD 111/bbl in 2011 and USD 115/bbl in 2012, Russian GDP growth is likely to reach 4.3% and 4.7% in these years. Relatively strong growth in Russia boosts demand for goods and services elsewhere in the region.

Kazakhstan is likely to deliver even more impressive growth results of 6.7% in 2011 and 6.5% in 2012, thanks to its more competitive economy and friendlier investment climate. Unlike Russia, which faced sizable capital outflows in 2011, Kazakhstan remains a regional leader in FDI. Ukraine is also now growing above expectations. We see GDP growth of 5% in 2011, although higher energy prices are likely to moderate growth to 4.5% in 2012-13. We consider the strong harvest of 2011 as a one-off effect supporting GDP growth in H2 2011 in all countries of the region.

■ Consumer spending drives GDP

The rise in consumer spending is likely to be strong in the main CIS countries, exceeding and driving GDP growth as a whole. In Russia, retail sales growth has been supported by a retail credit expansion of 23% y/y, which is more than likely to be stimulated by pre-election populism in Q4 2011-Q1 2012. We expect real wage growth and real disposable income growth of 4.5-5% y/y in 2011-12, boosting growth in private consumption to 4.5% in 2011 and 4.9% 2012. In Kazakhstan and Ukraine, retail sales growth jumped 12.4% and 15.5% y/y in H1 2011, driven by income growth (retail credit growth is still almost flat). Despite some slowdown in H2, we expect sales growth of 5-6% y/y to be maintained for these countries in 2011 and beyond.

In Belarus, a spike in inflation killed real wage and income growth and is very likely to pull it into negative territory in H2 2011. A sharp drop in retail sales and private consumption seems unavoidable in H2 2011 – a recovery is expected within 9-12 months, only if the government successfully stabilises the FX and financial markets.

Chart 1: GDP and CPI Forecasts

GDP (% y/y)

						2011		2012	
	2009	2010	2011	2012	2013	Q3	Q4	Q1	Q2
Russia	-7.9	4.0	4.3	4.7	4.8	5.2	4.3	3.9	5.0
Kazakhstan	1.1	7.0	6.7	6.5	7.0	6.4	6.1	5.5	6.6
Ukraine	-15.0	4.2	5.0	4.5	4.5	5.6	4.4	4.0	4.0
Belarus	0.2	7.6	4.8	3.0	6.5	-	-	-	-

CPI (% y/y)

						2011		2012	
	2009	2010	2011	2012	2013	Q3	Q4	Q1	Q2
Russia	11.8	6.9	8.8	7.2	7.2	8.3	7.7	6.8	6.9
Kazakhstan	7.3	7.1	8.4	7.0	6.6	8.7	7.9	7.1	7.1
Ukraine	16.0	9.4	9.0	9.4	7.3	8.9	8.7	9.6	8.2
Belarus	13.0	7.7	42.0	36.5	7.5	-	-	-	-

Source: FSSS, BelStat, UkrStat, KazStat, BNP Paribas

Chart 2: Current Account and Official Interest Rate Forecasts*

Current Account (% GDP)

						2011		2012	
	2009	2010	2011	2012	2013	Q3	Q4	Q1	Q2
Russia	4.0	4.9	4.2	1.7	0.7	2.4	2.3	2.2	2.0
Kazakhstan	-3.6	3.4	4.3	2.3	1.1	2.5	-2.2	7.1	3.7
Ukraine	-1.5	-2.0	-4.4	-4.9	-4.6	-4.7	-5.6	-4.4	-4.2
Belarus	-13.1	-15.5	-14.0	-9.8	-9.9	-	-	-	-

Official Interest Rate (%)

						2011		2012	
	2009	2010	2011	2012	2013	Q3	Q4	Q1	Q2
Russia	8.75	7.75	8.25	8.00	7.50	8.25	8.25	8.25	8.25
Kazakhstan	7.00	7.00	7.50	7.00	7.00	7.50	7.50	7.50	7.50
Ukraine	10.25	7.80	7.75	7.75	7.25	7.75	7.75	7.75	7.75
Belarus	13.90	10.50	40.00	28.00	16.00	-	-	-	-

*Source: FSSS, BelStat, UkrStat, KazStat, BNP Paribas *Interest rate end period*

■ Demand for financing low in Russia and Kazakhstan…

Oil prices remain high enough – and fiscal oil revenues in Russia and Kazakhstan large enough – to reduce demand for financing in 2011-12. No new Eurobond issuance is likely in 2011-12. Domestic borrowing is unlikely to substantially exceed domestic debt redemptions. At the same time, Kazakhstan has a more-prudent fiscal approach than Russia. The oil price at which the country breaks even is only USD 75/bbl (Brent), while Russia needs the price to be USD 125/bbl (Urals) to balance its budget in 2012. In Russia, the non-oil budget deficit reached 12% of GDP in 2011, which has significantly increased the country’s dependence on oil. Unlike Russia, Kazakhstan has aggressively accumulated new resources in the National Fund (we expect it to expand by USD 12bn a year in 2011-13). Although we expect the budget deficit to be very modest and not to exceed 1-2% of GDP in 2011-12, Russia is facing increasing fiscal risks in the medium term. Moreover, with a new administration from 2012 (a new Putin presidency), we expect a further easing of fiscal policy in Russia. This should result in a higher budget deficit of 3-5% of GDP and a spike in demand for financing in 2013 and beyond.

■ …but high in Ukraine, and huge in Belarus

In Ukraine and Belarus, the fiscal performance has been far stronger than expected this year, but we don't think the budget deficit will remain moderate. In Ukraine, delays in energy reform may increase the UAH 12bn budget subsidy to Naftagaz in 2011, while the recapitalisation needs of the Ukrainian banks are likely to increase pressure on the budget. In Belarus, the government will need to hike the salaries of government employees (24% of the country's wage fund) to support them in a time of very high inflation and financial turbulence.

We expect Ukraine to issue at least USD 2bn of Eurobonds in 2011 (particularly as the IMF loan is unlikely before November). Belarus has a huge need for foreign funds to stabilise its finances. However, investors' appetite for its credit might not be strong. Belarus is very likely to accelerate privatisation (the Beltrasgaz deal is coming in December), and attract more bilateral and syndicated loans. We expect it to recover rather quickly from the crisis, once external imbalances have been eliminated.

■ A good harvest suppressed inflation…

Russia and CIS enjoyed a very good harvest this year (in Russia, Kazakhstan and Ukraine, grain production is likely to increase in 2011 by 51%, 56% and 30% y/y, respectively). This will not only boost GDP growth in the second half of 2011, but has also helped to suppress food inflation.

As food accounts for a very substantial part of the CPI basket (from 38% in Russia to 53.5% in Ukraine), all the main CIS countries are likely to meet their governments' inflation targets for 2011. Moreover, although inflation is likely to remain high in absolute terms in 2012 (above 7% for Russia and Kazakhstan, and 8% in Ukraine), the trend is down.

In contrast, Belarus is likely to face hyperinflation in 2011 (we expect CPI inflation to accelerate to 70% y/y by the year-end), because of the devaluation of the currency. In 2012, inflation is very likely to drop to a more "normal" 9+% by the year-end.

■ …and made easing possible in 2012

Although Russia and the CIS countries are not targeting inflation and their central banks are not transparent in their decision-making, the current slowdown in inflation has made further tightening unnecessary in the main CIS countries. In fact, we expect monetary easing in Russia and Kazakhstan in Q2-Q3 2012.

Ukraine is likely to keep the rate stable until 2013 as some risk remains of an acceleration in inflation on the back of a hike in natural gas prices). In Belarus, the NBB is likely to continue aggressive monetary tightening, hiking the refi rate to 40% in 2011 to address the spike in inflation. We think the NBB is likely to use the rapid decline in inflation in 2012 as an opportunity to ease policy.

■ External sector risks

In Russia, the current account surplus is likely to remain sizable in Q4 2011, but capital outflows are very likely to substantially weaken the external balance, reducing our optimism on the rouble strengthening in Q4 2011-Q1 2012. We only expect capital inflows to start after the presidential elections (from Q2 2012), resulting in improvements in external balances.

In Kazakhstan, a current account deficit is likely in Q4 2011 on the back of seasonal factors but should be offset by strong FDI. In 2012, the country is likely to continue enjoying the healthy combination of a current account surplus and capital inflows, which will result in an acceleration of the accumulation of international reserves. Tenge strengthening to KZT 142/USD is unlikely to be enough to seriously affect this process next year.

In Ukraine, higher natural gas prices (above USD 400/tcm) in Q4 2011-2012 will cause the current account deficit to widen. We do not see substantial risks for the hryvnya, however, as privatisation revenues and FDI are expected to be sizable. We also expect the USD 6bn IMF loan, initially scheduled for 2011, to come at year-end or Q1 2012, strengthening the case for hryvnya stability.

In Belarus, the sharp devaluation has not been enough to shrink the current account deficit quickly, and it is expected to still amount to around 10% in 2012-13. This makes the country's external financing needs acute and the success of its aggressive privatisation plans essential for financial stabilisation.

■ Political stability

In Russia and Ukraine, economic policy may be affected by some pre-election populism, but we expect decision-making to remain rational. In Kazakhstan and Belarus, political stability is certain.

In Russia, PM Putin has decided to participate in the presidential elections of March 2012 and is more than likely to win the race. The pro-Putin United Russia party is likely to repeat its success and win the constitutional majority in the parliamentary elections of December 2011. The current ruling group will continue to control the country fully in 2012-18, making substantial revisions to the economic model unlikely. At the same time, we expect acceleration of some structural reforms (to pensions and banking).

In Ukraine, President Yunukovich's administration and his Party of Regions are consolidating authority in their hands. If unpopular reforms do not materialise in the coming months, we expect them to be unlikely to happen after Q1 2012 (elections are scheduled for October 2012).

Latin America: Policy Dilemma

■ Growth slows into 2012

As developed economies turn down significantly, can emerging market economies, like those in Latin America, decouple? In our view, extreme views on either side of the decoupling debate are misguided.

The truth lies somewhere in between. Decoupling should be seen as a spectrum of outcomes, not as a binary choice between yes-or-no extremes.

On the one hand, no economy is absolutely immune to a global slowdown. In that sense, there is no decoupling. On the other hand, emerging markets such as Latam should continue to perform much better than most advanced markets.

Latam economies are now in much better shape than they used to be, and in comparison with the dismal picture facing most developed economies at the moment. Gone are the days when developed economies would sneeze and Latam would catch a cold. If anything, if Latam has a cold, advanced economies have pneumonia.

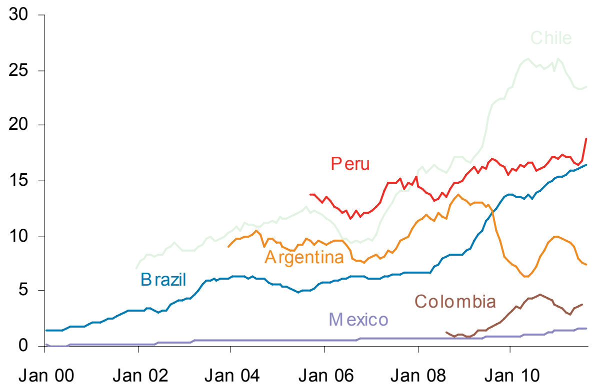
Within Latin America, links with the global economy vary between countries. Brazil and many other countries in the region are benefiting from closer ties with fast-growing China (Chart 1). Indeed, China has become an increasingly important destination for exports for virtually all Latin American economies.

The notable exception in the region is Mexico, where its deep links with the US economy are the key international driver (Chart 2). More than 80% of Mexico's exports still go to the United States, while homebound remittances from Mexicans working in the US are significant. For Mexico, China is more often seen as a competitor in US markets than a potential importer of Mexican goods.

Overall, we expect growth to moderate (Chart 3). After a fall in GDP of 2% during the recession of 2009, real GDP growth in Latin America as a whole had rebounded to 6% last year but is now slowing to an expected 4.0% this year. We expect growth to slow further to below the 3% mark next year, before a recovery towards 4% in 2013.

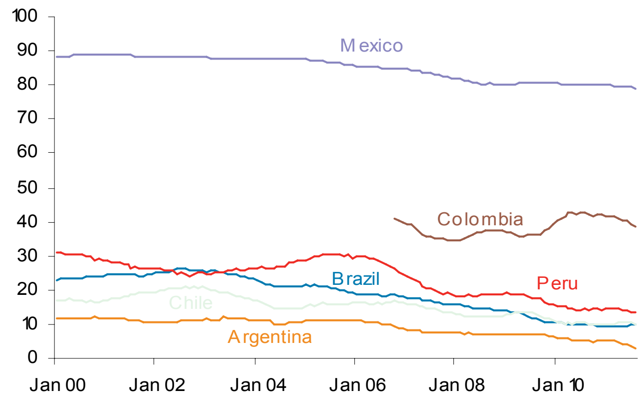
Growth performances will vary within the region, of course, although we see growth weaker in 2012 than in 2011 for every single economy we cover in the region. Our long-standing, well-below consensus view on Brazil foresees growth slowing to below 3% into next year. For its part, Mexico has been the clear laggard in the post-2009 recovery (Chart 3), and is unlikely to do well if the US economy falls into recession. However, the largest expected growth downshift in 2012 is in Argentina, where a booming economy will give way to much tamer expansion next year. By contrast, Colombia's deceleration in GDP

Chart 1: Latam Exports to China (% share of total exports, 12-month average)



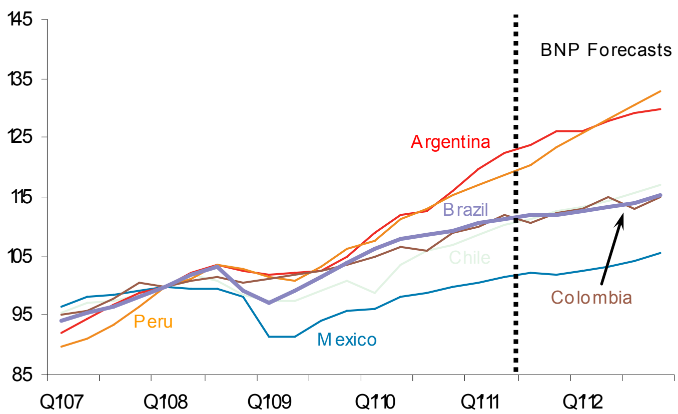
Source: Reuters EcoWin Pro

Chart 2: Latam Exports to the US (% share of total exports, 12-month average)



Source: Reuters EcoWin Pro

Chart 3: Latam Quarterly Real GDP (Q1 2008=100)



Source: Reuters EcoWin Pro, BNP Paribas

growth next year is likely to be limited, while Peru should be the fastest growing economy in the region next year.

■ Inflation to moderate, but still high in Brazil

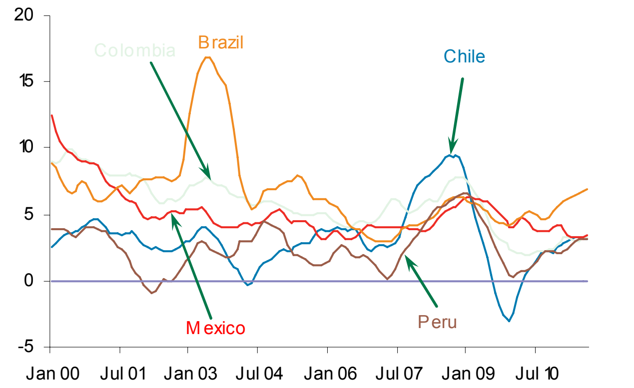
Headline CPI inflation in Latin America has been picking up this year from cyclical lows last year (Chart 4). Base effects should help to slow inflation ahead, but we expect it to finish 2011 above the centre of official target ranges in the region. Outside Brazil, inflation is largely contained – with the usual exception of double-digit inflation in Venezuela and Argentina. Similarly, in Brazil, inflation has already exceeded the target tolerance ceiling.

Looking ahead, while the growth slowdown should help temper upward price pressures, inflation will also depend on currency moves and other external developments, including international commodity prices.

■ Policy will ease

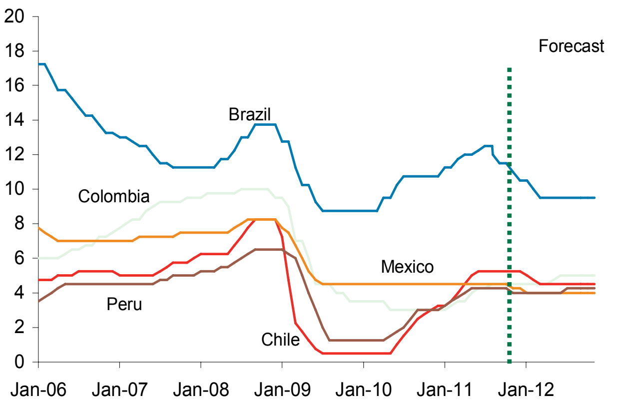
Despite above-target inflation in many countries, concerns about the impact of the global growth downturn on the local economy will lead Latam policymakers to ease. Some countries, such as Peru, are ready to spend more and cut rates. Others, like Brazil, plan to focus on monetary rather than fiscal easing. Across most economies, central banks will cut rates (Chart 5). Brazil took the lead, swinging suddenly from rate-hiking straight into cutting in a sharp policy U-turn. There is plenty more easing in the pipeline.

Chart 4: Latam CPI Inflation (% y/y, 3mma)



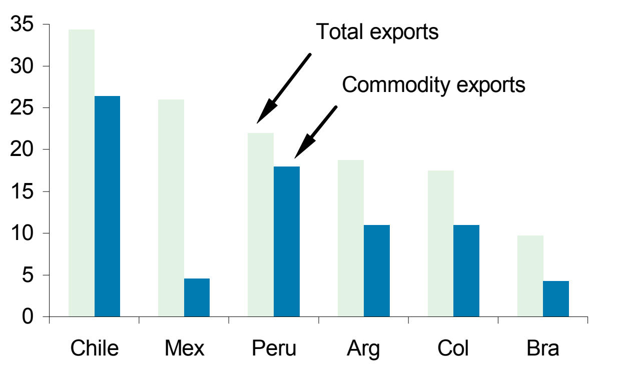
Source: Reuters EcoWin Pro

Chart 5: Latam Policy Rate Cycle (%)



Source: Reuters EcoWin Pro, BNP Paribas

Chart 6: Latam – Total and Commodity Exports (% of GDP)



Source: BNP Paribas

Market Outlook: Positions Too Big To Close

■ Hit by shrapnel as inflows reverse

In July's edition of *EM Outlook* we pointed out that the market was being ruled by flows into bond funds. As Chart 1 shows, inflows remained sizeable until they suddenly stopped in late August and reversed sharply in September. In addition, the GBI and EMBI have given up most of their earlier gains in recent weeks. At the time of writing, the EMBI is still slightly up on the year while the GBI has already dipped into negative territory. The latter has also been hit by the depreciation of EM currencies and we have already seen foreign investors attempting to hedge FX risk through the forward market. This could delay the pain in local markets but it also means the risk of a sell-off is unlikely to disappear soon.

We have seen indiscriminate selling across emerging markets as liquidity has dried up and investors have started to worry about (or outright face) redemptions. Table 1 gives a snapshot of foreign positions in local bond markets around the world. In some cases, such as Indonesia, Mexico, Poland and South Africa, positioning has reached historically high levels. More importantly, the firepower of local investors – who in many cases provided bids during the 2008/09 crisis – is considerably smaller.

■ Underlying reasons to invest in local markets remain intact

But have the macro reasons in favour of investing in emerging markets changed? Let's revisit the basics:

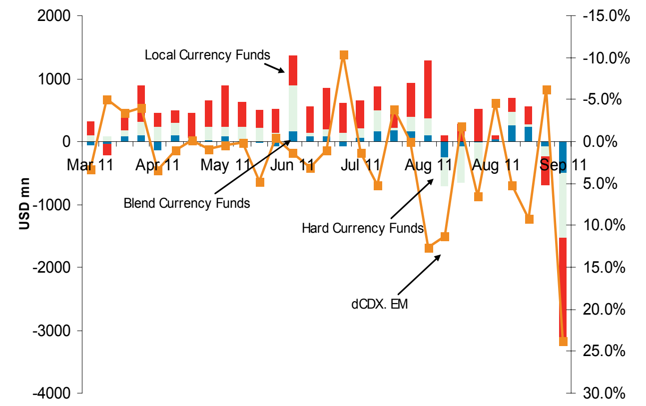
- BNP Paribas expects the growth differential between emerging and developed markets to stand at 5.2pp in 2011 versus 4.2pp in 2010. We forecast the difference will moderate to 4.7 and 4.0pp in 2012 and 2013, respectively. In other words, we think this year will be the peak in the emerging world's outperformance, although the difference will remain sizeable.
- EMs will continue to experience faster price increases than developed economies, although we expect the difference to narrow from around 4.0pp in 2010-11 to 3.5pp in 2013.
- Hence, it must be assumed that nominal interest rates will stay fairly high in EM space.
- At the same time, Chart 2 shows that real rates in the US and Germany are now very close to zero, which maintains the appeal of emerging markets.
- The diversification story has arguably become even more valid in the last few months given worries about both the US's sovereign rating and the debt crisis in the eurozone.

We conclude that, given the amount of nervousness and outright panic in the market in the last couple of months, emerging markets have held up fairly well. However, the sustainability of this outperformance in a bear market depends on the flows into funds investing in local assets, and for the time being, this is in serious question.

■ Risks of a hard landing resurface

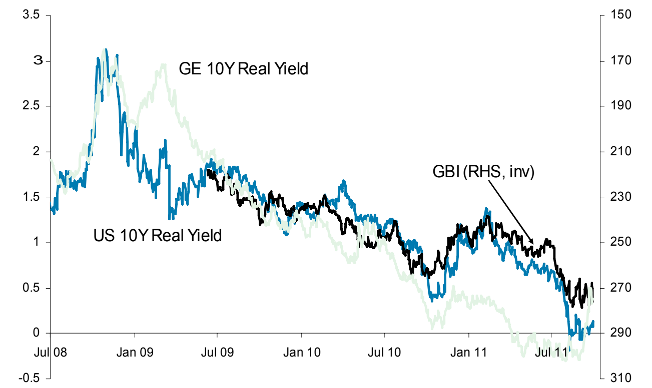
Even if the situation in global markets stabilises, EM markets will find it difficult to return to outright bullish positions. First, the memory of difficulties in finding bids will stay for a while. Second, worries about a deeper-than-expected economic slowdown will

Chart 1: Sharp Reversal in Flows to Bond Funds



Source: EPFR, BNP Paribas

Chart 2: Real Rates and Local Bonds



Source: Bloomberg, BNP Paribas

Table 1: Foreign Ownership of Local Bonds (%)

Brazil	11
Mexico	40
Poland	29
South Africa	30
Turkey	17
Indonesia	34
China	<1
Russia	<5
South Korea	11

Source: National sources, BNP Paribas estimates intensify. After all, with bank CDS at record highs and sovereigns finding it difficult to fund themselves because of concerns about their creditworthiness, it is difficult to expect significant credit action and/or investment. In addition, although forecasts for growth have been revised down, economic indicators continue to surprise to the downside, which suggests the market has not yet fully adjusted to the new reality.

What can local markets do about it? Well, to start with, in Q3 we saw a massive reversal of expectations for monetary policies. Our economists believe that many EM central banks will cut interest rates and that inflation is not going to be a major obstacle. In contrast, developed economies have very little room to stimulate growth using monetary or fiscal tools, supporting our view that the growth differential will remain substantial.

On EM monetary policy, we highlight the example of the central bank of Turkey. A year ago the CBRT embarked on non-standard and widely criticised policies. Since then, the lira has fallen significantly but local bonds have actually performed better than expected. Significantly, despite the exchange rate correction, the curve has not steepened dramatically. This brings us back to the question of the correct response of emerging markets to the persistence of negative real rates in the developed world. For the time being, reducing local real rates as low as possible appears to be the desired strategy. Indeed, this appears to be the viewpoint of BCB's Governor Tombini, which is particularly telling given Brazil's long history of maintaining very high real rates to anchor inflation expectations.

■ Front ends will be protected by expectations of policy easing

Consequently, we think that front ends of curves in local markets will stay low. Taking into account investor sentiment of late, it might be tempting to assume that curve steepening will continue. However, we would caution against such a generalised approach. Starting with Asia, the market's positioning against a slowdown could lead to inverted curves, as seen, for example, in INR OIS or CNY NDIRS. Similarly, if the sell-off in CEE currencies is sustained, we would not be surprised if expectations of emergency rate hikes resurface in Hungary or even Poland. In Latam, on the other hand, the risk-off scenario will drive back ends higher and is likely to push breakevens up.

■ Currencies – can the cheap get even cheaper?

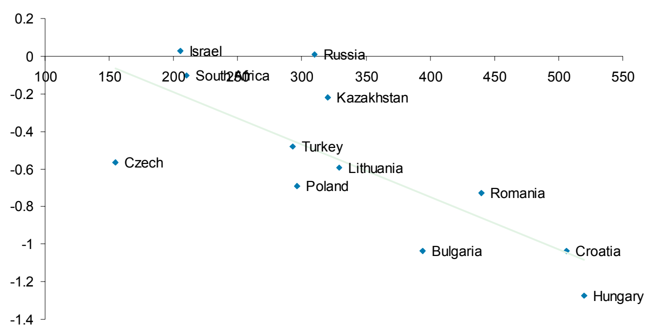
They most definitely can. Most of the traditional purchasing power parity indicators show that many local currencies have become extremely cheap. This applies particularly to Asian currencies, but also to the likes of Mexico and South Africa. Table 2 shows our forecasts versus the consensus and current level

Table 2: BNPP Forecasts vs. the Consensus

	Last Price	Year-End	% Change	Consensus	Difference
CLP	513	470	8.4	470	0.0
KRW	1174	1080	8.0	1070	-0.9
SGD	1.29	1.20	7.2	1.21	0.8
COP	1917	1780	7.2	1790	0.6
MYR	3.18	2.96	6.9	2.95	-0.3
INR	49.0	46.0	6.1	45.5	-1.1
ILS	3.72	3.50	5.9	3.54	1.1
MXN	13.5	12.7	5.6	12.35	-2.8
THB	31.2	29.7	4.7	29.7	0.0
IDR	8856	8500	4.0	8500	0.0
EURPLN	4.42	4.25	3.9	4.1	-3.7
TRY	1.85	1.78	3.9	1.75	-1.7
TWD	30.4	29.3	3.7	29.1	-0.7
PEN	2.77	2.68	3.3	2.7	0.7
ZAR	7.86	7.6	3.3	7.05	-7.8
RUBBASK	37.2	36.0	3.1	36.2	0.6
PHP	43.6	42.5	2.6	42.3	-0.5
CNY	6.40	6.31	1.4	6.31	0.0
EURRON	4.33	4.29	0.8	4.28	-0.2
KZT	148	147	0.6	143	-2.8
EGP	5.96	5.95	0.2	6	0.8
VND	20832	20800	0.2	20900	0.5
VEF	4.29	4.29	0.1	4.3	0.2
UAH	8.00	8.00	0.0	8.00	0.0
HKD	7.79	7.80	-0.1	7.79	-0.1
EURHUF	291	292	-0.4	275	-6.2
BRL	1.84	1.85	-0.5	1.65	-12.1
EURCZK	24.5	25.0	-1.9	24.2	-3.3
ARS	4.21	4.45	-5.8	4.35	-2.3

Source: Bloomberg, BNP Paribas

Chart 3: Net Investment Position (% of GDP) Determines the CDS Level in CEEMEA



Source: JEDH, BNP Paribas

in descending order of undervaluation. It is important to note that our FX strategy team is forecasting continued upward pressure on EURUSD, which will naturally support currencies quoted against the USD.

As noted above, we are generally bullish on Asian currencies, seeing a lot of value particularly in the KRW and SGD. This seems to be in line with the broad consensus and has recently been supported by the significant activity of Asian central banks.

In CEEMEA, we believe that the ILS offers potential despite interest rate cuts as the balance of payments story remains quite positive and the international investment position is attractive (Chart 3).

Russia could be a very interesting story. The RUB's sell-off in the last few months has not been a surprise to us as far as the direction is concerned, but the pace has been extreme. We think the political risks are receding, with Putin more than likely to be elected as the new president. So the chances of the RUB recovering by the year-end are significant, global conditions permitting.

In CEE, central banks have become more active, as seen by the NBP's first intervention to defend the zloty in more than a decade. We think that this will continue to be the preferred course of action and do not assume further depreciation. But the key will be what foreign bond holders do (or are forced to do).

In Latam, we are fairly bullish on Chile and Colombia given their ties to Asia. The MXN appears to be fundamentally undervalued but Mexico's close ties to the US economy – what we call its "wrong ZIP code" –might prevent a significant appreciation in the near term. Brazil seems to have made it perfectly clear that it won't allow substantial appreciation from current levels and so we are neutral on the BRL.

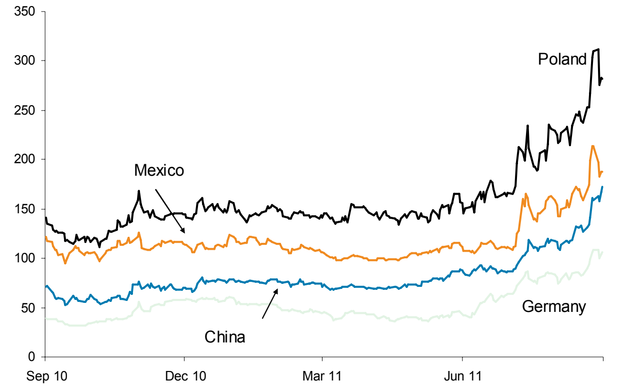
■ External debt: racing for protection is a dangerous strategy, particularly for sound credits

The last few months have seen significant moves in the external debt markets too. In fact, as international investors have been reluctant to sell local bonds, the CDS market has witnessed similar moves to the FX market. While the CDS market is much smaller than the local bond market, in most cases it has been attracting a lot of attention such that it has been the tail that is wagging the dog. Moves in CDS have also made local bonds look quite expensive. In countries such as Poland, Hungary and South Africa, it is now much more beneficial to express the bullish view by selling the CDS rather than buying local paper.

As the end of September drew near, it seemed that external debt markets lost touch with reality and investors began to consider any sovereign CDS trading in double digits or low triple digits as expensive and bound to catch up. Chart 4 gives a few examples of how credit markets, which until recently were considered "safe and sound", blew up.

In this respect, China is definitely worth a mention. Because of the widening of the basis for the reserve requirements, investors seem to have become cautious about the banking system. Also, stories are flying around that the property market is in a bubble that is about to burst, which would increase the risk for the country. In our opinion, these fears have been blown out of proportion but, of course, the timing of bullish positions is key. Similarly, even though China has recently been fixing the yuan at ever stronger levels, the forward points have turned positive, which goes against the macro fundamentals.

Chart 4: Even the Most Stable CDS Markets Have Widened Sharply



Source: BNP Paribas

Another interesting development over the last quarter was the fact that SovX CEEMEA rose back above its Western Europe counterpart. Russia and CEE have played an important role here while the Middle East and Africa have remained quieter. Judging by the refinancing needs in the region in the next six to nine months, we do not see any significant issues. The notable exception is Ukraine, which could eventually be forced to change its hardline stance versus the IMF. In fact, bigger redemptions will not begin until around Q2 2012, which should bring some comfort. That said, investors will remain very cautious towards the region and we would expect more and more relative value plays. In this context, we would fade any jumps in the cost of protection for the Czech Republic, South Africa or safe GCC names such as Abu Dhabi and Qatar.

■ Conclusion – stay defensive

In summary, we believe that the risk reward does not yet favour bullish positions. Liquidity is very poor and event risk from the eurozone and the US is simply too high. In addition, we have not really seen big liquidations in the local bond markets as investors have only hedged their FX exposure away, hoping to ride out volatility. The flip side is that if markets don't stabilise in the coming months, the risk of exits from local markets will become a reality.

In our view, interest rate cuts in the eurozone along with a resolution of the debt problem or QE3 in the US could be game changers. If that happens, the best returns on bullish positions could be obtained in the CDS market, which has been pushed around by fast money investors creating significant mispricing. FX is another asset class that might benefit. In this case, we would consider short vega strategies (if and after QE3), particularly given quite a decisive response from various EM central banks to recent moves in the currency market.

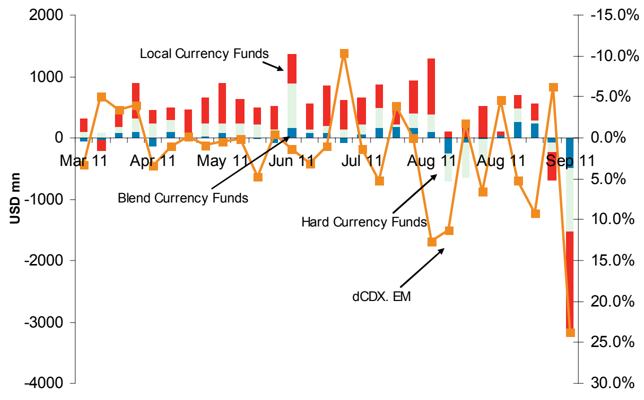
But the very near term will be ruled by the direction of flows to global funds, although in a very different context than in the first half of the year.

EM Flows

Redemptions at the end of Q3 wiped out the inflows accumulated over the previous two quarters

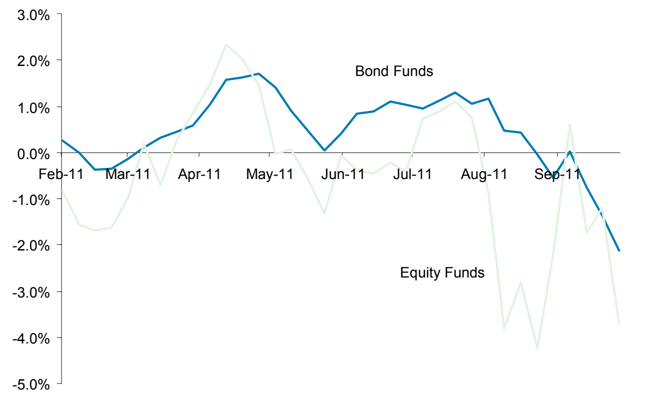
- The outflows registered in the last two weeks of Q3 wiped out almost all of the inflows accumulated over the previous two quarters.
- The USD 3.2bn of outflows in the week to 28 September were the highest since 2008.
- Put in perspective, however, the outflow is less apparent because total assets under management are far more than they were in 2008.
- Global EM (BRIC) funds were responsible for most of the outflows.

Chart 1: Weekly FF by Currency Type vs. dCDX.EM



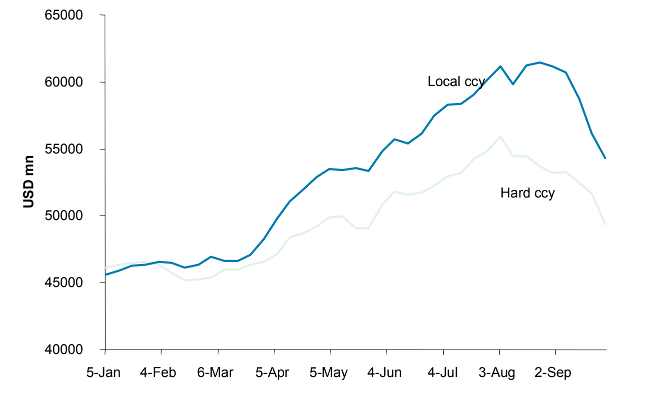
Source: EPFR

Chart 2: 4-Week Rolling Change in AUM



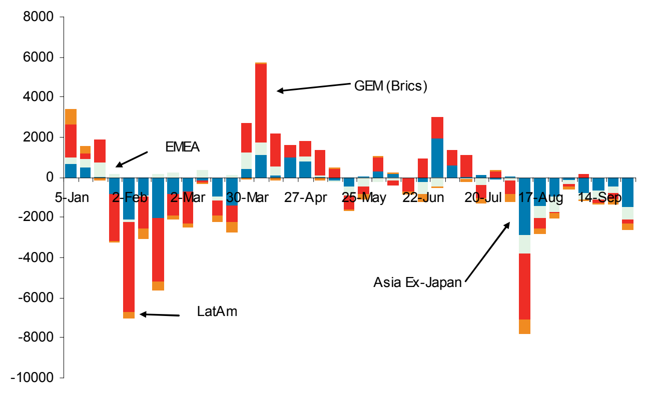
Source: EPFR

Chart 3: Current AUM by Currency Type



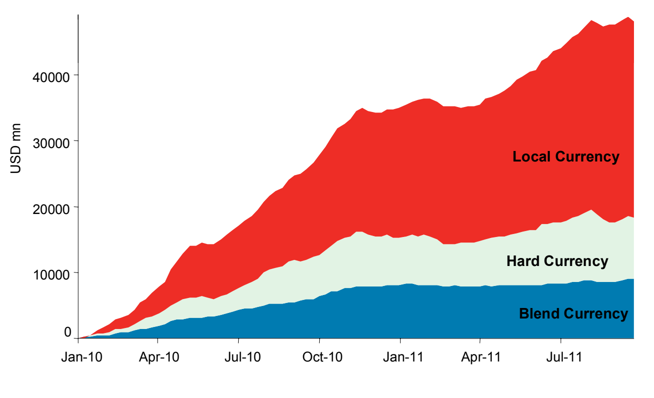
Source: EPFR

Chart 4: Equity FF by Region



Source: EPFR

Chart 5: Cumulative FF by Currency Type Since '10



Source: EPFR

Asian Markets: Balance Sheets Intact

■ **External headwinds prompt de-risking**

After a fairly good start to the third quarter, Asian currencies ended it on a much poorer footing, thanks to the deepening debt worries in Europe, which are threatening to throw global markets into a crisis like that seen in 2008. As a worst-case scenario, markets are pricing in a potential default by Greece. As a result, we have seen an aggressive scaling back of positions, reversing the gains in Asian currencies.

The hardest-hit currencies in this round of financial market stress have been the INR and IDR: the INR because of the country's current account deficit and the lack of capital inflows to finance them; the IDR because of the reduction in foreign holdings of Indonesian bonds (foreign holdings have been trimmed to 34% of Indonesian government bonds from a peak of 35% as of 16 September 2011) as part of a general reduction in risk taking.

For example, the need for banks to shore up their balance sheets and "play safe" has led to US money market funds exiting European asset holdings. This reduction arguably started the ball rolling towards a full-scale deleveraging of risk positions, pulling emerging Asia down in the process.

■ **Asian macros to soften, but remain strong**

The latest round of financial market tensions has prompted our economists to lower forecasts for the US and EU, with smaller reductions to Asian growth. Indeed, our economists see the Chinese economy still growing by 9.4% in 2011 and, although softening to 8.5% in 2012, remaining respectable by any measure. In addition, India's GDP is forecast to slow to 6.7% in 2012, from 7.5% in 2011, though that is hardly a reason for its central bank to cut rates for the next few quarters. Indeed, the likely outcome is a shift to neutral policy from tightening. The easing of inflationary pressures will allow the other Asian central banks to pause with an eye towards easing if the need arises.

Asian rates have thus peaked, with INR OIS and CNY NDIRS yields peaking. The inversion in their curves suggests the market is positioning for a slowdown in Asia. With the end game of the European debt crisis still unsure, inverted curves via bull-flattening plays are likely to persist for at least another quarter.

■ **USD funding stresses intermittent**

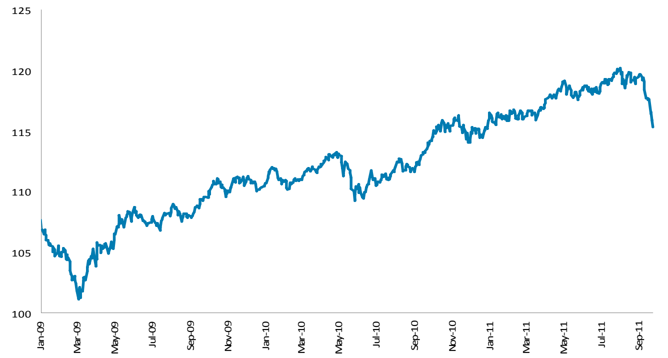
Cross-currency basis swaps have widened as Europe's crisis has raised fears of another USD credit crunch. This has prompted a precautionary hoarding of USD and rising USD yields, as implied via FX swaps. However, the shift to the left in the FX forward curve has been much less severe than during the peak of the US credit crisis. This reflects several developments: (1) new regulations by Asian central banks (e.g., Korea) to reduce exposure to FX derivatives and the consequent scramble for USD during heightened periods of stress in the financial sector; (2) bilateral swap arrangements

Table 1: BNP Paribas' End-Quarter Foreign Exchange Forecasts

	Spot*	Q4 2011	Q1 2012	Q2 2012	Q3 2012	Q4 2012
USDSGD	1.31	1.20	1.18	1.17	1.16	1.15
USDMYR	3.20	2.96	2.93	2.87	2.83	2.80
USDIDR	8,950	8,500	8,300	8,100	8,000	7,900
USDTHB	31.22	29.70	29.30	28.70	28.50	28.30
USDPHP	43.98	42.50	41.80	41.00	40.50	40.00
USDHKD	7.79	7.80	7.80	7.80	7.80	7.80
USDCNY	6.38	6.31	6.28	6.24	6.18	6.12
USDTWD	30.60	29.30	28.70	28.30	27.80	27.30
USDKRW	1,181	1,080	1,040	1,010	1,000	990
USDINR	49.2	46.00	45.50	45.00	44.50	44.00
USDVND	20,832	20,800	20,700	20,600	20,500	20,400

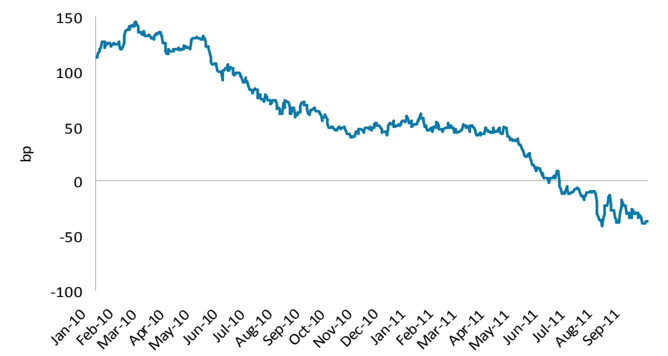
Source: BNP Paribas *3 October

Chart 1: ADXY Breaks Down



Source Bloomberg, BNP Paribas

Chart 2: INR 2-5Y OIS Curve Inversion



Source: Bloomberg, BNP Paribas

between the Fed and Asian central banks providing USD liquidity when needed; (3) new investment rules for domestic investments – e.g., Indonesia's new rulings on bond investments; and (4) increased cash stockpiling by banks and corporates in view of the uncertain economic and financial outlook.

As such, even if Europe's crisis were to linger and credit concerns heighten, the widening of basis swaps in Asian currencies is likely to be temporary. Ample FX reserves by Asian central banks could prevent a sharper spillover to robust Asian banks in the region.

■ After the storm, Asian FX strength to resume

Like all storms in the financial markets, the current one will come to an end. When calm returns, we expect Asian currencies to resume their appreciation trend. It is still hard to say when the storm will abate, given the uncertainties in Europe, but in the meantime, Asian central banks are continuing to act as shock absorbers, slowing the pace of Asian currency depreciation.

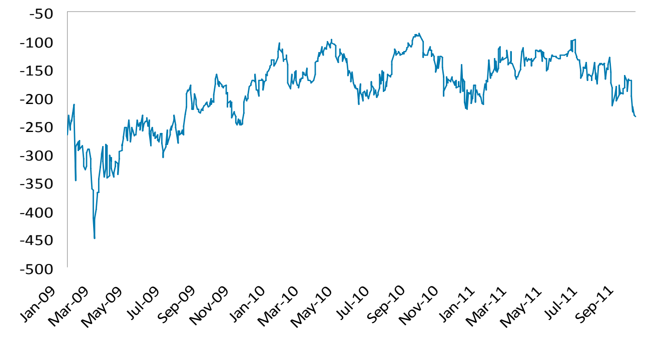
In our view, the reasons for Asian currencies' appreciation trend against the USD remain the same: sound Asian balance sheets via balance of payments surpluses, and the ability of Asian governments and central banks to offset economic crises via fiscal and monetary easing.

Indeed, the aggressive tightening of monetary policy in China appears to have taken a different form. The central bank is trying to ward off imported inflation pressures through a stronger CNY rather than through rate hikes. Rate changes are a blunt instrument, especially where the market mechanism for them to filter through to borrowing and lending is less than perfect. Certainly, credit and administrative measures will continue to be an important tool used by policymakers. In this regard, developments in the offshore CNY market, or the CNH as it is popularly known, and the repatriation of CNH could keep up the strong capital inflows to China and require the PBOC to maintain a restrictive monetary policy via high reserve requirement ratios. The management of liquidity in China thus remains the central bank's key priority. Further fine-tuning of the CNH rollout, the extension of CNH trading to other major centres (e.g., Singapore, London and New York), and liquidity management should keep both onshore and CNY NDIRS yields supported for the time being.

■ Outperformers versus underperformers

Our view on the likely top performers and underperformers is largely unchanged. The CNY, IDR, KRW, MYR and SGD should fare well against the INR. The TWD has been an underperformer as expectations that the country would benefit from closer cross-Strait ties and capital inflows failed to materialise. Indeed, the TWSE is down nearly 20% in the year to date, making it the worst performing Asian bourse in the region.

Chart 3: KRW 1y Basis Swap Widening

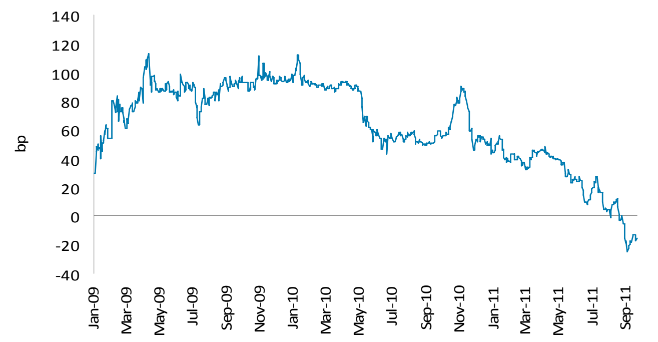


Source: Bloomberg, BNP Paribas

Chart 4: USDCNY Still Headed Lower

Source: Bloomberg, BNP Paribas

Chart 5: CNY Repo IRS Curve



Source: Bloomberg, BNP Paribas

Unless and until fund inflows to the nation improve, we will not change our lowered forecasts for the TWD. In contrast, we would position for CNY appreciation via 6m and 1y USDCNY puts with strikes at 6.20 and 6.00, respectively.

■ Favourite rate trades

In contrast to bull flatteners generally, the CNY repo IRS curve is expected to steepen as liquidity management continues to keep back-end rates firm. Buying SGS (Singapore government securities) and Indonesian government bonds on dips looks to perform too as the SGD remains a safe-haven choice and SGS bonds are still in demand. The imminent upgrade of Indonesia to investment-grade status is expected to bring in buyers as bonds sell off.

CEEMEA Markets: Funders and Fundees

■ **CEEMEA markets have undergone a massive repricing of expectations for interest rates, although, so far, the CBRT and the BoI have been the only central banks to ease**

In the last *EM Outlook* we said that because our regional economists expected a slowdown in growth, rate-hike expectations would need to be scaled back. Chart 1 shows most of the CEEMEA countries are now pricing in almost imminent rate cuts, and that's after some profit taking following a huge rally in July-August. During most of Q3, interest rates in the region traded completely obliviously to currency moves. The best examples are South Africa and Turkey, where the rates market was only recently catching up with currency depreciation (Chart 2). We think the fact that the rates market is not worried about the pass-through from FX depreciation to inflation reflects the view that core pressures will be limited by the slowdown in global economic growth. It will be difficult for commodity prices to beat the rise from late 2010/early 2011, which bodes well for inflation rates everywhere.

We see a significant chance that markets in South Africa, Poland and the Czech Republic will start pricing in more aggressive policy easing. In the case of Hungary, we think this will be impossible until the FX mortgages story is fully resolved (see below). In Turkey, the rates market is already red-hot so we would not assume further strengthening at this juncture. One market that is interesting could turn out to be Israel. Despite the country's relatively strong economic fundamentals, the BoI has pre-emptively cut interest rates and we think that there could be more to come. Finally, the Central Bank of Russia will find it difficult to cut rates, particularly if our fears about capital outflows come true.

■ **Funding issues have resurfaced in the region, particularly CEE. We expect more action from central banks to remedy this situation in the remainder of the year**

The European sovereign debt problem has inevitably led to tensions in the money markets. Cross-currency basis has widened to proportions unseen since the Lehman crisis and that has naturally percolated into CEE. The two worst-hit countries were Poland and Hungary, which have significant funding needs in hard currencies. Each will respond differently to the situation. The National Bank of Poland has already reiterated that it was ready to provide liquidity in FX swaps if needed, which in our view is the right strategy. In the case of Hungary, the government has decided to tackle the problem head-on by simply allowing borrowers to convert their mortgages at an attractive rate. We think this strategy could eventually reduce shortages in hard currencies, but in the meantime it could lead to the underperformance of Hungarian assets. Even in South Africa, the cross-currency basis – after years of stability – widened towards 2008/09 levels, although we do not think this is sustainable given the soundness of the banking system.

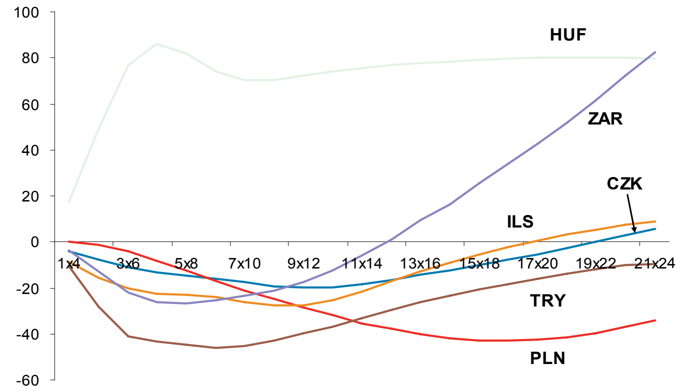
In contrast, the response of the Central Bank of Russia to currency weakness has been to intervene in the FX

Table 1: BNP Paribas' End-Quarter Foreign Exchange Forecasts

	Spot*	Q4 2011	Q1 2012	Q2 2012	Q3 2012	Q4 2012
EURPLN	4.43	4.25	4.20	4.10	4.00	3.80
EURCZK	24.80	25.00	24.30	24.10	23.80	23.50
EURHUF	294	292	290	285	280	280
EURRON	4.33	4.29	4.25	4.20	4.05	4.10
EURRSD	101.7	100.0	98.0	97.0	96.0	95.0
USDRUB	32.46	30.27	29.61	28.98	27.76	27.14
USDUAH	8.01	8.00	8.00	8.00	8.00	8.00
USDKZT	148	147	147	147	145	142
USDTRY	1.86	1.78	1.75	1.68	1.72	1.73
USDZAR	8.09	7.60	7.25	7.00	6.80	6.70
USDEGP	5.97	5.95	5.85	5.80	5.80	5.75
USDILS	3.75	3.50	3.40	3.30	3.40	3.50

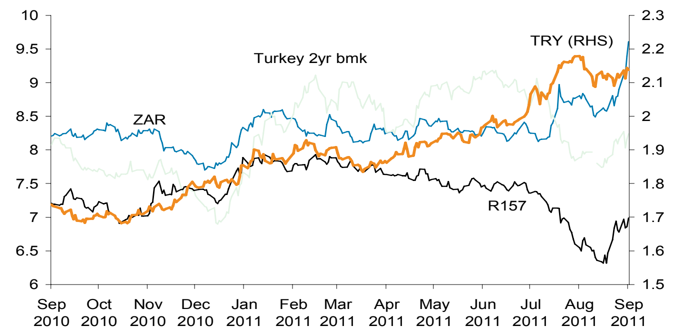
Source: BNP Paribas *3 October

Chart 1: Rate-Hike Expectations Have Disappeared



Source: BNP Paribas

Chart 2: ZAR and TRY Rates vs. FX



Source: Bloomberg

market, which has removed some liquidity from the RUB. Therefore, we have seen cross-currency rates rising, leading to an underperformance of local bonds.

■ **Commodity currencies have remained under pressure with the RUB and ZAR losing ground. We think the move has further to go. We expect PLNHUF to edge higher, while the CZK should remain the region's safe haven. The ILS could see some pressure if the BoI continues to ease policy**

Commodity currencies have suffered globally, which in CEEMEA has led to an underperformance of the RUB and ZAR. In the case of the RUB, we have revised our already-weak forecasts down further as we expect ongoing capital outflows ahead of the elections. In South Africa, we think the above-mentioned widening of the cross-currency basis, as well as the likelihood of interest rate cuts in the remainder of the year, will remove some carry. Appreciation could resume in 2012 as the relatively sound fundamentals return to the forefront. Meanwhile, the rand could depreciate against the Turkish lira. While we believe there is a chance of an additional rate cut, the TRY has lost a lot this year, and some improvement in external balances in the remainder of 2011 will keep it supported. That said, our economists' view is that the current account will not improve significantly in 2012, which might lead to renewed weakness.

One country that could attract attention is Ukraine. The government is not ready to comply with some of the IMF's requirements, which is best evidenced by the plan to provide some money for Naftogaz by the end of the year. At this stage, we think the NBU will keep the hryvnia very close to 8.00/USD.

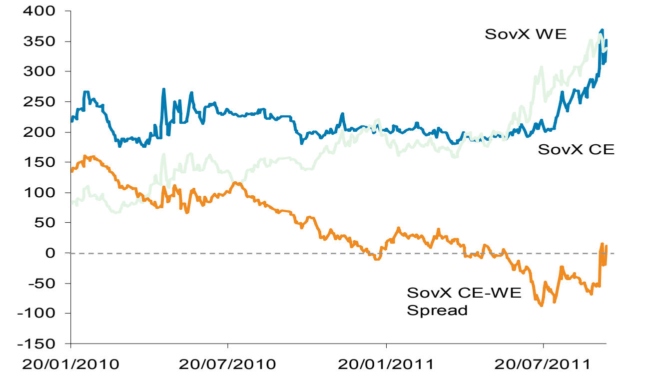
In CEE, we think the HUF could underperform due to the FX mortgages plan, even if it eventually makes the country's financial system more sustainable. The Czech koruna will remain the safe haven in the region and, in our view, some depreciation can be expected only if the CNB cuts interest rates. Finally, as mentioned above, we think that the BoI could continue to ease monetary policy, which could put some pressure on the shekel despite sound fundamentals.

■ **CEEMEA credit is no longer trading through Western Europe but our core views there have remained the same. That said, the economic slowdown will expose fiscally weaker countries**

The spread between CEEMEA and Western Europe credit has narrowed back to par despite the previous out-performance of the former (Chart 3). We have seen significant divergences within constituents on this rising, with CEE clearly underperforming. A lot of that can be explained by international investment positions (Chart 4). In Chart 5 we present an updated version of our proprietary country-risk model. We think the performance of CEEMEA credit will largely depend on flows. We still like the Middle East and Africa on a relative basis. CEE is probably already wide enough and we would be looking for selective long positions (Poland, Croatia), although the big question remains Hungary.

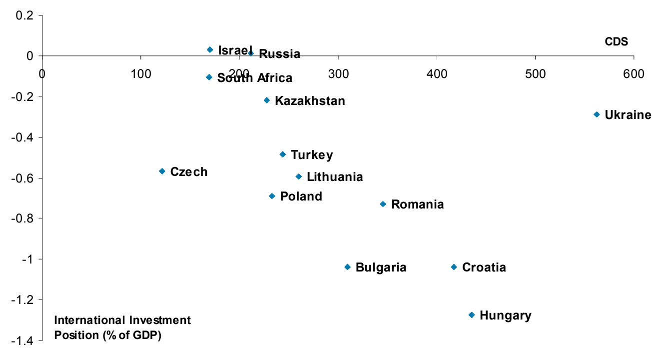
In CIS, we are still wary of risks in Russia and the price action in Russian assets has not been encouraging in recent weeks, particularly considering Russia 30s are among the most liquid USD bonds in the region. Due to its high and persistent correlation with Russia, Kazakhstan might follow, while Ukraine is already close to its widest levels, in our view.

Chart 3: SOVX CEEMEA vs. WE



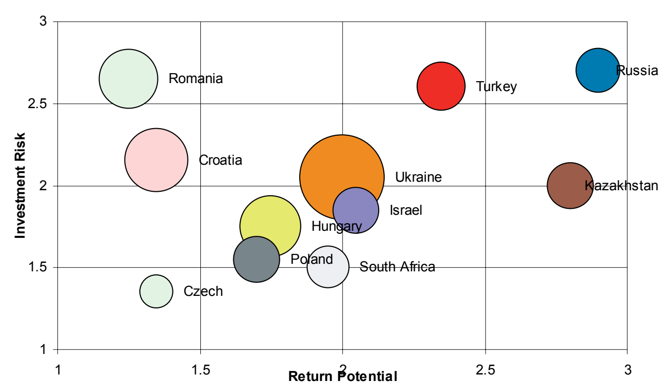
Source: Bloomberg

Chart 4: International Investment Positions



Source: JEDH, BNP Paribas

Chart 5: Sovereign Risk Model



Source: BNP Paribas

Latam Markets: Selective Bear

■ Latam: lessons from the (recent) past

The fundamental improvements in Latam economies over the past decade will be tested again. The deterioration in developed economies – the US in particular – has greatly affected the MXN. The BRL is also under pressure, undermined by a succession of FX measures and a sudden easing in monetary policy. There is little reason to expect the BRL's underperformance to come to an end soon. BRL weakness will, in turn, have implications for the ARS, given Argentina's need for a weak ARS to keep the real exchange rate competitive. The COP is not immune to the global deterioration in sentiment, but in the coming months, we do not expect to see a repeat of 2010, when it fell sharply on a shortage of dollar inflows. Among the Latam currencies, the CLP has the closest economic ties with Asia, due to Chile's strong copper exports, notably to Japan and China, where growth is still solid. Thus the CLP is likely to find some structural support. The PEN also closely connected with Asia and is expected to perform well.

In Q4 we expect the CLP and PEN to do better than the COP, with the MXN lagging the expected rebound after the announcement of QE3. The BRL should be the beaten dog in Latam, fuelling a more pronounced decline in ARS. We forecast that the overall appreciation in Latam currencies will resume in 2012.

■ Brazil: learning from the Turkish CB

Brazil and Turkey have quite different fundamentals. In particular, Brazil is much less vulnerable on its external accounts, with a current account deficit of just 2% of GDP (against Turkey's 10%-of-GDP deficit). It also has reserves equal to 20 months of import cover versus just five months in Turkey. But the BCB does share the CBRT's concern about excessive hot money inflows. That is why, after the BCB's unexpected 50bp cut in August, the BRL started to mirror the TRY's sharp fall in late 2010. The BRL's appeal as a currency used for the carry trade is being severely challenged. BNP Paribas forecasts the SELIC rate will be cut to 9.50% by April 2012 with the risk of a sharper decline. Hence BRL's is likely to become about as attractive as the AUD, NZD, ZAR, and CLP, among others (Chart 1).

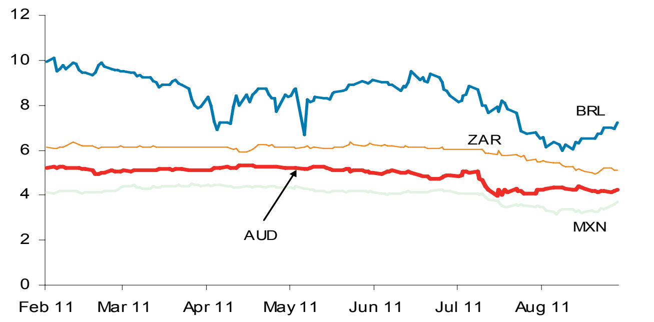
Moreover, we see the latest move to limit short USDBRL exposure in the derivative market as a game changer (Chart 2). The derivative market is around eight times bigger than that for spot. Hence we have revised down our forecast for the BRL substantially for coming quarters. The BCB's selling of USD in the derivative market was much more a result of market malfunctioning than a desire to prevent BRL's fall. While we still expect an appreciation trend in the coming years, we think it will be less pronounced than the rise in the BRL's Latam peers.

Table 1: BNP Paribas' End-Quarter Foreign Exchange Forecasts

	Spot*	Q4 2011	Q1 2012	Q2 2012	Q3 2012	Q4 2012
USDARS	4.21	4.45	4.54	4.68	4.79	4.95
USDBRL	1.90	1.85	1.80	1.75	1.72	1.67
USDCLP	521	470	460	440	450	455
USDMXN	13.84	12.70	12.40	12.10	11.70	11.40
USDCOP	1,930	1,780	1,760	1,735	1,729	1,720
USDVEF	4.29	4.29	4.29	4.29	4.29	4.29
USDPEN	2.77	2.68	2.66	2.65	2.63	2.62

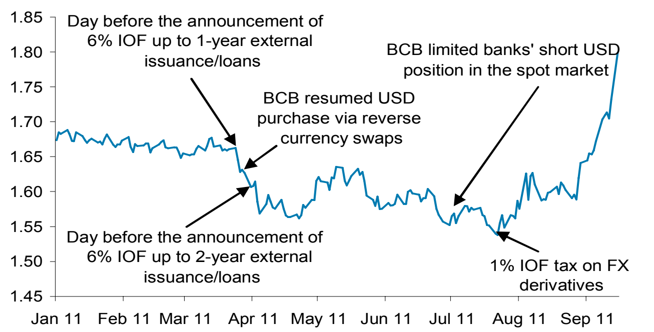
Source: BNP Paribas *3 October

Chart 1: Implied NDF Yields (12-month tenor)



Source: Bloomberg, BNP Paribas

Chart 2: USDBRL vs. FX Measures



Source: BNP Paribas, Reuters EcoWin Pro

■ Mexico: ZIP code matters

The Mexican economy is extremely dependent on the US economy through both trade and remittances from Mexican citizens who live in the US, with the latter an important inflow on the balance of payments. Hence, MXN weakness is very understandable as the US flirts with another recession. However, with the pair at the current levels, our relative purchasing power parity model indicates USDMXN is already overvalued (Chart 3), suggesting the room for additional MXN weakening is limited. Although our USDMXN forecasts have been revised up for the near term, we expect a strong MXN rebound once the US economy recovers during 2012 following the QE3 announcement in Q4 2011.

■ Colombia: will COP repeat its late 2010 sell-off?

We think not. In late-2010, the COP underperformed massively on a shortage of USD inflows in the spot market. Our analysis suggests that spot USD inflow will be small in coming months, given Sura's plans to invest in foreign assets, with a potential outflow of USD 2-3bn. In isolation, such a flow would squeeze the market. However, officials are being cautious about not allowing a market reaction similar to the plunge of 2010, as can be seen by the way NDF points are trading very much on the positive side. While the COP has also been affected by the surge in risk aversion, we do not expect a massive COP depreciation. Our model suggests USDCOP should move to the low-1700s handle in the medium term.

■ Chile: the closest links to Asia in Latam

Chile's copper exports are mainly bought by Asia (Chart 4). Japanese reconstruction needs and still-solid Chinese growth are key reasons to be positive about the CLP in the medium and long term. However, the CLP is also being affected by global risk aversion. QE3 in the US and its impact on commodities would have a direct positive effect on Chile's balance of payments due its dependence on copper. Thus, while USDCLP has risen recently, the rebound of the CLP should be pronounced during 2012.

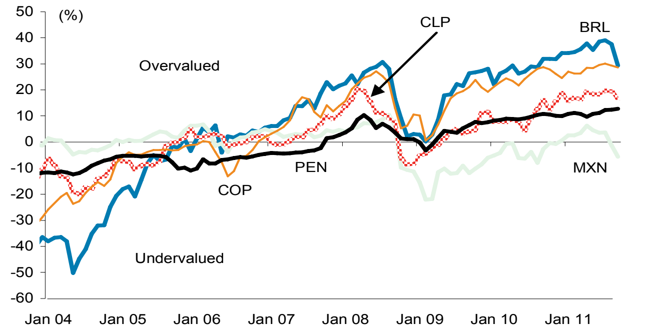
■ Argentina: acceleration of the ARS's fall

The Argentinean economic model is very much dependent on the maintenance of strong growth, although at the cost of high inflation. The export sector is very important and the competitiveness of the ARS is a hot topic. With Brazil its most important trading partner, the Argentinean economy cannot live with the BRL's sharp decline. Given that the country's 20-25% inflation rate is keeping the ARS rising in real terms (Chart 5), the ARS must depreciate sharply in nominal terms to maintain some competitiveness. We have lowered our forecasts for the ARS even further.

■ Peru: new government, same policies

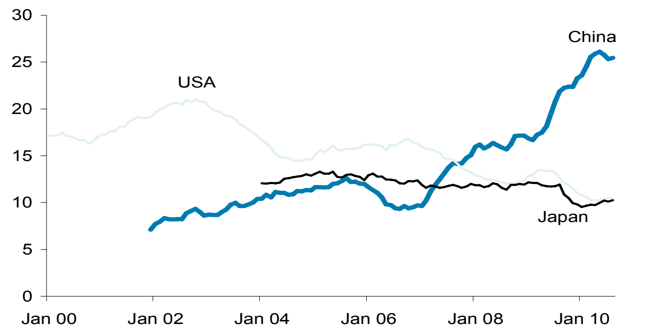
Concerns about the new administration are easing. The PEN demonstrated very strong resilience during the recent sell-off. Some FDI flows were postponed during the presidential campaign, and the resumption of these and the announcement of a market-friendly economic team have increased the USD inflow. With exports very much dependent on gold, zinc and copper, the country looks well-balanced for both bear and bull markets, barring any catastrophic events. S&P's upgrade of the sovereign rating from BBB- to BBB further supports our positive medium-term outlook. Moody's still holds its Baa3 rating, but it has had a positive outlook since March 2011, meaning another upgrade may be on the cards.

Chart 3: Latam Relative Purchasing Power Parity



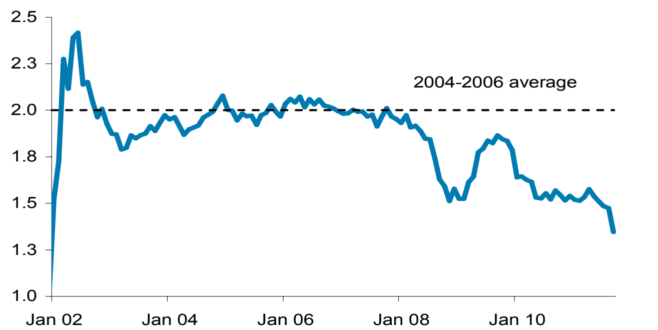
Source: BNP Paribas

Chart 4: Chilean Exports' Destination (% of Total)



Source: Reuters EcoWin Pro

Chart 5: ARS in Real Terms*



*Source: BNP Paribas *we assume nominal wage as a substitute to the official CPI release by INDEC*

■ Venezuela: no light at the end of the tunnel

The mess that is the public accounts continues. The CB has transferred an additional USD 1.5bn from reserves to Fonden, the public development fund. Public spending needs to rise to at least offset the massive inflation (officially at 27% y/y). At the same time, pressures to sustain the fixed-FX regime continue to force the government to feed the market with fresh hard currency. The government issued USD 1.5bn of 20-year bonds in Q3. We reinforce our message that Venezuela needs rising (not just high) oil prices to reduce pressure on the VEF black market. Current negative sentiment prompted S&P to downgrade the sovereign rating again, from BB- to B+. This is now in accordance with Fitch but still one notch above Moody's. For 2013, we reiterate our expectation of a massive 50% devaluation of the VEF.

EM Credit: Risk-Off, Despite Fundamentals

■ Credit strategy: risk-off for now, but opportunistic medium term

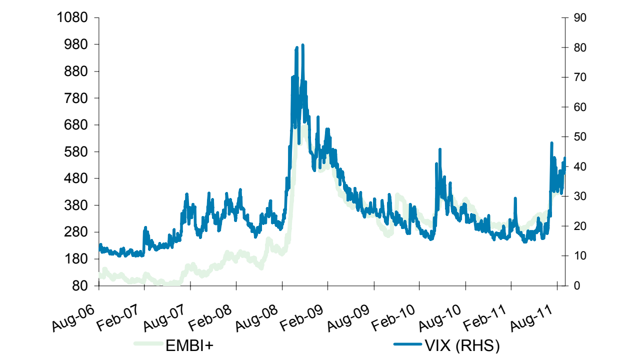
The recent spike in market volatility and resulting sell-off and illiquidity, has made it almost impossible to execute relative value ideas between credits. Furthermore, poor spread performance in September will impact YTD returns which could lead to further deleveraging by investors, triggering a further decline in asset prices. Given the risk-off environment, we recommend taking a defensive position as we expect the market to trade lower from current levels.

We recommend staying with our defensive view until we get more clarity on key global macro market drivers which include: (i) approval of the Greek IMF/EU package and Greek PSI, (ii) further potential moves towards QE3, and (iii) a resolution of the funding problems of European banks. A successful resolution of the Greek situation, coupled with a healthy dose of QE3, will be supportive for spreads, particularly for EM corporate bonds and especially those exposed to the commodity sectors. Successful capital raising by EU banks will substantially decrease systematic risk for the EU banking sector and be positive for emerging markets.

Given the mixed picture as we go to print, we recommend the following:

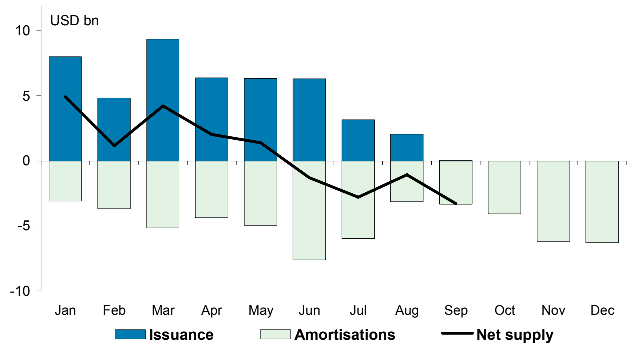
- Although valuations have cheapened stay defensive, as we believe that the market will trade lower from current levels, mainly due to negative technicals. The growth slowdown will however weigh on the fundamental picture, which, until recently, has been strong.
- Within the banking sector, we believe that CIS banks are more vulnerable compared to their Middle Eastern peers, given the overhang of bad debt from the previous crisis and the prospects of a protracted period of weak economic growth in CIS. We expect this to weigh on banks' asset quality in the medium term, while weaker capital markets would likely result in poorer profitability at many Russian banks as seen in H211. Within the CIS bank space, we expect local banks in Ukraine and Kazakhstan to be particularly vulnerable given the sheer size of their legacy NPLs; in Kazakhstan the uncertainty surrounding the failed institutions further adds to the risk profile of the sector. Spread widening in the CIS bank space has been relatively modest thus far especially compared to western European banks that are facing a multitude of headwinds.
- Within the CEE corporate sector, we like non-cyclical names with strong credit profiles, clear domestic focus, low re-financing needs and healthy cash flow generation. Here we recommend utilities and selective oil and gas companies given their often quasi-sovereign status, high quality credit profiles and proven cash flow generation capacity. Within the hydrocarbon sector, we prefer gas and pipeline companies (Novatek, Gazprom, Transneft) over integrated oils - the latter being much more vulnerable to a sharp decline in oil prices.

Chart 1: Global Markets Are Interconnected



Source: Bloomberg, BNP Paribas

Chart 2: CEEMEA Net Supply has Gradually Turned Negative Indicating Cash Accumulation



Source: Bloomberg, BNP Paribas

- Within MEA corporates, we note that certain sovereigns and quasi-sovereign entities in Abu Dhabi and Qatar are looking particularly attractive (Mubadala, IPIC). On the other hand, Dubai remains a speculative play and certain credits there could be vulnerable to global growth expectations (Emirates Airlines, DP World).
- We expect cash to underperform CDS in this environment, as further de-risking occurs.

■ Correlated markets driven by macro risks.

Spread performance in emerging markets remains highly correlated with developed markets; as shown by the relationship between the VIX and the EMBI (Chart 1).

In these turbulent markets, we note that the most liquid emerging market corporate names sold-off strongly, without regard to their credit fundamentals, as investors resorted to the mantra of 'sell what you can' rather than 'sell what you should'. This wave of risk aversion led to a reversal of strong performance in 2010 and H1-2011. The poor returns in September offset a strong performance in earlier months, leading to flat returns for the year. Emerging markets performed poorly, mirroring developments in developed markets which were helped somewhat by the flight to safety bid, which helped drive bund/UST yields lower thereby helping the performance of the core sovereigns.

- **Weaker technicals: threat of redemptions**

As previously stated, EPFR data confirms sharp outflows from emerging markets reversing a trend of strong inflows. A further bout of risk aversion could easily take us into negative territory for returns, which in turn would trigger redemption calls and forced selling by investors, almost certainly leading to wider spreads. Within CEEMEA credit, we note that the level of supply has been below redemptions (and coupons), indicating that investors are increasing their cash levels (Chart 2). We expect opportunistic investors, who turned progressively liquid over the summer, to step in once the air finally clears. The true test will be a reopening of the primary market and the level of new issue premium, of which we see little evidence thus far.

- **Lower growth forecasts largely priced in**

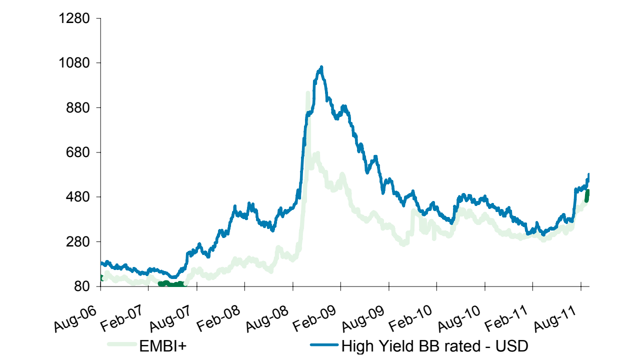
We expect global growth in 2011 and 2012 to drop to 3.9% and 3.4% respectively, with a marked decline in G7 growth to 1.1% in 2011 and only 0.9% in 2012. US growth will be particularly challenged, dropping from 1.3% to 0.9%, while eurozone growth will drop from 1.5% to 0.7%. On the other hand, we expect EM growth to remain strong at 6.6% in 2011 (2012: 5.9%), led largely by China (2011: 9.4%, 2012: 8.5%) and India (2011: 7.5%, 2012: 6.7%). We expect a moderation in CEE growth to 3.5% in 2012 from 4.4% this year and a much sharper slowdown in Latam from 4.4% in 2011 to 2.9% in 2012. Overall, emerging market credit spreads have widened dramatically and are now pricing in this slowdown (Chart 3). In the near term, we believe that there is a danger of an overshoot for technical reasons – mainly due to deleveraging, which should correct once we normalise.

In the medium term, we expect that there will be buying opportunities given that: (a) growth in emerging economies, despite the slowdown, remain at multiples of developed markets growth, (b) corporate fundamentals are very strong, (c) balance sheets are very liquid, and (d) refinancing requirements at the sovereign, bank and corporate levels are relatively low compared to the developed

Chart 3: EMBI Spreads are Pricing In a Slowdown

Source: Bloomberg, BNP Paribas

Chart 4: EBMI: Sharp Sell-Off, Despite Respectable Fundamentals



Source: Bloomberg, BNP Paribas

Although the EMBI is a sovereign index, the EM corporate index broadly follows the direction of the EMBI

world. At 350bp, the CEEMEA SovX is pricing in a 26% default probability over a 5 year period (40% recovery), which appears exceptionally high given their balance sheets. Furthermore, the ratio of spread to yield also confirms that valuations have cheapened significantly, due to a combination of very low UST yields and elevated spread valuations.

- **Broad credit fundamentals better in EMK compared to the high yield market**

The ratio of upgrades to downgrades in the CEE region (2.2x), remains well above levels for high yield markets in Western Europe (0.5x), or the US (1.25x). The sell-off in the EMBI however, has largely been in line with US high yield (Chart 4), despite the fact that average credit ratings across emerging markets are in investment grade territory.

Regional distinctions make generalisation difficult – The CEEMEA credit picture varies considerably and our key thoughts by regions/ sectors are as follows.

MIDDLE EASTERN CORPORATES:

- **Middle Eastern credits have not been immune to the recent sell-off:** The widening was generally indiscriminate across regions and industries. However, the more solid Abu Dhabi and Qatari names fared relatively well compared to some of the weakest highly speculative regional credits, particularly those within the real estate sector, namely Dubai Holding and Emaar Properties**.**

- **Financial resources likely to provide some buffer:** We believe that a further deterioration in global economic indicators would ultimately affect the Middle East credit environment. Broader economic weakness could potentially lead to a lower oil demand and will significantly affect hydrocarbon related inflows into the region, which remain a key driver of liquidity. However, the vast financial resources accumulated by Middle Eastern countries should provide a buffer and continue to act as a safety net, providing some liquidity support to the economy in the event of weaker global economic growth.

- **Valuations are already looking attractive for certain names:** This liquidity buffer should be generally perceived as supportive of some of the strongest government linked names in the region, particularly quasi-sovereign credit in Abu Dhabi and Qatar. In this context, we note that valuations for some of the Abu Dhabi investment holding companies, namely Mubadala and IPIC, are already looking particularly attractive at current levels. Dubai continues to be a speculative play and we believe that the Emirates remain the most vulnerable to a further deterioration in global growth expectations. Aside from the distressed names, the companies that look particularly exposed to any deterioration in global growth and trade volumes are Emirates Airlines and DP World. Therefore, DEWA remains our favourite pick in Dubai given its higher resiliency to broader macroeconomic conditions, a solid financial profile and sound liquidity.

- **Q4 refinancing risk is manageable given the high quality of the underlying credits:** Given the uncertain economic environment and continued pressure on banks, we place particular emphasis on liquidity and related refinancing risk of corporates. We estimate that Q4 2011 corporate maturities amount to $12.4bn, almost entirely represented by loans. We are not particularly concerned about this refinancing exercise, particularly given the solid underlying credit quality of the companies involved, which include some of the strongest regional names such as Saudi Aramco, Sabic and Nakilat.

Table 1: EE Corporates Underperformed Their ME Peers

Region	Z-Spread Sept-28	1M change Bp	3M change bp	YTD change bp
Eastern Europe	446	32	106	90
Middle East	357	14	48	47
Western European Banks – Senior	192	25	74	75

Source: BNP Paribas, average spreads for traded corporate universe

CEE CORPORATES

- **The CEE corporate sector will continue underperforming the MEA:** The recent spread widening of CEE corporates was broad-based, although higher-rated energy names and quasi-sovereigns performed relatively better. The extent of the spread widening within CEE however, was much more intense compared to Middle Eastern names (Table 1). We attribute this to relative differences in credit quality, abundant local liquidity in the Middle East and a high level of market participation by local investors. We expect this trend to continue in the face of expected global slow down and the threat that it poses to oil prices, not least given Russian vulnerability to lower oil prices, both on the sovereign and corporate sides.

- **Recent results show improving credit quality, but this could deteriorate:** Credit quality remains healthy across most industries in the region, supported by high commodity prices, buoyant consumer demand and continued infrastructure investments. We think that this trend is likely to continue in the near-term but believe that credit outlook has turned less positive given the threat of a global slow-down and the on-going market turmoil. Under a less optimistic scenario, CEE corporates, particularly those exposed to commodities (which account for 28% of the corporate bond index compared to 8% in the Middle East), could be negatively impacted by lower commodity prices, weaker local demand and weaker exports (for cyclical commodities like steel). Given that these account for a large portion of the benchmarks, the ultimate spread impact is greater.

- **We like non-cyclical names with robust credit profiles, clear domestic focus and low re-**

financing needs: Given the uncertain macro environment, we recommend a defensive position. We like non-cyclical names with robust credit profiles, clear domestic focus, low re-financing needs and healthy cash flow generation. We like utilities and selective oil and gas companies given their often quasi-sovereign status, high quality credit profiles and proved cash flow generation capacity. This includes Transneft, Gazprom and Novatek, with the latter being our top pick. On the other hand, integrated oil producers like Lukoil, TNK-BP and Alliance Oil look more exposed to falling oil prices. That said, large, well-diversified players like Lukoil and TNK-BP are better positioned to withstand any oil weakness, compared to smaller, less diversified players with lower margins like Alliance Oil.

- We believe that telecoms, including MTS and Vimpelcom in Russia, are relatively more exposed to the global slow down given their lower starting credit quality and a certain level of cyclicality in their business. That said, we believe that these companies are likely to continue to benefit from higher demand for their services locally even in the slow down scenario, supported by expansion of their fixed-line business. Finally, we see metals and mining companies, steels in particular, Evraz and Severstal as being most exposed given the high cyclicality of that business and an uncertain outlook for the steel market.

- **Re-financing risks appear manageable but vulnerabilities exist:** We see re-financing risks of corporate bond issuers in CEE as manageable for the next year, given that reported cash balances at most of the companies cover their short-term debt maturities. That said, we believe that problems may emerge if local and global liquidity continue to erode. In that respect, we see Ukrainian lower-rated credits as most vulnerable. Additional risks stem from the overall market refinancing requirements for the next quarter, which are not negligible as demonstrated in Table 2.

CEEMEA BANKS

- CEE Banks are set to take a hit as their economic growth slows. Although it will take a few quarters before the economic problems start to feed through into deterioration in asset quality, most financials have started experiencing some pain via higher funding costs and tighter liquidity.

- The news flow on Russian banks has been negative since early September, as RUB liquidity tightened and local interest rates rose sharply. The crisis in 2008 showed that a number of smaller and medium-sized institutions failed due to liquidity issues. However, we see very little liquidity risk for major banks and in particular for the "state champions" as we expect the CBR to standby and provide liquidity to the system. Furthermore, the reliance of local banks on capital markets is now much lower than it was in 2008, as most banks have built-up their deposit franchises. Liquidity however may be a worry at some weaker privately owned institutions, which have a greater reliance on short-term, non-core deposits for their funding. We also anticipate negative profit surprises at most Russian banks in H211, as a result of market-related losses on securities portfolios and higher funding costs (VTB's IB business is of a particular concern in this respect). On a more medium term basis, NPLs could increase, as certain loans that were restructured during 2008-2009 turn non-performing. The scale of potential problems would depend on the macroeconomic scenario. However, unless there is a severe recession, we expect only a moderate increase in provisioning in the medium term.

Table 2: Overall Market Re-Financing Requirements (USD mn)

	CEE	MEA
Bonds	7,506	4,216
Loans	16,801	14,827

Source: BNP Paribas, Dealogic

- In Kazakhstan and Ukraine in particular, the situation is somewhat different. Local banks appear to be more vulnerable to a potential economic slowdown, given the large bad debt overhang from the previous crisis. Furthermore, the persisting uncertainty over the destiny of the failed institutions (BTA, Alliance), only adds to the risk profile of the Kazakh financial sector overall. Another default by BTA appears likely in the medium term which will add to contagion risk.

- CEE markets are most exposed to the contagion facing Western Europe and Hungarian banks are most exposed to the evolving CHF mortgages crisis, which is far from over. Higher funding costs and a more difficult political/regulatory environment for banks, feeds through into non-existent loan growth and hence greater problems for the real economy.

- On a positive note, Turkish banks remain on a relatively sound footing thanks to their strong fundamentals: continued strong asset quality, limited FX lending, strong capitalisation and core profits as well as less-sophisticated, deposit-funded balance sheets. We also take comfort from the fact that Turkish banks have a successful track record of managing their way through previous economic slowdowns.

This section is classified as non-objective research

Oil: Risk Off, Risk On

■ Risk off

Oil prices have fallen from their April highs, when Brent closed the month at USD 125.89/bbl. They corrected in early May and again in June. Oil bounced back in the first half of July, before collapsing at the end of the month. Activity indicators have worsened, especially in the US and in Europe. With the accumulation of weaker data, the downgrade of the rating of US debt by Standard & Poor's, and concern about sovereign risk contagion in the eurozone, oil prices followed the gyrations in the equity markets. They plunged lower into early August, with a low of USD 102.57/bbl for Brent and USD 79.30/bbl for WTI on 9 August. The downside in WTI was probably more pronounced due to the release of light sweet oil from the US Strategic Petroleum Reserve. Since then, oil prices have partially recovered, but the rally has been uneven. In particular, the spread between the light benchmarks, Brent and WTI, has widened further (Chart 1), reaching more than USD 26/bbl in early September. Risk aversion remains rife in the oil market, as witnessed by the deepening of a positive put skew in the options market (Chart 2).

Since 2009 and the implementation of loose monetary policy, financial markets have increasingly allocated funds on a risk-on and risk-off basis, causing assets to become positively correlated, particularly oil and equities. In a low-yield environment, oil has been the beneficiary of rises in risk appetite – and the victim of falls. As such, the July correction in oil prices contained a strong element of risk aversion.

Consequently, we lowered our forecast for crude oil prices on 23 August[1] but held a positive bias for oil prices to year-end, which we retain (Table 1). Admittedly, global oil demand may end up lower than expected in light of further deterioration of the economic outlook. However, supply-side factors, monetary accommodation and ongoing geopolitical risk caution against forecasting a collapse in oil prices.

■ Economic downgrades vs. oil demand

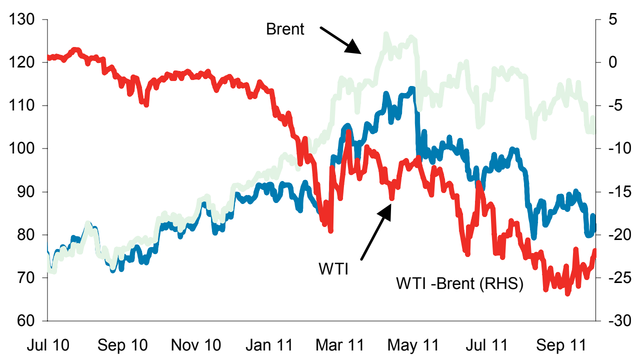
Downward revisions to economic forecasts have concerned the US and Europe, with the US potentially witnessing a fall in GDP in Q4. These downgrades followed much weaker activity indicators and a plunge in confidence surveys. Fiscal consolidation is also raising questions about economic growth prospects. However, to date, the spillover effects of these revisions into the economic forecasts for emerging markets appear contained, although this may change. Equally, despite the risk-off driven correction in July-August, most Asian currencies have seen little turbulence, unlike in the recession of 2008. Resilience in emerging markets is central to the outlook for growth in global oil demand. Growth in oil demand stems mostly from countries such as China (Chart 3) and regions such as the Middle East and South Asia. Global oil demand will grow by 1.0 mb/d y/y in 2011 to 89.3 mb/d and by 1.4 mb/d in 2012, according to September's estimates from the International Energy Agency (IEA). In both years growth will be exclusively driven by emerging markets.

Table 1: BNP Paribas Crude Oil Price Forecast*

	WTI	Revision(1)	Brent(2)	Revision(1)
Q1 11 (actual)	94.60	..	105.52	..
Q2 11 (actual)	102.34	..	116.99	..
Q3 11	91.00	-1.00	113.00	..
Q4 11	92.00	-6.00	114.00	-2.00
Q1 12	96.00	-7.00	115.00	-4.00
Q2 12	97.00	-7.00	113.00	-7.00
Q3 12	103.00	-5.00	117.00	-6.00
Q4 12	107.00	-4.00	119.00	-6.00
2009 (actual)	62.09	..	62.97	..
2010 (actual)	79.61	..	80.34	..
2011	95.00	-2.00	112.00	-2.00
2012	101.00	-6.00	116.00	-8.00

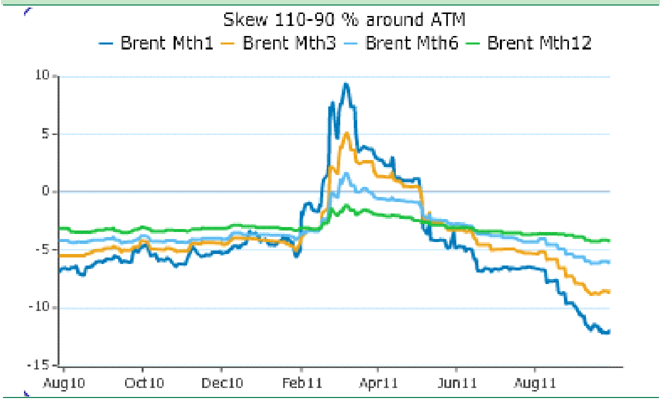
*Source: BNP Paribas 1) versus 23 August 2011. 2) Brent is derived from an assumed spread. *14 September 2011*

Chart 1: NYMEX WTI and ICE Brent (USD/bbl)



Source: Bloomberg, BNP Paribas

Chart 2: Brent Options Positive Put Skew



Source: BNP Paribas

[1] BNP Paribas Oil Market Comment, *Le Salaire de la Peur* (23 August 2011).

Oil demand is expected to contract in the OECD in 2011. The US faces a 160 kb/d y/y decline and OECD countries in Europe a fall of over 200 kb/d y/y. Japan provides some offset to this picture, notably on increased use of oil in power generation as a result of outages at nuclear plants.

Non-OECD demand growth in 2011 is tentatively seen at around 1.5 mb/d y/y. China's demand alone is expected to grow 0.5 mb/d y/y, perhaps more, should it accelerate stimulus policies. Other Asian countries outside the OECD should see demand grow by over 300 kb/d, and the Middle East by more than 200 kb/d. Once again, China is faced with the need to balance growth and inflation. Chinese exports are likely to suffer from a slowdown in the West. However, higher infrastructure investment will offset some of the fall in GDP, aided by further selective credit-easing measures. We don't expect slower quarterly activity readings in China until Q1-Q2 2012.

■ Supply-side uncertainty

While the demand side of the oil market has taken a more negative turn, the supply side, the main driver of oil prices above USD 100/bbl for WTI and USD 120/bbl for Brent, still presents a number of uncertainties.

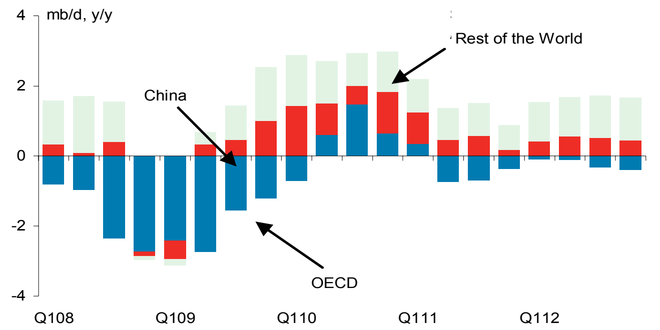
Developments in Libya accelerated in August, and the end-game has begun. Various reports on the country's oil infrastructure suggest damage to oil terminals is limited but the status of wells remains to be assessed. Logistically, it would not be unreasonable to see a partial return of output before year-end (Chart 4). However, security conditions and title on the oil may still represent stumbling blocks. How keen OPEC will be to step up production given the recent correction in prices, downgrades to the economic outlook and the potential for a partial return of Libyan oil, remains to be seen. OPEC, including Iraq, was producing some 30.03 mb/d in August (Table 2), below the 'call' on its crude oil in the third quarter, estimated by the IEA at 31.3 mb/d (Chart 5). Recent increases in Saudi production, offsetting lost Libyan volumes, but also lower Iranian production, have automatically reduced spare production capacity. In the meantime, geopolitical uncertainty in the Middle East has not subsided – witness recent events in Syria.

Finally, projections for non-OPEC supply have been revised down in 2011, with year-on-year growth delayed until H1 2012. Combined with weaker demand, this postponement of the growth in supply will temporarily constrain upward price pressure.

■ Some risk on: fundamentals vs. liquidity

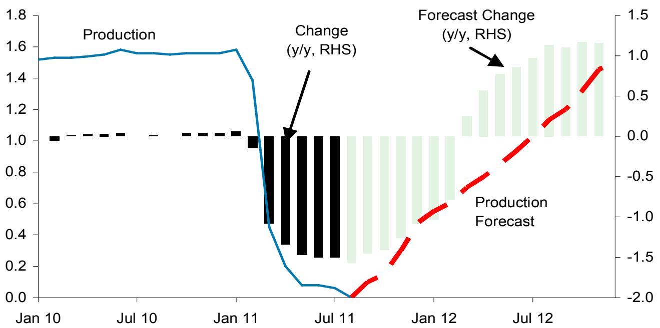
While one can argue the relative strength of supply and demand fundamentals, monetary accommodation is here to stay. Bar India perhaps, many emerging markets have room to ease. The Fed will maintain low rates into 2013 and most FOMC members are pondering when and how much policy support should be provided, rather than whether it should be. In addition, the negative implication of future US monetary policy on the USD to some extent buffers against potential price falls linked to the economic outlook.

Chart 3: Growth in Global Oil Demand



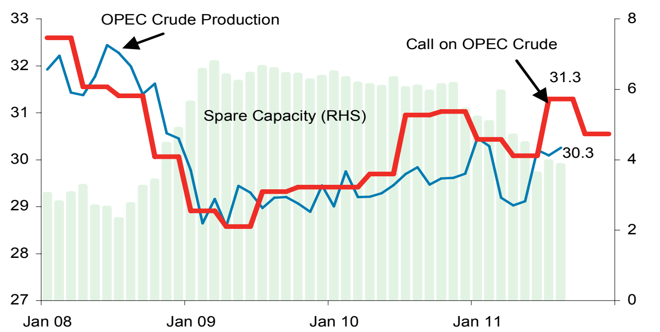
Source: IEA Oil Market Report, BNP Paribas

Chart 4: Libya's Crude Oil Production (mb/d)



Source: IEA Oil Market Report, BNP Paribas

Chart 5: OPEC Crude Oil Production vs. Call (mb/d)



Source: IEA Oil Market Report, BNP Paribas

Table 2: OPEC Crude Production and Capacity*

mb/d	May	Jun	Jul	Aug	Capacity	Spare
Algeria	1.28	1.26	1.28	1.28	1.34	0.06
Angola	1.57	1.49	1.67	1.69	1.95	0.26
Ecuador	0.50	0.50	0.49	0.49	0.53	0.04
Iran	3.60	3.65	3.53	3.51	3.72	0.21
Kuwait	2.44	2.49	2.51	2.53	2.54	0.01
Libya	**0.10**	**0.08**	**0.06**	**0.00**	**0.20**	**0.20**
Nigeria	2.32	2.28	2.26	2.32	2.53	0.21
Qatar	0.81	0.82	0.82	0.82	1.04	0.22
Saudi Arabia	9.00	9.70	9.70	9.80	12.04	2.24
UAE	2.42	2.50	2.50	2.53	2.74	0.21
Venezuela	2.42	2.62	2.63	2.61	2.64	0.03
OPEC-11	26.44	27.49	27.45	27.58	31.26	3.68
Iraq	2.68	2.72	2.65	2.68	2.84	0.16
OPEC	29.12	30.21	30.09	30.26	34.1.0	3.84

*Source: IEA Oil Market Report. * Capacity represents effective production capacity, a level of production that can be reached within 30 days and sustained for at least 90 days.*

Agriculture: Safe Haven in Harsh Times

■ The road to self-preservation

As financial markets went through one of their worst setbacks in history over such a short period of time, three assets have once again been regarded as safe havens: gold, US Treasuries and grains. In fact, much money ended up in non-cyclical soft commodities this summer as investors spotted their attractive fundamentals. The picture is one of lower-than-expected US crops, tight global grain inventories, scarce water reserves in some parts of the world, and increasing demand from emerging markets, where high-value food products such as meat, vegetable oils and confectionery are becoming more prevalent in diets. In fact, the ratio between grain inventories and world population may continue to fall unless demand is rationed in the near future. If a supply shock occurs next year, global grain ending stocks per capita may reach the low levels last seen in the mid-1970s.

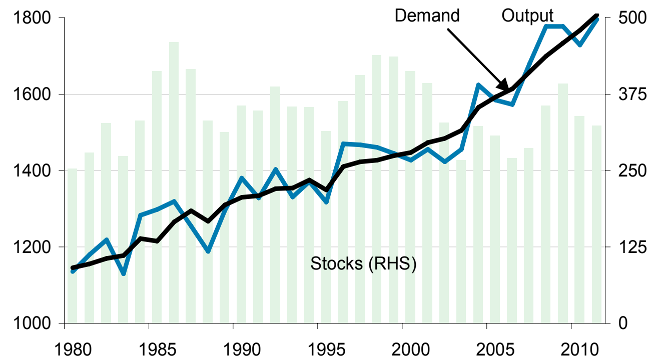
History suggests that during economic turmoil (such as the US Depression and the Asian Crisis), food demand tends to remain relatively stable versus other sectors because it is a basic necessity. On 9 September, the agriculture sector had lost a mere 3.0% since the end of May versus 15.0% for crude oil and 14.2% for the S&P 500.

Table 1: Agriculture Price Forecasts

	2009	2010	2011[1]	2012[1]
Corn (US¢/Bu)	375	430	680	750
Cotton (US¢/lb)	57	95	138	117
Wheat (US¢/Bu)*	562	610	800	770

*Source: Bloomberg and BNP Paribas *Simple averages of the front-month CBOT contract. (1) Annual average*

Chart 1: Global Grains Fundamentals (million metric tonnes)



Source: USDA, BNP Paribas

■ Wheat: weathering the storm

In July and August wheat prices recouped about half of the losses recorded between late April and early July, and are now flirting with important resistance levels. The recent price recovery coincided with the normal seasonal pattern after the US winter wheat harvest. It also reflected concerns about the state of EU and US wheat crops. After suffering one of its worst spring droughts on record, the EU is experiencing heavy rainfalls which are delaying the wheat harvest in Germany and raising concerns about the quality of the grain. But despite both that and the increasing use of wheat for animal feed on the back of higher corn prices, US and global wheat balances are not tight by historical standards. In fact, wheat prices may weaken further with the arrival of new wheat shipments from Kazakhstan and Russia, signs that India may allow larger wheat quantities to be exported and the realisation that beginning stocks in Canada are higher than previously thought. Nevertheless, weather patterns suggest yields may be lower by springtime in the Northern hemisphere. With grain inventories tight globally, such a possibility may be enough to trigger a sharp rally in wheat prices during wintertime.

■ Corn: a driving force coming to a slowdown

Grain kept most of its spring gains despite violent moves this summer. In fact, lower yield forecasts in the US Corn Belt and strong demand from ethanol producers lent support to corn prices while the world was busy selling most financial assets. US ethanol output stood at 888,000 barrels per day in early September, little changed since earlier this year. However, demand for corn is being destroyed in the animal feed industry and in US exports due to high prices. As of 1 September, the new crop export sales commitment was 14% below last year, versus a USDA forecast of 4% below. With Ukraine expected to cut export duties on grains by the end of the year and cheaper feed grain offered in Europe and South America, US corn exports may be lower than expected. In fact, Ukraine may export a record 10 to 12 million tonnes in 2011/12. That would make it the third largest exporter of corn behind Argentina and the US. Although US production estimates could fall further, past seasons point to lower prices as the US harvest reaches its full potential this autumn.

■ General outlook

September to November usually sees a consolidation in agriculture prices on the back of harvest pressures in North America, as well as slower international trade. With grains and oilseed currently trading at relatively high prices for this time of the year, the odds are for a potential setback in agriculture prices this autumn.

Base Metals: Some Key Supports Remain

■ Remarkably resilient for most of Q3 2011

Base metals were rather weaker in Q3 2011 than we had expected, but relative performance within the sector has been broadly as expected. After a 4% fall in Q2, aggregate average prices declined by 6% in Q3. But base metals were remarkably resilient until late in the quarter, given what was thrown at them in terms of financial market turbulence and economic worries. Aluminium, long our preferred defensive play, has held up relatively well in recent sell-offs, although copper was at the heart of the earlier resilience.

Base metals have remained correlated with other risky assets, if less strongly than in 2010. And they are more geared to economic activity than other commodity sectors. But prices have been supported by the fact that demand growth is driven more by emerging nations than beleaguered developed countries, by signs of reduced Chinese destocking since H1 2011 and by still-strong supply-side fundamentals. The last is chiefly down to copper, which, as the market leader, propped up other metals, although some of them are now also underpinned by prices being close to the cost curve.

■ Fundamentals remain broadly supportive

Despite the deterioration in economic prospects, we still expect base metals to post respectable global demand growth in 2011-12. China's share of world first-use demand is now about 40%, while that of Western Europe, North America and Japan combined is barely more than 30%. And although these figures overstate and understate, respectively, final demand, developed countries were never going to be the main contributors to growth this year or next. Growth was always likely to slow from the base-effect and restocking-boosted rate of 2010 of 13-14%. But we forecast a still above-trend 5-6% on average in both 2011 and 2012.

The supply side remains supportive. The copper mining industry is suffering from persistently falling grades and has been hit hard this year by strike action. Strikes are temporary factors but they can be seen as part of a wider trend of stakeholders fighting for a share in the mining bonanza. This can only add to cost pressures. New capacity may start to boost copper production in 2012, but supply constraints will then begin to bite in the lead and zinc markets. The still oversupplied aluminium market is the most exposed to upward pressure on energy costs and power shortages in China. Only nickel faces the likelihood of a lengthy period of surplus, due to several new mines.

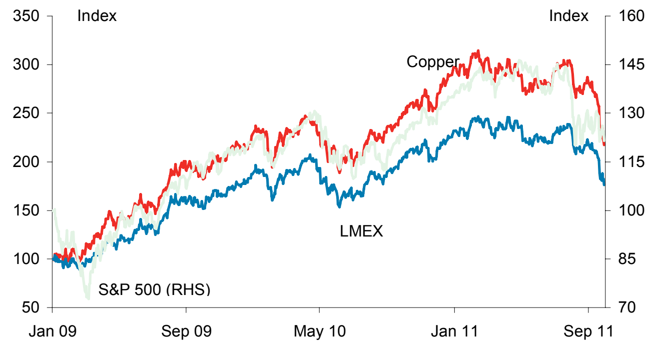
Some metals have remained in surplus this year, but Chinese destocking has masked deficits in the copper and tin markets. There are signs that this destocking is winding down, which should be supportive for all metals, given copper's outsize influence on the sector.

Table 1: Base Metals Price Forecasts (USD/tonne)

	Spot Price(1)	2010(2)	2011(3)	2012(3)
Aluminium	2,207	2,173	2,485	2,550
Copper	7,131	7,539	9,240	9,150
Lead	2,060	2,148	2,530	2,750
Nickel	18,305	21,809	23,975	21,600
Tin	20,850	20,447	27,225	29,000
Zinc	1,905	2,159	2,270	2,375

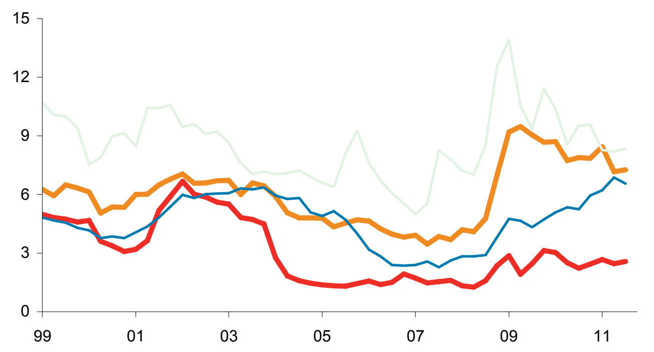
(1) As at 30 September 2011, (2) Cash averages, (3) Forecast cash averages.
Source: LME, BNP Paribas

Chart 1: LME Copper, LMEX and the S&P 500*



Source: LME, Bloomberg, BNP Paribas ** All rebased, January 2009 = 100*

Chart 2: Reported Metal Stocks, Weeks of Demand



Source: LME, COMEX, SHFE, IAI, CRU, BNP Paribas

■ Prices should regain some traction in Q4 2011

The outlook is not as bright as it was three months ago; we have cut our forecasts and the risks are skewed to the downside. But we believe firm demand in emerging nations, supply constraints and loose monetary conditions will support base metal prices into 2012. We expect copper to regain traction in Q4 2011 before it peaks by mid-2012 due to likely faster production growth. Other metals will broadly track copper, but most will gain some impetus of their own during 2012 as their fundamentals improve in turn, as in 2006-08. Nickel may miss out, although after its steep correction, we are no longer bearish even here. Should the wider environment deteriorate more than expected, we would still view aluminium as the best defensive play.

China: No Panic About External Uncertainties

- **Activity: renewed weakness in the US and European economies has probably accelerated China's move to slower growth. We have revised down China's growth forecast for next year, but do not expect a hard landing**
  - External weakness and the tightness of domestic liquidity are likely to drag growth down with a delay. We expect GDP growth to slow only modestly this year, from 9.6% y/y in H1 2011 to 9.2% in Q3 and 9.0% in Q4 (the whole-year forecast remains 9.4%). For next year, we have reduced our growth forecast to 8.5% (from 9.2% previously). On a quarter-on-quarter annualised basis, we expect growth to be weakest in Q1 2012, at 7.4%.
  - We maintain an 8.3% growth forecast for 2013. Beyond the near-term cyclical slowdown, the move to a slower growth trend is also being driven by structural constraints.
  - Industrial output growth has only shown limited moderation so far to 13.5% y/y from 14.0% in April to July. Apart from the financial crisis, PMIs are at their weakest on record. Export growth was strong in August, but orders fell, which is likely to drag down IP growth from September.
  - Fixed asset investment is likely to slow, but remains the primary driver of growth over our forecast horizon. From 25.6% y/y in H1, we expect growth in FAI to slow to about 21.0% in H2 2011 for annual growth of 23%. Funding is a restraint this year, but a faster pace of project approvals may keep investment growth high next year to offset external weakness and to make progress on the Twelfth Five-Year Plan. Thus, we look for 17.5% FAI growth in 2012.
  - Consumption is likely to be stable, with some upside in real terms when inflation eases. Real retail sales grew just 11% y/y in July after inflation ate into consumers' discretionary income. We expect slightly higher real consumption growth next year.
  - Both export and import growth will slow in a cyclical slowdown. However, the trade surplus is likely to benefit from an improvement in the terms of trade in H2 and amount to USD 172bn in 2011, down just slightly from last year's USD 183bn. Beyond this year, the surplus is likely to continue to narrow, thanks to weaker external demand than domestic. We do not expect a whole-year trade deficit but we do see net exports dropping from 4.0% of GDP in 2010 to 1.5% by 2014.

- **Inflation: downside risks to inflation may emerge given a weaker external environment and tighter domestic policy**
  - The food CPI rose 13.4% y/y in August, down from 14.8% in July. Thanks to a base effect, inflation will fall in all the major food categories. Month-on-month inflation is also moderating.
  - The non-food CPI, flat seasonally adjusted in July and up just slightly in August, is already past the fast-rising stage. PPI is likely to follow commodity prices down.
  - Amid a global economic slowdown, inflation's direction is undoubtedly down. We revise up our 2011 forecast from 4.9% to 5.3% to reflect the higher-than-expected CPI currently. But tighter liquidity and a much higher cost of funding amid external weakness will continue to weigh on demand and prices. As a result, we have revised down our 2012 CPI inflation forecast to 3.6% from 4.0% previously.
  - Beyond 2012, however, we continue to expect excess liquidity, and rises in labour and other costs to support higher inflation. We expect a rebound to 4.0% and 4.3% in 2013 and 2014.

- **Policy: the authorities still have the flexibility to avoid a hard landing, but would be unwilling to stage another round of major stimulus**
  - Monetary policy is now probably on hold. Given the impending slowdown in both growth and inflation, we believe the political environment no longer supports further interest rate or RRR hikes. At the same time, a shallow contraction in the US and Europe, as is our base case, is unlikely to threaten China's growth enough to push for rate cuts. We do not expect any rate changes until 2013.
  - Policy may have shifted toward risk management. The side effects of previous stimulus and over-investment have stretched local government financing, fuelled the property bubble and increased systemic banking concerns. Leaders view lower growth as acceptable, but systemic risk as not, which brings higher policy uncertainty. We expect more tightening in prudential regulations after the current downturn to fend off tail risks.
  - Selective easing remains possible, but mostly for fiscal policy. Authorities may cut import duties, reduce SME taxes and fees, pause RMB appreciation, facilitate trade finance, speed up project approval, and provide more central government funding for investment.

China: Economic & Financial Forecasts

	Year					2010				2011				2012			
	'09	'10	'11 [1]	'12 [1]	'13 [1]	Q1	Q2	Q3	Q4	Q1	Q2	Q3 [1]	Q4 [1]	Q1 [1]	Q2 [1]	Q3 [1]	Q4 [1]
Components of Growth [2]																	
Total GDP	9.2	10.3	9.4	8.5	8.3	11.9	10.3	9.6	9.8	9.7	9.5	9.2	9.0	8.2	8.1	8.5	8.7
Consumption	8.7	12.9	14.1	12.5	12.3	11.7	12.1	11.5	12.7	14.1	15.0	14.1	13.4	12.2	12.3	12.6	12.9
Capital Formation	18.9	20.7	19.1	14.0	14.5	18.1	17.2	15.8	16.4	21.1	21.8	17.7	16.5	13.6	14.2	14.0	14.5
Exports	-16.0	31.4	19.1	10.7	9.0	28.7	41.0	32.2	24.7	26.5	22.1	19.4	11.0	7.5	10.2	11.8	12.6
Imports	-11.2	39.1	22.4	14.3	10.2	64.6	44.3	27.4	28.9	32.6	23.2	22.7	13.2	9.0	12.7	16.3	18.7
Industrial Output [3]	11.0	15.7	14.0	12.0	11.4	19.6	15.9	13.5	13.3	14.4	14.2	13.5	12.9	11.2	11.3	12.5	12.9

	Year					2010				2011				2012			
	'09	'10	'11 [1]	'12 [1]	'13 [1]	Q1	Q2	Q3	Q4	Q1	Q2	Q3 [1]	Q4 [1]	Q1 [1]	Q2 [1]	Q3 [1]	Q4 [1]
Inflation																	
CPI	-0.7	3.3	5.3	3.6	4.0	2.2	2.9	3.5	4.7	5.0	5.7	6.2	4.5	3.9	3.3	3.0	4.0
PPI	-5.4	5.3	6.3	3.2	4.5	5.2	6.8	4.5	5.7	7.1	6.9	7.1	4.3	2.1	2.7	3.5	4.5

	Year					2010				2011				2012			
	'09	'10	'11 [1]	'12 [1]	'13 [1]	Q1	Q2	Q3	Q4	Q1	Q2	Q3 [1]	Q4 [1]	Q1 [1]	Q2 [1]	Q3 [1]	Q4 [1]
External Trade																	
Trade Balance (USD bn) [4]	195.7	183.1	172.0	129.0	117.2	36.5	65.1	101.7	102.1	-1.1	46.0	66.5	60.7	-7.2	40.0	54.2	42.0
Current Account (USD bn)	261.1	305.4	306.3	274.4	275.8	36.5	65.1	101.7	102.1	29.8	69.6	99.1	107.9	26.5	78.8	90.8	78.3
Current Account (% GDP)	5.2	5.1	4.1	3.2	2.7	3.1	4.8	7.1	5.8	2.0	4.2	5.6	4.6	1.5	4.1	4.4	2.9
Memo: Nominal GDP (USD bn)	4991	5922	7410	8601	10109	1196	1343	1430	1953	1469	1672	1777	2349	1729	1938	2061	2747

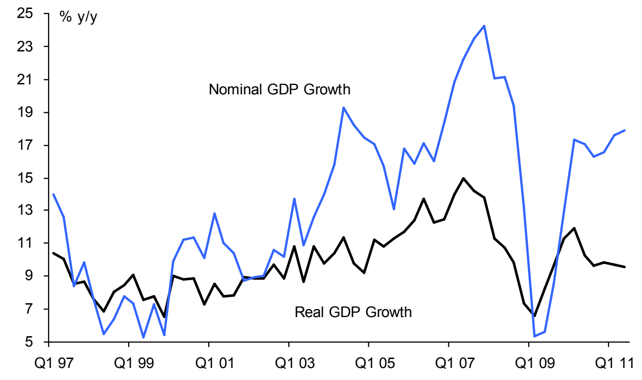
	Year					2010				2011				2012			
	'09	'10	'11 [1]	'12 [1]	'13 [1]	Q1	Q2	Q3	Q4	Q1	Q2	Q3 [1]	Q4 [1]	Q1 [1]	Q2 [1]	Q3 [1]	Q4 [1]
Financial Variables																	
Gen. Gov. Budget (% GDP)	-2.8	-2.5	-1.9	-2.1	-3.0	-	-	-	-	-	-	-	-	-	-	-	-
Primary Budget (% GDP)	-2.3	-2.0	-1.4	-1.6	-2.5	-	-	-	-	-	-	-	-	-	-	-	-
Foreign Reserves (USD bn) [5]	2399	2847	3380	3835	4272	2447	2454	2648	2847	3045	3198	3319	3380	3427	3553	3698	3835

	Year					2010				2011				2012			
	'09	'10	'11 [1]	'12 [1]	'13 [1]	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4 [1]	Q1 [1]	Q2 [1]	Q3 [1]	Q4 [1]
Interest & FX Rates [5]																	
Official Interest Rate (%)	5.31	5.81	6.56	6.56	6.56	5.31	5.31	5.31	5.81	6.06	6.56	6.56	6.56	6.56	6.56	6.56	6.56
USDRMB	6.83	6.62	6.31	6.12	5.89	6.83	6.79	6.70	6.62	6.56	6.47	6.39	6.31	6.28	6.24	6.18	6.12

Footnotes: (1) Forecast (2) Forecasts of GDP growth and industrial output are in real terms but, in the absence of data, forecasts of consumption, investment, exports and imports are in nominal terms (3) Industrial output for enterprises with annual revenue greater than RMB 5 million (4) Trade balance is customs merchandise trade balance (5) End period
Figures are year-on-year percentage changes unless otherwise indicated

Source: NBS, PBOC, BNP Paribas

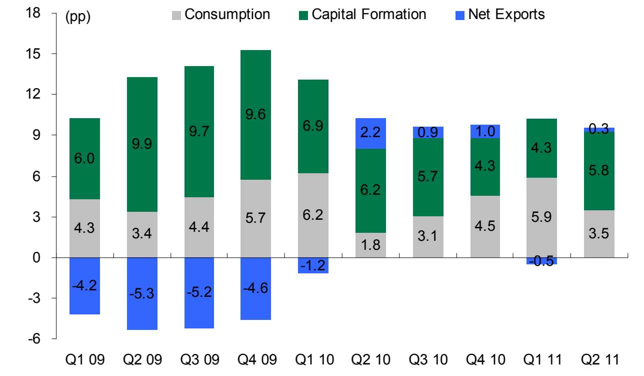
Chart 1: Policymakers Comfortable with Slowdown



Source: NBS, BNP Paribas

Policymakers are comfortable with the extent of the current slowdown in growth and are unlikely to introduce stimulus, unless growth suddenly falls below 8%.

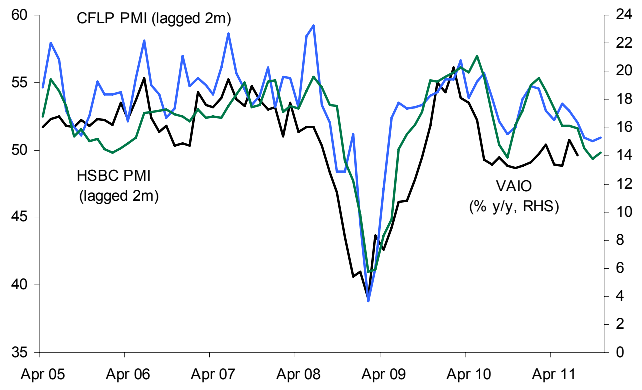
Chart 2: Investment Remains Main Growth Engine



Source: NBS, BNP Paribas

In Q2, an upside surprise to growth came mainly from the 0.3pp contribution of net exports. This contribution is set to diminish as external demand withers.

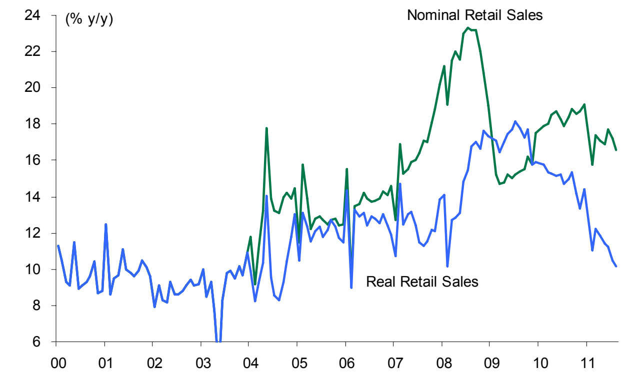
Chart 3: Domestic Orders Remain Robust



Source: Markit PMI, NBS, BNP Paribas

Still-robust domestic orders indicate China is unlikely to see a hard landing as a result of external uncertainties and domestic tightening.

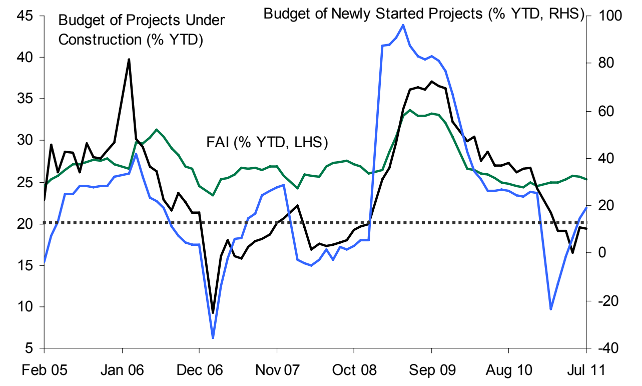
Chart 4: High inflation Erodes Purchasing Power



Source: NBS, BNP Paribas

Growth in real retail sales has fallen sharply as high inflation has eroded consumers' purchasing power.

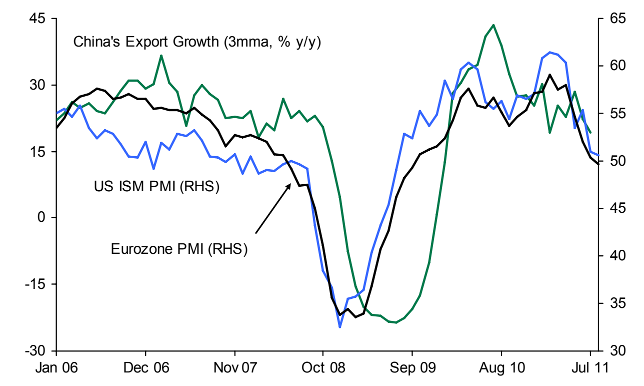
Chart 5: Selective Easing of Project Approvals (% YTD)



Source: NBS, BNP Paribas

Selective easing of the approval of projects and building for public housing will ensure that the moderation in growth in FAI is not abrupt.

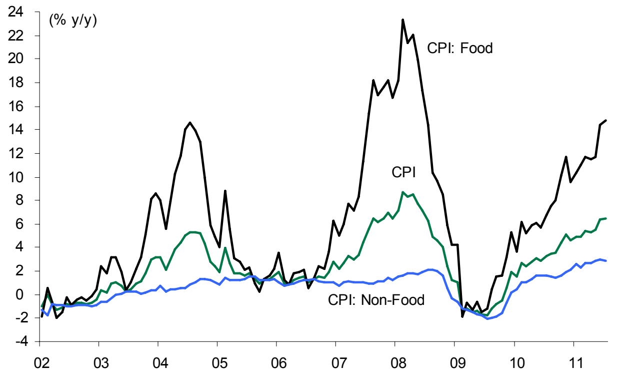
Chart 6: The Fall in US and Eurozone PMIs Points to Muted Export Growth



Source: Bloomberg, BNP Paribas

Exports are not immune to the deterioration in the US and eurozone economies. Export growth below 10% would prompt moves by the government to support the sector.

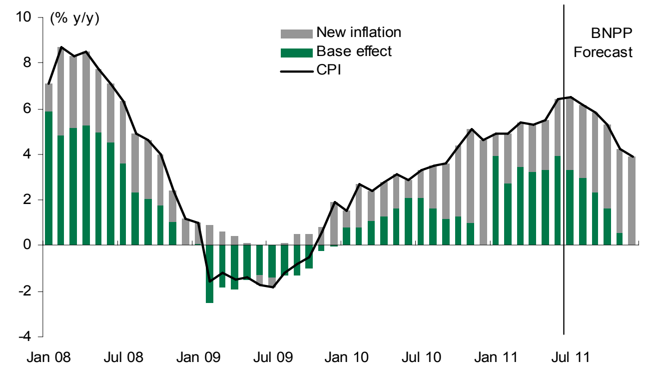
Chart 7: Food Remains Primary Inflation Driver



Source: NBS, BNP Paribas

As in 2007-08, a rise in pork prices has coincided with a rise in the price of other food items.

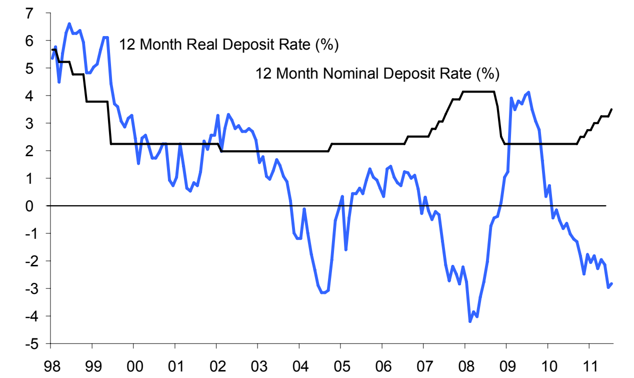
Chart 8: Inflation Rate Set to Ease on Base Effect



Source: NBS, BNP Paribas

Thanks to an increasingly favourable base effect in H2 2011, the year-on-year measure of inflation is set to retreat steadily and slowly.

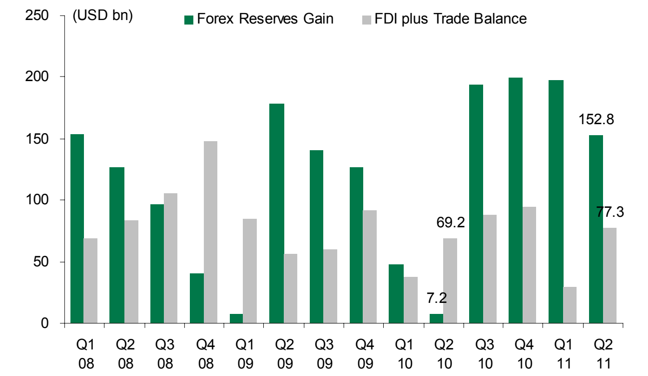
Chart 9: Real Deposit Rate Deeply Negative



Source: PBOC, BNP Paribas

A deeply negative real deposit rate is prompting deposit flight into wealth management products and reducing the effectiveness of monetary policy.

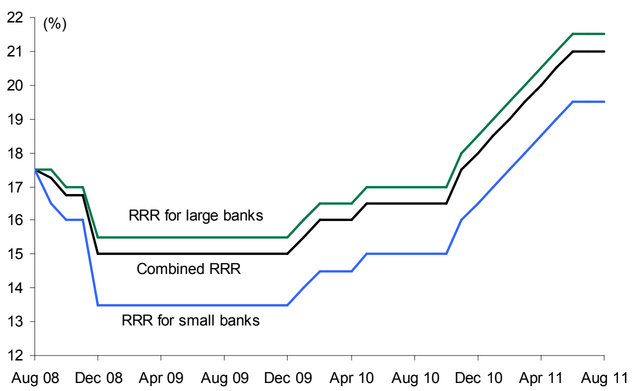
Chart 10: Massive Capital Inflows



Source: PBOC, China Customs Administration, BNP Paribas

Massive capital inflows have made the central bank busy with sterilising liquidity – this time more though RRR hikes than issuance of PBOC bills.

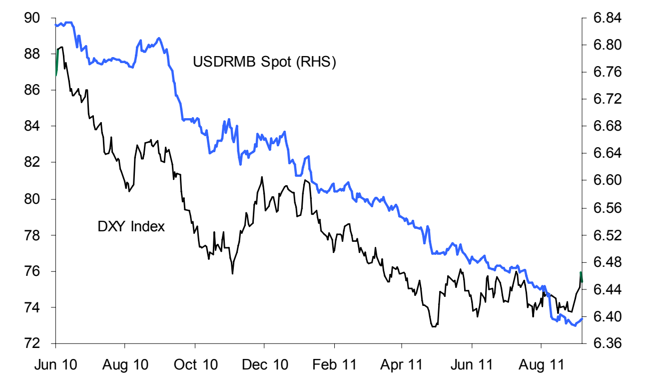
Chart 11: RRR Hike to Lock Up Excess Liquidity



Source: PBOC, BNP Paribas

PBOC adopted continuous RRR hikes to lock up excess liquidity, but the recent broadening of the reserve requirement deposit base is mainly targeted at reining in off-balance-sheet lending risk.

Chart 12: RMBUSD is Tracking the DXY Index



Source: Bloomberg, BNP Paribas

Although the RMB's daily appreciation suddenly accelerated during August, overall, moves in USDRMB are still tracking the DXY index.

India: Diminishing Returns

Activity: slowdown arrives

- Indian GDP growth held up at 7.7% y/y in Q2. The estimates of GDP were compiled using the new index of industrial production. But with the full series of revised data not yet available, interpreting the true degree of momentum in the economy remains difficult. Survey evidence, especially the activity indices in the PMI survey, has weakened across the board. The output index is now at its lowest since November 2009 while new orders are the weakest since March 2009. Non-food credit growth has also slowed and domestic vehicle sales have stalled, signalling that the economy, after overheating last year, is now cooling off quickly under the impact of progressive policy tightening.
- An expected double dip in the US economy and stagnation in Europe in H2 2011 also threaten to push Indian growth lower, although, at 3.5% of GDP, India's trade exposure to the US and the EU is among the lowest in Asia. The one bright spot for growth in the near term should be agriculture, with cumulative rainfall for the monsoon season above normal so far.
- Restrictive policy, coupled with a slower global economy, should produce a period of sub-8% growth through FY 2013. Our FY 2012 and FY 2013 growth forecasts are cut to 7.2% and 7.1% before a recovery to 8.7% in FY 2014.

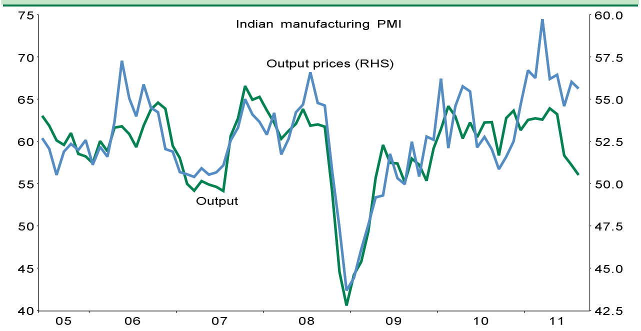
Inflation: latent upside risks

- Both headline and core WPI inflation have been stubbornly running at close to double-digit rates this year. A genuine improvement is unlikely before Q1 2012 when base effects from onion and cotton prices kick in.
- Despite slowing growth, serial revisions to WPI back data, high inflation expectations and the rising risk of electricity price hikes to keep pace with coal prices mean inflation risks lie to the upside for the rest of 2011. The RBI also noted that, if a US recession were to trigger QE3, as we expect it would, higher commodity prices would be an additional inflation risk.
- Palpably below-trend growth, allied to favourable base effects should see inflation fall back but remain well above the RBI's comfort zone of 5.0-5.5% in 2012.

Policy: inflation control

- The Indian economy has begun to slow. However, there is little sign yet of weaker activity beginning to lessen price pressures. The RBI has openly acknowledged that it sees a sustained period of below-trend GDP growth as needed to pull inflation down. Market expectations for aggressive policy easing, beginning this year, look overblown.
- Given the likely recalcitrance of inflation this year, rate cuts are unlikely before Q2 2012 at the earliest. Our current baseline forecast assumes 75bp rate cuts in H2 2012.

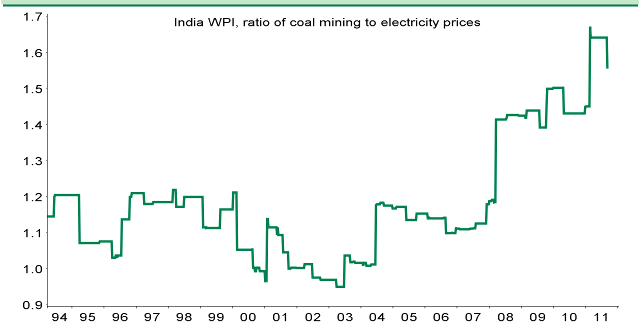
Chart 1: Slowdown in Output, But Not Prices



Source: BNP Paribas, Markit Economics

There is little sign that weaker activity is beginning to lessen price pressures.

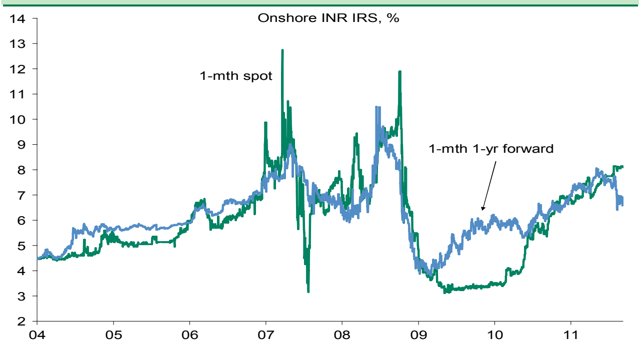
Chart 2: Latent Price Pressures



Source: BNP Paribas, Markit Economics

The failure of electricity prices to keep pace with recent coal price rises points to considerable latent price pressure in the system.

Chart 3: Onshore INR IRS – Overly Optimistic (%)



Source: BNP Paribas, Bloomberg

At the one-year horizon, OIS forwards are pricing in approximately 145bp of rate cuts by the RBI, which looks too aggressive.

India: Economic & Financial Forecasts

	Fiscal Year					2010				2011				2012			
	'09	'10	'11	'12 (1)	'13 (1)	Q1	Q2	Q3	Q4	Q1	Q2	Q3 (1)	Q4 (1)	Q1 (1)	Q2 (1)	Q3 (1)	Q4 (1)
Components of Growth																	
GDP	6.8	7.9	8.4	7.2	7.1	9.4	8.8	8.9	8.3	7.8	7.7	7.4	7.1	6.6	6.3	6.5	7.1
Agriculture & Allied Activities	0.0	1.3	6.5	4.0	5.8	2.2	3.0	5.8	9.6	6.6	3.6	3.7	3.6	5.2	7.4	6.2	5.1
- Agriculture & Forestry & Fishing	-0.1	0.4	6.6	4.3	6.0	1.1	2.4	5.4	9.9	7.5	3.9	4.2	3.7	5.4	7.9	6.5	5.2
- Mining & Quarrying	1.3	7.0	5.8	2.5	4.6	8.9	7.4	8.2	6.9	1.7	1.8	1.1	2.3	4.4	4.5	4.4	4.6
Industry	4.7	8.4	7.8	5.9	7.1	12.7	9.2	8.4	7.2	6.5	5.4	7.0	6.5	4.7	6.2	6.0	7.2
- Manufacturing	4.2	9.4	7.9	6.3	7.1	15.2	10.6	10.0	6.0	5.5	7.2	6.9	6.6	4.8	4.5	5.9	8.0
- Electricity, Gas & Water Supply	4.9	6.4	5.6	7.0	5.3	7.3	5.5	2.8	6.4	7.8	7.9	8.8	7.4	4.2	4.4	4.9	5.5
- Construction	5.4	7.0	8.1	4.7	7.6	9.2	7.7	6.7	9.7	8.2	1.2	6.8	6.2	4.7	10.3	6.3	6.1
Services	10.1	9.9	9.3	8.6	7.4	10.2	10.4	9.9	8.4	8.7	10.0	8.4	8.6	7.8	6.1	6.8	7.8
- Trade, Hotel, Transport & Comm.	7.5	9.3	10.1	10.8	6.9	13.7	12.1	10.9	8.6	9.3	12.8	11.7	11.0	8.2	5.6	6.1	7.0
- FIRE & Business Service	12.5	9.2	9.9	7.7	8.1	6.3	9.8	10.0	10.8	9.0	9.1	7.7	6.5	7.5	6.1	7.2	8.9
- Community, Social & Personal Ser.	12.7	11.8	7.0	5.6	7.7	8.3	8.2	7.9	5.1	7.0	5.6	2.9	6.5	7.3	7.2	7.6	7.9
Industrial Production	4.0	8.8	7.4	5.9	6.6	13.7	9.7	9.0	6.2	5.3	6.7	6.4	6.1	4.7	4.5	5.7	7.4
Private Consumption	7.7	7.2	8.7	7.1	6.7	6.6	9.5	8.9	8.6	8.0	6.3	7.5	7.4	7.2	7.0	5.6	6.9
Public Consumption	10.7	16.4	4.8	5.7	5.3	6.2	6.7	6.4	1.9	4.9	2.1	0.6	9.4	9.3	7.6	4.6	4.6
Fixed Investment	1.5	7.7	7.2	7.4	7.1	19.2	11.1	11.9	7.8	0.4	7.9	7.5	7.3	7.1	6.6	6.2	7.1
Exports	14.4	-5.5	17.9	15.6	12.9	10.6	9.8	10.7	24.8	25.0	24.3	24.1	10.5	6.9	9.0	11.2	14.5
Imports	22.7	-1.8	9.1	19.5	11.0	21.1	15.2	11.6	0.4	10.3	23.6	23.9	21.6	9.9	2.9	8.9	15.0
Net Trade (Cont. to Growth, y/y)	-2.8	-0.7	1.1	-1.9	-0.3	-3.0	-2.1	-1.0	4.6	2.3	-1.7	-1.8	-3.3	-1.1	1.2	-0.2	-1.1
Memo:																	
Non-Agricultural GDP	8.2	9.3	8.8	7.7	7.3	10.9	10.0	9.4	8.0	7.8	8.4	7.8	7.8	6.8	6.1	6.5	7.5
Nominal GDP	12.0	17.3	20.2	15.6	13.6	27.2	22.1	20.2	20.6	18.2	17.5	17.4	15.4	12.9	12.8	13.3	13.6
Nominal GDP (INR trn)	55.8	65.5	78.7	90.9	103.3	18.8	17.6	18.1	20.8	22.2	20.6	21.2	24.0	25.1	23.3	24.1	27.2

	Calendar Year					2010				2011				2012			
	'09	'10	'11 (1)	'12 (1)	'13 (1)	Q1	Q2	Q3	Q4	Q1	Q2	Q3 (1)	Q4 (1)	Q1 (1)	Q2 (1)	Q3 (1)	Q4 (1)
GDP	7.0	8.9	7.5	6.7	8.6	9.4	8.8	8.9	8.3	7.8	7.7	7.4	7.1	6.6	6.3	6.5	7.1

	Calendar Year					2010				2011				2012			
	'09	'10	'11 (1)	'12 (1)	'13 (1)	Q1	Q2	Q3	Q4	Q1	Q2	Q3 (1)	Q4 (1)	Q1 (1)	Q2 (1)	Q3 (1)	Q4 (1)
Inflation																	
WPI	2.4	9.6	9.4	6.8	5.7	9.6	10.5	9.3	8.9	9.6	9.6	9.6	8.9	7.1	6.8	7.0	6.2
WPI (Food)	12.1	13.9	8.0	6.7	6.2	19.5	15.7	12.3	9.1	8.0	8.4	8.5	7.2	6.8	6.9	6.9	6.4
WPI (ex. Food & Energy)	0.2	7.0	9.1	6.0	5.9	5.1	7.3	7.1	8.3	9.7	9.4	9.2	8.1	5.6	5.8	6.7	5.9
CPI - Industrial Workers	10.9	12.0	8.2	6.3	6.0	15.3	13.7	10.3	9.2	9.0	8.9	8.2	7.0	6.1	6.7	6.4	6.2

	Calendar Year					2010				2011				2012			
	'09	'10	'11 (1)	'12 (1)	'13 (1)	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
External Trade																	
Trade Balance (USD bn)	-107.0	-132.2	-148.7	-172.4	-209.7	-	-	-	-	-	-	-	-	-	-	-	-
Current Account (USD bn)	-25.9	-51.7	-53.7	-58.5	-61.1	-	-	-	-	-	-	-	-	-	-	-	-
Current Account (% of GDP)	-2.0	-3.1	-2.8	-2.6	-2.2	-	-	-	-	-	-	-	-	-	-	-	-

	Fiscal Year					2010				2011				2012			
	'09	'10	'11	'12 (1)	'13 (1)	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Financial Variables																	
Cen. Gov. Budget (INR trn)	-3.4	-4.2	-4.0	-4.6	-4.8	-	-	-	-	-	-	-	-	-	-	-	-
Cen. Gov. Budget (% GDP)	-6.0	-6.4	-5.1	-5.1	-4.6	-	-	-	-	-	-	-	-	-	-	-	-
Primary Budget (% GDP)	-2.6	-3.1	-2.0	-2.1	-1.7	-	-	-	-	-	-	-	-	-	-	-	-
Gross Cen. Gov. Debt (% GDP) (2)	50.9	48.7	45.3	44.3	43.6	-	-	-	-	-	-	-	-	-	-	-	-

	Calendar Year					2010				2011				2012			
	'09	'10	'11 (1)	'12 (1)	'13 (1)	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4 (1)	Q1 (1)	Q2 (1)	Q3 (1)	Q4 (1)
Interest and FX Rates (2)																	
Repo Rate (%)	4.75	6.25	8.25	7.50	7.00	5.00	5.25	6.00	6.25	6.75	7.50	8.25	8.25	8.25	8.25	7.75	7.50
3-Month Rate (%)	4.18	8.59	9.05	8.10	7.50	5.02	5.99	7.10	8.59	9.85	9.15	9.20	9.05	9.50	9.00	8.35	8.10
USDINR	46.53	44.70	46.00	44.00	42.00	44.92	46.45	44.95	44.70	44.72	45.00	48.97	46.00	45.50	45.00	44.50	44.00

Footnotes: (1) Forecast (2) End period
Figures are year-on-year percentage changes unless otherwise indicated

Source: BNP Paribas

South Korea: Volte Face

Activity: downside risks

- South Korea's export orientation leaves it exposed to an expected downturn in the US and stagnation in Europe in H2 2011. Direct exports to those countries are worth close to 8.5% of GDP. However, its trade exposure to the West is considerably higher given its large trade surplus with China, of which a significant portion is based on processing trade and is driven by final demand in the US and EU. Hence, export growth is set to stall in H2 2011.
- Surveys show business confidence is already sagging and reduced export demand will have a spillover effect on facilities investment, but, with capacity short, the downside should be limited. The construction sector remains a drag on overall investment, however.
- With South Korea's more developed financial system, the plunge in equity prices represents a significant downside risk to household consumption. However, the unemployment rate remains low, albeit set to rise, which is an important insulator against income shocks.
- In 2012, an expected recovery of the global economy should lift South Korea's growth in quarter-on-quarter terms. But back-to-back quarters of markedly sub-trend growth in late 2011 and possibly early 2012 should see GDP growth average only a marginally higher 3.4% for 2012, after 2011's 3.3%. These projections are well below the BoK's 4.3% and 4.6% forecasts for 2011 and 2012, respectively.

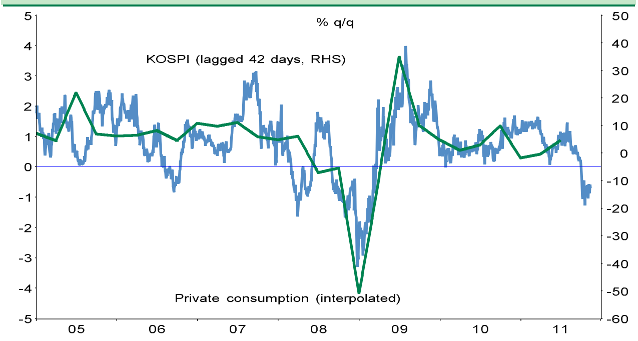
Inflation: above target

- Headline CPI inflation has consistently run above the BoK's 2-4% tolerance range this year. This, in turn, has resulted in household inflation expectations rising above the 4% ceiling, threatening to ratchet up inflation.
- Headline inflation is likely to slow from Q3 but will remain above the 4% target limit until Q1 2012 when strong base effects from the previous food and energy price shocks kick in.
- Core inflation is expected to march higher in the remainder of 2011 before a lagged impact from the expected stagnation of the economy brings it back below 3% later in 2012.

Policy: volte face

- Although the economy ran at a rapid pace through 2010, the policy rate has only been nudged up five times from its record low of 2% to 3.25%, 75-100bp below the neutral level.

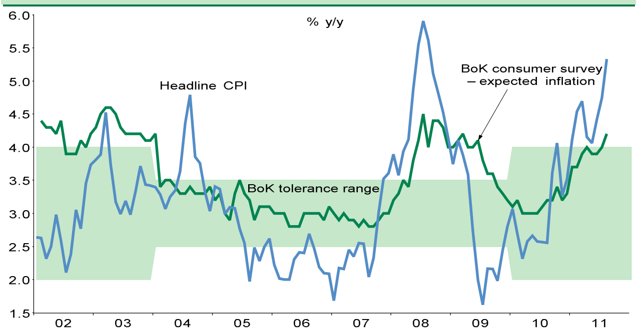
Chart 1: Downside To Consumption (% q/q)



Source: BNP Paribas, Reuters EcoWin Pro

Sharply lower equity prices represent a significant downside risk to growth in household consumption.

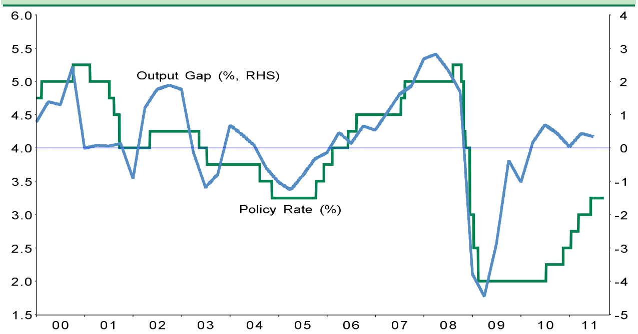
Chart 2: Not So Great Expectations (% y/y)



Source: BNP Paribas, Reuters EcoWin Pro

Sustained 4%-plus inflation has resulted in household inflation expectations rising above the Bank of Korea's tolerance range.

Chart 3: Lagged Response (%)



Source: BNP Paribas, Reuters EcoWin Pro

Policy accommodation has failed to be withdrawn in tandem with developments in the output gap and, by implication, inflation.

- Faced with the prospect of quarters of below-trend growth, the BoK will be forced to cut rates again to shore up the domestic economy. But given high inflation and by implication inflation expectations, the BoK seems unlikely to ease policy by much more than 50bp.
- Easier fiscal policy is a feasible route if significant stimulus is required.

South Korea: Economic & Financial Forecasts

	Year					2010				2011				2012			
	'09	'10	'11 (1)	'12 (1)	'13 (1)	Q1	Q2	Q3	Q4	Q1	Q2	Q3 (1)	Q4 (1)	Q1 (1)	Q2 (1)	Q3 (1)	Q4 (1)
Components of Growth																	
GDP (% q/q)	-	-	-	-	-	2.1	1.4	0.6	0.5	1.3	0.9	0.3	0.4	0.6	1.4	1.3	1.5
GDP	0.3	6.2	3.3	3.4	4.8	8.4	7.3	4.4	4.7	3.9	3.4	3.0	2.9	2.2	2.8	3.8	4.9
Domestic Demand ex. Stocks	0.5	4.8	1.4	3.6	4.5	7.3	4.5	4.5	3.2	1.1	1.8	1.1	1.7	3.1	3.0	3.6	4.6
Private Consumption	0.0	4.1	2.4	3.1	4.6	6.6	3.6	3.6	2.9	2.8	3.0	2.0	1.7	2.0	2.3	3.2	4.8
Public Consumption	5.6	3.0	3.0	4.2	3.4	3.3	2.8	2.6	3.4	1.5	2.0	3.4	4.9	4.4	4.6	4.1	3.9
Fixed Investment	-1.4	7.3	-1.3	4.2	5.0	11.2	7.3	7.5	3.5	-2.6	-0.6	-1.8	-0.2	4.7	3.5	4.0	4.6
Stocks (Cont. to Growth, y/y)	-3.1	1.0	0.8	0.4	0.4	1.9	2.8	0.6	-1.0	0.2	0.6	0.3	1.8	-0.1	0.0	0.8	1.0
Exports	-1.2	14.5	9.6	4.8	10.1	17.0	14.4	11.5	15.6	16.8	9.7	7.6	5.3	2.5	3.5	5.5	7.8
Imports	-8.0	16.9	6.8	6.5	11.4	21.7	18.0	14.6	14.1	10.9	7.8	4.4	4.3	4.1	4.2	7.3	10.1
Net Trade (Cont. to Growth, y/y)	2.8	0.1	1.9	-0.3	0.2	-0.5	-0.3	-0.4	1.6	3.4	1.5	1.9	0.8	-0.5	0.0	-0.3	-0.4
Industrial Production	-0.8	16.6	7.5	3.5	6.9	26.4	18.8	12.9	10.0	11.2	6.7	5.8	6.3	0.6	2.8	4.2	6.2
Memo:																	
Nominal GDP (KRW trn)	1065	1173	1239	1322	1432	285	292	294	301	306	306	312	315	320	327	334	341
Nominal GDP	3.8	10.1	5.6	6.7	8.3	12.3	10.8	8.1	9.5	7.5	4.9	5.9	4.4	4.6	6.7	7.2	8.3

	Year					2010				2011				2012			
	'09	'10	'11 (1)	'12 (1)	'13 (1)	Q1	Q2	Q3	Q4	Q1	Q2	Q3 (1)	Q4 (1)	Q1 (1)	Q2 (1)	Q3 (1)	Q4 (1)
Inflation & Labour																	
CPI	2.8	3.0	4.5	3.5	3.3	2.7	2.6	2.9	3.6	4.5	4.2	4.9	4.6	3.8	3.9	3.3	3.1
Core CPI (ex. Food & Energy)	3.0	1.9	2.9	2.9	3.0	1.9	1.8	1.9	1.9	2.5	2.8	3.1	3.3	3.1	3.0	2.8	2.8
Employment	-0.3	1.4	1.7	1.0	1.6	0.6	1.8	1.5	1.5	1.8	1.7	1.8	1.6	1.0	0.6	0.7	1.5
Unemployment Rate (%)	3.5	3.5	3.6	3.7	3.5	3.8	3.5	3.7	3.5	4.0	3.3	3.3	3.6	3.9	4.0	3.8	3.7

	Year					2010				2011				2012			
	'09	'10	'11 (1)	'12 (1)	'13 (1)	Q1	Q2	Q3	Q4	Q1	Q2	Q3 (1)	Q4 (1)	Q1 (1)	Q2 (1)	Q3 (1)	Q4 (1)
External Trade																	
Trade Balance (USD bn)	37.9	41.9	29.0	22.5	26.8	7.7	9.1	12.5	12.6	10.2	3.1	8.6	7.1	6.3	5.5	5.1	5.6
Current Account (USD bn)	32.8	28.2	19.7	13.5	18.0	3.2	6.7	9.4	8.9	7.1	2.1	5.9	4.6	4.0	3.4	2.7	3.3
Current Account (% of GDP)	3.9	2.8	1.7	1.0	1.2	1.3	2.7	3.7	3.4	2.6	0.7	2.1	1.6	1.3	1.1	0.8	1.0

	Year					2010				2011				2012			
	'09	'10	'11 (1)	'12 (1)	'13 (1)	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Financial Variables																	
Gen. Gov. Budget (KRW trn)	0.4	19.8	13.4	6.9	15.1	-	-	-	-	-	-	-	-	-	-	-	-
Gen. Gov. Budget (% GDP)	0.0	1.7	1.1	0.5	1.1	-	-	-	-	-	-	-	-	-	-	-	-
Gen. Gov. Primary Budget (% GI	-1.0	1.0	0.5	0.0	0.4	-	-	-	-	-	-	-	-	-	-	-	-
Gross Gov. Debt (% GDP) (2)	32.5	33.9	34.1	33.7	32.9	-	-	-	-	-	-	-	-	-	-	-	-

	Year					2010				2011				2012			
	'09	'10	'11 (1)	'12 (1)	'13 (1)	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4 (1)	Q1 (1)	Q2 (1)	Q3 (1)	Q4 (1)
Interest and FX Rates (2)																	
7-Day Repo Rate (%)	2.00	2.50	3.00	3.25	4.00	2.00	2.00	2.25	2.50	3.00	3.25	3.25	3.00	2.75	2.75	3.00	3.25
3-Month Rate (%)	2.86	3.03	3.35	3.75	4.50	2.92	2.73	2.81	3.03	3.59	3.73	3.68	3.35	3.05	3.10	3.45	3.75
10-Year Rate (%)	5.40	4.47	4.00	4.60	5.00	4.94	4.94	4.12	4.47	4.48	4.31	3.95	4.00	4.10	4.20	4.40	4.60
USDKRW	1164	1126	1080	990	950	1131	1222	1140	1126	1100	1070	1178	1080	1040	1010	1000	990

Footnotes: (1) Forecast (2) End period

Figures are year-on-year percentage changes unless otherwise indicated

Source: BNP Paribas

Taiwan: Taking a Hit

Activity: export-driven weakness

- An expected drop in US activity and stagnation in the eurozone in H2 2011 will affect Taiwan more than most other Asian economies. Its exports to the US and EU amount to 11% of GDP. Moreover, Taiwan is heavily exposed to China, which is also likely to grow below trend through much of the remainder of 2011. Overall, therefore, we expect Taiwanese exports to fall modestly in H2.
- A fall in exports will have a knock-on impact on investment. A fall in gross fixed capital formation in Q2 2011 is likely to be followed by a further decline in the second half of the year. A pass-through to imports from weaker export and investment demand will cushion the blow to GDP.
- The one bright spot for growth in the near term should be consumption. Unemployment is low and confidence remains high, consistent with robust spending growth. However, even here, recent turbulence in markets may have a dampening effect in the near term.
- In 2012, the global economy should recover to a moderate rate of growth. This should lift the Taiwanese economy out of stagnation and return it to robust growth from mid-year.

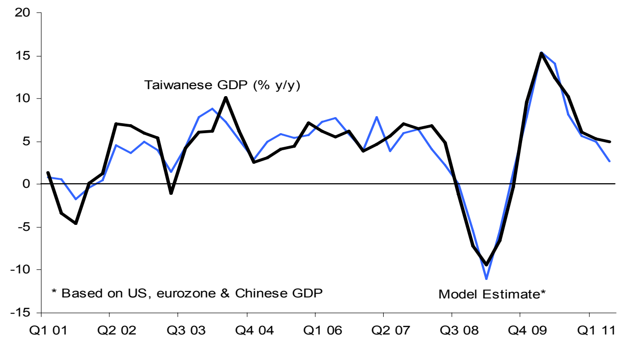
Inflation: moderation in 2012

- Headline inflation did not pick up as strongly as expected during the summer, the result of food inflation undershooting relative to measures of global food prices.
- Core inflation has continued to nudge up. We expect it to rise further in the remainder of 2011, reflecting our estimate of the output gap that suggests the economy was in overheating territory in Q1 2011.
- However, the likely modest decline in activity during H2 2011 should take the heat out of the economy. Given the output gap is a key driver of core inflation, we expect this sluggishness to show through in reduced core inflation during 2012.

Policy: near-term ease

- Taiwan enters the current period of weakness with policy rates 50-90bp below normal. Certainly, relative to past behaviour, policy normalisation has lagged developments in the output gap and inflation developments.
- However, concerns about recessions in Western markets plus two to three quarters of weakness in Taiwan will probably cause the CBC to cut by 25bp at the end of 2011. Although conditions should improve through 2012, the CBC is likely to remain on hold for most of the year only re-engaging in policy tightening in Q4, to start bringing interest rates more into line with the level of activity relative to trend.

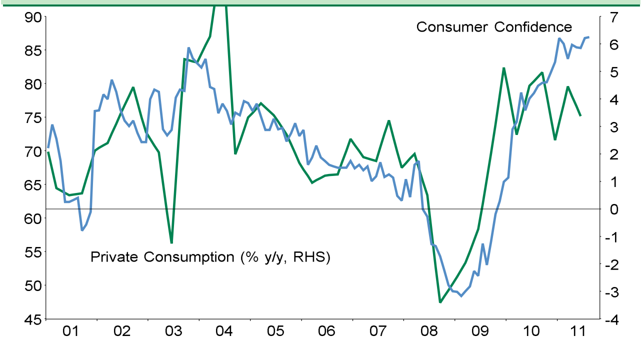
Chart 1: Tied to the Global Cycle



Source: Reuters EcoWin Pro, BNP Paribas

Given Taiwan's export orientation, growth tracks developments in the major markets closely.

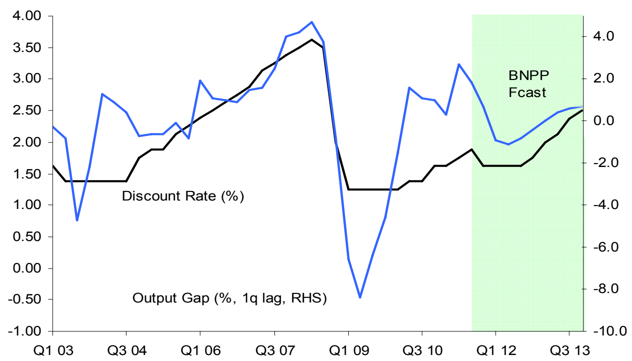
Chart 2 Bright Spot



Source: Reuters EcoWin Pro, CEIC

While exports and investment will be soft in the coming quarters, consumer spending should hold up.

Chart 3: Taking A Break



Source: Reuters EcoWin Pro, BNP Paribas

Policy has so far lagged developments in the output gap and inflation. The CBC is likely to ease slightly at the end of 2011, but policy normalisation should resume from late 2012.

Taiwan: Economic & Financial Forecasts

	Year					2010				2011				2012			
	'09	'10	'11 (1)	'12 (1)	'13 (1)	Q1	Q2	Q3	Q4	Q1	Q2	Q3 (1)	Q4 (1)	Q1 (1)	Q2 (1)	Q3 (1)	Q4 (1)
Components of Growth																	
GDP (% q/q)	-	-	-	-	-	4.2	0.6	0.9	0.3	3.5	0.2	-0.1	-0.5	0.8	1.4	1.4	1.4
GDP	-1.9	10.9	4.3	2.5	5.2	15.3	12.4	10.3	6.0	5.3	4.9	3.8	3.0	0.3	1.5	3.1	5.2
Domestic Demand ex. Stocks	-1.3	7.3	2.7	2.9	4.8	7.4	9.3	8.0	4.5	4.7	2.6	2.1	1.3	1.6	2.3	3.1	4.4
Private Consumption	1.1	3.7	3.6	3.6	4.2	2.7	4.5	5.0	2.5	4.5	3.4	3.3	3.2	3.4	3.3	3.5	4.0
Public Consumption	3.9	1.8	0.1	2.0	2.2	2.6	1.9	0.2	2.3	-0.3	0.2	1.4	-1.0	1.7	2.0	2.0	2.1
Fixed Investment	-11.9	23.9	1.6	1.3	8.1	28.9	32.6	24.2	12.2	8.7	1.8	-0.9	-2.7	-3.4	-0.5	2.6	7.0
Stocks (Cont. to Growth, y/y)	-2.2	2.2	-0.5	-0.4	0.0	5.8	1.2	1.8	0.4	-1.5	0.2	-0.6	-0.2	-0.8	-0.7	-0.1	0.0
Exports	-8.7	25.7	4.0	2.2	10.5	38.6	31.9	21.1	14.6	10.2	4.5	2.7	-1.0	-2.1	-0.4	3.0	8.4
Imports	-12.8	28.2	0.0	2.4	11.5	48.0	33.6	22.9	14.1	6.3	0.5	-1.8	-4.7	-4.0	0.5	4.2	9.3
Industrial Production	-8.1	26.9	6.1	1.6	7.7	48.2	28.6	18.7	17.5	14.5	7.2	6.6	-2.9	-6.7	1.7	4.5	7.7

	Year					2010				2011				2012			
	'09	'10	'11 (1)	'12 (1)	'13 (1)	Q1	Q2	Q3	Q4	Q1	Q2	Q3 (1)	Q4 (1)	Q1 (1)	Q2 (1)	Q3 (1)	Q4 (1)
Inflation																	
CPI	-0.9	1.0	1.4	0.7	0.7	1.3	1.1	0.4	1.1	1.3	1.6	1.3	1.4	0.8	0.5	0.9	0.5
Core CPI (ex. Food & Energy)	-0.6	0.5	0.8	0.5	0.6	0.2	0.5	0.7	0.7	0.6	0.8	0.8	0.9	0.7	0.5	0.4	0.4
Employment	-1.2	2.1	2.0	0.9	1.6	1.3	2.1	2.6	2.3	2.2	2.1	1.9	1.7	1.0	0.8	0.7	1.1
Unemployment Rate (%)	5.8	5.2	4.5	4.7	4.6	5.6	5.3	5.1	4.8	4.6	4.4	4.4	4.5	4.6	4.7	4.7	4.7

	Year					2010				2011				2012			
	'09	'10	'11 (1)	'12 (1)	'13 (1)	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
External Trade																	
Trade Balance (USD bn)	30.9	28.7	22.9	17.7	17.0	-	-	-	-	-	-	-	-	-	-	-	-
Current Account (USD bn)	43.4	42.0	37.0	32.6	33.8	-	-	-	-	-	-	-	-	-	-	-	-
Current Account (% of GDP)	11.4	9.6	7.9	6.5	6.0	-	-	-	-	-	-	-	-	-	-	-	-

	Year					2010				2011				2012			
	'09	'10	'11 (1)	'12 (1)	'13 (1)	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Financial Variables																	
Cen. Gov. Budget (% GDP)	-4.5	-3.3	-2.6	-2.5	-1.3	-	-	-	-	-	-	-	-	-	-	-	-
Primary Budget (% GDP)	-3.6	-2.5	-1.7	-1.6	-0.3	-	-	-	-	-	-	-	-	-	-	-	-
Gross Gov. Debt (% GDP) (2)	33.1	33.4	34.9	36.0	34.3	-	-	-	-	-	-	-	-	-	-	-	-

	Year					2010				2011				2012			
	'09	'10	'11 (1)	'12 (1)	'13 (1)	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4 (1)	Q1 (1)	Q2 (1)	Q3 (1)	Q4 (1)
Interest and FX Rates (2)																	
Discount Rate (%)	1.25	1.63	1.63	1.75	2.50	1.25	1.38	1.38	1.63	1.63	1.75	1.88	1.63	1.63	1.63	1.63	1.75
3-Month Rate (%)	1.37	1.42	1.33	1.30	2.00	1.41	1.48	1.51	1.42	1.48	1.41	1.39	1.33	1.23	1.23	1.18	1.30
10-Year Bond Yield (%)	0.12	1.55	1.50	1.70	1.95	1.44	1.41	1.20	1.55	1.36	1.55	1.27	1.50	1.55	1.60	1.65	1.70
USDTWD	32.0	29.2	29.3	27.3	26.0	31.8	32.3	31.2	29.2	29.4	28.7	30.5	29.3	28.7	28.3	27.8	27.3

Footnotes: (1) Forecast (2) End period

Figures are year-on-year percentage changes unless otherwise indicated

Source: BNP Paribas

Hong Kong: Too Loose for Too Long

Activity: short-term external shock

- Growth slowed through the middle of 2011 due to softer global conditions. Weak external demand, given the US downturn and a slowing down in the Chinese economy, should keep Hong Kong growth below trend in the near term.
- With the weakness expected to be most pronounced around the turn of the year, the impact is seen in the 2012 growth number. However, on a quarterly basis, external demand should improve through the year as the US economy slowly recovers, and as selective policy easing on the mainland leads to an upturn there from Q2 2012.
- Financial market volatility is likely to have some impact on Hong Kong's business and consumer confidence, which should affect domestic demand growth to some extent in the near term.
- However, the theme for Hong Kong in the coming years is that heavily negative real interest rates and exceptionally loose financial and monetary conditions should drive domestic consumer spending and fixed investment.
- We expect consumer spending growth to average over 7.0% in the coming years. This may appear excessive, but the last time real interest rates were as negative as they are now, which was 1991-1993, consumption growth averaged 8.5% y/y. An already tight labour market is also likely to support spending.

Inflation: temporary respite

- Hong Kong faces an inflation problem over the coming years. The recent high in inflation of close to 8.0% is unlikely to be revisited in the foreseeable future, but underlying price pressures will, on average, continue to build.
- The moderation in global food and energy prices should help to bring headline inflation down late this year and in 2012. Softer activity should also temporarily break the up-trend in core inflation.
- However, as the economy picks up again next year and consumption grows rapidly, core inflation will once again push higher.

Policy: inevitable problems

- Hong Kong's peg to the USD creates inevitable problems given the two economies are poles apart in terms of economic conditions. Real interest rates will remain heavily negative through 2012 and 2013 given the Fed's commitment to a zero-rate policy until mid-2013.
- Property prices look likely to push higher for some time yet. With no recourse to interest rates, policymakers will probably have to make further use of administrative measures to rein in already buoyant mortgage growth. Fiscal policy could be used to cool the economy, but thus far the government has tried to support incomes, which are being eroded by high inflation.
- The sustainability of the dollar peg will be increasingly questioned in coming years, but the alternatives all have their disadvantages at present. We forecast it will be maintained.

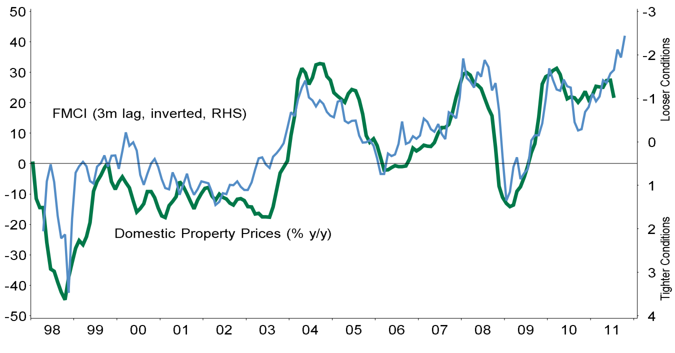
Hong Kong: Economic Forecasts

	2009	2010	2011 (1)	2012 (1)	2013 (1)
Components of Growth					
Total GDP	-2.7	7.0	5.1	3.5	6.2
Dom. Demand ex Stocks	-0.3	6.3	6.4	6.5	7.4
Private Consumption	0.7	6.2	7.8	6.9	7.3
Public Consumption	2.3	2.7	1.6	1.6	3.2
Fixed Investment	-4.0	7.9	4.0	7.2	9.3
Stocks (Cont. to Growth)	1.7	2.5	-0.8	-0.5	0.1
Exports	-10.3	16.8	5.7	2.7	8.2
Imports	-9.0	17.3	5.8	3.8	8.8
Net Trade (Cont. to Growth)	-4.1	0.7	1.0	-1.7	-0.4
Inflation & Labour					
CPI	0.6	2.3	5.0	3.9	4.4
Core CPI	1.1	1.1	4.5	4.6	5.3
Employment	-1.0	0.2	2.9	0.4	1.5
Unemployment Rate (%)	5.2	4.4	3.6	4.0	3.8
External Trade					
Trade Balance (USD bn)	15.6	12.6	10.2	13.6	13.9
Current Account (USD bn)	18.0	13.9	12.8	16.4	17.2
Current Account (% GDP)	8.6	6.2	5.3	6.2	5.9
Financial Variables					
Gen. Gov. Budget (% GDP)	1.6	4.8	0.3	1.5	1.7
Primary Budget (% GDP)	1.6	4.9	0.3	1.5	1.8
Gross Gov. Debt (% GDP) (2)	3.4	4.6	4.3	4.0	3.8
Interest & FX Rates (2)					
Interest Rate (%)	0.14	0.28	0.25	0.25	0.85
Official Benchmark Rate (%)	0.50	0.50	0.50	0.50	1.00
USDHKD	7.80	7.80	7.80	7.80	7.80

Footnotes: (1) Forecast (2) End Period
Figures are year-on-year percentage changes unless otherwise indicated.

Source: BNP Paribas

Chart 1: Monetary Conditions Too Loose



Source: Reuters EcoWin Pro, BNP Paribas

Financial and monetary conditions are too loose in Hong Kong and are pumping up the property market.

Indonesia: No Hard Landing Here

Activity: resilient consumption

- Among the ASEAN economies, it is well known that Indonesia is the least dependent on exports. Exports account for only 46.4% of GDP compared with 218.4% and 110.0% for Singapore and Malaysia, respectively. What is less well known is that the correlation of Indonesia's other demand components of GDP with exports is low. In our view, this puts the country in a strong position to ride out the increasing risks of a US recession.
- In recent years, the correlation between private consumption and exports has been negative in Indonesia (compared with 0.77 for Thailand and 0.73 for Malaysia). We believe the key reason for this is that Indonesian consumption spending is beginning to take off. Experience in other Asian economies has shown consumption tends to be a lot more resilient during such a period. Accordingly, we expect the economy to expand by 6.5% this year and 7.0% in 2012.
- Although the current account surplus narrowed to just USD 200mn in Q2 2011 from USD 2.1bn in Q1, we do not see this as the start of a trend deterioration. The key reason for the narrowing of the surplus was a rise in oil prices. Weaker oil prices should have reversed the deterioration in Q3. Notably, the rise in foreign reserves to a record USD 123bn in July signals there is no danger of the IDR coming under speculative pressure. That said, the risk comes more on the capital account where foreign ownership of Indonesian government bonds reached 35.4% in July 2011. The fear is that this will turn into an outflow should global risk appetite head south.

Inflation: under control

- As we had expected, the inflation rate remains modest at 4.6% y/y in July. In particular, the price of spices has continued to fall as the supply of chillies presumably played catch-up after a weather-induced shortage in early 2011. Compared with a rise of 59.7% y/y in January, chilli prices fell by 25.9% y/y in July.
- The government's decision to stockpile rice through massive imports in the past two years has clearly helped to moderate food inflation.

Policy: accommodative

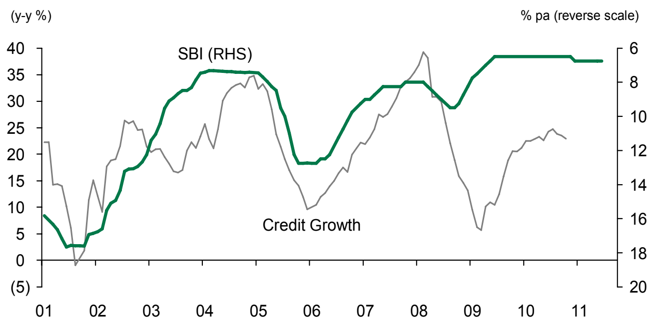
- The central bank is not concerned about the pick-up in credit growth to 22.9% y/y. Its view is that such a growth rate is consistent with its projected (sustainable) real GDP growth of 6-7% for 2011 and 2012.

Indonesia: Economic Forecasts

	2009	2010	2011 (1)	2012 (1)	2013 (1)
Components of Growth					
Total GDP	4.6	6.1	6.5	6.8	7.0
Dom. Demand ex Stocks	5.4	5.2	5.8	6.8	6.8
Private Consumption	4.9	4.6	4.8	5.2	5.5
Public Consumption	15.7	0.3	5.2	8.0	9.0
Fixed Investment	3.3	8.5	8.5	10.0	9.0
Stocks (Cont. to Growth)	-0.2	0.4	0.3	-0.3	0.3
Exports	-9.7	14.9	10.7	10.5	13.7
Imports	-15.0	17.3	12.8	11.3	15.1
Net Trade (Cont. to Growth)	1.2	0.8	0.4	0.8	0.8
Inflation					
CPI	4.8	5.1	5.8	5.6	6.2
Core CPI	5.7	4.1	4.7	4.9	5.0
External Trade					
Trade Balance (USD bn)	37.5	47.0	66.2	78.2	85.1
Current Account (USD bn)	10.2	6.3	4.9	6.6	6.9
Current Account (% GDP)	1.9	0.9	0.6	0.6	0.6
Financial Variables					
Gen. Gov. Budget (% GDP)	-1.6	-0.6	-1.5	-1.2	-1.0
Primary Budget (% GDP)	0.1	0.7	0.0	0.5	0.9
Gross Gov. Debt (% GDP) (2)	31.1	31.0	30.4	29.8	27.0
Interest & FX Rates (2)					
Interest Rate (%)	7.06	6.64	6.80	7.30	7.80
Official Benchmark Rate (%)	6.50	6.50	6.75	7.25	7.50
USDIDR	9,400	8,991	8,500	7,900	7,500

Footnotes: (1) Forecast (2) End Period
Figures are year-on-year percentage changes unless otherwise indicated.
Source: BNP Paribas

Chart 1: Credit Growth Remains Under Control



Source: BNP Paribas, CEIC

Despite interest rates staying low for a sustained period, banks in Indonesia have not been lending recklessly.

- We believe Bank Indonesia has finished raising rates for this year.

Other ASEAN: Heading Down But Not Out

Thailand: revised down

- Despite the slowdown in real GDP growth to just 2.6% y/y in Q2 2011 from 3.2% in Q1, the central bank argued in its August policy statement that the Thai economy retains momentum due to increased diversification of exports to new markets in the region, and fiscal stimulus. Indeed, while the BOT has become less optimistic about the outlook for global demand, especially in the advanced economies, its decision in August to raise its policy interest rate by another 25bp to 3.5% (for a total rise of 225bp from its low of 1.25% in June 2010) suggests it is confident 1) the slowdown in growth is temporary, 2) domestic demand is robust enough to withstand the rate hikes and 3) the new government's fiscal measures will boost domestic demand.
- Q2's slowdown may well prove temporary, reflecting supply-chain disruption from Japan's earthquake on the country's automotive industry. However, we are concerned about the twin impact of rising interest rates and the 300 baht minimum wage scheme promised by the government on the competitiveness of Thailand's corporate sector. This will clearly affect the country's ability to attract FDI which, in 2010, amounted to only USD 5.8bn. While higher than the previous year's USD 5bn, it is telling that, on FDI, Thailand has lagged Vietnam (USD 8.2bn) for three consecutive years. Thailand can clearly do better if the political risks are reduced.
- Accordingly, we have lowered our GDP growth forecast for this year to 4.0% from 4.6%. For next year, we see a rebound to 5.3% on the back of a pick-up in consumption and stronger manufacturing output.
- The key concern on the inflation front is the risk of the new government pushing up the price of domestic unmilled rice as promised during the election.

Thailand: Economic Forecasts

	2009	2010	2011 (1)	2012 (1)	2013 (1)
GDP (% y/y)	-2.3	7.8	4.0	5.3	6.1
CPI (% y/y)	-0.8	3.3	3.8	3.0	3.9
Current Account (% GDP)	8.3	4.6	3.4	2.0	1.7
Budget Balance (% GDP)	-4.4	-3.8	-4.0	-4.0	-3.8
Primary Budget (% GDP)	-2.4	-1.9	-1.7	-0.8	-0.6
Gross Gov. Debt (% GDP) (2)	43.9	42.4	41.2	39.3	36.9
Interest Rate (%) (2)	1.35	2.15	3.35	3.80	4.10
Official Benchmark Rate (%) (2)	1.25	2.00	3.50	3.75	4.00
USDTHB (2)	33.36	30.12	29.70	28.30	27.50

(1) Forecast (2) End Period

Source: BNP Paribas

Malaysia: patience required

- The economy grew by 4.5% y/y in H1 2011 and 4.0% in Q2 2011. While better than the consensus expectation, a source of concern is that the pace of investment spending slowed to a modest 3.2% y/y in Q2 from 6.5% in Q1. The numerous investment commitments announced by the government as part of its Economic Transformation Program have so far not translated into an increase in investment spending. On the same note, construction growth slowed to 0.6% y/y from 3.8% in the previous quarter. We nonetheless take the view that the government will push investment spending up, given that a general election will have to be held in 2012.
- On the inflation front, the central bank appears to be one of the more proactive in the region, raising its policy rate by 100bp since February 2010. We expect the central bank to pause for the rest of the year before resuming the normalisation of rates in 2012, when we expect two hikes to increase the policy rate to 3.5%.

Malaysia: Economic Forecasts

	2009	2010	2011 (1)	2012 (1)	2013 (1)
GDP (% y/y)	-1.6	7.2	4.5	5.7	7.0
CPI (% y/y)	0.6	1.7	3.3	2.8	3.3
Current Account (% GDP)	16.5	11.8	9.3	10.4	10.7
Budget Balance (% GDP)	-7.6	-5.7	-5.3	-4.9	-4.6
Primary Budget (% GDP)	-4.3	-3.6	-3.4	-3.3	-3.3
Gross Gov. Debt (% GDP) (2)	53.3	56.7	54.1	53.3	51.0
Interest Rate (%) (2)	2.17	3.00	3.45	3.65	3.70
Official Benchmark Rate (%) (2)	2.00	2.75	3.00	3.50	3.50
USDMYR (2)	3.42	3.08	2.96	2.80	2.70

(1) Forecast (2) End Period

Source: BNP Paribas

Singapore: worst stage of the cycle

- While exports and hence economic growth are set to slow on the back of the deterioration in the global outlook, the Singaporean economy also has to grapple with the effects of rising unit labour costs (ULCs) and MAS policy tightening. In Q2 2011, ULCs rose by a record 10.4% y/y, the fastest pace of increase since March 1983. The combination of slower economic growth and a surge in ULC pressures forms a clear headwind to the local equity market.
- A key by-product of the rise in ULCs is higher inflation which, in turn, has prompted the MAS to tighten its exchange rate policy in the last twelve months.

- In previous cycles, such a combination would inevitably have led to a sharp decline in real GDP growth. However, our forecast is 4.9% for 2011, compared with the government's forecast range of 5-6%, and 5.6% in 2012. A much sharper slowdown should be averted for two key reasons: record low interest rates and capex spending (especially residential building). The government is embarking on a massive residential building programme to keep public sector housing affordable in response to Singaporeans' call for such housing after the recent general election. That said, all bets are off if the world economy suffers a financial meltdown in H2 2011.

Philippines: room for manoevre

- At a time when fiscal concerns have taken centre stage, especially in the OECD economies, it is interesting to note what is happening in the Philippines, which in the past was known to suffer from fiscal recklessness. The country's public sector debt (including contingent liabilities) hit a record high of PHP 4.64trn (or 95% of GDP) in 2004 after budget deficits averaging 4-5% of GDP in the period 2000-2004. These high and unsustainable deficits triggered bouts of instability in the peso exchange rate.
- Fast forward to 2011 and the country has made tremendous improvements in its fiscal position which, in turn, have prompted sovereign upgrades in the past twelve months. A key reason for the upgrade is the sharp drop in the fiscal deficit, which shrank to just PHP 17bn in H1 2011 from PHP 197bn in the same period of 2010. Behind this massive improvement lie both the reduction in interest payments in the government's budget – which narrowed to PHP 136bn in H1 2011 compared with PHP 148bn in the same period a year earlier – and a cut in government expenditure.
- In our view, the reduction in interest payments (due to lower borrowing costs) will help create more fiscal space for additional investment. While the expenditure cuts are expected to be reversed in H2 2011 and should underpin Philippine economic growth, we do not think this will have a significant impact on the overall budget balance, which the government is targeting to fall to 3.2% of GDP this year from 3.74%. We expect the peso to be a major beneficiary of the fiscal turnaround.

Vietnam: stabilising

- Inflation hit a new high of 23.0% y/y in August (up from 22.2% in July). However, investors should not be too distracted by these figures. Given the slew of anti-inflation measures introduced, it is the month-on-month figures that should be monitored. These figures are encouraging, with August's inflation slowing to 0.9% m/m from a peak of 3.3% in April. The recent sharp improvement in the trade balance is also evidence that the tightening measures are starting to bite.
- The move by the SBV in July to slash repo rates by 100bp underscores a theme we have been highlighting: the risk of overzealous tightening. We do not think the cut in the reverse repo rate is a policy mistake given the slowdown in credit and M2 growth. Indeed, with the global financial markets in turmoil again at the time of writing, this is the right step by the SBV.
- The earlier-than-expected cut in the reverse repo rate removes the likelihood of further rate hikes this year especially as, barring unforeseen poor weather, inflation is already falling.

Singapore: Economic Forecasts

	2009	2010	2011 (1)	2012 (1)	2013 (1)
GDP (% y/y)	-0.8	14.5	4.9	5.6	7.2
CPI (% y/y)	0.6	2.8	4.7	2.4	2.5
Current Account (% GDP)	19.0	22.2	23.5	24.1	22.3
Budget Balance (% GDP)	-0.3	-0.1	0.0	1.0	0.5
Primary Budget (% GDP)	-0.8	-0.3	0.3	0.4	0.5
Gross Gov. Debt (% GDP) (2)	109.3	96.1	86.9	80.4	74.6
Interest Rate (%) (2)	0.68	0.44	0.40	0.60	0.80
USDSGD (2)	1.40	1.30	1.20	1.15	1.11

(1) Forecast (2) End Period

Source: BNP Paribas

Philippines: Economic Forecasts

	2009	2010	2011 (1)	2012 (1)	2013 (1)
GDP (% y/y)	1.1	7.6	4.3	5.7	6.3
CPI (% y/y)	3.3	3.8	4.7	3.4	4.6
Current Account (% GDP)	5.8	4.8	3.5	2.9	2.2
Budget Balance (% GDP)	-3.7	-3.5	-2.9	-2.3	-2.0
Primary Budget (% GDP)	-0.3	-0.2	0.4	0.7	0.9
Gross Gov. Debt (% GDP) (2)	60.7	58.0	57.3	55.7	53.7
Interest Rate (%) (2)	5.00	1.06	4.70	5.10	5.20
Official Benchmark Rate (%) (2)	4.00	4.00	4.50	4.75	4.75
USDPHP (2)	46.36	43.80	42.50	40.00	38.00

(1) Forecast (2) End Period

Source: BNP Paribas

Vietnam: Economic Forecasts

	2009	2010	2011 (1)	2012 (1)	2013 (1)
GDP (% y/y)	5.3	6.8	6.0	7.0	7.5
CPI (% y/y)	7.0	9.2	18.0	6.5	9.0
Current Account (% GDP)	-6.5	-8.0	-4.6	-4.7	-4.3
Budget Balance (% GDP)	-7.7	-5.4	-3.2	-3.0	-2.9
Primary Budget (% GDP)	-7.6	-5.1	-2.5	-2.1	-2.0
Gross Gov. Debt (% GDP) (2)	51.2	52.8	51.5	51.0	50.1
Interest Rate (%) (2)	8.00	9.00	14.00	11.00	12.00
USDVND (2)	17942	18932	20800	20400	20000

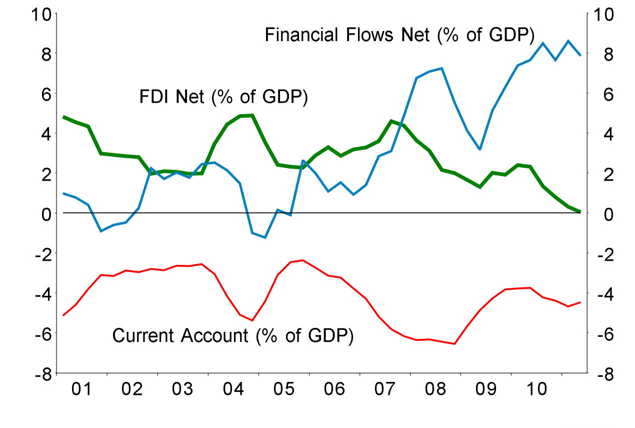
(1) Forecast (2) End Period

Source: BNP Paribas

Poland: Hard-Landing Concerns

- **Activity: risk of a harder landing has risen**
  - Hard data and most surveys suggest a sharp slowdown in growth started in Q3. We expect economic conditions to remain poor, given the weakness of external demand and rising stress in financial markets.
  - Since the adjustment to Poland's fiscal and external imbalances has not really started, hard-landing concerns will continue to grow, especially if eurozone demand fails to recover swiftly in 2012 and global risk aversion persists.
  - The latter is a particular risk for Poland, given its recent heavy reliance on foreign financial flows.
  - The eurozone's fiscal crisis will, in our view, serve as an additional incentive for the government to tighten budgetary policy. Thus as the fiscal stimulus is reversed, we expect economic growth to slow below 2.5% y/y next year and to remain below 3.0% in 2013.
  - Political uncertainty, with parliamentary elections on 9 October, may temporarily increase the risk premium. But we expect the current major ruling party to remain in power, which should please markets.
- **Inflation: lower inflation will support rate cuts**
  - Weaker growth points to a fall in inflation, although the latest wave of zloty weakness may cause inflation to be choppy and will limit disinflation slightly in the near term.
  - But as the output gap re-widens and the impact of 2011's VAT hike fades, we expect a substantial fall in inflation.
  - Given the weakness of the economy, we expect 100bp in rate cuts next year. Tighter fiscal policy and ECB rate cuts will also provide arguments for the MPC doves.
- **FX and rates: official support**
  - It is clear that officials have been growing increasingly uncomfortable with the weakening in the zloty and we expect EURPLN moves towards 4.50 to be met with intervention.
  - We estimate that the BGK has a further EUR 10bn from EU funds and foreign bond issues, part of which should be converted into PLN by the year-end. This should provide enough ammunition to stem excessive zloty weakness in the coming quarter.
  - The long end of the Polish bond curve has seen some support, particularly with the actions from the BGK in Q3, and we think stability in the currency will be met with further support to long-dated bonds, particularly on the 10-year segment.

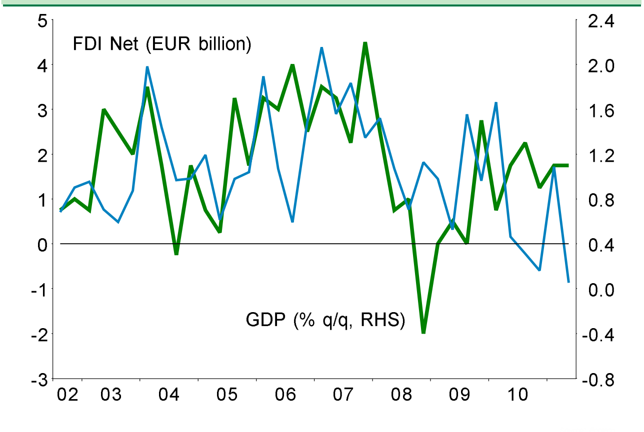
Chart 1: Vulnerable to Financial Markets' Mood



Source: Reuters EcoWin Pro

A still-wide current account deficit, reflecting loose fiscal policy, is being financed by capital inflows. This increases the zloty's vulnerability to stress on global financial markets.

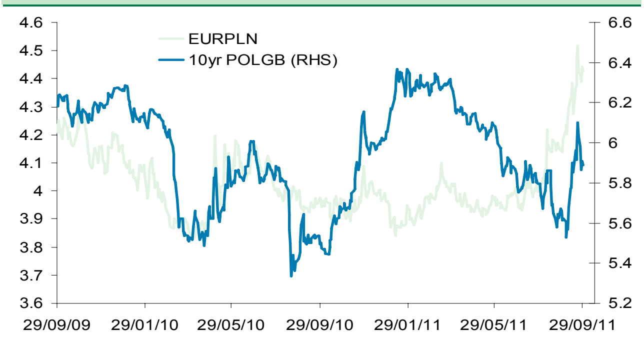
Chart 2: FDI Slump Heralds Weak Growth



Source: Reuters EcoWin Pro, BNP Paribas

A slump in FDI is also extremely bad news for the growth outlook – especially as fiscal policy will be tightened more sharply.

Chart 3: PLN Bid to Support Long-End of Bonds



Source: Reuters EcoWin Pro, NBP, BNP Paribas

Poland: Economic & Financial Forecasts

	Year					2010				2011				2012			
	’09	’10	’11 (1)	’12 (1)	’13 (1)	Q1	Q2	Q3	Q4	Q1	Q2	Q3 (1)	Q4 (1)	Q1 (1)	Q2 (1)	Q3 (1)	Q4 (1)
Components of Growth																	
GDP (% q/q)	-	-	-	-	-	0.7	1.1	1.3	0.9	1.1	1.1	0.2	0.5	0.5	0.7	0.6	0.8
GDP	1.6	3.8	3.7	2.3	2.9	3.0	3.4	4.2	4.5	4.4	4.3	3.3	2.8	2.3	2.2	2.3	2.5
Final Domestic Demand	1.5	2.2	3.5	2.5	3.6	0.4	2.4	2.9	3.2	3.9	3.6	3.5	2.9	2.5	2.5	2.2	2.7
Private Consumption	2.1	3.2	3.1	2.2	3.3	2.2	3.2	3.4	4.0	3.9	3.5	2.7	2.4	1.9	1.9	2.2	2.8
Public Consumption	2.1	3.9	0.0	1.3	2.5	0.8	2.6	4.7	7.6	1.5	-1.3	0.5	-0.6	1.4	1.2	1.2	1.5
Fixed Investment	-1.6	-2.2	7.3	4.8	5.0	-11.4	-0.4	1.5	1.6	6.0	7.8	7.8	7.7	6.0	5.7	3.7	3.9
Stocks (Cont. to Growth, y/y)	-2.3	2.1	0.8	-0.2	0.4	1.5	2.0	2.5	2.3	1.4	1.1	0.4	0.1	-0.3	-0.3	-0.2	0.0
Exports	-6.8	10.2	6.8	6.8	5.9	10.1	14.9	8.7	7.0	5.9	6.7	8.8	5.9	6.3	4.7	7.1	9.0
Imports	-12.4	11.6	6.6	6.1	8.5	7.5	17.9	9.3	11.6	6.2	6.6	8.4	5.1	5.5	4.4	5.8	8.8
Industrial Production	-3.6	11.1	6.3	4.7	6.6	10.1	12.5	12.0	9.8	9.2	5.5	5.6	4.7	4.1	4.1	4.8	6.0

	Year					2010				2011				2012			
	’09	’10	’11 (1)	’12 (1)	’13 (1)	Q1	Q2	Q3	Q4	Q1	Q2	Q3 (1)	Q4 (1)	Q1 (1)	Q2 (1)	Q3 (1)	Q4 (1)
Inflation & Labour																	
CPI	3.5	2.6	4.2	2.3	2.2	2.6	2.3	2.5	3.1	4.3	4.2	4.4	3.9	3.1	2.4	1.9	1.8
Core CPI	2.7	1.6	2.3	2.0	1.5	2.0	1.5	1.2	1.6	2.0	2.4	2.5	2.3	2.1	2.0	1.9	1.8
Employment	0.4	0.6	1.2	-0.1	-0.3	-0.9	0.9	1.1	1.2	1.9	1.1	1.3	0.5	0.3	0.0	-0.4	-0.5
Wages	5.2	4.2	5.4	4.9	4.0	4.1	3.8	2.9	6.0	4.5	5.3	5.5	6.4	5.8	5.1	4.6	4.3
ULC	0.4	-0.5	-0.8	0.0	-1.2	-0.4	-0.7	-1.3	0.3	-1.2	-1.9	-0.3	0.3	0.5	0.0	-0.1	-0.5
Unemployment Rate (%)	11.0	12.1	11.9	12.4	12.9	13.0	12.1	11.5	11.8	13.1	12.2	10.8	11.6	13.2	12.6	11.2	12.3

	Year					2010				2011				2012			
	’09	’10	’11 (1)	’12 (1)	’13 (1)	Q1	Q2	Q3	Q4	Q1	Q2	Q3 (1)	Q4 (1)	Q1 (1)	Q2 (1)	Q3 (1)	Q4 (1)
External Trade																	
Trade Balance (EUR bn)	-5.44	-8.61	-12.01	-8.03	-9.96	-1.30	-1.80	-2.28	-3.24	-1.90	-3.03	-2.94	-4.13	-1.02	-2.45	-1.58	-2.98
Current Account (EUR bn)	-12.21	-15.84	-16.49	-13.76	-16.37	-2.18	-3.01	-4.98	-5.67	-3.38	-2.55	-3.95	-6.61	-2.45	-2.27	-3.08	-5.97
Current Account (% of GDP)	-3.9	-4.5	-4.5	-3.5	-3.6	-2.6	-3.6	-5.6	-5.6	-3.9	-2.7	-4.5	-6.5	-2.8	-2.4	-3.1	-5.1

	Year					2010				2011				2012			
	’09	’10	’11 (1)	’12 (1)	’13 (1)	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Financial Variables																	
Gen. Gov. Budget (PLN bn)	-99	-111	-87	-78	-71	-	-	-	-	-	-	-	-	-	-	-	-
Gen. Gov. Budget (% GDP)	-7.3	-7.9	-5.7	-4.9	-4.2	-	-	-	-	-	-	-	-	-	-	-	-
Primary Budget (% GDP)	-4.5	-4.9	-2.6	-2.0	-1.3	-	-	-	-	-	-	-	-	-	-	-	-
Gen. Gov. Debt (% GDP)	50.9	55.0	57.8	57.1	56.4	-	-	-	-	-	-	-	-	-	-	-	-

	Year					2010				2011				2012			
	’09	’10	’11 (1)	’12 (1)	’13 (1)	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4 (1)	Q1 (1)	Q2 (1)	Q3 (1)	Q4 (1)
Interest Rates & Bonds (2)																	
Policy Rate (%)	3.50	3.50	4.50	3.50	3.50	3.50	3.50	3.50	3.50	3.75	4.50	4.50	4.50	4.00	3.50	3.50	3.50
3-Month Rate (%)	4.27	3.95	4.70	3.70	3.70	4.10	3.87	3.84	3.95	4.19	4.69	4.70	4.70	4.20	3.70	3.70	3.70
2-Year Bond (%)	5.19	4.80	4.45	4.65	4.70	4.53	4.85	4.71	4.80	5.03	4.86	4.55	4.45	4.35	4.45	4.55	4.65
5-Year Bond (%)	5.91	5.52	5.15	5.35	5.50	5.14	5.41	5.06	5.52	5.80	5.36	5.20	5.15	5.05	5.15	5.25	5.35
10-Year Bond (%)	6.24	6.07	5.60	5.85	5.95	5.54	5.94	5.49	6.07	6.29	5.84	5.77	5.60	5.65	5.60	5.70	5.85
Spread over Bund (bp)	285	311	360	285	270	244	336	322	311	293	299	410	360	340	310	295	285
Interest Rate Swaps (2)																	
2-Year Swap (%)	5.10	4.88	4.45	4.20	4.40	4.72	4.60	4.64	4.88	5.24	5.14	4.70	4.45	4.30	4.10	4.15	4.20
5-Year Swap (%)	5.77	5.48	4.75	4.70	4.80	5.19	5.18	4.92	5.48	5.69	5.32	4.85	4.75	4.65	4.50	4.55	4.70
10-Year Swap (%)	5.81	5.64	5.00	5.35	5.45	5.40	5.42	4.95	5.64	5.71	5.40	5.05	5.00	4.95	5.05	5.25	5.35
FX Rates (2)																	
EURPLN	4.10	3.96	4.25	3.80	3.70	3.85	4.15	3.96	3.96	4.02	3.98	4.30	4.25	4.20	4.10	4.00	3.80
USDPLN	2.86	2.96	2.93	2.57	2.64	2.85	3.38	2.91	2.96	2.84	2.74	3.12	2.93	2.84	2.73	2.67	2.57

Footnotes: (1) Forecast (2) End period

Figures are year-on-year percentage changes unless otherwise indicated

Source: BNP Paribas

This section is classified as non-objective research

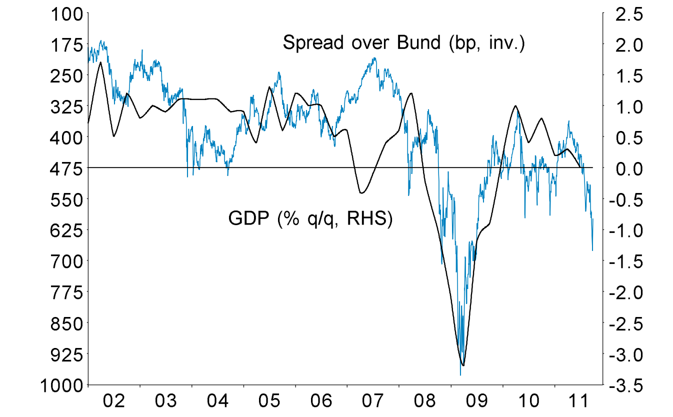
Hungary: Uncertainty Makes Things Worse

- **Activity: sharply weaker on high risk aversion**
  - The domestic economy's fragile fundamentals leave Hungary extremely vulnerable to the slowdown in external demand that we forecast.
  - To make matters worse, the government's plan to allow the early repayment of FX-denominated mortgages has exacerbated the rise in risk aversion, as the costs of the operation are set to be borne entirely by banks. There may be legal disputes between banks and the government, but this plan may intensify the credit squeeze and fuel further forint weakness, despite NBH's commitment to use its reserves to absorb the resultant outflow of hard currency.
  - The recent widening of spreads is actually consistent with a double-dip recession. Our forecast assumes very weak, but still positive, growth next year, but the risk for a much worse outcome has certainly increased.
  - Since Hungary does not have a ready-to-use external safety net, such as the IMF's Flexible Credit Line in Poland or the precautionary Stand-By Arrangement in Romania, the government must stick to fiscal tightening measures, irrespective of the growth outlook. We expect the deficits to be kept in check, but this will increase downside risks to GDP.

- **Inflation: level above 3% will prevent rate cuts**
  - Indirect tax hikes and a weaker forint will keep inflation above the 3% target in 2012, preventing interest rate cuts by the NBH.
  - Any further increase in risk aversion beyond Q4 2011 would probably trigger emergency rate hikes to defend the currency.

- **FX and rates: flatter curve**
  - The forint is likely to underperform due to the government's plan for FX mortgage repayments and the uncertainty surrounding the eligibility guidelines, which would determine the take-up ratio and the subsequent impact on the financial system.
  - Positioning in HGBs remains particularly high and at a slightly precarious level in our view, particularly given the widening in CDS spreads and the volatility in the cross-currency basis.
  - Given the lack of potential for the NBH to deliver rate cuts at this stage, we could see the Hungarian curve breaking the EM trend and flattening, particularly on the 2s5s segment.

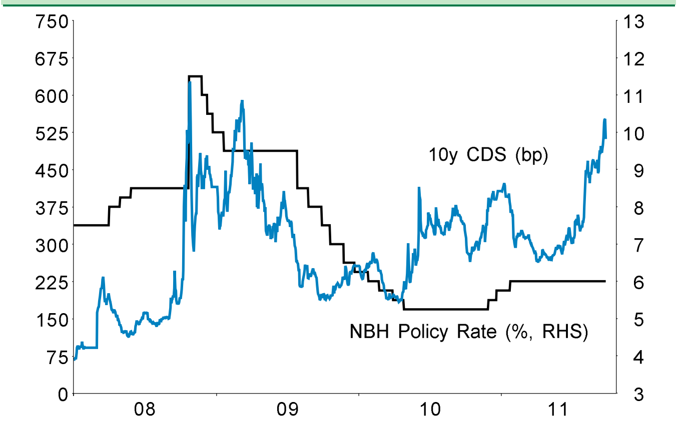
Chart 1: Rising Risk Aversion Points to Recession Risk



Source: Reuters EcoWin Pro

A higher risk premium is consistent with weaker growth. The latest widening of spreads is consistent with recession.

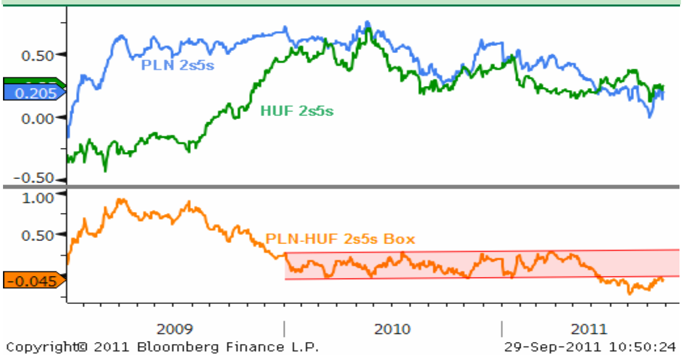
Chart 2: Risk Premium is Too High for Rate Cuts



Source: Reuters EcoWin Pro

A rising risk premium argues against rate cuts, despite a dire picture for the real economy.

Chart 3: PLN-HUF 2s5s Box Spread



Source: Bloomberg, BNP Paribas

Michal Dybula, Dina Ahmad

Hungary: Economic & Financial Forecasts

	Year					2010				2011				2012			
	'09	'10	'11 (1)	'12 (1)	'13 (1)	Q1	Q2	Q3	Q4	Q1	Q2	Q3 (1)	Q4 (1)	Q1 (1)	Q2 (1)	Q3 (1)	Q4 (1)
Components of Growth																	
GDP (% q/q)	-	-	-	-	-	1.0	0.3	0.8	0.1	0.3	0.0	0.2	0.0	0.0	0.2	0.4	0.7
GDP	-6.7	1.2	1.2	0.7	2.6	0.1	1.0	1.7	1.9	2.5	1.5	0.9	0.0	0.2	0.5	0.6	1.5
Final Domestic Demand	-6.2	-2.8	-1.3	-0.6	2.3	-3.3	-4.2	0.4	-3.9	-0.4	-1.7	-1.1	-1.9	-0.3	-0.6	-0.8	-0.7
Private Consumption	-6.8	-2.2	-1.1	-1.0	2.6	-4.0	-5.0	1.2	-0.8	-0.8	0.1	-1.6	-2.1	-0.7	-0.5	-1.5	-1.3
Public Consumption	2.0	-0.2	0.0	1.4	-0.4	3.6	1.4	1.7	-7.6	3.8	0.1	-0.5	-3.3	4.4	0.0	0.1	0.9
Fixed Investment	-7.8	-5.3	-2.6	-0.6	3.0	-4.8	-4.5	-2.6	-9.1	-1.6	-8.1	0.2	-0.9	-2.0	-1.3	0.7	0.0
Stocks (Cont. to Growth, y/y)	-4.8	1.5	0.5	0.1	0.0	-0.8	3.0	-0.1	3.9	1.3	0.2	0.2	0.2	-0.1	0.0	-0.1	0.4
Exports	-9.4	14.2	9.9	7.2	9.5	15.5	15.8	13.9	11.7	14.4	8.8	9.8	6.6	3.3	6.1	7.6	11.8
Imports	-14.3	12.0	7.9	5.2	9.1	10.4	14.4	13.0	10.3	14.4	6.1	7.2	4.0	2.2	4.3	5.3	9.1
Industrial Production	-17.3	10.6	5.9	2.5	4.5	5.2	13.5	13.1	10.5	12.5	4.3	4.7	2.0	-0.8	1.6	2.8	6.4

	Year					2010				2011				2012			
	'09	'10	'11 (1)	'12 (1)	'13 (1)	Q1	Q2	Q3	Q4	Q1	Q2	Q3 (1)	Q4 (1)	Q1 (1)	Q2 (1)	Q3 (1)	Q4 (1)
Inflation & Labour																	
CPI	4.3	4.9	4.0	3.8	2.9	5.9	5.3	3.8	4.7	4.5	3.5	4.2	3.8	3.8	3.8	3.8	3.9
Core CPI	4.1	2.9	3.0	3.8	2.5	4.7	3.5	1.5	2.0	2.5	3.0	3.4	3.2	3.9	3.8	3.8	3.8
Employment	-2.5	0.0	0.2	-0.5	0.1	-1.2	-0.5	1.0	0.6	0.4	0.8	-0.1	-0.3	-0.5	-0.5	-0.4	-0.4
Wages	0.6	1.5	4.6	4.8	6.1	5.6	0.3	1.5	-1.6	1.5	5.8	6.6	4.6	4.4	5.4	4.7	4.8
ULC	0.8	-2.6	0.3	-0.7	0.7	2.9	-3.1	-4.2	-6.0	-2.9	1.7	1.6	0.7	-0.8	0.0	-0.7	-1.4
Unemployment Rate (%)	10.0	11.2	11.3	11.9	12.2	11.8	11.1	10.9	10.8	11.6	10.8	11.3	11.3	12.4	11.5	11.9	12.0

	Year					2010				2011				2012			
	'09	'10	'11 (1)	'12 (1)	'13 (1)	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4 (1)	Q1 (1)	Q2 (1)	Q3 (1)	Q4 (1)
External Trade																	
Trade Balance (EUR bn)	2.34	3.23	5.00	6.57	6.76	0.86	0.91	0.56	0.89	1.34	1.78	0.85	1.03	1.53	2.14	1.30	1.61
Current Account (EUR bn)	-0.18	1.06	1.15	3.73	3.03	0.26	0.37	0.26	0.18	0.38	0.74	-0.13	0.16	0.70	1.77	0.48	0.77
Current Account (% of GDP)	-0.2	1.1	1.1	3.5	2.5	1.1	1.6	1.0	0.7	1.6	2.8	-0.5	0.6	3.1	6.9	1.8	2.6

	Year					2010				2011				2012			
	'09	'10	'11 (1)	'12 (1)	'13 (1)	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Financial Variables																	
Gen. Gov. Budget (HUF bn)	-1162	-1153	1119	-1224	-1119	-	-	-	-	-	-	-	-	-	-	-	-
Gen. Gov. Budget (% GDP)	-4.5	-4.3	3.9	-4.1	-3.6	-	-	-	-	-	-	-	-	-	-	-	-
Primary Budget (% GDP)	0.1	-0.2	8.6	0.4	0.9	-	-	-	-	-	-	-	-	-	-	-	-
Gen. Gov. Debt (% GDP)	78.4	80.2	74.1	73.8	72.9	-	-	-	-	-	-	-	-	-	-	-	-

	Year					2010				2011				2012			
	'09	'10	'11 (1)	'12 (1)	'13 (1)	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4 (1)	Q1 (1)	Q2 (1)	Q3 (1)	Q4 (1)
Interest Rates & Bonds (2)																	
Policy Rate (%)	6.25	5.75	6.00	6.00	6.00	5.50	5.25	5.25	5.75	6.00	6.00	6.00	6.00	6.00	6.00	6.00	6.00
3-Month Rate (%)	6.19	5.85	6.15	6.15	6.15	5.48	5.28	5.37	5.85	6.10	6.10	6.15	6.15	6.15	6.15	6.15	6.15
3-Year Bond (%)	7.64	7.85	6.35	6.05	5.85	6.10	7.28	6.59	7.85	6.79	6.81	6.45	6.35	6.30	6.20	6.10	6.05
5-Year Bond (%)	7.80	7.99	7.25	7.50	7.10	6.37	7.58	6.68	7.99	7.09	7.23	7.25	7.25	7.20	7.30	7.35	7.50
10-Year Bond (%)	8.21	8.09	7.70	7.80	7.30	7.01	7.84	6.94	8.09	7.34	7.45	7.90	7.70	7.65	7.70	7.75	7.80
Spread over Bund (bp)	483	513	570	480	405	392	527	468	513	399	444	623	570	540	520	500	480
Interest Rate Swaps (2)																	
3-Year Swap (%)	7.07	6.80	6.45	6.40	6.20	5.89	6.08	6.07	6.80	6.58	6.31	6.55	6.45	6.40	6.35	6.30	6.40
5-Year Swap (%)	7.27	7.05	6.75	6.75	6.75	6.00	6.32	6.21	7.05	6.70	6.52	6.80	6.75	6.75	6.65	6.55	6.75
10-Year Swap (%)	7.21	7.28	7.20	7.20	6.85	6.42	6.50	6.31	7.28	6.87	6.78	7.20	7.20	7.30	7.15	7.10	7.20
FX Rates (2)																	
EURHUF	264	270	292	280	260	265	285	276	278	266	266	286	292	290	285	280	280
USDHUF	188.3	188.0	201	189	186	196	233	202	208	187	183	207	201	196	190	187	189

Footnotes: (1) Forecast (2) End period

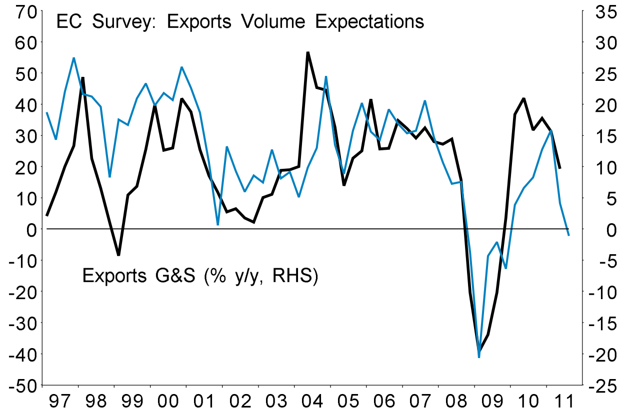
Figures are year-on-year percentage changes unless otherwise indicated

Source: BNP Paribas

Czech Republic: 0.75% Not Low Enough

- **Activity: tough times ahead**
  - The Czech economy is becoming a victim of its low external and public debt, as well as its strong fiscal and current account performance: while its safe-haven status in Central Europe is keeping its risk premium low, it is also leading to currency strength.
  - This is bad news for exports, since external demand is falling sharply, and for overall growth, as the domestic economy will remain depressed due to the ongoing sharp fiscal tightening.
  - We expect GDP growth to slow to around 1.2% next year, but we are relatively upbeat about the longer-term prospects for the Czech economy.
  - Once the fiscal adjustment is complete, around 2013 according to our forecast, tightening measures will no longer strangle aggregate demand, and economic growth will accelerate swiftly.
- **Inflation: what inflation?**
  - Unsurprisingly, a wide output gap and strong koruna mean there is no inflation pressure at all. The planned harmonisation of VAT rates next year will temporarily boost CPI and core readings, but inflation will still remain very low.
  - Although the scope for policy rate cuts is certainly limited given its current level of a mere 0.75%, we expect the CNB to deliver 25bp of conventional monetary easing in Q1 2012.
  - Non-orthodox measures later in 2012 cannot be ruled out, especially if growth fails to recover swiftly or the appreciation trend of the koruna accelerates.
- **FX and rates: safe-haven play**
  - We expect the koruna to remain supported in the coming quarter as it is likely to remain a defensive play for the region. However, we wouldn't rule out some weakening as rate-cut expectations begin to intensify in the coming months.
  - The front end of the Czech IRS curve should be further boosted by an expected shift from the CNB towards a more dovish tone and clearer indications of future cuts in rates.
  - Front-end receivers in the Czech Republic should perform well; we prefer to receive the spread in 1y1y rates between the Czech Republic and the eurozone.

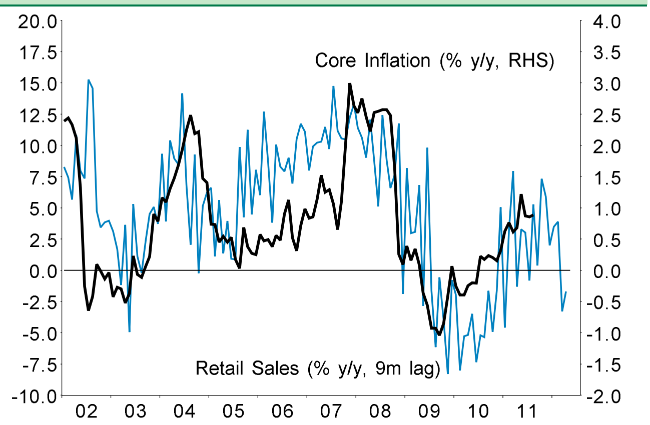
Chart 1: Slump in Exports Expected



Source: Reuters EcoWin Pro

Expectations for exports are in free fall as external demand is dwindling and the koruna remains strong. In light of the domestic economy's weakness, the slowdown in exports will hit GDP growth severely.

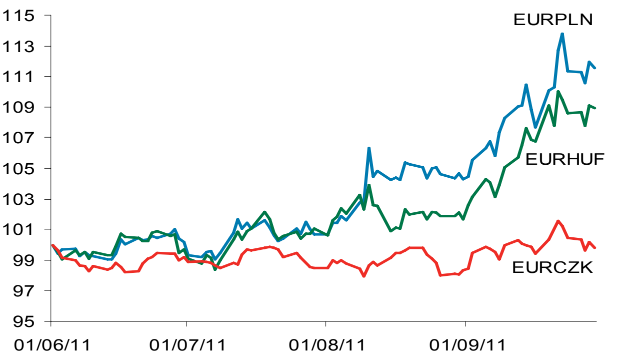
Chart 2: VAT Hike Will Prevent Deflation in 2012



Source: Reuters EcoWin Pro

If it had not been for the VAT harmonisation, which according to the CNB may add 1pp to inflation, we would be forecasting core deflation in the Czech Republic next year.

Chart 3: CZK is Regional Out-Performer (1/6/2011 = 100)



Source: Reuters EcoWin Pro, BNP Paribas

Czech Republic: Economic & Financial Forecasts

	Year					2010				2011				2012			
	'09	'10	'11 (1)	'12 (1)	'13 (1)	Q1	Q2	Q3	Q4	Q1	Q2	Q3 (1)	Q4 (1)	Q1 (1)	Q2 (1)	Q3 (1)	Q4 (1)
Components of Growth																	
GDP (% q/q)	-	-	-	-	-	0.8	0.6	0.8	0.5	0.9	0.1	0.1	0.1	0.3	0.5	0.7	0.8
GDP	-4.0	2.2	2.0	1.2	3.2	1.2	2.3	2.6	2.7	2.8	2.2	1.8	1.4	0.7	0.8	1.5	1.8
Final Domestic Demand	-1.8	-0.8	0.6	0.5	2.7	-1.6	-1.1	-0.2	-0.3	0.5	0.3	0.7	0.9	0.3	0.5	0.6	0.6
Private Consumption	-0.1	0.1	-0.3	-0.3	2.6	-0.1	-0.1	-0.1	0.6	-0.3	-0.6	-0.2	-0.1	-0.7	-0.3	-0.2	-0.2
Public Consumption	2.6	-0.1	-0.6	0.3	0.8	2.4	0.8	-0.8	-2.6	-1.1	-1.4	0.0	0.2	0.3	0.5	0.3	0.1
Fixed Investment	-7.9	-3.1	3.2	2.1	4.1	-7.7	-4.5	0.0	-0.1	3.4	3.6	2.9	3.0	2.0	1.6	2.3	2.6
Stocks (Cont. to Growth, y/y)	-2.5	2.1	0.2	-0.1	0.4	0.0	1.9	4.2	2.5	0.1	0.5	0.1	-0.1	-0.3	-0.2	0.0	0.2
Exports	-10.9	17.9	10.8	7.9	10.0	18.6	19.5	16.5	16.8	15.1	9.7	10.6	7.8	6.7	5.7	9.1	10.3
Imports	-10.3	17.6	8.9	6.4	9.6	15.4	18.5	19.2	17.4	12.6	7.8	8.7	6.5	5.1	4.5	7.4	8.5
Industrial Production	-13.2	10.2	7.8	3.5	5.1	6.7	11.7	10.7	11.9	12.5	9.1	5.7	4.0	2.6	2.4	3.8	5.3

	Year					2010				2011				2012			
	'09	'10	'11 (1)	'12 (1)	'13 (1)	Q1	Q2	Q3	Q4	Q1	Q2	Q3 (1)	Q4 (1)	Q1 (1)	Q2 (1)	Q3 (1)	Q4 (1)
Inflation & Labour																	
CPI	1.1	1.5	1.7	2.0	1.4	0.7	1.2	2.0	2.3	1.7	1.8	1.7	1.6	2.5	2.2	1.8	1.5
Core CPI	-0.6	-0.4	0.7	1.0	0.3	-1.0	-0.8	0.1	0.3	0.6	0.9	0.7	0.5	1.3	1.0	0.8	0.7
Employment	-5.5	-1.6	0.1	-1.0	-0.1	-4.1	-1.6	-0.3	-0.5	0.1	0.0	0.0	0.1	-0.6	-1.1	-1.5	-1.0
Wages	3.3	1.9	3.1	4.3	4.6	2.6	2.7	1.9	0.6	2.1	2.5	4.0	3.9	4.0	4.0	4.7	4.5
ULC	-0.5	-0.8	0.7	0.4	0.1	-0.9	-0.7	-0.2	-1.5	0.4	0.6	0.7	1.2	0.6	0.3	0.3	0.3
Unemployment Rate (%)	8.1	9.0	8.7	8.8	8.7	9.8	8.8	8.6	8.9	9.5	8.3	8.4	8.7	9.4	8.4	8.6	9.0

	Year					2010				2011				2012			
	'09	'10	'11 (1)	'12 (1)	'13 (1)	Q1	Q2	Q3	Q4	Q1	Q2	Q3 (1)	Q4 (1)	Q1 (1)	Q2 (1)	Q3 (1)	Q4 (1)
External Trade																	
Trade Balance (EUR bn)	3.34	2.11	2.57	3.76	4.39	1.22	0.89	-0.18	0.18	1.39	1.02	-0.23	0.38	1.30	1.30	0.23	0.93
Current Account (EUR bn)	-3.49	-4.69	-5.48	-3.71	-3.25	0.55	-1.07	-3.54	-0.63	0.87	-2.05	-3.51	-0.79	1.08	-1.17	-3.23	-0.38
Current Account (% of GDP)	-2.5	-3.2	-3.6	-2.3	-1.9	1.6	-3.1	-9.7	-1.7	2.3	-5.7	-8.9	-2.0	2.7	-3.1	-8.0	-0.9

	Year					2010				2011				2012			
	'09	'10	'11 (1)	'12 (1)	'13 (1)	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Financial Variables																	
Gen. Gov. Budget (CZK bn)	-212	-171	-159	-138	-118	-	-	-	-	-	-	-	-	-	-	-	-
Gen. Gov. Budget (% GDP)	-5.8	-4.7	-4.2	-3.6	-2.9	-	-	-	-	-	-	-	-	-	-	-	-
Primary Budget (% GDP)	-4.5	-3.3	-2.8	-2.2	-1.5	-	-	-	-	-	-	-	-	-	-	-	-
Gen. Gov. Debt (% GDP)	35.3	38.5	41.7	44.1	45.3	-	-	-	-	-	-	-	-	-	-	-	-

	Year					2010				2011				2012			
	'09	'10	'11 (1)	'12 (1)	'13 (1)	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4 (1)	Q1 (1)	Q2 (1)	Q3 (1)	Q4 (1)
Interest Rates & Bonds (2)																	
Policy Rate (%)	1.00	0.75	0.75	0.50	0.50	1.00	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.50	0.50	0.50	0.50
3-Month Rate (%)	1.54	1.22	1.15	0.90	0.90	1.44	1.23	1.21	1.22	1.23	1.18	1.15	1.15	0.90	0.90	0.90	0.90
2-Year Bond (%)	1.88	1.82	1.20	1.15	1.45	1.30	1.88	1.74	1.82	1.76	1.48	1.40	1.20	1.05	1.00	1.10	1.15
5-Year Bond (%)	3.31	3.18	1.85	2.10	2.15	3.01	2.85	2.62	3.18	3.15	2.74	2.01	1.85	1.75	1.70	1.90	2.10
10-Year Bond (%)	4.04	3.95	3.12	3.20	3.25	4.02	4.17	3.42	3.95	4.06	3.84	3.22	3.12	3.01	2.95	3.10	3.20
Spread over Bund (bp)	66	99	112	20	0	92	159	116	99	71	83	155	112	76	45	35	20
Interest Rate Swaps (2)																	
2-Year Swap (%)	2.39	1.95	1.20	1.15	1.45	2.30	1.76	1.70	1.95	2.24	2.10	1.40	1.20	1.05	1.00	1.10	1.15
5-Year Swap (%)	3.15	2.43	1.55	1.80	1.85	3.06	2.42	2.18	2.43	2.87	2.68	1.72	1.55	1.45	1.40	1.60	1.80
10-Year Swap (%)	3.60	2.90	2.10	2.30	2.45	3.57	3.03	2.68	2.90	3.32	3.17	2.20	2.10	2.01	2.00	2.15	2.30
FX Rates (2)																	
EURCZK	26.32	25.00	25.00	23.50	23.30	25.37	25.68	24.58	25.00	24.52	24.28	24.40	25.00	24.30	24.10	23.80	23.50
USDCZK	18.38	18.67	17.24	15.88	16.64	18.80	20.99	17.95	18.67	17.31	16.75	17.68	17.24	16.42	16.07	15.87	15.88

Footnotes: (1) Forecast (2) End period

Figures are year-on-year percentage changes unless otherwise indicated

Source: BNP Paribas

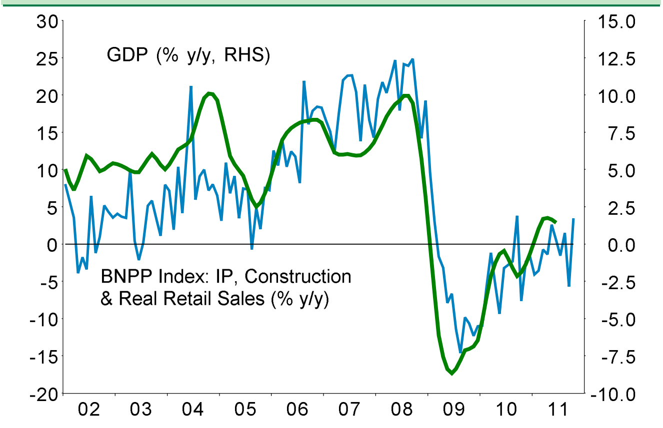
Romania: Modest Monetary Easing in 2012

- **Activity: relatively resilient in the near term**
  - We expect growth to remain around 1.0% y/y over the next one to two years, as the slowdown in external demand will be partly offset by a slightly stronger performance of the domestic economy.
  - As the impact of the 5pp VAT hike in July 2010 fades, inflation will fall, boosting real disposable income growth in the remainder of the year. As a result, consumption growth should strengthen in the near term, although the ongoing credit crunch will prevent a significant recovery.
  - In 2012, the cyclical slowdown in Europe will increasingly be reflected in a weakening of the labour market and restrain overall economic growth. While this will be bad news for public finances, we expect the government to remain on its fiscal tightening track next year.

- **Inflation: slowing, allowing for rate cuts**
  - Given the weakening in growth we expect further disinflation. However, the 3% inflation target is unlikely to be reached before 2013, as wage rigidities will maintain inflationary pressures over the next several months.
  - We expect some limited policy easing by early 2012, once the NBR feels more confident the disinflation trend is becoming sustainable.
  - The precautionary Stand-By Arrangement with the IMF allows Romania to borrow EUR 5.4bn from the Fund, if necessary. This helps to keep the risk premium relatively low and should also support monetary easing by early 2012.
  - We expect 50bp in rate cuts to be delivered, matching ECB monetary easing.

- **FX and rates: wide CDS spreads weigh on RON**
  - While eurozone issues are likely to keep the leu vulnerable in the coming months, we expect the NBR to be ready and willing to intervene directly in FX markets in order to limit RON depreciation.
  - Liquidity in the local banking system will be strained, despite rate cuts, as the demand for RON loans outstrips growth of RON deposits.
  - The CDS of Romania will remain elevated, although it could tighten marginally from its two-year high of 435bp. The tensions in the credit markets will keep the bid under USDRON as it is far from the highs seen in 2010. Deteriorating economic activity and the implied rate cuts are likely to weigh on the appeal of RON assets.

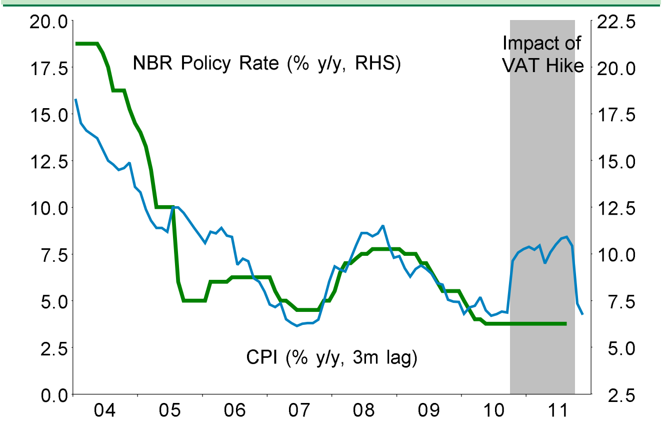
Chart 1: Growth Holding Up Relatively Well



Source: Reuters EcoWin Pro, BNP Paribas

The unwinding of the impact of last year's VAT hike will support some recovery in domestic demand in the near-term.

Chart 2: Modest Monetary Easing in 2012



Source: Reuters EcoWin Pro, BNP Paribas

Weaker growth points to disinflation ahead, opening the way for a little monetary easing by early 2012.

Chart 3: 5y CDS and USDRON

Source: Reuters EcoWin Pro, BNP Paribas

Romania: Economic & Financial Forecasts

	Year					2010				2011				2012			
	'09	'10	'11 (1)	'12 (1)	'13 (1)	Q1	Q2	Q3	Q4	Q1	Q2	Q3 (1)	Q4 (1)	Q1 (1)	Q2 (1)	Q3 (1)	Q4 (1)
Components of Growth																	
GDP (% q/q)	-	-	-	-	-	0.0	0.1	-0.2	0.4	0.5	0.2	0.1	0.1	0.2	0.3	0.4	0.4
GDP	-7.1	-1.3	1.4	1.5	2.0	-2.2	-0.4	-2.2	-0.6	1.7	1.4	1.4	1.1	1.7	1.4	1.4	1.6
Private Consumption	-10.7	-1.7	0.9	2.2	3.0	-4.5	-0.4	-0.9	-0.9	-0.6	-0.7	1.9	2.9	1.6	2.3	2.1	2.7
Fixed Investment	-21.4	-14.1	-0.9	4.0	5.4	-28.3	-7.7	-15.5	-4.7	-2.2	-1.4	1.9	-2.0	4.0	3.0	4.3	4.6
Exports	-5.0	13.1	11.0	5.7	7.2	8.4	15.8	11.3	17.1	23.6	6.3	7.3	6.6	5.2	6.0	5.4	6.0
Imports	-20.5	11.6	9.6	7.8	9.7	7.8	18.5	7.8	12.2	15.4	7.7	8.3	7.0	5.7	7.7	8.4	9.4

	Year					2010				2011				2012			
	'09	'10	'11 (1)	'12 (1)	'13 (1)	Q1	Q2	Q3	Q4	Q1	Q2	Q3 (1)	Q4 (1)	Q1 (1)	Q2 (1)	Q3 (1)	Q4 (1)
Inflation & Labour																	
CPI	5.6	6.1	6.7	3.9	3.2	4.2	4.4	7.8	8.0	8.0	7.9	5.7	5.2	4.9	4.0	3.5	3.1
Employment	-4.4	-7.7	-2.5	-0.5	0.0	-9.4	-8.1	-7.0	-6.3	-5.0	-2.8	-1.4	-0.6	-0.7	-0.4	-0.5	-0.3
Wages	8.0	1.9	5.3	7.7	6.1	5.6	3.5	-1.5	-0.1	-0.3	3.3	8.3	9.7	8.8	7.5	7.4	7.0
ULC	6.2	-8.8	-5.8	1.0	0.1	-3.8	-8.1	-14.1	-9.3	-15.1	-7.9	-1.6	1.4	0.6	0.8	1.3	1.4
Unemployment Rate (%)	6.3	7.6	5.6	6.1	6.4	8.3	7.7	7.4	7.0	6.4	5.1	4.9	5.8	7.1	5.5	5.4	6.3

	Year					2010				2011				2012			
	'09	'10	'11 (1)	'12 (1)	'13 (1)	Q1	Q2	Q3	Q4	Q1	Q2	Q3 (1)	Q4 (1)	Q1 (1)	Q2 (1)	Q3 (1)	Q4 (1)
External Trade																	
Trade Balance (EUR bn)	-6.87	-5.91	-5.61	-6.47	-7.36	-1.29	-1.90	-1.22	-1.50	-0.57	-1.93	-1.33	-1.77	-0.68	-2.16	-1.57	-2.06
Current Account (EUR bn)	-4.91	-4.97	-5.33	-5.68	-6.47	-1.54	-2.10	-0.48	-0.84	-0.73	-1.87	-1.17	-1.56	-0.60	-1.90	-1.38	-1.81
Current Account (% of GDP)	-4.1	-4.5	-4.1	-3.9	-4.2	-6.5	-7.8	-1.5	-2.2	-2.8	-6.2	-3.3	-3.9	-2.2	-5.9	-3.5	-4.1

	Year					2010				2011				2012			
	'09	'10	'11 (1)	'12 (1)	'13 (1)	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Financial Variables																	
Gen. Gov. Budget (RON bn)	-42	-33	-28	-28	-21	-	-	-	-	-	-	-	-	-	-	-	-
Gen. Gov. Budget (% GDP)	-8.5	-6.8	-5.0	-4.7	-3.3	-	-	-	-	-	-	-	-	-	-	-	-
Primary Budget (% GDP)	-6.9	-5.2	-3.0	-2.6	-1.1	-	-	-	-	-	-	-	-	-	-	-	-
Gen. Gov. Debt (% GDP)	23.7	31.0	33.6	36.5	37.7	-	-	-	-	-	-	-	-	-	-	-	-

	Year					2010				2011				2012			
	'09	'10	'11 (1)	'12 (1)	'13 (1)	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4 (1)	Q1 (1)	Q2 (1)	Q3 (1)	Q4 (1)
Interest Rates (2)																	
Policy Rate (%)	8.00	3.50	6.25	5.75	5.75	6.50	6.25	6.25	6.25	6.25	6.25	6.25	6.25	5.75	5.75	5.75	5.75
3-Month Rate (%)	10.65	3.95	6.10	5.90	5.90	5.68	7.16	6.76	6.17	5.68	5.49	6.30	6.10	5.60	5.90	5.90	5.90
FX Rates (2)																	
EURRON	4.24	4.23	4.29	4.10	3.95	4.09	4.36	4.26	4.23	4.12	4.23	4.30	4.29	4.25	4.20	4.05	4.10
USDRON	2.96	3.17	2.93	2.57	2.64	3.02	3.56	3.13	3.17	2.91	2.92	3.12	2.93	2.84	2.73	2.67	2.57

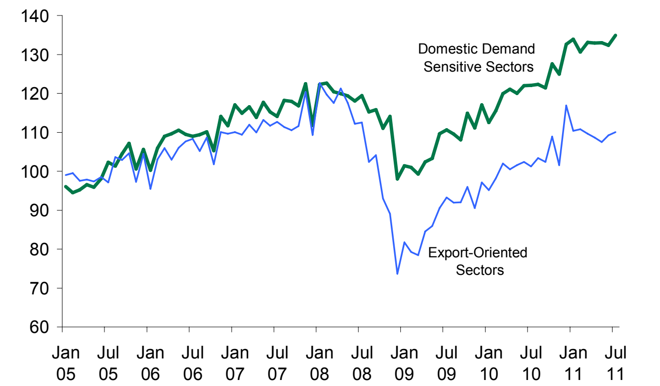
Footnotes: (1) Forecast (2) End period

Figures are year-on-year percentage changes unless otherwise indicated

Source: BNP Paribas

Turkey: Little Room to Manoeuvre

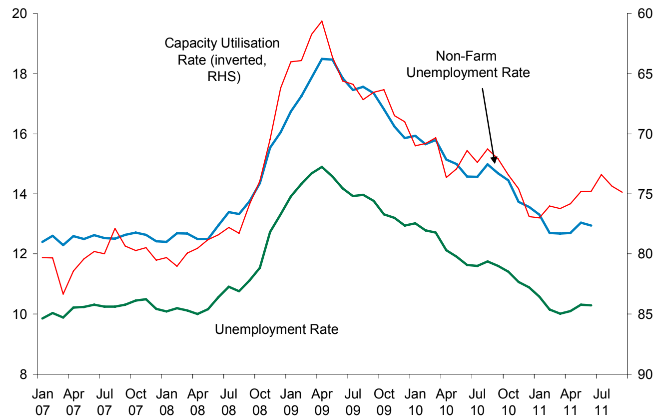
Chart 1: Industrial Production Index (2005=100)



Source: Reuters EcoWin Pro, TEB Research

Industrial production has weakened since January, mostly on the back of a fall in output in export-related sectors.

Chart 2: Unemployment and Capacity Utilisation Rate (s.a., %)



Source: Reuters EcoWin Pro, TEB Research

The unemployment rate, which has recorded a 5pp decline since April 2009, is expected to increase moderately towards 11%.

Activity: slowing down

- GDP growth has been slowing but from a very high rate in Q2 2011. Recent indicators point to softer economic activity in Q3. Tight credit conditions and a weak global backdrop imply activity will be broadly flat in the second half of the year. Although slowing, GDP should grow by around 7% this year on the back of strong growth in the first half of the year.
- The weakness of external demand will continue to weigh on growth and, as the room to stimulate domestic demand through policy remains limited, we expect 2012 growth to fall below 3%.
- Despite the expected slowdown in growth, the current account deficit is likely to be around 9% of GDP in 2012. As imports are almost double the amount of exports, for the current account deficit to approach a more sustainable level, such as 5% of GDP, the growth rate of exports has to significantly outpace that of imports, which is unlikely, barring a deep recession.

Inflation: unlikely to approach the CBRT's target

- The significant depreciation of the TRY is likely to continue to put upward pressure on prices. The recent utility price hikes could add to the already existing inflationary pressures and push the inflation rate close to 8% by end-2011. The pause (or decline) in commodity prices will absorb some of the pressure but not enough to lead to a clear fall in the inflation rate.
- In parallel with the slowing down of domestic demand and the dissipating impact of utility price increases, the inflation rate is set to ease down to around 6% in 2012. For it to approach the CBRT's target rate of 5%, the slowdown in economic activity needs to be greater than in our baseline scenario.

Policy: growth is the new priority of the CBRT

- The Bank sees the inflation outlook as benign and remains keen to cut its policy rate further. Reserve requirement ratios are likely to continue to play a major role in the CBRT's policymaking. It could reduce TRY reserve requirement ratios if a recession emerges. The CBRT will wait for possible action from the Fed towards another round of QE, and for the pressures on TRY to recede, before going for another rate cut.
- The central government budget balance was in small surplus until August on the back of the boost to revenue from strong growth and the government's tax amnesty scheme. We expect a government deficit of 1.4% of GDP in 2011, rising to slightly above 2% of GDP in 2012 as growth slows and amnesty-related revenues fall.
- The policy stimulus provided to growth in late 2010 and early 2011 pushed the current account deficit to close to 10% of GDP and inflation above 6%. This leaves the authorities with little room for further monetary and fiscal easing in 2012.

Selim Çakır, Emre Tekmen

Turkey: Economic & Financial Forecasts

	Year					2010				2011				2012			
	'09	'10	'11 [1]	'12 [1]	'13 [1]	Q1	Q2	Q3	Q4	Q1	Q2	Q3 [1]	Q4 [1]	Q1 [1]	Q2 [1]	Q3 [1]	Q4 [1]
Components of Growth																	
GDP	-4.7	8.9	7.1	2.5	4.6	12.2	10.2	5.3	9.2	11.6	8.8	6.0	3.0	2.1	1.3	2.6	3.8
Private Consumption	-2.3	6.7	7.0	1.1	4.6	8.0	3.2	6.7	9.0	12.4	9.2	5.7	1.8	0.5	0.1	1.5	2.3
Fixed Investment	-19.2	30.1	16.5	2.8	10.6	16.8	28.4	30.0	42.1	33.6	28.9	6.7	3.0	1.2	0.4	2.2	7.1
Exports	-5.4	3.8	6.0	6.5	5.8	-0.9	12.5	-1.6	4.3	8.3	0.2	8.0	7.8	8.5	6.1	5.9	5.7
Imports	-14.4	20.8	13.2	3.3	10.8	22.0	19.2	16.2	25.4	27.2	18.8	5.5	5.1	3.0	2.4	2.3	5.4

	Year					2010				2011				2012			
	'09	'10	'11 [1]	'12 [1]	'13 [1]	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4 [1]	Q1 [1]	Q2 [1]	Q3 [1]	Q4 [1]
Inflation & Labour																	
CPI	6.3	8.6	6.0	6.6	6.1	9.3	9.2	8.4	7.4	4.3	5.9	6.4	7.2	7.5	6.4	6.6	5.9
CPI [2]	6.5	6.4	7.9	5.8	5.8	9.6	8.4	9.2	6.4	4.0	6.2	6.2	7.9	7.6	6.9	6.4	5.8
Core CPI [2]	3.8	3.0	7.0	5.3	5.5	5.4	4.9	3.7	3.0	3.8	5.3	7.0	7.0	5.9	5.3	5.2	5.3
Unemployment Rate (%) [3]	14.0	11.9	10.3	10.9	10.0	13.7	10.5	11.3	11.4	10.2	10.2	10.3	10.5	10.7	10.9	11.0	10.9

	Year					2010				2011				2012			
	'09	'10	'11 [1]	'12 [1]	'13 [1]	Q1	Q2	Q3	Q4	Q1	Q2	Q3 [1]	Q4 [1]	Q1 [1]	Q2 [1]	Q3 [1]	Q4 [1]
External Trade																	
Trade Balance (USD bn)	-38.8	-71.7	-103.1	-103.3	-121.7	-12.5	-16.2	-20.2	-22.8	-24.6	-29.4	-25.7	-23.4	-22.0	-26.9	-27.1	-27.3
Current Account (USD bn)	-14.0	-47.7	-75.2	-70.6	-87.6	-9.5	-10.7	-10.4	-17.0	-21.9	-23.4	-14.0	-15.9	-18.1	-19.6	-14.0	-18.9
Current Account (% of GDP)	-2.3	-6.5	-9.9	-8.7	-9.7	-	-	-	-	-	-	-	-	-	-	-	-

	Year					2010				2011				2012			
	'09	'10	'11 [1]	'12 [1]	'13 [1]	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Financial Variables																	
Gen. Gov. Budget (% GDP)	-5.5	-3.6	-1.4	-2.6	-2.8	-	-	-	-	-	-	-	-	-	-	-	-
Primary Budget (% GDP)	0.0	0.8	2.0	0.8	0.6	-	-	-	-	-	-	-	-	-	-	-	-
Gen. Gov. Debt (% GDP)	46.3	42.8	40.4	37.8	36.3	-	-	-	-	-	-	-	-	-	-	-	-

	Year					2010				2011				2012			
	'09	'10	'11 (1)	'12 (1)	'13 (1)	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4 [1]	Q1 [1]	Q2 [1]	Q3 [1]	Q4 [1]
Interest Rates and Bonds [2]																	
Policy Rate (%)	6.50	6.50	5.25	6.25	7.25	6.50	7.00	7.00	6.50	6.25	6.25	5.75	5.25	5.25	5.25	5.75	6.25
3-Month Rate (%)	6.84	6.34	6.75	7.75	9.35	6.91	7.15	7.18	6.34	7.57	7.79	7.25	6.75	6.75	6.75	7.25	7.75
2-Year Bond (%)	8.87	7.13	7.60	9.00	10.00	8.79	8.40	8.09	7.13	8.92	9.14	8.34	7.60	8.10	8.40	8.70	9.00
5-Year Bond (%)	10.43	7.84	8.10	9.70	10.80	10.17	9.31	8.64	7.84	9.18	9.32	8.68	8.10	8.60	9.00	9.30	9.70
FX Rates [2]																	
USDTRY	1.49	1.54	1.78	1.73	1.69	1.52	1.58	1.44	1.54	1.54	1.64	1.85	1.78	1.75	1.68	1.72	1.73
EURTRY	2.14	2.14	2.58	2.56	2.37	2.05	1.94	2.17	2.14	2.04	2.34	2.50	2.58	2.59	2.52	2.58	2.56

Footnotes: (1) Forecast (2) End period (3) Seasonally adjusted

Figures are year-on-year percentage changes unless otherwise indicated

Source: TEB Research

IMPORTANT DISCLOSURE:
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South Africa: Rate Cut Ahead

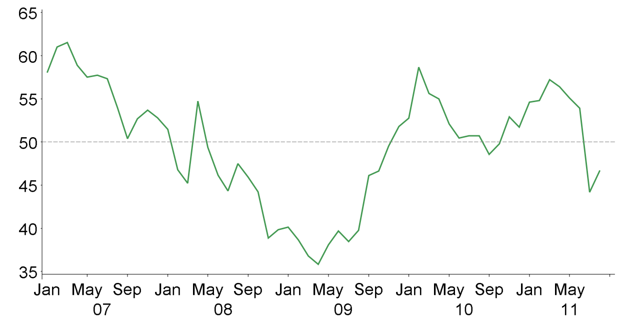
Activity: slowing down

- The economy has been losing momentum since March. After the relatively strong start to the year on the back of the growth in consumption and inventories, growth in the manufacturing sector shrank in Q2 as a result of strikes. The PMI remains in contractionary territory on the back of a decline in new orders.
- Although we expect manufacturing activity to recover in the coming quarters, investment is likely to remain subdued in light of the worsening of business sentiment. Moreover, jitters over the global economy could lead to further delays in rebuilding inventories.
- Consumption is likely to hold up better as it remains supported by real wage increases. In addition, growth prospects are supported by the government's infrastructure investment programme. Accordingly, we expect GDP growth of 3.0% in 2011 and 2.7% in 2012.

Inflation: set to remain within the target range

- We expect the inflation rate to continue to rise gradually to end the year at 5.9%. In 2012, the inflation rate is likely to remain close to the upper end of the 3-6% target range. We do not expect it to exceed 6% for long in 2012 and it should finish the year at around 5%. The impact of the recent depreciation of the ZAR on the CPI is likely to be reduced by the decline in global energy prices.
- Real wage growth and the need to hike utility prices to cover public enterprises' costs are the main impediments to a sustained decline in the inflation rate. Credit growth remains anaemic and the economy is likely to operate below potential for a long time, which, in turn should partly limit the cost-push inflation pressures. In addition, the housing market and rents remain sluggish.
- A sustained depreciation of the ZAR, within a global risk-off environment, poses the main challenge to the inflation outlook.

Chart 1: PMI



Source: Reuters EcoWin Pro

The uncertain global environment and domestic strikes are hurting manufacturing activity.

Policy: low rates for longer

- As the risks to both inflation and growth are tilted to the downside, we expect the SARB to opt for an additional rate cut in Q4. Such a move may be supported by additional monetary stimulus from the major central banks as global economic activity weakens. Thereafter, the Bank is likely to keep monetary policy loose until the recovery gains traction. Hence, following a rate cut in Q4 2011, the SARB is likely to keep rates unchanged during H1 2012. As consumption and investment remain weak, a premature exit from loose monetary policies could endanger growth.
- The government's fiscal plans, particularly the planned curtailment of current spending in 2012-13, will be difficult to achieve. At the same time, its ambitious infrastructure investment plans are unlikely to be implemented in full due to administrative capacity constraints, particularly at the local government level. Accordingly, we expect the fiscal deficits to remain within the targets of the medium-term programme although with current spending replacing part of the planned increase in investment.

Selim Çakır, Emre Tekmen, Nazli Toraganli

South Africa: Economic & Financial Forecasts

	Year					2010				2011				2012			
	'09	'10	'11 (1)	'12 (1)	'13 (1)	Q1	Q2	Q3	Q4	Q1	Q2	Q3 (1)	Q4 (1)	Q1 (1)	Q2 (1)	Q3 (1)	Q4 (1)
Components of Growth																	
GDP	-1.7	2.8	3.0	2.7	3.5	1.7	3.1	2.7	3.8	3.5	3.0	2.6	3.1	2.0	2.5	3.1	3.2
Private Consumption	-2.0	4.4	3.1	1.7	3.8	2.3	4.6	5.4	5.4	5.1	4.8	1.6	1.2	1.1	1.7	2.0	2.0
Fixed Investment	-2.2	-3.7	2.0	2.4	7.1	-8.0	-6.0	-1.4	0.9	1.2	2.6	2.6	1.6	1.8	2.5	2.8	2.6
Exports	-19.5	4.5	2.8	4.1	4.0	-0.9	6.7	7.7	4.6	5.0	5.0	1.4	0.4	2.6	3.5	5.1	5.0
Imports	-17.4	9.6	5.2	2.3	7.2	-3.2	12.5	19.5	10.2	11.3	8.1	1.6	0.9	0.8	2.4	3.1	3.0

	Year					2010				2011				2012			
	'09	'10	'11 (1)	'12 (1)	'13 (1)	Q1	Q2	Q3	Q4	Q1	Q2	Q3 (1)	Q4 (1)	Q1 (1)	Q2 (1)	Q3 (1)	Q4 (1)
Inflation & Labour																	
CPI	7.1	4.3	4.9	5.1	5.5	5.7	4.5	3.5	3.5	3.8	4.6	5.5	5.8	5.5	4.9	4.9	5.1
CPI (2)	6.3	3.5	5.9	5.2	5.7	5.1	4.2	3.2	3.5	4.1	5.0	5.8	5.9	5.1	4.8	5.0	5.2
Core CPI (2)	6.3	3.3	4.2	4.2	4.7	5.0	4.2	3.2	3.3	3.0	3.5	4.1	4.2	4.0	3.9	4.0	4.2

	Year					2010				2011				2012			
	'09	'10	'11 (1)	'12 (1)	'13 (1)	Q1	Q2	Q3	Q4	Q1	Q2	Q3 (1)	Q4 (1)	Q1 (1)	Q2 (1)	Q3 (1)	Q4 (1)
External Trade																	
Trade Balance (USD bn)	-1.8	1.6	-0.1	5.9	4.5	-1.2	0.4	0.1	2.3	-0.6	0.2	-0.2	0.5	1.1	1.7	1.1	2.1
Current Account (USD bn)	-11.4	-10.1	-12.4	-7.1	-9.3	-3.5	-2.3	-3.6	-0.7	-3.3	-3.2	-3.9	-2.1	-1.8	-2.1	-2.7	-0.6
Current Account (% of GDP)	-4.0	-2.8	-3.0	-1.5	-1.8	-	-	-	-	-	-	-	-	-	-	-	-

	Year					2010				2011				2012			
	'09	'10	'11 (1)	'12 (1)	'13 (1)	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Financial Variables																	
Gen. Gov. Budget (% GDP)	-4.6	-4.2	-4.8	-4.6	-3.4	-	-	-	-	-	-	-	-	-	-	-	-
Primary Budget (% GDP)	-2.3	-1.8	-2.4	-2.6	-2.6	-	-	-	-	-	-	-	-	-	-	-	-
Gen. Gov. Debt (% GDP)	26.8	33.7	35.7	37.1	37.1	-	-	-	-	-	-	-	-	-	-	-	-

	Year					2010				2011				2012			
	'09	'10	'11 (1)	'12 (1)	'13 (1)	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4 (1)	Q1 (1)	Q2 (1)	Q3 (1)	Q4 (1)
Interest Rates and Bonds (2)																	
Policy Rate (%)	7.00	5.50	5.00	6.00	7.00	6.50	6.50	6.00	5.50	5.50	5.50	5.50	5.00	5.00	5.00	5.50	6.00
3-Month Rate (%)	7.23	5.55	5.05	6.08	7.10	6.67	6.62	6.03	5.55	5.58	5.58	5.58	5.05	5.05	5.05	5.57	6.08
5-Year Bond (%)	8.54	7.32	6.60	7.50	7.90	7.96	7.79	7.03	7.32	7.83	7.52	6.88	6.60	6.40	6.90	7.30	7.50
10-Year Bond (%)	9.05	8.14	8.20	8.20	8.50	8.51	8.78	7.95	8.14	8.75	8.44	8.32	8.20	7.70	8.10	8.15	8.20
FX Rates (2)																	
USDZAR	7.38	6.63	7.60	6.70	6.90	7.34	7.64	6.98	6.63	6.79	6.82	8.03	7.60	7.25	7.00	6.80	6.70

Footnotes: (1) Forecast (2) End period

Figures are year-on-year percentage changes unless otherwise indicated

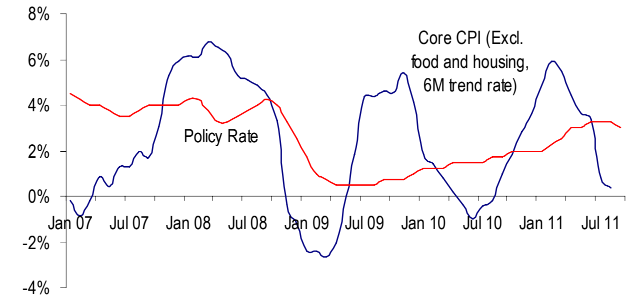
Source: TEB Research

This section is classified as non-objective research

Israel: Room to Move

- **Activity: still quite strong, but further slowdown is on the way**
  - Because of monetary tightening of 275bp since Q4 2009 and the economic slowdown in developed countries, economic activity has slowed from last year's strong pace. However, recent indicators of economic activity still cannot be described as weak. Growth in Q3 remained relatively strong. The state-of-the-economy index continued to expand by 0.3% m/m and the three-month trend growth rate (annualised) even surged to 3.5% in August, from 3.0% in May, according to our calculations (Chart 2).
  - As export growth will probably slow, we expect GDP growth also to slow to 2.8% next year from 4.6% this year. This is also shown in the leading indicators.
- **Inflation: slightly above target, but trending down**
  - Down from the recent peak of 4.3% y/y in March, inflation rate eased to 3.4% in August, due mainly to the economic slowdown.
  - While inflation remains above the target range of 1-3%, it will ease to 2.3% in twelve months' time according to Central Bank staff forecasts. In addition, the two-year breakeven inflation rate calculated from CPI-linked bonds has eased to 2.0% recently, given the increase in the downside risks to growth.
- **Policy: room for manoeuvre**
  - In a surprise move, Bank of Israel Governor Stanley Fischer cut the policy rate by 25bp to 3.00% at September's meeting. In the accompanying statement, it was reported that the decision to reduce rates was based mainly on the deterioration in the global economy and was intended to minimise the negative effect on the economy of the global slowdown.
  - BoI says that it will continue to monitor developments in the economy and financial markets and decide on policy rates accordingly. While we expect a further 25bp rate cut this year and 50bp in 2012, much depends on the global economic outlook and how the European debt crisis unfolds. In the last downturn in 2008, Fischer lowered the rates to a record low of 0.5%, so there is clearly room to cut rates further in the event of a further worsening of economic conditions in developed economies.
  - If rate cuts are aggressive, which would not be extraordinary for Fischer, depreciation pressure on the ILS may intensify. Moreover, the short end of the yield curve may face more aggressive declines and this would lead to bull steepening of the yield curve in the 2y5y segment (Chart 3).

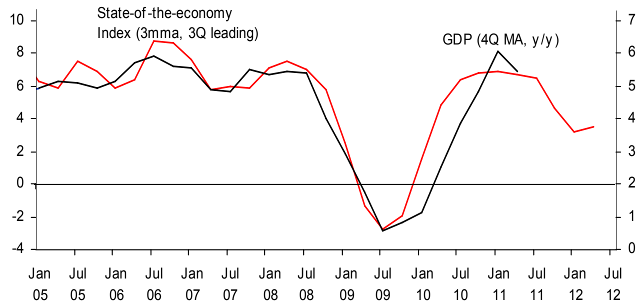
Chart 1: Core Inflation and Policy Rate



Source: Israel Central Bureau of Statistics, BNP Paribas

Core inflation trend slowed down to levels consistent with the inflation target of 1-3%.

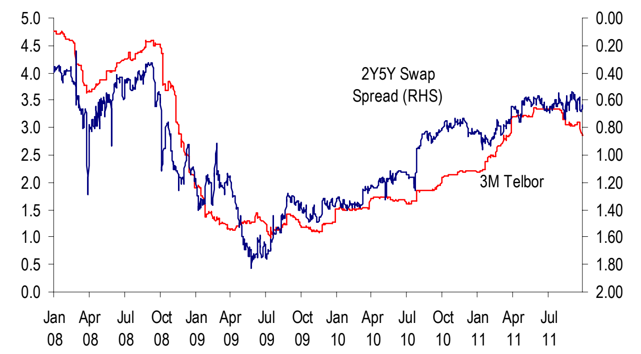
Chart 2: Economic Activity is Set to Slow Down



Source: Israel Central Bureau of Statistics, BNP Paribas

Leading indicators already point to some slowing down in the coming quarters.

Chart 3: Rate Cuts Will Steepen the Yield Curve



Source: Bloomberg, BNP Paribas

Further rate cuts will lead to a steepening of the yield curve.

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Erkin Işık

Israel: Economic & Financial Forecasts

	Year					2010				2011				2012			
	'09	'10	'11 (1)	'12 (1)	'13 (1)	Q1	Q2	Q3	Q4	Q1	Q2	Q3 (1)	Q4 (1)	Q1 (1)	Q2 (1)	Q3 (1)	Q4 (1)
Components of Growth																	
GDP	0.8	4.8	4.6	2.8	4.8	2.0	5.8	5.2	6.4	6.9	3.5	4.6	3.3	2.6	2.5	2.7	3.5
Private Consumption	1.4	5.3	4.9	4.3	7.6	6.3	5.7	4.1	5.4	5.3	5.2	5.0	4.2	3.4	2.8	3.9	7.2
Fixed Investment	-4.9	13.7	12.2	3.8	13.2	5.1	14.7	10.4	24.1	22.0	15.9	9.2	3.6	2.9	2.4	3.4	6.5
Exports	-11.9	13.6	6.9	4.5	9.5	12.9	20.5	15.7	6.5	9.4	3.7	9.2	5.6	3.9	3.6	4.2	6.2
Imports	-14.0	12.8	11.3	4.6	12.2	14.8	16.4	8.4	12.1	13.8	12.6	15.0	4.2	2.8	1.8	3.8	9.8

	Year					2010				2011				2012			
	'09	'10	'11 (1)	'12 (1)	'13 (1)	Q1	Q2	Q3	Q4	Q1	Q2	Q3 (1)	Q4 (1)	Q1 (1)	Q2 (1)	Q3 (1)	Q4 (1)
Inflation & Labour																	
CPI	3.3	2.7	3.7	2.9	2.8	3.5	2.8	2.0	2.5	4.0	4.1	3.3	3.2	2.5	2.7	3.3	2.9
CPI (2)	3.9	2.7	3.1	2.7	3.0	3.2	2.4	2.4	2.7	4.3	4.2	3.1	3.1	2.5	2.6	3.2	2.7
Core CPI (2)	3.1	1.3	2.8	3.0	2.9	2.8	1.5	0.7	1.3	3.2	3.5	3.0	2.8	2.3	2.9	3.5	3.0
Unemployment Rate (%) (3)	7.2	6.5	6.0	6.5	6.2	-	-	-	-	-	-	-	-	-	-	-	-

	Year					2010				2011				2012			
	'09	'10	'11 (1)	'12 (1)	'13 (1)	Q1	Q2	Q3	Q4	Q1	Q2	Q3 (1)	Q4 (1)	Q1 (1)	Q2 (1)	Q3 (1)	Q4 (1)
External Trade																	
Trade Balance (USD bn)	-4.9	-7.8	-13.8	-11.2	-18.4	-1.1	-1.2	-2.2	-3.2	-2.9	-3.7	-4.8	-2.4	-1.6	-2.0	-4.0	-3.7
Current Account (USD bn)	7.0	6.3	2.0	2.7	3.7	2.2	2.3	0.8	1.1	1.1	-0.4	0.4	0.9	0.6	0.8	0.8	0.6
Current Account (% of GDP)	3.6	2.9	0.8	1.0	1.3	-	-	-	-	-	-	-	-	-	-	-	-

	Year					2010				2011				2012			
	'09	'10	'11 (1)	'12 (1)	'13 (1)	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Financial Variables																	
Gen. Gov. Budget (% GDP)	-5.1	-3.7	-3.1	-2.3	-3.0	-	-	-	-	-	-	-	-	-	-	-	-
Primary Budget (% GDP)	0.3	1.5	2.1	2.9	2.2	-	-	-	-	-	-	-	-	-	-	-	-
Gen. Gov. Debt (% GDP)	77.8	74.5	71.9	69.5	68.5	-	-	-	-	-	-	-	-	-	-	-	-

	Year					2010				2011				2012			
	'09	'10	'11 (1)	'12 (1)	'13 (1)	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4 (1)	Q1 (1)	Q2 (1)	Q3 (1)	Q4 (1)
Interest Rates and Bonds (2)																	
Policy Rate (%)	1.00	2.00	2.75	2.25	3.50	1.25	1.50	1.75	2.00	2.50	3.25	3.00	2.75	2.50	2.25	2.25	2.25
3-Month Rate (%)	1.43	2.10	2.45	2.50	3.62	1.59	1.47	1.98	2.10	3.12	3.26	2.75	2.45	2.23	2.25	2.25	2.50
2-Year Bond (%)	3.20	3.33	3.01	3.30	4.26	2.96	2.50	2.59	3.33	4.16	4.00	3.05	3.01	2.87	3.14	3.14	3.30
5-Year Bond (%)	4.11	3.76	4.02	4.44	5.28	3.92	3.56	3.55	3.76	4.50	4.29	3.39	4.02	3.93	4.34	4.34	4.44
FX Rates (2)																	
USDILS	3.76	3.62	3.50	3.50	3.45	3.73	3.79	3.78	3.62	3.60	3.43	3.55	3.50	3.40	3.30	3.40	3.50
EURILS	5.56	4.91	5.08	5.18	4.83	5.16	4.81	4.90	4.91	4.93	4.94	5.01	5.08	5.03	4.95	5.10	5.18

Footnotes: (1) Forecast (2) End period (3) Seasonally adjusted

Figures are year-on-year percentage changes unless otherwise indicated

Source: TEB Research

IMPORTANT DISCLOSURE:
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Saudi Arabia: Surpluses Everywhere

- **Activity: driven by oil production and fiscal stimulus**
  - Non-oil GDP growth remains strong, supported by the government's massive fiscal expansion and a pick-up in private consumption. The PMI remains at comfortably expansionary levels, but has been falling since the beginning of the year amid the global fall in PMIs and the political turmoil in the Middle East. The recent global jitters pushed the PMI down to a ten-month low of 60.0.
  - Credit growth has been recovering recently but it remains significantly below the rate in pre-crisis years. Private sector credit is growing by 8% y/y whereas growth in credit to the public sector has reached 26% y/y. The construction sector is benefiting from the government's housing drive.
  - In addition, oil production has increased by 1.2mn bbl/day this year. If oil production remains at its current level until the end of the year, GDP growth will approach 7% in 2011.
  - We expect the growth rate to ease to around 4% in 2012 in parallel with slower oil production growth. Growth in the non-oil sector is likely to be around 5% in 2012, supported by the fiscal expansion and a rise in credit.
  - As a risk scenario, if oil production falls back to the 2010 level, the growth rate will decline below 2% in 2012.

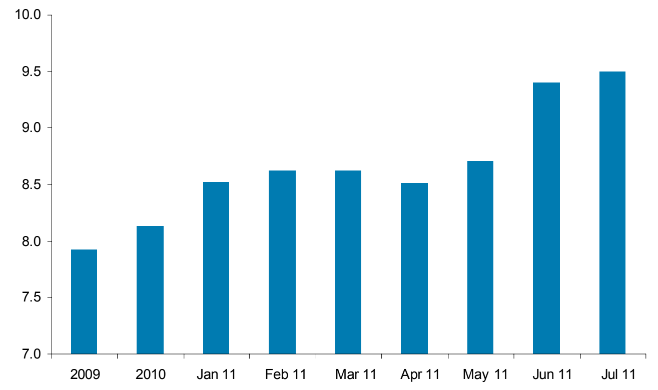
- **Inflation: base effects will be dominant in Q4**
  - The inflation rate has been hovering around 4.7% y/y, in line with our expectation. We expect food inflation to rise more slowly in coming months, partly due to favourable base effects, and annual inflation to fall to 4.4% by the end of the year.
  - The government's efforts to increase the housing stock will start to bear fruit from 2012. However, the ongoing fiscal expansion, combined with upward adjustments in private sector salaries, is likely to keep service prices high and limit the impact of the increase in housing units on rental prices.
  - However, we expect inflationary pressure from food prices to be muted relative to 2011. Accordingly, we expect the inflation rate to gradually ease towards the end of the year and finish the year at 4.4% before increasing slightly to end 2012 at 4.8%.

Saudi Arabia: Economic Forecasts

	2009	2010	2011 (1)	2012 (1)	2013 (1)
Real GDP (% y/y)	0.2	3.8	6.9	4.1	4.4
CPI (% y/y)	5.5	5.2	4.7	4.6	4.9
CPI (% y/y) (2)	4.2	5.5	4.4	4.8	5.0
Current Account (% GDP)	5.6	15.4	22.1	21.4	20.3
Budget Balance (% GDP)	-6.2	6.7	10.7	12.5	13.1
Primary Budget (% GDP)	-5.2	7.4	11.3	13.0	13.6
Gross Gov. Debt (% GDP) (2)	16.1	11.4	7.8	6.9	5.6
Interest Rate (%) (2)	2.00	2.00	2.00	2.00	2.50
USDSAR (2)	3.75	3.75	3.75	3.75	3.75

(1) Forecast (2) End period
Source: TEB Research

Chart 1: Saudi Arabia Oil Production (mn bbl/day)



Source: IEA
Increased oil production is raising fiscal and current account surpluses.

- **Policy: surpluses continue to rise**
  - We believe the decline in oil prices, and hence the impact on Saudi Arabia's fiscal and current account balances, will be limited. Accordingly, we continue to expect the current account surplus to remain above 20% of GDP and the fiscal surplus above 10% of GDP in both 2011 and 2012.
  - Nevertheless, expenditure is set to increase significantly between 2011 and 2013 and some of the spending commitments are likely to become permanent. If oil prices fall below USD 83/bbl the fiscal balance is likely to turn negative, according to our calculation. However, even under such a scenario, we believe the authorities would not curb their spending plans as they have ample reserves. Similarly, the country's external reserves would provide a buffer to a possible current account deficit in the event of a steeper decline in oil prices.

Selim Çakır, Emre Tekmen

UAE: Slowing Inflation

Activity: recovery on track

- Abu Dhabi has increased its oil output by around 10% in response to the global shortfall in production due to the turmoil in the Middle East. Accordingly, growth in oil GDP is set to reach 7% in 2011.
- Meanwhile, non-oil activity is being supported by infrastructure investment by the Abu Dhabi government and government-related entities (GREs). The recovery in Dubai's tourism, transport and logistics sectors has also supported non-oil GDP growth. Hotel occupancy rates reached 70% in Dubai in June and the number of passengers through Dubai airport has risen to a record high. Non-oil exports rose 23.7% y/y in the first half of the year.
- Dubai's successful sovereign bond issue helped to alleviate investor fears, and capital inflows into the UAE, partly as a result of the turmoil in the region, have increased the banking system's liquidity. However, credit growth to the private sector remains very low as banks continue to deleverage their balance sheets to meet regulatory requirements.
- The real-estate sector is likely to remain a drag on banks' balance sheets. Oversupply is likely to increase as projects are completed.
- We expect GDP growth to reach 4.9% in 2011, but decline in 2012 to 3.6% as the growth rate in oil production will be subdued.
- Although the UAE is a net external creditor due to Abu Dhabi's external reserves, a slowdown in global activity and increased risk aversion could renew concerns about Dubai debt, which, in turn, could hurt the already fragile recovery. According to the IMF, Dubai's and its GREs' debt repayments will total about USD 15bn, or 13.8% of GDP, in 2012. In an adverse scenario, the Dubai government may again request support from the Abu Dhabi government to help it to meet the obligations of its GREs.

Inflation: heading below 1%

- Although food and homeware prices continue to increase, the decline in rents is offsetting the impact on headline inflation. As more housing units become available, the decline in rents could become more entrenched and keep the annual inflation rate below 2% in both 2011 and 2012. In Abu Dhabi, the annual inflation rate remains about 1.6pp higher than in Dubai. However, the significant increase in real-estate investment in Abu Dhabi is likely to push rents and regional inflation down as well.

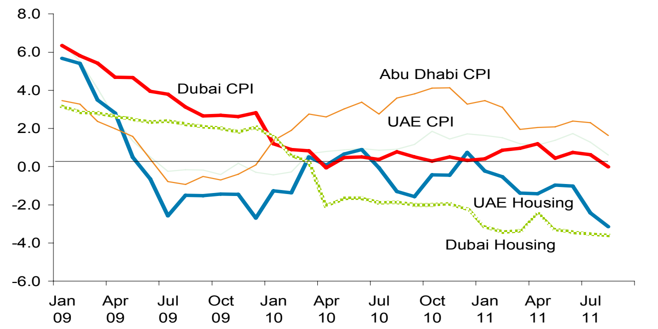
UAE: Economic Forecasts

	2009	2010	2011 (1)	2012 (1)	2013 (1)
Real GDP (% y/y)	-3.2	3.2	4.9	3.6	3.9
CPI (% y/y)	1.6	0.9	0.0	1.4	3.3
CPI (% y/y) (2)	-0.3	1.7	0.8	1.9	4.6
Current Account (% GDP)	2.9	3.8	10.6	9.7	8.6
Budget Balance (% GDP)	-13.2	-2.1	4.4	6.1	5.8
Primary Budget (% GDP)	-12.6	-1.3	5.1	6.8	6.3
Gross Gov. Debt (% GDP) (2)	22.5	21.3	17.2	14.6	13.6
Interest Rate (%) (2)	1.00	1.00	1.00	1.00	1.50
USDAED (2)	3.67	3.67	3.67	3.67	3.67

(1) Forecast (2) End period

Source: TEB Research

Chart 1: Inflation (% y/y)



Source: Haver, DSC

The weakness in Dubai's real-estate market is pulling the UAE's inflation rate down.

Policy: low rates for longer suit the UAE well

- Despite the fiscal expansion plans of the government of Abu Dhabi, as long as oil prices remain above USD 90/bbl, we expect the government budget to remain in surplus.
- As noted above, the debt repayments of the Dubai GREs are likely to pose the main challenge for the authorities in 2012. The Dubai authorities have not been very active in asset sales. We believe the Abu Dhabi government will help the Dubai government at times of stress.
- The Fed's pledge to keep rates low until mid-2013 suits the UAE's monetary policy well, as the economy remains in a recovery phase.

Qatar: Solid Growth

- **Activity: National Development Strategy makes diversification a priority**
  - The authorities have recently released their National Development Strategy (NDS). As the 20-year hydrocarbon investment programme will expire by end-2012, growth will slow from its double-digit pace. Nevertheless, non-hydrocarbon GDP growth will remain high – supported, in particular, by public infrastructure spending – and the non-oil sector will become the main source of growth.
  - According to the NDS, public infrastructure spending is likely to peak in 2012 and remain at around 15% of GDP until 2016. As a result, non-hydrocarbon GDP growth is estimated to average 9% during 2012-2016. In turn, GDP growth is expected to decline from a double-digit rate to around 7% in 2012 and then to 4-5% in the following years. The government expects private investment to reach 85% of GDP until 2016. As the bulk of NDS investments will be done through government-linked enterprises, there is a strong likelihood that these companies will deliver these ambitious plans. Nevertheless, the government calculates hydrocarbon GDP still will account for around 40% of GDP in 2016, and oil and gas revenues will continue to be the main driver of fiscal and export revenues.
- **Inflation: rising**
  - After about two years of deflation, the annual inflation rate has remained in positive territory since October 2010 and reached 2.0% y/y in July 2011. Apart from rents, homeware and healthcare, almost all CPI inflation rates exceed 5% but the decline in rents is restraining overall inflation.
  - Domestic demand should remain strong as a result of the public spending plans. In addition, the authorities are keen to revive credit growth as evidenced by their rate cuts. Hence the stabilisation in rental prices could lead to rapid increases in the inflation rate.
- **Policy: plenty of room to ease fiscal and monetary policies**
  - Qatar lowered key interest rates in August to boost lending to the private sector. The authorities cut both the overnight lending facility and the repo rate to 4.5% from 5% previously. The authorities also reduced the deposit rate to 0.75% from 1% after the Fed's announcement that it will keep rates at current levels for another two years. The lending rate, at 4.5%, remains significantly higher than in other countries in the region such as the UAE and Saudi Arabia, where rates are at 2%. This gives Qatar room to cut its rate further in the coming months, inflation pressures permitting. At the same time, due to the abundance of liquidity, interbank rates are close to the QCB's borrowing rate, rather than the policy rate.
  - The boost to hydrocarbon revenues from increased production capacity and higher energy prices has secured Qatar's public finances further. This provides fiscal room for the large infrastructure investments outlined in the NDS. Despite the high level of fiscal spending, we calculate the breakeven oil price to be USD 50/bbl for Qatar's budget. Similarly, the breakeven level for the current account balance is USD 47/bbl, on our calculations. Therefore, even under a worst-case scenario, Qatar's public finances are more than strong enough to maintain the current investment plans.

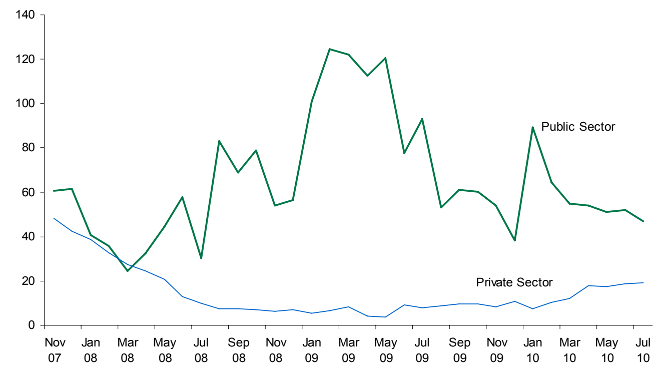
Qatar: Economic Forecasts

	2009	2010	2011 (1)	2012 (1)	2013 (1)
Real GDP (% y/y)	12.0	16.6	19.3	7.3	4.4
CPI (% y/y)	-4.7	-2.4	2.3	3.9	5.3
CPI (% y/y) (2)	-10.0	-0.1	2.9	4.8	5.7
Current Account (% GDP)	6.8	13.6	27.0	27.2	26.0
Budget Balance (% GDP)	15.2	2.9	9.8	11.3	11.1
Primary Budget (% GDP)	16.3	4.1	10.7	12.2	11.9
Gross Gov. Debt (% GDP) (2)	28.7	20.1	13.5	10.5	10.3
Interest Rate (%) (2)	5.55	5.55	4.50	4.50	5.00
USDQAR (2)	3.64	3.64	3.64	3.64	3.64

(1) Forecast (2) End period

Source: TEB Research

Chart 1: Credit Growth (% y/y)



Source: QCB Note: includes financial securities.

Credit growth is mainly driven by the public sector thanks to large infrastructure investments.

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Egypt: In A Tenuous Position

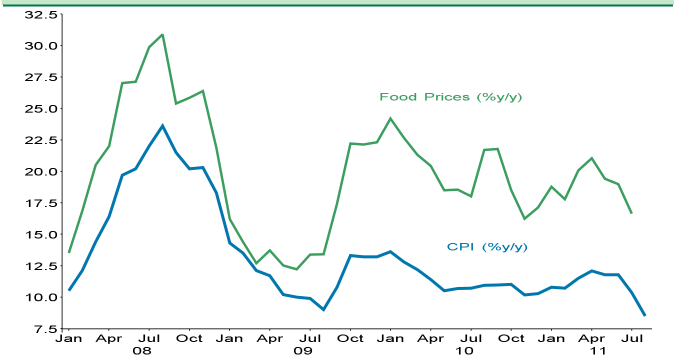
- **Activity: fragile growth outlook**
  - Economic activity has slowed sharply on the back of political turmoil and a long period of uncertainty. Real GDP fell 4.2% y/y during Q1 and registered weak growth of 0.04% y/y in Q2. While the tourism sector has shown some signs of improvement in the last quarter, investment activity remains poor and is unlikely to rebound in the coming quarters given the political uncertainty.
  - We do not expect the current account deficit to deteriorate significantly as the fall in receipts should be partially offset by reduced imports given the weakness of the domestic environment.
- **Inflation: stabilisation in price growth**
  - Inflation fell sharply during the summer, to 8.5% y/y growth in August, down from 10.4% y/y in July. The bulk of the adjustment came from the slowdown in food inflation in year-on-year terms. However we expect this to be a temporary adjustment due to favourable base effects on the back of last year's poor harvest. Production constraints as well as the high proportion of imported food are likely to place upward pressure on food prices in the coming months.
  - External factors, such as the moderation in commodity prices, as well as domestic factors such as sluggish growth in private consumption, present some downside risks. We expect inflation to stabilise above 10% for 2011.
- **Policy: electoral period to spur looser policy**
  - The CBE has managed to keep the EGP within a tight band against the USD during the past quarter, with outflows from T-bills showing signs of stabilising in Q3. While this has put a strain on reserves (Chart 2), we think the CBE will continue to pursue a managed float policy for the currency in the coming quarter.
  - Given the stabilisation expected in inflation, albeit at a high level, we don't see the CBE changing rates before the parliamentary elections at the end of November.
  - We expect the fiscal deficit to reach 10% of GDP this year. This is higher than the government's projection of 8.6% of GDP as, with parliamentary elections in November and presidential elections in late 2012 or early 2013, we doubt the government will be able to rein back expenditure as much as it has targeted. In addition, subdued business activity is also likely to limit tax revenues.
  - The parliamentary elections, scheduled to start 28 November with three rounds ending on 17 March, are likely to create a period of heightened volatility in Egyptian markets. The ruling SCAF has amended the electoral law to allow for 66% proportional representation. The rest of the seats are to be won through a simple majority and are for independent candidates only. While this is an improvement from the previous law, it presents a risk to reforms as it raises the possibility that a significant number of ex-NDP members will win seats.

Egypt: Economic Forecasts

	2009	2010	2011(1)	2012(1)	2013(1)
Real GDP (% y/y)	4.7	5.1	0.7	1.6	3.7
CPI (% y/y)	11.7	11.6	10.6	11.8	11.2
CPI (% y/y) (2)	13.2	10.3	10.5	11.2	10.8
Current Account (% GDP)	-2.3	-2.0	-2.9	1.0	1.6
Budget Balance (% GDP)	-6.9	-8.1	-10.0	-9.2	-8.1
Deposit Rate (%) (2)	11.50	8.25	8.25	8.25	9.00
USDEGP (2)	5.48	5.80	5.95	5.75	5.50

(1) Forecast (2) End period
Source: BNP Paribas

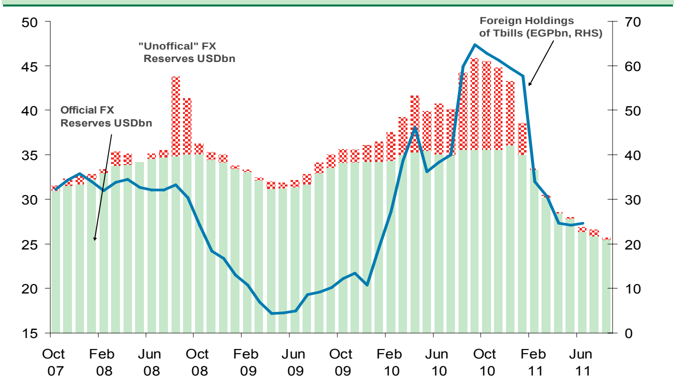
Chart 1: Relief from Food Prices (% y/y)



Source: Reuters EcoWin Pro, BNP Paribas

Headline CPI inflation has shown signs of moderating but this has been largely on the back of the decline in food prices, which is unlikely to be lasting as it has been driven by favourable base effects.

Chart 2: Significant Decline in CBE Reserves

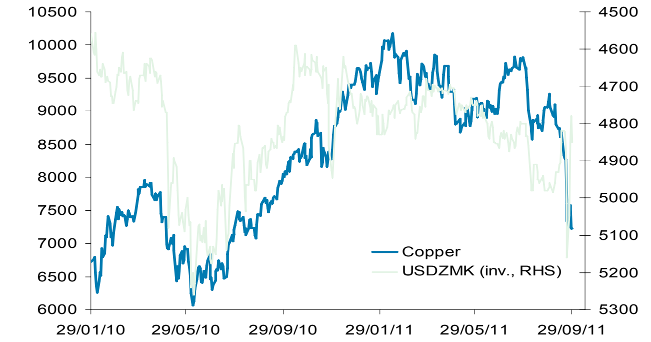


Sub-Saharan Africa: FX Fragilities

- **Zambia: copper-led kwacha**
  - Opposition leader Michael Sata claimed a victory in the presidential elections, over incumbent Rupiah Banda. While this should lead to little change as far as economic policy is concerned, the election result could affect China's investment in the country given reports of its relatively strong relations with Banda's MMD party. Nonetheless, we expect PF leader Sata to maintain pragmatic policies, with continued investment in infrastructure.
  - Unsurprisingly, the election period saw volatility in the ZMK and while we have since seen some stabilisation, the sharp decline in copper prices since the start of September is likely to put further strain on the currency (Chart 1) given that the commodity accounts for over 80% of Zambia's total exports. A sustained drop in copper prices would also be likely to lead to a deterioration in external liquidity. Foreign exchange reserves are relatively low (approximately 3.2 months' worth of imports), which suggests the kwacha could remain particularly vulnerable to shifts in risk sentiment and, in turn, changes in copper prices.
- **Ghana: booming growth**
  - The onset of oil production in Ghana continues to support GDP growth in the country, boosting both fiscal and current account revenues. However, despite growing oil exports, the current account remains in deficit. Remittances into Ghana comprise a large proportion of receipts on the current account. Given both the decline in oil prices and the expected deceleration in global growth, workers' remittances are likely to take a hit in the fourth quarter of the year.
  - Strong FDI in Ghana has more than covered the country's external financing needs. However, this was boosted significantly by the prospect of oil production and so the level of investment could moderate. Nonetheless, FDI is expected to remain strong with flows likely to contribute to the BoG's build-up of reserves.
  - The BoG has remained relatively dovish, cutting rates by 50bp since May. The relative stability of the cedi in the last six months has helped inflation to moderate to below 9% y/y in recent months. However, inflation could re-accelerate on the back of September's sell-off in the currency as a result of demand for foreign currency from importers.
- **Kenya: a bid to support the KES**

  Following a surprise 25bp rate cut by the Central Bank of Kenya at the start of the year, the CBK has since had to hike rates very aggressively in

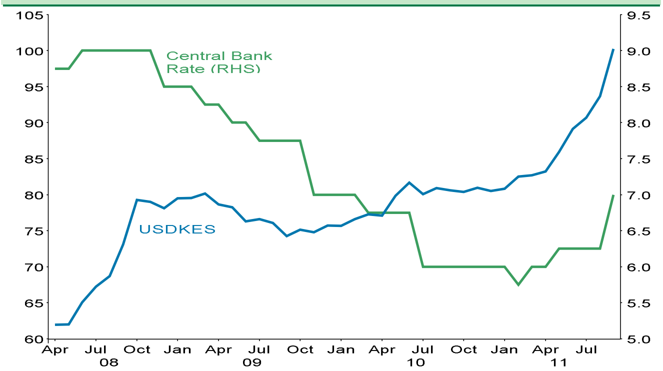
Chart 1: Copper Decline Poses Risk for ZMK



Source: Bloomberg, BNP Paribas

The ZMK has suffered on the back of the decline in copper prices.

Chart 2: CBK Resorts to Aggressive Rate Hikes



Source: Reuters EcoWin Pro, BNP Paribas

The Central Bank of Kenya has resorted to aggressive monetary tightening in an effort to stem the decline in the KES, which was instigated by a rate cut in February despite a surge in inflation.

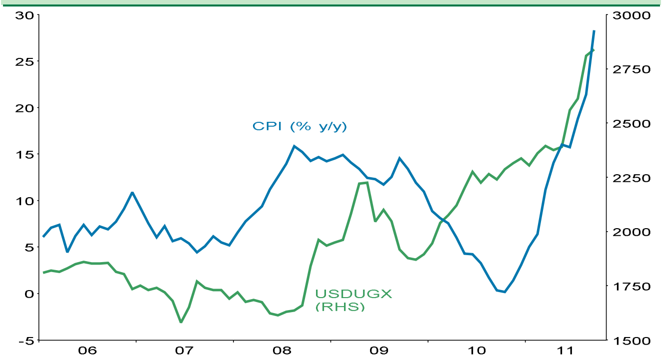
response to the sharp sell-off in the Kenyan shilling and the consequent pass-through to inflation. The interest rate cut has done significant damage to the CBK's credibility and to investor confidence in the policy framework. This situation, coupled with the poor global growth outlook, has led market players to drive the USDKES to record highs, with the KES depreciating by over 20% since the start of the year. This has been accompanied by a surge in inflation, which has been stoked to 17.3% y/y in September from just over 5% in January. As a result, costs in the local bond market have soared to the highest levels in over ten years, making domestic issuance increasingly difficult and forcing financing to be raised abroad.

  - Given these issues, the CBK has started to pursue a particularly hawkish policy stance. In addition, PM Odinga is set to announce a set of measures in early October in an effort to stabilise the shilling. With FX reserves relatively low, and declining (approximately USD 3.82bn on 23

September or 3.5 months of import cover) the CBK's ammunition to intervene is relatively weak. Instead, citing the need to stem inflation and the potential for further hikes in the coming months, it has hiked rates aggressively, raising the benchmark rate by a whopping 4pp in October. This follows a 75bp hike a month earlier and brings the policy rate to 11%. It is also likely that the bank will sell FX directly to importing industries in an effort to steady the currency. Furthermore, we wouldn't be surprised to see officials imposing measures restricting capital outflows.

- **Nigeria: not at all costs**
  - The NGN has fallen to a record low against the USD despite the reduction in political risk after elections earlier this year and despite the hawkish stance of the CBN and the ongoing tightening in monetary policy. The CBN raised rates for the fifth time this year in September, increasing the policy rate by 50bp to 9.25% in an effort to bring back the bid to the currency and stem inflation. The rate of price growth has moderated in the past quarter, falling to 9.3%, the lowest level for over three years, but the pass-through from the currency is threatening a re-acceleration.
  - The CBN has continued to dip into its foreign exchange reserves in an effort to keep the naira within a band of 3pp band above or below 150/USD by selling foreign currency in its twice-weekly auctions. However, it has recently allowed the currency to depreciate beyond this band. While the CBN is likely to continue to try and limit the depreciation of the currency, Governor Sanusi has stated openly that the Bank will not defend the naira at any cost.
  - The NGN could weaken further in the coming months despite the interest rate hikes and the consequent rise in carry. We could see increasing pressure next year in particular on the back of growing demand for foreign currency as infrastructure projects begin. Furthermore, the decline in oil prices in the second half of 2011, and the poor global growth outlook are bound to thwart support for the NGN.
- **Uganda: large imbalances**
  - The UGX has been a regional underperformer over the past quarter, with an unsupportive current account deficit and social unrest prolonging the sell-off in the currency. The 12.5% depreciation in the shilling versus the US dollar over the last quarter (and 28% fall since the start of the year) has contributed to a surge in inflation. Headline inflation reached an 18-year peak in September of 28.3% y/y (from an average of approximately 9% y/y over the five preceding years), and is up sharply from the 6% headline inflation seen at the start of the year (Chart 3).

Chart 3: UGX Sliding on Surging Inflation



Source: Reuters EcoWin Pro, NBP, BNP Paribas

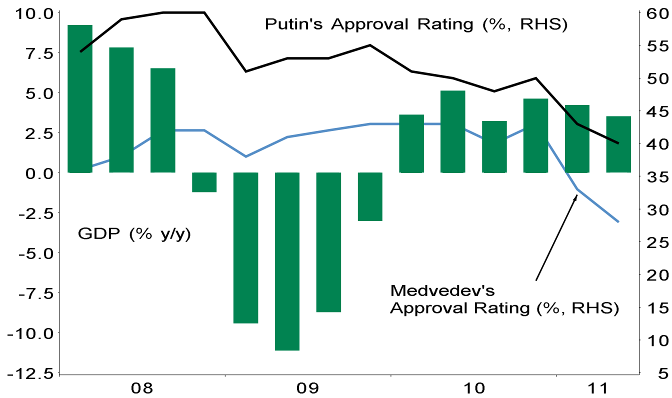
The Ugandan shilling is sliding against the USD on the back of surging inflation. While rate hikes from the BoU should eventually bring the bid back to the currency, inflation needs to moderate first.

  - The Bank of Uganda introduced inflation targeting as a policy in July this year, with the goal of reducing core inflation to 5% over the medium term (from 27.5% now). This has led the BoU to maintain a tightening bias, raising rates by 300bp since August and bringing the policy rate to 16%. While the BoU is likely to continue to hike, this is not expected to lower inflation sharply, given that its acceleration has been largely due to supply-side factors and given the weak transmission mechanism of the policy rate.
  - The Ugandan shilling is likely to remain vulnerable in the coming quarter as external imbalances remain high. Furthermore, credit growth is accelerating sharply, which is likely to boost import growth further, exacerbating the wide current account deficit.
- **Tanzania: energy reforms are crucial**
  - Tanzania's economy has suffered slightly from a slowdown in its manufacturing sector. In Q2 GDP rose at a robust rate of 6.7% y/y although this was a deceleration from that registered a year earlier. Power outages have put a dampener on growth but FinMin Mkulo has indicated that the government will be working to liberalise its energy sector in order to alleviate the burden on the economy from the shortages. In support of this initiative, China has agreed to loan Tanzania USD 1bn to fund the construction of a gas pipeline. The discovery of new gas reserves should also boost domestic activity as it will help meet local demand and increase current account receipts. The current account deficit had widened to 8% of GDP in the year to June, mostly on the back of oil and food imports. The energy crisis is also having a significant effect on inflation, which rose for a tenth consecutive month in August to 14.1% y/y. The current account deficit is likely to put further pressure on the TZS, suggesting that there may be a further acceleration in inflation ahead.

Russia: Cushioned by Oil

- **Activity: temporarily hit by capital outflows**
  - Economic growth in Q2 was modest at 3.4% y/y, affected by base effects and capital outflows. Net capital outflows are likely in H2 2011 also, capping GDP growth. However, a good harvest (grain output should be up 50% y/y) will boost activity in coming quarters. Nevertheless, we are cutting our GDP growth projection for 2011 from 4.5% to 4.3%. We are also revising down our forecast for 2012 from 5.2% to 4.7% on the back of our revisions of oil price projections.
  - We expect increased government spending in the pre-election period to stimulate domestic demand through H2 2012.
  - We view the parliamentary elections in December as a rehearsal for the presidential elections in March 2012. A widening of the political spectrum in the Duma would not affect its loyalty to the government. The current political elite will continue to control the country, with no significant change in economic policy expected. PM Putin is very likely to win a new presidency for 2012-18.
- **Inflation: slowing on food**
  - A good harvest this year and a slowdown in global food inflation have led to a deceleration in Russia's food inflation. We expect some acceleration in monthly rises in the CPI in Q4 on the back of pre-election increases in social spending and a weaker rouble. However, these are unlikely to result in an acceleration in inflation in year-on-year terms. We maintain our inflation forecast for 7.5% y/y at the end of 2011 and 2012.
- **Policy: flat rates, neutral budget**
  - The government has targeted inflation of 6.5-7.5% y/y for 2011 and the slowdown in food inflation has made this target realistic. Moreover, the refinancing rate has recently turned positive in real terms. Slowing inflation means rates are likely to remain on hold until easing begins in H2 2012.
  - In 2012, the Brent oil price needed to balance the federal budget is likely to increase from USD 110/bbl now to USD 125/bbl. Although the budget deficit is likely to be modest in 2012 (we expect a balanced budget in 2011), the high and rising threshold for oil prices increases fiscal risks for 2013 and beyond. Russia may have to borrow heavily again within a few years. In 2011-12, however, the country is unlikely to issue new Eurobonds.
  - Higher global uncertainty has affected the rouble since August. We do not see substantial upside for the rouble in 2011 because of net capital outflows. At the same time, high oil prices have resulted in a current account surplus of more than 4% of GDP and should cushion the rouble this year and next.

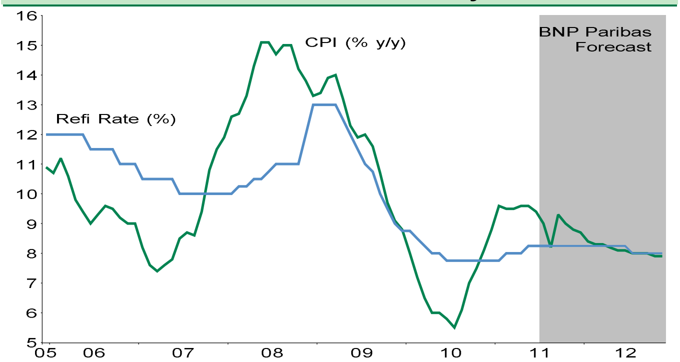
Chart 1: Economic Growth and Politicians' Ratings



Source: FSSS, Bloomberg, WCIOM

High oil prices are supporting economic growth. Although the approval ratings of the most popular politicians have dropped, we do not expect political changes to result in a new economic policy.

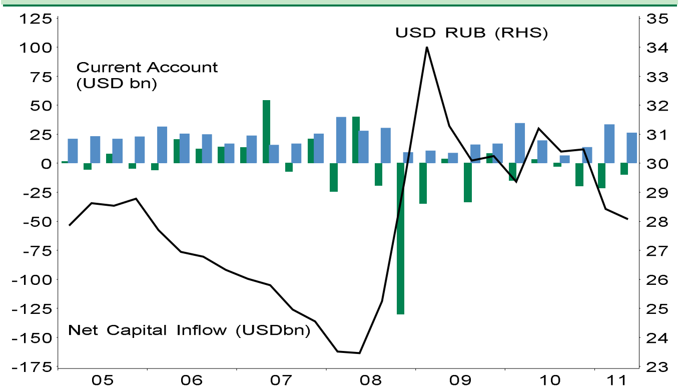
Chart 2: Inflation and Policy Rate



Source: CBR, FSSS, BNP Paribas

A substantial slowdown in CPI inflation has led to the CBR finishing its tightening cycle this year. Easing is likely in mid-2012.

Chart 3: External Balances and the Rouble



Source: CBR, BNP Paribas

Net capital outflows have limited appreciation of the rouble. High oil prices and a strong current account surplus have prevented a sharp depreciation.

Russia: Economic & Financial Forecasts

	Year					2010				2011				2012			
	'09	'10	'11 (1)	'12 (1)	'13 (1)	Q1	Q2	Q3	Q4	Q1	Q2	Q3 (1)	Q4 (1)	Q1 (1)	Q2 (1)	Q3 (1)	Q4 (1)
Components of Growth																	
GDP (% q/q) nsa	-	-	-	-	-	-15.0	8.0	10.9	2.7	-15.3	7.3	12.8	1.8	-15.6	8.4	12.8	1.5
GDP (% q/q) sa	-	-	-	-	-	1.0	0.7	-1.0	3.7	0.6	0.0	0.8	2.9	0.2	1.1	0.8	2.6
GDP (% y/y)	-7.9	4.0	4.3	4.7	4.8	3.5	5.0	3.1	4.5	4.1	3.4	5.2	4.3	3.9	5.0	5.0	4.7
GDP (USD bn)	1225.8	1465	1806	2005.0	2280	330.0	358.0	384.2	392.3	407.0	441.5	473.8	483.8	451.8	490.1	526.0	537.1
Private Consumption	-4.8	2.7	4.5	4.9	4.6	0.1	4.6	6.7	0.0	3.5	3.8	5.0	5.5	4.3	5.0	5.0	5.2
Public Consumption	-0.5	0.7	0.9	3.0	0.3	1.8	0.7	0.2	0.5	0.5	0.5	1.0	1.5	2.0	2.0	4.0	4.0
Fixed Investment	-16.2	6.0	5.8	4.3	5.5	-4.1	5.3	7.2	9.8	-0.8	4.8	8.0	11.0	3.5	3.0	4.5	6.0
Exports (% y/y)	-4.7	11.1	10.6	0.5	0.5	18.5	3.9	9.5	12.3	13.0	10.0	8.0	11.5	0.5	1.0	0.5	0.0
Imports (% y/y)	-30.4	25.4	20.5	15.0	15.0	10.7	20.8	34.8	35.3	12.0	20.0	25.0	25.0	14.0	14.4	15.5	16.0
Industrial Production	-11.0	8.2	5.0	4.5	4.1	9.5	10.9	6.4	6.5	5.9	4.8	4.6	4.8	3.5	4.5	5.0	4.9
Savings Ratio (%)	18.8	18.0	18.6	21.0	21.0	12.4	19.9	18.8	20.7	17.0	19.0	19.0	19.5	19.5	20.5	22.0	22.0

	Year					2010				2011				2012			
	'09	'10	'11 (1)	'12 (1)	'13 (1)	Q1	Q2	Q3	Q4	Q1	Q2	Q3 (1)	Q4 (1)	Q1 (1)	Q2 (1)	Q3 (1)	Q4 (1)
Inflation & Labour																	
CPI	11.8	6.9	8.8	7.2	7.2	7.2	5.9	6.2	8.1	9.6	9.6	8.3	7.7	6.8	6.9	7.6	7.5
CPI (2)	8.8	8.8	7.5	7.3	7.0	6.4	5.8	7.0	8.8	9.5	9.4	7.2	7.5	6.7	7.1	7.6	7.3
Unemployment Rate (%)	8.2	7.5	6.8	6.3	6.1	8.8	7.4	6.8	7.2	7.6	6.8	6.2	6.5	6.5	6.5	5.9	6.2

	Year					2010				2011				2012			
External Trade	'09	'10	'11 (1)	'12 (1)	'13 (1)	Q1	Q2	Q3	Q4	Q1	Q2	Q3 (1)	Q4 (1)	Q1 (1)	Q2 (1)	Q3 (1)	Q4 (1)
Trade Balance (USD bn)	111.6	151.4	150.0	110.0	90.0	46.5	39.2	29.2	36.4	48.2	36.8	32.5	32.5	30.0	30.0	30.0	20.0
Current Account (USD bn)	49.5	71.1	75.0	35.0	15.0	33.3	18.0	5.7	14.1	31.8	20.5	11.4	11.4	10.0	10.0	8.0	7.0
Current Account (% GDP)	4.0	4.9	4.2	1.7	0.7	10.1	5.0	1.5	3.6	7.8	4.6	2.4	2.3	2.2	2.0	1.5	1.3
Net FDI (USDbn)	-7.2	-10.5	5.0	11.0	15.0	-2.2	-2.0	-3.3	-3.0	-1.0	0.0	3.0	3.0	2.5	1.5	4.5	2.5
Net FDI (% GDP)	-0.6	-0.7	0.3	0.5	0.7	-0.7	-0.6	-0.9	-0.8	-0.2	0.0	0.6	0.6	0.6	0.3	0.9	0.5

	Year					2010				2011				2012			
	'09	'10 (1)	'11 (1)	'12 (1)	'13 (1)	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Financial Variables																	
Gen. Gov. Budget (% GDP)	-6.4	-3.9	0.0	-1.0	-3.0	-	-	-	-	-	-	-	-	-	-	-	-
Primary. Gov. Budget (% GDP)	-5.8	-3.4	0.5	-0.5	-2.6	-	-	-	-	-	-	-	-	-	-	-	-
Gross Gov. Debt (% GDP) (2)	7.5	7.9	7.8	8.2	9.0	-	-	-	-	-	-	-	-	-	-	-	-

	Year					2010				2011				2012			
	'09	'10	'11 (1)	'12 (1)	'13 (1)	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4 (1)	Q1 (1)	Q2 (1)	Q3 (1)	Q4 (1)
Interest & FX Rates (2)																	
Official Interest Rate (%)	8.75	7.75	8.25	8.00	7.50	8.25	7.75	7.75	7.75	8.00	8.25	8.25	8.25	8.25	8.25	8.00	8.00
3-Month Rate (%)	7.05	4.10	4.50	4.50	3.50	4.50	4.00	3.80	4.10	3.96	4.25	6.54	4.50	4.00	4.20	4.40	4.50
USDRUB	30.20	30.40	30.27	27.14	28.81	29.00	30.20	30.60	30.4	28.40	28.07	31.87	30.3	29.6	29.0	27.8	27.1

Footnotes: (1) Forecast (2) End Period

Figures are year-on-year percentage changes unless otherwise indicated

Source: BNP Paribas

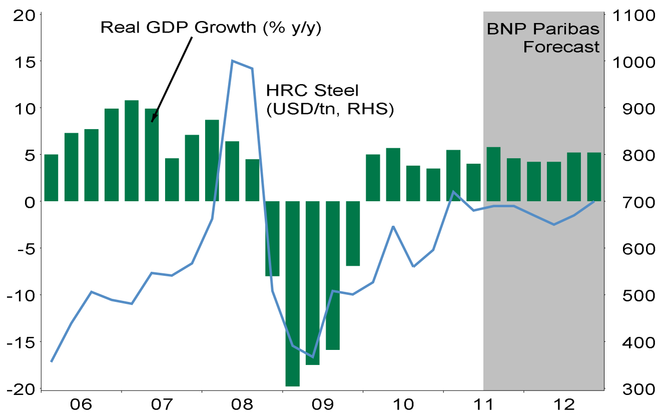
Ukraine: Exceeding Expectations

- **Activity: economic acceleration**
  - Economic growth has exceeded expectations so far this year with output rising by 5% y/y in January to July. Solid steel prices (above USD 670/tn) and a good harvest (with the crop up by about 30% y/y) support a continuation of robust growth. We have raised our growth forecast from 4.5% to 5.0% in 2011 and continue to expect GDP to rise by 4.5% per annum in 2012 and 2013.
  - Fixed capital investment and retail sales remained strong in H1 2011 and domestic demand will remain the main driver of healthy economic growth.
  - Although delays in structural reforms will not allow the country to receive IMF loans by November, we expect more tranches from the IMF programme in 2012. The government will not face financing difficulties this year and the stronger IMF support should help smooth government financing in 2012 and 2013 when sovereign redemptions peak at USD 3.8bn and USD 3bn, respectively.
  - We expect a further consolidation of political authority in the hands of the current ruling group (headed by President Yuanukovich) especially since the arrest of the opposition leader Yulia Tymoshenko. Although political developments are negative for Ukraine's image, we do not expect them to hold back the economy.

- **Inflation: slowing on a strong harvest**
  - Inflation slowed to 8.9% y/y in August, helped by a good harvest. In addition, the 50% hike in the natural gas tariff initially scheduled for 2011 is likely to be postponed, reducing price pressure. We expect inflation to average 9% this year.
  - After rising on the back of natural gas price rises in 2012, inflation should slow again in 2013.

- **Policy: no tightening, large issuance, gradual liberalisation of the FX market**
  - Falling inflation will provide a strong argument for the NBU to keep rates unchanged until 2013, in our view. We expect the Bank to increase its support to the banking sector and inject liquidity into the markets.
  - Although the fiscal performance remains relatively strong, government demand for financing makes new Eurobond issuance (around USD 2bn) very likely this year. Delays with the IMF loan increase the need further.
  - We expect the hryvnya to remain stable until year-end and to appreciate in the medium term. The NBU is continuing its gradual liberalisation of the FX market after the agreement with the IMF. In August, the Bank widened the currency's band from 2% to 5%, allowing higher volatility. Nevertheless, the NBU will continue to intervene to avoid sharp fluctuations of the hryvnya.

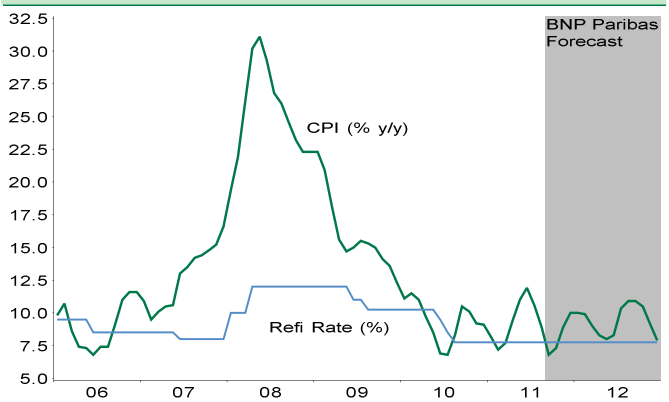
Chart 1: Steel Price and GDP Growth



Source: UkrStat, BNP Paribas

Economic growth has exceeded expectations in 2011. In H2 2011, growth will also be supported by a strong harvest.

Chart 2: Inflation and Policy Rate



Source: CBR, BNP Paribas

Inflation has fallen as a result of lower food inflation. Thus we expect interest rates to be kept unchanged until Q1 2013.

Ukraine: Economic & Financial Forecasts

	Year					2010				2011				2012			
	'09	'10	'11 [1]	'12 [1]	'13 [1]	Q1	Q2	Q3	Q4	Q1	Q2	Q3 [1]	Q4 [1]	Q1 [1]	Q2 [1]	Q3 [1]	Q4 [1]
Components of Growth																	
GDP (% y/y)	-15.0	4.2	5.0	4.5	4.5	4.9	5.9	3.4	3.0	5.3	4.8	5.6	4.4	4.0	4.0	5.0	5.0
GDP (USD bn)	114.1	137.7	159.0	185.3	213.1	28.9	34.7	35.9	38.4	33.0	39.0	42.3	44.7	38.5	47.5	49.0	50.3
GDP per capita (USD)	2454	3060	3533	4118	4735.6	-	-	-	-	-	-	-	-	-	-	-	-

	Year					2010				2011				2012			
	'09	'10	'11 [1]	'12 [1]	'13 [1]	Q1	Q2	Q3	Q4	Q1	Q2	Q3 [1]	Q4 [1]	Q1 [1]	Q2 [1]	Q3 [1]	Q4 [1]
Inflation & Labour																	
CPI	16.0	9.4	9.0	9.4	7.3	11.2	8.3	8.5	9.5	7.7	10.8	8.9	8.7	9.6	8.2	10.7	9.2
CPI [2]	12.3	9.1	10.0	8.0	7.0	11.0	6.9	10.5	9.1	7.7	11.9	9.5	10.0	9.1	8.3	8.2	8.0
Unemployment Rate (%)	9.6	9.1	8.8	8.5	8.2	9.8	9.2	8.7	8.8	9.5	8.8	8.5	8.5	8.6	8.5	8.5	8.4

	Year					2010				2011				2012			
External Trade	'09	'10	'11 [1]	'12 [1]	'13 [1]	Q1	Q2	Q3	Q4	Q1	Q2	Q3 [1]	Q4 [1]	Q1 [1]	Q2 [1]	Q3 [1]	Q4 [1]
Trade Balance (USD bn)	-4.3	-8.4	-14.0	-16.5	-18.0	-1.2	-0.8	-2.8	-3.6	-3.0	-3.0	-3.5	-4.5	-3.5	-4.0	-4.0	-5.0
Current Account (USD bn)	-1.7	-2.7	-7.0	-9.1	-9.8	0.0	0.5	-0.8	-2.3	-1.3	-1.2	-2.0	-2.5	-1.7	-2.0	-2.3	-3.1
Current Account (% GDP)	-1.5	-2.0	-4.4	-4.9	-4.6	0.0	1.5	-2.4	-6.1	-3.9	-3.1	-4.7	-5.6	-4.4	-4.2	-4.7	-6.2
net FDI (USDbn)	4.7	5.7	6.5	10.0	14.0	0.9	1.2	1.5	2.1	0.9	1.6	2.0	2.0	2.0	2.5	2.5	3.0
International Reserves (USDbn) [2]	26.5	34.6	40.0	43.0	45.0	25.1	29.5	34.7	34.6	36.4	37.6	38.5	40.0	40.0	41.0	41.5	43.0
External debt (USDbn)	103.3	117.3	133.0	150.0	177.0	102.9	104.6	111.6	117.3	120.5	124.0	127.0	133.0	137.0	140.0	145.0	150.0
External debt (%GDP)	90.6	85.2	83.6	80.9	83.1	-	-	-	-	-	-	-	-	-	-	-	-

	Year					2010				2011				2012			
	'09	'10	'11 [1]	'12 [1]	'13 [1]	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Financial Variables																	
Gen. Gov. Budget (% GDP)	-6.5	-6.0	-4.0	-3.0	-2.8	-	-	-	-	-	-	-	-	-	-	-	-
Primary Budget Balance (%GDP)	-5.6	-4.6	-2.5	-1.4	-1.1	-	-	-	-	-	-	-	-	-	-	-	-
Gross Gov. Debt (% GDP) [2]	34.7	31.1	38.5	42.1	45.9	-	-	-	-	-	-	-	-	-	-	-	-

	Year					2010				2011				2012			
	'09	'10	'11 [1]	'12 [1]	'13 [1]	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4 [1]	Q1 [1]	Q2 [1]	Q3 [1]	Q4 [1]
Interest & FX Rates [2]																	
Official Interest Rate (%)	10.25	7.80	7.75	7.75	7.25	10.25	9.50	7.75	7.80	7.75	7.75	7.75	7.75	7.75	7.75	7.75	7.75
1-Month Rate (%)	18.5	11.83	13.00	7.50	7.10	9.08	5.58	4.55	11.83	5.83	7.00	12.75	13.00	10.00	9.00	8.00	7.50
USDUAH	8.00	7.93	8.00	8.00	7.30	8.00	7.90	7.90	7.93	7.96	7.98	8.00	8.00	8.00	8.00	8.00	8.00

Footnotes: (1) Forecast (2) End Period

Figures are year-on-year percentage changes unless otherwise indicated

Source: BNP Paribas

Kazakhstan: Robust Growth

■ **Activity: oil stimulates consumption**

- High oil prices are providing strong support for an acceleration of economic growth, which reached 7.1% y/y in H1 2011. As a result of our bullish view on the Urals oil price, we expect economic growth to remain in the 6.5-7.0% per annum range for 2011-13.
- A substantial rebound in domestic demand, in particular a 12.4% y/y rise in retail sales in H1 2011, has made growth more balanced. A rise in incomes is the main driver of the recovery of consumption (retail loans have fallen in real terms).
- We expect consumption to remain strong. Economic growth will also increasingly be supported by the recovery of the banking sector.

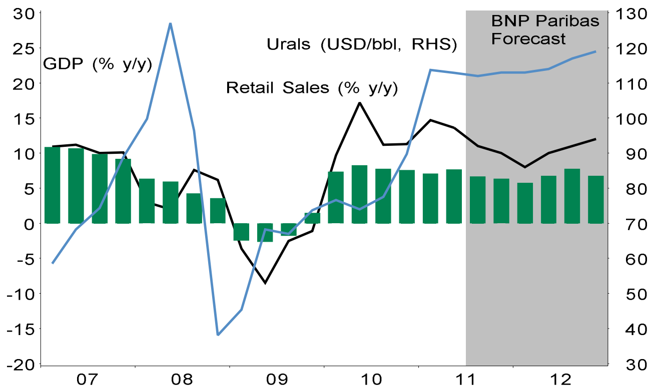
■ **Inflation: clear slowdown on food**

- CPI inflation slowed to 9% y/y in August on the back of a sharp decline in food inflation. A good harvest in 2011 (we expect the grain crop to rise 56% y/y) and limits on grain exports from poor infrastructure should help to slow food inflation further.
- As food represents 44% of the CPI basket, we expect inflation to slow sharply in coming months. The relatively modest growth rate of the money supply (13.6% y/y in H1 2011) also supports a slowdown in inflation. We continue to expect inflation to end 2011 and 2012 at 8.0% and 7.0% y/y, respectively.

■ **Policy: no revaluation, no policy tightening**

- The government and NBK target inflation in the range of 6-8% for 2011. This is realistic given the fall in food inflation. Thus we do not expect any change in rates for the next nine to twelve months. Rather, the NBK is likely to concentrate its efforts on stimulating credit.
- The slowdown in inflation also makes a revaluation of the tenge less pressing, and the rouble's recent weak performance does not support such a move. Although fundamental factors (particularly a strong current account surplus) call for appreciation, the NBK could postpone it to 2012 or later.
- The government is continuing its efforts to develop Kazakhstan's financial markets. In H2 2012 it plans to start the so-called People's IPO, floating shares in companies controlled by state-owned Samruk-Kazyna. However, the planned sale of USD 300-500mn worth of shares is unlikely to be sufficient to lead to a significant development of the equity market.
- A strong fiscal performance and sizable accumulation in the National Fund make new sovereign borrowing unlikely in 2011-12. The country has no tradable sovereign debt, making sub-sovereign issues important as the country's benchmark.

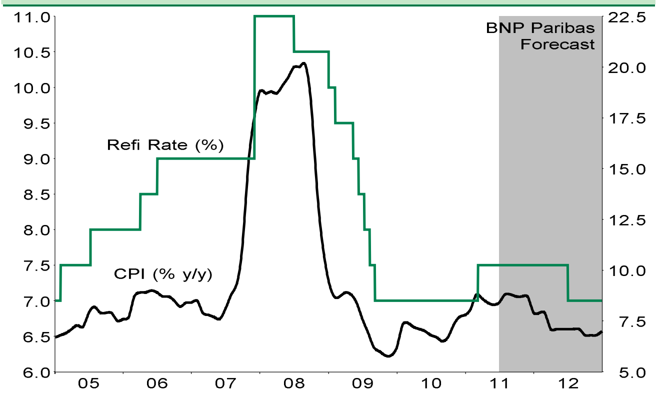
Chart 1: Economic Growth and the Oil Price



Source: KazStat, Reuters EcoWin Pro, BNP Paribas

With the Urals oil price above USD 110/bbl, we expect the economy to remain strong – with the recovery in consumer demand likely to remain the main driver of economic growth.

Chart 2: Inflation and Policy Rate



Source: KazStat, BNP Paribas

The slowdown in food inflation has helped to limit CPI pressure and makes monetary tightening unlikely.

Kazakhstan: Economic & Financial Forecasts

	Year					2010				2011				2012			
	'09	'10	'11 [1]	'12 [1]	'13 [1]	Q1	Q2	Q3	Q4	Q1	Q2	Q3 [1]	Q4 [1]	Q1 [1]	Q2 [1]	Q3 [1]	Q4 [1]
Components of Growth																	
GDP (% y/y)	1.1	7.0	6.7	6.5	7.0	7.1	8.0	6.3	6.4	6.8	7.4	6.4	6.1	5.5	6.5	7.5	6.5
GDP (USD bn)	116.3	146	162.0	194.0	228.0	29.6	32.4	34.7	49.3	35.2	33.8	39.5	53.5	42.2	40.5	47.3	64.1
GDP per capita (USD)	7313.6	9182	10256	12064	13491	-	-	-	-	-	-	-	-	-	-	-	-

	Year					2010				2011				2012			
	'09	'10	'11 [1]	'12 [1]	'13 [1]	Q1	Q2	Q3	Q4	Q1	Q2	Q3 [1]	Q4 [1]	Q1 [1]	Q2 [1]	Q3 [1]	Q4 [1]
Inflation & Labour																	
CPI	7.3	7.1	8.4	7.0	6.6	7.3	7.0	6.6	7.6	8.5	8.5	8.7	7.9	7.1	7.1	6.8	7.0
CPI [2]	6.2	7.8	8.0	7.0	6.5	-	-	-	-	-	-	-	-	-	-	-	-
Unemployment Rate (%)	6.6	5.8	5.2	5.0	4.9	6.2	5.8	5.6	5.5	5.5	5.3	5.1	5.0	5.0	4.9	4.9	5.0

	Year					2010				2011				2012			
	'09	'10	'11 [1]	'12 [1]	'13 [1]	Q1	Q2	Q3	Q4	Q1	Q2	Q3 [1]	Q4 [1]	Q1 [1]	Q2 [1]	Q3 [1]	Q4 [1]
External Trade																	
Trade Balance (USD bn)	15.2	29.0	36.0	37.0	34.0	8.0	8.5	6.0	6.5	11.3	11.4	6.8	6.5	12.0	10.0	9.0	6.0
Current Account (USD bn)	-4.2	4.9	7.0	4.5	2.5	2.8	2.0	-0.6	0.7	4.4	2.8	1.0	-1.2	3.0	1.5	0.0	0.0
Current Account (% GDP)	-3.6	3.4	4.3	2.3	1.1	9.5	6.2	-1.7	1.4	12.5	8.3	2.5	-2.2	7.1	3.7	0.0	0.0
Net FDI (USDbn)	10.5	1.2	8.0	12.0	13.0	3.3	1.8	0.3	-4.3	2.8	1.8	2.0	1.4	3.0	3.0	3.0	3.0
International Reserves (USDbn) [2]	26.4	28.3	38.0	42.0	45.0	26.6	26.1	27.3	28.3	37.0	37.0	37.0	38.0	38.5	39.5	41.0	42.0
External debt (USDbn)	111.7	119.0	130.0	144.0	160.0	111.5	114.5	112.8	119.0	124.2	127.0	129.0	130.0	132.0	135.0	140.0	144.0
External debt (%GDP)	96.1	81.5	80.2	74.2	70.2	-	-	-	-	-	-	-	-	-	-	-	-

	Year					2010				2011				2012			
	'09	'10	'11 [1]	'12 [1]	'13 [1]	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4 [1]	Q1 [1]	Q2 [1]	Q3 [1]	Q4 [1]
Financial Variables																	
Cons Gov. Budget (% GDP) [3]	-3.0	-3.0	-1.0	-1.0	-1.5	-	-	-	-	-	-	-	-	-	-	-	-
Primary Budget Balance (%GDP)	-2.6	-2.6	-0.5	-0.5	-1.0	-	-	-	-	-	-	-	-	-	-	-	-
Gross Gov. Debt (% GDP) [2]	9.8	13.0	10.3	11.3	10.5	5.8	8.8	10.2	13.0	13.2	12.8	10.6	10.3	12.2	11.9	11.5	11.3

	Year					2010				2011				2012			
	'09	'10	'11 [1]	'12 [1]	'13 [1]	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4 [1]	Q1 [1]	Q2 [1]	Q3 [1]	Q4 [1]
Interest & FX Rates [2]																	
Official Interest Rate (%)	7.00	7.00	7.50	7.00	7.00	7.00	7.00	7.00	7.00	7.50	7.50	7.50	7.50	7.50	7.50	7.00	7.00
3-Month Rate (%)	3.0	2.00	3.50	4.50	3.50	2.64	2.00	2.00	2.00	2.00	3.00	3.50	3.50	3.50	4.00	4.00	4.50
USDKZT	148.5	147.5	147.0	142.0	130.0	148.5	147.1	147.5	147.5	145.7	146.3	148.1	147.0	147.2	147.0	145.0	142.0

Footnotes: (1) Forecast (2) End Period (3) Without adjustment to National Fund accumulation

Source: BNP Paribas

Belarus: On a Knife Edge

- **Activity: moderate growth ahead**
  - Belarus is facing the worst economic crisis in its history, rendering its centrally planned development model unsustainable. Although growth has remained high to date (output rose 9.8% y/y in January-July), we expect it to slow sharply on the back of the introduction of drastic restrictions on imports, which will undermine production and employment, and lead to a fall in domestic demand.
  - Nevertheless, recession is avoidable in 2011-12 as sectors oriented towards external demand remain competitive and are benefiting from this year's huge devaluation of the rouble. We expect the economy to expand by 4.8% and 3.0% in 2011 and 2012, respectively.
  - The size of the Russian subsidy to Belarus via low energy tariffs remains essential for Belarus's economic performance. We expect this subsidy to remain at about 5% of GDP (Russia has agreed to keep a significant discount on the natural gas price for Belarus). We see this size of subsidy as optimal as it supports economic growth, but keeps incentives for structural reforms high.
- **Inflation: devaluation is still passing through into prices**
  - The inflation rate has jumped this year and reached 60.7% y/y in August after an average of 7.7% last year. The main reason for the spike in inflation is the rouble's devaluation. Now, September's devaluation is being passed through, boosting inflation. We expect inflation to accelerate to 70% y/y at end-year, significantly above the government's forecast of 39%.
- **Policy: privatisation urgently needed**
  - The NBB is likely to continue its aggressive tightening and has increased the size of rate hikes from 2pp to 5pp. We expect at least two to three more moves in 2011 and the policy rate to end the year at around 40%. However, with the NBB expected to seek to support the banking sector, the tightening is unlikely to be sufficiently aggressive with the policy rate remaining sharply negative in real terms.
  - The crisis in the FX market persists. The liberalisation of the FX regime in September has resulted in a new wave of devaluation, easing pressure on the currency but increasing inflation risks.
  - We expect Russia to buy Beltransgaz (50% for USD 2.5bn) in the main privatisation deal as soon as December 2011. The beginning of the privatisation programme will give the Belarusian government access to the second tranche of the Eurasia Bailout Fund (USD 0.4bn in Q4). We expect this financing to stabilise the FX market in Q4.

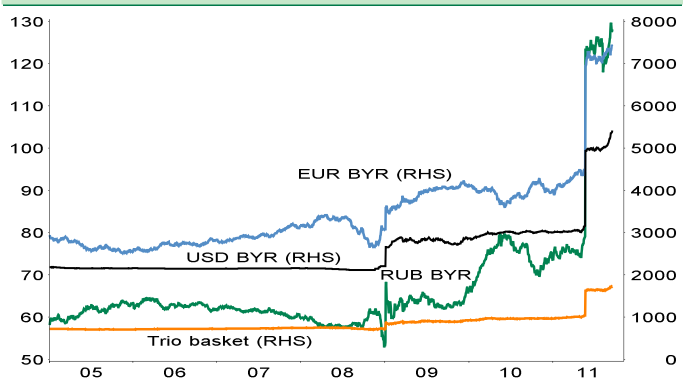
Belarus: Economic Forecasts

	Year				
	'09	'10	'11 (1)	'12 (1)	'13 (1)
Components of Growth					
GDP (% y/y)	0.2	7.6	4.8	3.0	6.5
GDP (BYR bn)	136790	162964	233980	328964	376623
GDP (USD bn)	49.0	54.7	43.0	47.0	53.8
GDP per capita (USD)	5148	5760	4535	4862	5605
Inflation & Labour					
CPI	13.0	7.7	42.0	36.5	7.5
CPI (2)	10.1	10.0	70.0	9.3	8.2
PPI	14.5	13.6	52.5	32.8	11.0
Unemployment Rate (%)	0.9	0.7	2.5	3.0	2.5
External Trade					
Trade Balance (USD bn)	-6.9	-9.1	-7.0	-5.0	-6.0
Current Account (USD bn)	-6.4	-8.5	-6.0	-4.6	-5.3
Current Account (% GDP)	-13.1	-15.5	-14.0	-9.8	-9.9
Net FDI (USDbn)	1.8	1.3	3.5	4.5	4.0
External Debt (USD bn)	20.8	25.8	29.0	34.0	37.0
External Debt (% GDP)	42.5	47.2	67.4	72.3	68.8
Financial Variables					
Budget Balance(% GDP)	-0.7	-2.6	-3.9	-3.7	-3.0
Primary Budget (%GDP)	0.3	-1.3	-2.4	-2.0	-1.4
Gross Gov. Debt (% GDP) (2)	21.9	24.8	41.5	43.7	49.0
Interest & FX Rates (2)					
Official Interest Rate (%)	13.90	10.50	40.00	28.00	16.00
USDBYR	2792	3011	8000	7000	7000

Footnotes: (1) Forecast (2) End Period
Figures are year-on-year percentage changes unless otherwise indicated

Source: BNP Paribas

Chart 1: Exchange Rates



Source: NBRB, BNP Paribas

Despite the 40% devaluation in H1 2011, pressure on the rouble remains high, resulting in a new devaluation. The current account deficit is likely to narrow in 2011, but the country urgently needs USD 3bn of inflows to stabilise the FX market.

Chile: Rate Cuts Are Likely in 2012

- **Activity: enjoying the cushion of strong links to Asia**
  - Real GDP growth has remained healthy, but as expected, the year-on-year rate of expansion has moderated from Q1's unsustainable pace. The latter had resulted from base effects related to the earthquake that hit Chile in early 2010.
  - The slowdown in year-on-year terms is likely to have continued into H2 2011, but the moderation will probably be softer quarter over quarter. We see the economy running at its trend 4.0-4.5% speed by end-2011 before slowing (temporarily) to below potential in H1 2012. Next year's growth forecast has been lowered to 4.0% on global growth concerns.
  - The impact of the slowdown in developed economies will be cushioned by Chile's strong links to Asia – China in particular. Since the 2008 crisis, exports to Asia have risen to 48% of the total from 40% in early 2008 (Chart 1).

- **Inflation: cooling down**
  - The acceleration in price pressures seen at the beginning of the year has given way to more subdued readings lately. Inflation expectations had moderated as a result of pre-emptive tightening by BCCh and have plunged more recently, reflecting less-upbeat global growth prospects.
  - CPI forecasts for both this year and next have been marked down, but inflation is still expected to end 2011 slightly above the 3.0% official target. This acceleration should prove temporary, though, and the inflation rate should moderate in 2012.

- **Policy: neutral, but rate cuts are likely in 2012**
  - BCCh has adopted a neutral stance, which suggests it will remain on hold in the near term due to heightened global uncertainty. We have, therefore, removed the additional tightening our previous forecast had pencilled in.
  - We do not think a rate cut is the most likely scenario near term. But we think the downturn in global growth will prove deeper than the central bank expects. Faltering global growth will in turn translate into a slide of inflation expectations below the 3% target and an unwanted increase in the real policy interest rate (Chart 2).
  - Against this backdrop, the central bank will probably be inclined to ease in 2012. We are thus accordingly revising our rate outlook and now expect BCCh to deliver 75bps of easing next year, starting in mid-Q1 2012 and taking the policy rate to 4.5% by April 2012. Tightening should resume in 2013.

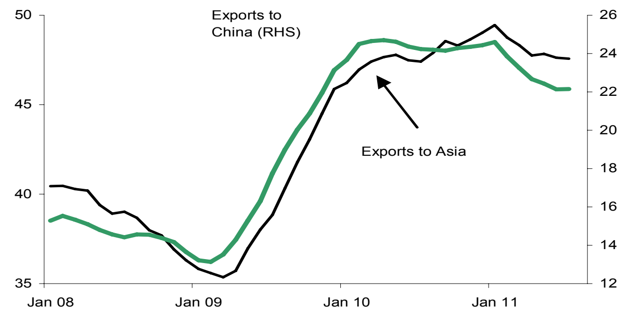
Chile: Economic Forecasts

	2009	2010	2011 (1)	2012 (1)	2013 (1)
Real GDP (% y/y)	-1.5	5.2	6.5	4.0	4.5
CPI (% y/y)	0.4	1.4	3.2	3.1	3.0
CPI (% y/y) (2)	-2.6	3.0	3.6	3.1	3.0
Trade Balance (USD bn)	14.0	15.1	17.4	14.0	6.0
Current Account (USD bn)	2.6	3.8	0.0	-2.0	-8.0
Current Account (% GDP)	1.7	2.0	0.0	-0.8	-3.0
Budget Balance (% GDP)	-4.6	-0.3	1.2	0.5	0.9
Primary Budget (% GDP)	-4.3	0.0	1.5	1.0	1.4
Gross Gov. Debt (% GDP) (2)	6.6	8.4	8.2	7.2	6.4
Interest Rate (%) (2)	0.50	3.25	5.25	4.50	6.00
USDCLP (2)	507	468	470	455	470

(1) Forecast (2) End Period

Source: BNP Paribas

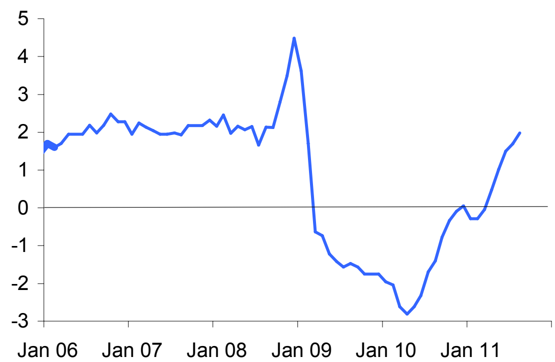
Chart 1: Merchandise Exports to Asia and China (% of total exports)



Source: Central Bank, BNP Paribas

Chile's trade exposure to Asia has risen since the 2008-09 crisis and will cushion the impact of the slowdown in developed economies.

Chart 2: Real Policy Interest Rate (deflated by inflation expectations, %)



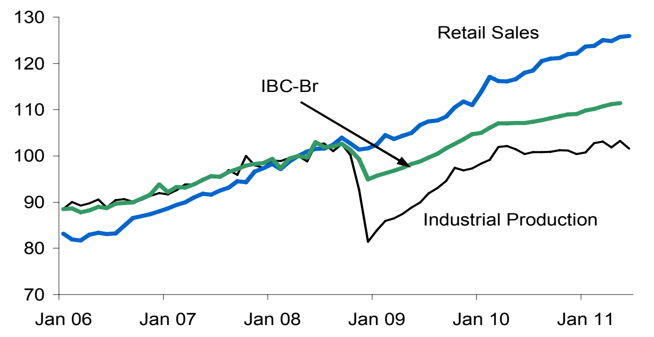
Source: Central Bank, Reuters EcoWin Pro, BNP Paribas

The real policy rate has increased visibly during the past year. A plunge in inflation expectations would lift it further.

Brazil: Fighting the Slowdown

- **Activity: growth to slow heading into 2012**
  - Global headwinds are joining forces with the lagged impact of domestic monetary policy tightening earlier this year to weigh on growth in the second half of the year.
  - The economy's expansion will finish 2011 on a much softer note than it started the year. Growth will prove slower in 2012 than most observers seem to expect.
  - Our long-standing, below-consensus view sees real GDP growth sliding below the 3% mark going into 2012.
- **Inflation: stubbornly above target**
  - Inflation has exceeded 7%. That is significantly above the 4.5% target centre and is also higher than the 6.5% tolerance ceiling.
  - In particular, services inflation remains stubbornly high against a backdrop of tight labour markets, with the unemployment rate at a record low and wages rising.
  - Moreover, inflation expectations have become unmoored. Observers are questioning whether the authorities are really committed to doing whatever it takes to lower inflation to the target centre fast enough.
  - One complication is that high inflation can prove sticky, especially in countries like Brazil, with its entrenched indexation mechanisms. The longer inflation remains high, the harder and more costly it will be to eventually bring it down.
- **Policy: more monetary easing in store**
  - Despite above-target inflation, the central bank has already taken a sharp U-turn in monetary policy, shifting from rate hiking to outright rate cutting in consecutive meetings.
  - The authorities' main concern is the impact of the global slowdown on Brazil's economy.
  - While formally following an inflation-targeting regime, the central bank is now perceived by many to effectively be pursuing a dual mandate. The central bank seems to be attaching a greater weight to growth considerations.
  - More monetary easing is in the pipeline. The pace of individual rate cuts and the degree of overall easing seem to depend mainly on the authorities' perceptions about the implications of international developments.

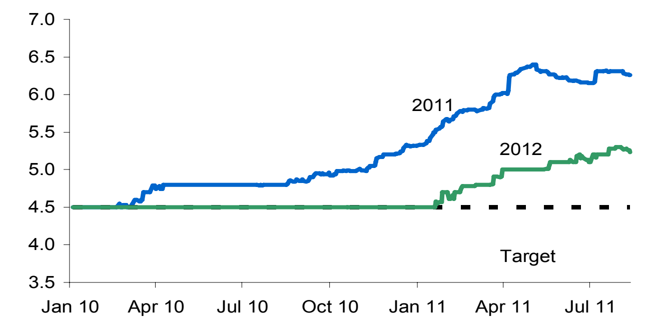
Chart 1: Economic Activity Indices (April 2008 = 100, s.a.)



Source: BCB, IBGE, BNP Paribas

Divergence between retail sales (more a reflection of domestic conditions) and industrial production (more exposed to external conditions) suggests there is a dichotomy within the economy.

Chart 2: Inflation Expectations (% Dec/Dec)



Source: BCB, IBGE, BNP Paribas

Inflation expectations remain above the 4.5% target centre for both 2011 and 2012.

Chart 3: Unemployment Rate (%, s.a.)

Source: BCB, IBGE, BNP Paribas

Labour markets have tightened sharply in recent years. The unemployment rate has fallen to a record low, while wages have increased significantly.

Brazil: Economic & Financial Forecasts

	Year					2010				2011				2012			
Components of Growth	09	10	11 (1)	12 (1)	13 (1)	Q1	Q2	Q3	Q4	Q1	Q2	Q3 (1)	Q4 (1)	Q1 (1)	Q2 (1)	Q3 (1)	Q4 (1)
GDP (% q/q SAAR)	-	-	-	-	-	8.7	6.3	1.8	3.1	5.3	3.6	3.2	2.4	1.6	2.4	2.8	3.2
GDP	-0.6	7.5	3.5	2.5	4.1	9.3	9.2	6.7	5.0	4.2	3.5	3.9	3.7	2.7	2.4	2.3	2.5
Demand Side																	
Private Consumption	4.2	7.0	4.1	2.3	4.0	8.4	6.4	5.9	7.5	5.9	5.0	3.5	2.7	2.3	1.8	2.2	3.0
Public Consumption	3.9	3.3	2.3	3.6	3.0	2.7	5.6	4.1	1.2	2.1	1.6	2.3	2.6	3.0	3.4	3.9	4.1
Fixed Investment	-10.3	21.9	6.9	2.1	5.0	28.4	28.1	21.2	12.3	8.8	6.5	6.4	6.0	3.6	2.1	1.3	1.5
Exports	-10.2	11.5	4.7	5.5	5.0	14.7	7.2	11.3	13.5	4.3	7.2	2.2	5.9	12.9	3.4	2.8	4.3
Imports	-11.5	36.2	11.4	3.8	10.0	39.6	38.9	40.9	27.2	13.1	20.7	5.8	3.4	9.6	0.2	3.4	2.7
Net Exports (Cont. to Growth)	0.0	-3.1	-0.8	0.3	-0.6	-3.2	-3.8	-3.6	-1.7	-1.8	-1.6	-0.4	0.3	0.3	0.4	-0.1	0.2
Stocks (Cont. to Growth)	-2.0	1.7	0.0	-	-	1.5	3.2	2.2	-0.4	-0.3	-	-	-	-	-	-	-
Supply Side																	
Agricultural	-4.6	6.5	4.9	4.9	4.0	5.4	10.4	7.0	1.1	3.1	5.0	6.0	6.0	4.5	4.5	5.5	5.5
Industrial	-6.4	10.1	2.8	3.0	4.1	15.1	14.1	8.3	4.3	3.5	1.8	3.0	3.1	3.8	3.6	2.3	2.4
Services	2.2	5.4	2.9	1.7	4.1	6.2	6.0	4.9	4.6	4.0	2.9	2.4	2.5	1.8	1.7	1.6	1.7
Industrial Production	-7.4	10.5	1.0	1.5	5.1	17.3	14.1	8.0	3.6	2.6	0.7	1.5	1.5	-0.3	0.9	1.4	2.2
Industrial Production (% q/q SAAR)	-	-	-	-	-	12.3	4.4	-2.6	0.2	8.4	-3.1	0.3	0.5	1.1	1.5	2.4	3.6

	Year					2010				2011				2012			
Inflation & Labour	09	10	11 (1)	12 (1)	13 (1)	Q1	Q2	Q3	Q4	Q1	Q2	Q3 (1)	Q4 (1)	Q1 (1)	Q2 (1)	Q3 (1)	Q4 (1)
IPCA	4.9	5.0	6.7	6.3	6.1	4.9	5.1	4.6	5.6	6.1	6.6	7.1	6.8	6.5	6.2	6.4	6.1
IPCA (2)	4.3	5.9	6.7	6.0	5.5	5.2	4.8	4.7	5.9	6.3	6.7	7.3	6.7	6.4	6.3	6.3	6.0
IPCA Core (2)	4.3	5.5	5.3	5.7	5.5	4.5	4.9	5.0	5.5	5.6	5.9	5.5	5.3	5.7	5.4	5.9	5.7
IGP-M (2)	-1.7	11.3	5.3	5.6	4.9	2.0	5.2	7.8	11.3	11.0	8.6	7.3	5.3	4.9	5.6	5.5	5.6
Employment	0.7	3.5	2.1	0.9	2.5	3.8	3.5	3.5	2.9	2.4	2.3	2.1	1.7	0.8	1.1	0.9	1.0
Unemployment Rate (%)	8.1	6.7	6.1	6.7	6.5	7.6	7.0	6.2	5.3	6.5	6.2	6.1	5.2	7.2	6.8	6.8	5.7
Wages	8.4	9.2	10.3	7.4	8.0	7.0	8.4	11.3	12.7	10.2	10.9	10.9	8.9	8.2	7.6	6.8	5.7

	Year					2010				2011				2012			
External Trade (USD bn)	09	10	11 (1)	12 (1)	13 (1)	Q1	Q2	Q3	Q4	Q1	Q2	Q3 (1)	Q4 (1)	Q1 (1)	Q2 (1)	Q3 (1)	Q4 (1)
Trade Balance	25.3	20.3	29.6	23.1	12.6	0.9	7.0	4.9	7.5	1.3	10.2	7.1	11.0	1.0	7.9	5.5	8.5
Current Account	-24.3	-47.5	-49.4	-54.2	-68.4	-12.3	-12.0	-11.3	-12.0	-12.7	-12.5	-11.7	-12.4	-14.0	-13.7	-12.9	-13.6
Current Account (% GDP)	-1.5	-2.3	-2.0	-2.0	-2.3	-2.3	-2.3	-2.2	-2.3	-2.1	-2.0	-1.9	-2.0	-2.0	-2.0	-1.9	-2.0
FDI (% GDP)	1.6	2.3	2.4	2.1	2.4	1.4	1.3	1.5	2.3	2.8	3.1	3.0	2.4	2.0	2.1	2.0	2.1

	Year					2010				2011				2012			
Financial Variables	09	10	11 (1)	12 (1)	13 (1)	Q1	Q2	Q3	Q4	Q1	Q2	Q3 (1)	Q4 (1)	Q1 (1)	Q2 (1)	Q3 (1)	Q4 (1)
General Gov. Budget (% GDP)	-3.3	-2.5	-2.5	-2.0	-2.0	-	-	-	-	-	-	-	-	-	-	-	-
Primary Budget (% GDP)	2.1	2.7	3.1	2.5	2.7	-	-	-	-	-	-	-	-	-	-	-	-
Gross Gov. Debt (% GDP) (2)	62.8	54.7	52.3	52.1	52.2	59.9	59.6	57.9	54.7	56.0	56.0	55.8	52.3	52.3	52.2	52.2	52.1

	Year					2010				2011				2012			
Interest Rates & FX Rates (2)	09	10	11 (1)	12 (1)	13 (1)	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4 (1)	Q1 (1)	Q2 (1)	Q3 (1)	Q4 (1)
SELIC Rate (%)	8.75	10.75	11.00	9.50	11.50	8.75	10.25	10.75	10.75	11.75	12.25	12.00	11.00	10.00	9.50	9.50	9.50
1-Year Swap Rate (%)	10.50	12.00	14.60	14.40	12.70	10.90	11.90	11.30	12.00	12.30	12.50	13.60	14.60	14.60	14.50	15.00	14.40
USDBRL	1.74	1.66	1.85	1.67	1.71	1.78	1.80	1.69	1.66	1.63	1.56	1.88	1.85	1.80	1.75	1.72	1.67
EURBRL	2.50	2.28	2.68	2.47	2.39	2.40	2.21	2.30	2.28	2.31	2.26	2.52	2.68	2.66	2.63	2.58	2.47

Footnotes: (1) Forecast (2) End period
Figures are year-on-year percentage changes unless otherwise indicated

Source: BNP Paribas

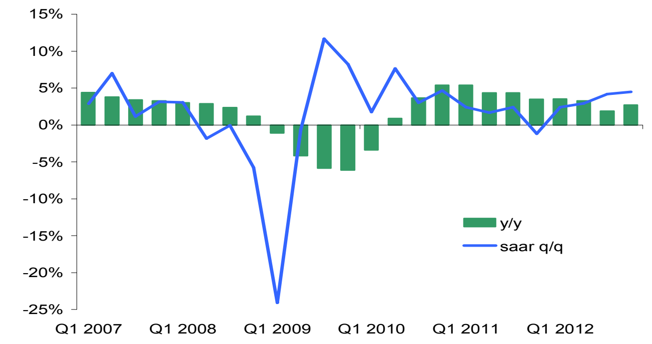
Mexico: Grinding Down

- **Activity: slowing**
  - Growth is decelerating in response to the weakening of activity in the US. As a consequence, the output gap is unlikely to close before Q4 2012.
  - Strengthening domestic demand may mitigate some of the weakness from a slowdown in the US, shielding the economy from a fully-fledged recession. Improvements in consumer confidence and the labour market, together with the increased availability of credit and an accommodative monetary policy, support a strengthening of domestic demand.
  - However, overall, growth is forecast to decelerate from an above-trend rate in 2010-2011 to below trend in 2012. In particular, activity will start 2012 at a low base as substantial weakness is expected in Q4 2011, due to an expected fall in US output (Chart 1).
  - Manufacturing, which is closely tied to the US and accounts for 57% of industrial production, will be the first sector adversely affected by the US recession. This sector will transmit the expected weakness in the US to the rest of the economy (Chart 2).

- **Inflation: low and stable**
  - Headline CPI inflation was 3.5% y/y in August and is set to remain above the 3.0% target in 2011-2012. Inflation is set to end both years below Banxico's 3.0%+ 1pp deviation tolerance.
  - We project core inflation will remain in the 3.3-3.5% range this year and next.

- **Policy: ready to cut**
  - The central bank has indicated that it will cut rates if domestic economic conditions or international financial markets cause an "unnecessary tightening" of monetary policy. On the domestic front, this would require, in our view, a significant growth slowdown or a substantial decline in inflation (or inflation expectations).
  - Based on our growth projections and our expectation that the Fed will initiate QE3 in November, we believe that Banxico will reduce its policy rate in two consecutive 25bp cuts beginning in December.
  - The government is on track to achieve its 2011 fiscal deficit target of 0.5% of GDP. Including spending by the state-owned PEMEX, the deficit is projected to amount to 2.5% of GDP this year.
  - FX policy consists of monthly auctions of USD 600mn put options by Banxico.

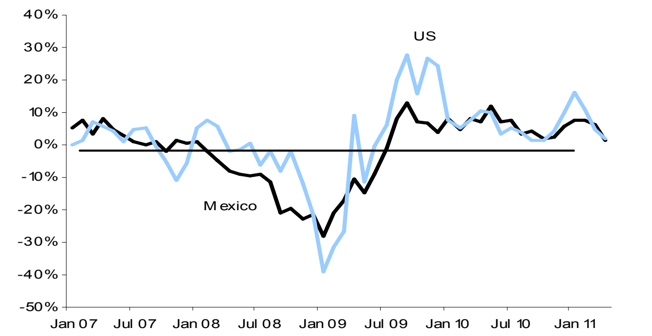
Chart 1: Weakening Growth Prospects



Source: BNP Paribas

Real GDP growth is set to decelerate to reflect weakening activity in the US.

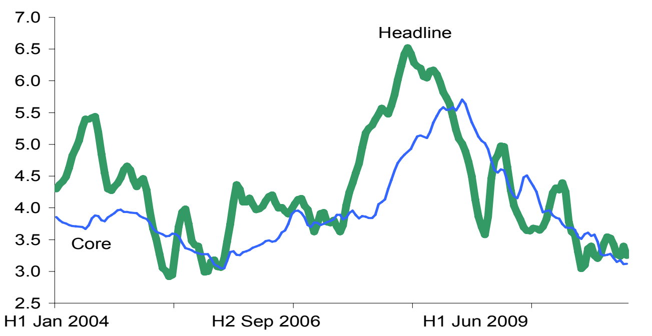
Chart 2: US Manufacturing Slowdown to Take a Toll



Source: BNP Paribas

Manufacturing will be the first sector adversely affected by weakness in the US

Chart 3: Inflation Remaining in Check



Source: INEGI, BNP Paribas

Inflation remains anchored and close to the 3% target.

Mexico: Economic & Financial Forecasts

	Year					2010				2011				2012				2013			
	09	10	11 (1)	12 (1)	13 (1)	Q1	Q2	Q3	Q4	Q1	Q2	Q3 (1)	Q4 (1)	Q1 (1)	Q2 (1)	Q3 (1)	Q4 (1)	Q1 (1)	Q2 (1)	Q3 (1)	Q4 (1)
Components of Growth																					
GDP (% q/q SAAR)		-	-	-	-	1.7	7.6	3.0	4.7	2.4	1.7	2.4	-1.2	2.4	3.0	4.2	4.5	1.1	4.2	6.7	0.9
GDP (% y/y)	-6.1	5.4	3.5	2.7	3.2	4.5	7.6	5.1	4.4	4.6	3.3	5.2	1.0	4.7	2.3	-0.2	4.1	1.4	3.2	5.1	3.1
Demand Side																					
Private Consumption	-7.2	5.0	3.6	4.2	3.3	4.0	6.8	4.6	4.6	4.9	4.2	2.8	2.6	2.9	3.2	4.9	5.8	3.5	3.4	3.3	3.2
Public Consumption	3.8	2.8	1.5	1.3	1.6	1.2	5.4	2.6	1.9	1.3	0.8	2.7	1.1	1.2	1.1	1.0	1.9	1.8	1.5	1.5	1.5
Fixed Investment	-11.9	2.4	5.5	3.1	5.5	-2.7	1.9	3.8	6.4	7.7	5.0	4.8	4.5	0.8	3.2	3.6	4.8	5.5	5.5	5.5	5.5
Exports	-13.7	25.6	5.3	1.0	11.0	24.7	34.6	28.0	16.9	14.1	8.8	6.2	-6.3	2.7	2.4	-5.6	5.0	1.8	8.6	20.1	13.8
Imports	-18.6	23.5	6.9	6.6	8.0	21.9	33.3	23.7	16.6	10.9	9.7	6.2	1.8	2.8	6.4	8.5	8.3	8.0	8.0	8.0	8.0
Supply Side																					
Agriculture	-2.2	3.3	0.7	3.2	-0.3	-1.0	2.6	5.1	6.2	2.2	-3.7	2.1	2.4	6.1	1.1	2.2	3.4	2.7	1.8	-4.7	-1.0
Industry	-7.6	6.0	3.7	2.7	3.7	5.1	8.0	6.2	4.8	5.2	3.4	3.5	2.9	1.1	2.7	3.6	3.6	3.5	4.0	4.0	3.2
Services	-5.7	5.2	4.2	3.2	3.2	4.5	7.7	4.6	4.2	4.4	3.7	4.9	3.8	4.5	3.6	1.1	3.4	2.3	2.4	4.7	3.4
Industrial Production (% y/y)	-7.6	6.0	3.8	2.7	3.7	5.1	8.0	6.2	4.8	5.2	3.4	3.5	2.9	1.1	2.7	3.6	3.6	3.5	4.0	4.0	3.2
Industrial Production (% q/q SAAR)	-	-	-	-		7.3	6.4	2.5	2.7	7.9	2.4	2.2	-0.9	-0.5	1.2	1.8	2.0	2.6	3.7	3.7	2.8

	Year					2010				2011				2012				2013			
	09	10	11 (1)	12 (1)	13 (1)	Q1	Q2	Q3	Q4	Q1	Q2	Q3 (1)	Q4 (1)	Q1 (1)	Q2 (1)	Q3 (1)	Q4 (1)	Q1 (1)	Q2 (1)	Q3 (1)	Q4 (1)
Inflation & Labour																					
IPC (% y/y)	5.7	4.2	3.5	3.8	3.8	4.9	4.5	4.1	4.2	3.5	3.3	3.6	3.6	3.8	3.9	3.7	3.7	3.6	3.7	3.9	3.9
IPC (% y/y) (2)	3.6	4.4	3.6	3.8	3.8	5.0	3.7	3.7	4.4	3.0	3.3	3.6	3.6	3.9	3.8	3.6	3.8	4.0	3.8	4.1	3.8
IPC Core (% y/y) (2)	5.0	3.6	3.2	3.7	3.5	4.3	3.8	3.7	3.6	3.2	3.2	3.3	3.2	3.4	3.6	3.7	3.7	3.6	3.5	3.6	3.5
Employment (% y/y)	-3.1	3.8	4.2	2.8	3.9	1.1	3.8	4.8	5.4	4.8	4.2	4.1	3.6	3.1	2.8	2.1	3.2	3.8	3.4	4.2	4.3
Unemployment Rate (%)	5.5	5.3	5.4	4.9	4.7	5.4	5.2	5.6	5.3	5.1	5.3	5.4	5.4	5.4	5.3	5.1	4.9	4.7	5.2	5.0	4.7

	Year					2010				2011				2012				2013			
	09	10	11 (1)	12 (1)	13 (1)	Q1	Q2	Q3	Q4	Q1	Q2 (1)	Q3 (1)	Q4 (1)	Q1 (1)	Q2 (1)	Q3 (1)	Q4 (1)	Q1 (1)	Q2 (1)	Q3 (1)	Q4 (1)
External Trade																					
Trade Balance (USD bn)	-4.7	-3.0	-1.6	-1.7	-1.9	0.4	-0.1	-2.3	-1.0	1.9	-0.1	-2.4	-1.1	2.0	-0.1	-2.5	-1.2	2.2	-0.1	-2.7	-1.3
Current Account (USD bn)	-6.4	-7.8	-7.5	-7.0	-6.5	0.4	-0.7	-1.8	-5.5	-2.6	-0.7	-2.1	-2.1	-0.2	-2.1	-3.2	-1.5	0.3	-1.9	-2.8	-1.7
Current Account (% GDP)	-0.7	-0.7	-0.6	-0.5	-0.5	-0.4	-0.5	-0.3	-1.3	-1.5	-0.8	-0.9	-1.2	-0.4	-0.5	-0.6	-0.5	-0.4	-0.5	-0.5	-0.5

	Year					2010				2011				2012				2013			
	09	10	11 (1)	12 (1)	13 (1)	Q1	Q2	Q3	Q4	Q1	Q2 (1)	Q3 (1)	Q4 (1)	Q1 (1)	Q2 (1)	Q3 (1)	Q4 (1)	Q1 (1)	Q2 (1)	Q3 (1)	Q4 (1)
Financial Variables																					
Public Balance (% GDP)	-1.8	-2.3	-2.3	-2.0	-2.0	-1.9	-2.4	-2.8	-2.1	-2.2	-2.0	-2.8	-2.4	-2.6	-1.7	-1.8	-2.1	-1.9	-2.0	-2.3	-1.9
Primary Budget (% GDP)	-0.7	-0.3	-0.9	-0.7	-0.6	0.3	-0.2	-0.5	-0.8	-0.9	-0.8	-0.3	-1.4	-1.5	-0.2	-0.5	-0.6	-0.4	-0.5	-0.8	-0.5
Gross Gov. Debt (% GDP) (2)	34.8	32.8	32.3	31.9	31.0	34.3	33.8	33.3	32.8	32.7	32.6	32.4	32.3	32.2	32.1	32.0	31.9	31.5	31.2	30.9	30.5

	Year					2010				2011				2012				2013			
	09	10	11 (1)	12 (1)	13 (1)	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4 (1)	Q1 (1)	Q2 (1)	Q3 (1)	Q4 (1)	Q1 (1)	Q2 (1)	Q3 (1)	Q4 (1)
Interest & FX Rates (2)																					
Benchmark Overnight Rate (%)	4.50	4.50	4.25	4.00	5.00	4.50	4.50	4.50	4.50	4.50	4.50	4.50	4.25	4.00	4.00	4.00	4.00	4.50	5.00	5.00	5.00
Cetes 1m	4.52	4.73	4.55	4.32	5.15	4.50	4.60	4.63	4.73	4.73	4.73	4.75	4.55	4.22	4.26	4.24	4.32	4.90	5.15	5.15	5.15
USDMXN	13.1	12.30	12.7	11.40	11.6	12.38	12.9	12.58	12.3	11.90	11.7	13.90	12.7	12.40	12.1	11.70	11.4	11.43	11.5	11.55	11.6
EURMXN	20.11	13.28	18.42	16.87	16.24	16.45	15.79	14.60	13.28	16.85	16.98	18.61	18.42	18.35	18.15	17.55	16.87	16.57	16.07	16.17	16.24

(1) Forecasts (2) End period
Figures are year-on-year percentage changes unless otherwise indicated

Source: BNP Paribas

Argentina: No Major Policy Changes in Sight

Activity: moderating but still strong

- Although still strong, growth looks to have slowed in Q3 affected by energy supply restrictions (which hurt industrial production the most). This negative impact is likely to have been cushioned by increasingly expansionary policies.
- This year's real GDP growth forecast has been raised to 8.5% due to a stronger-than-expected H1 performance according to official activity indicators. Still, we expect a clear moderation in growth in H2 2011 and 2012.
- The main spillover from the deterioration in the global outlook could be a significant decline in soft commodity prices. That said, our base case scenario does not pencil in a collapse in 2012, although this year's stellar gains are unlikely to be repeated. A decline in commodity prices would not only depress Argentina's trade surplus (directly) but also (indirectly) hurt growth through its negative impact on national income.

Inflation: no let-up in sight

- The pace of nominal wage growth accelerated to a whopping 29% in July. We expect wage and price pressures to remain high amid a context of expansionary macro policies.

Policy: no major changes expected

- Based on the results of the national primaries, President Cristina Kirchner is likely to be re-elected by a wide margin in the October presidential election. The government is likely to interpret this expected success as a sign that no major policy changes are needed.
- Fiscal performance is expected to continue to deteriorate until the year-end due to the election-related increase in primary spending and a growing subsidy bill (Chart 1). Energy-related subsidies are expected to exceed 3.0% of GDP this year (from 1.8% in 2010).
- Capital flight has accelerated and the supply of USD coming from the tradable sector has shrunk visibly in Q3 due to seasonal factors. Capital outflows are likely to remain high before the presidential election (scheduled to take place on 23 October). The central bank is expected to sell more than USD 2.0bn in the FX market in Q3 to alleviate nominal ARS depreciation pressure – which has nevertheless intensified (Chart 2).
- FX sales, coupled with loans to the Treasury to service hard currency-denominated debt, will translate into a decline in central bank reserves in 2011.

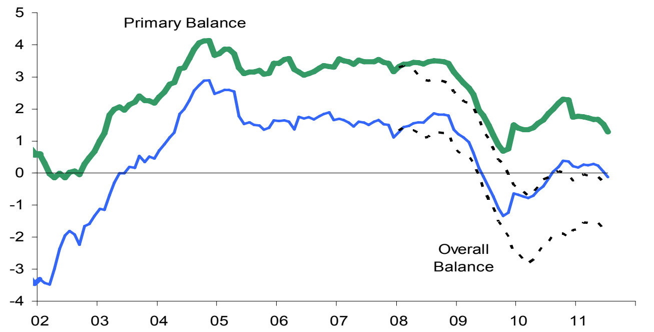
Argentina: Economic Forecasts

	2009	2010	2011 (1)	2012 (1)	2013 (1)
Real GDP (% y/y) (2)	0.9	9.2	8.5	3.5	3.5
CPI (% y/y) (2)	6.3	10.5	9.8	11.5	13.0
CPI (% y/y) (2)(3)	7.7	10.9	9.6	12.5	13.0
Trade Balance (USD bn)	16.9	12.1	8.5	3.0	1.0
Current Account (USD bn)	11.0	3.6	-1.4	-9.4	-11.5
Current Account (% GDP)	3.7	1.0	-0.3	-1.8	-2.0
Budget Balance (% GDP)	-0.6	0.2	-1.4	-1.7	-2.3
Primary Budget (% GDP)	1.5	1.7	0.2	-0.2	-0.7
Gross Gov. Debt (% GDP) (3)	48.6	44.8	39.2	35.5	35.0
Interest Rate (%) (3)	10.0	11.3	14.0	17.0	17.0
USDARS (3)	3.80	3.98	4.45	4.95	5.55

(1) Forecast (2) Official data (3) End period

Source: BNP Paribas

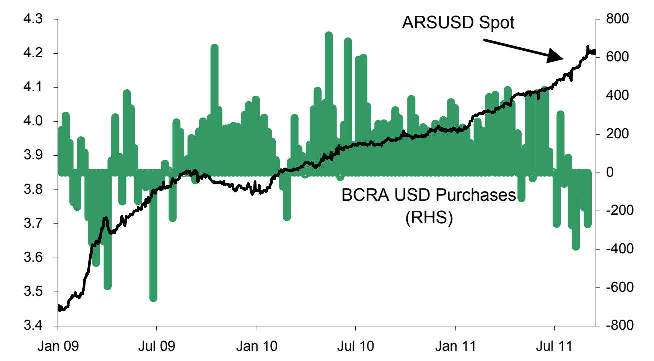
Chart 1: Fiscal Balance (12m sum, % of GDP)*



Source: BNP Paribas ** Dotted lines exclude intra-public sector transfers.*

The fiscal performance was fairly stable in H1 2011 but has deteriorated since. The decline is set to intensify as we approach presidential elections (scheduled for 23 October).

Chart 2: Spot FX Rate and BCRA Intervention



Source: Bloomberg, BCRA, BNP Paribas

USD purchases turned into sales in Q3 against the backdrop of a steady increase in capital outflows and a lower trade surplus.

- Beyond the usual uncertainty of election years, capital flight is also reflecting concerns about the peso's strong real appreciation. We expect the ARS to weaken faster and interest rates to rise further next year against a backdrop of little change in the policy mix.

Colombia: All Eyes on the Global Economy

Activity: growth is rapid, but set to decelerate

- The economy continues to grow at an above-trend pace supported by buoyant private consumption and investment.
- Despite strengthening global headwinds, the economy's momentum and an expected increase in public investment will support rapid growth well into Q4 2011.
- Nevertheless, we have lowered our 2011 growth forecast slightly from 4.9% to 4.7% due to deteriorating external conditions. The government expects growth to exceed 6.0% this year.
- According to our projections, the output gap is set to close this year.
- We expect growth to decelerate further in 2012 to reflect the lagged impact of weaker economic conditions abroad and tighter monetary conditions at home. We have revised down our 2012 growth forecast to 3.7%, 0.4pp below our previous projection and 1.1pp below the consensus view of 4.8%.

Inflation: subdued and within target

- Rapid growth in domestic demand has not resulted in generalised price pressures due to slack capacity in the economy.
- The central bank's pre-emptive, consecutive rate hikes in February-July have helped keep inflation and inflation expectations in check. The strengthening of the COP has also helped.
- We project inflation will end both 2011 and 2012 within the CB's target range of 3%±1pp.

Policy: in wait-and-see mode

- More monetary policy tightening is required to raise the policy rate close to neutral territory. Current inflation and inflation expectation levels indicate that real interest rates are about 1%, still below the 2.0-2.5% considered neutral for Colombia and below the ten-year average real rate of 1.5%.
- However, considerable uncertainties about the outlook for the global economy are making it difficult to assess the risks to growth and inflation in Colombia.
- Based on these considerations, the CB board shifted to a more cautious stance in August and opted to pause, as we had expected. The timing of the resumption of the tightening cycle will be data-dependent. We expect this pause to continue well into 2012.

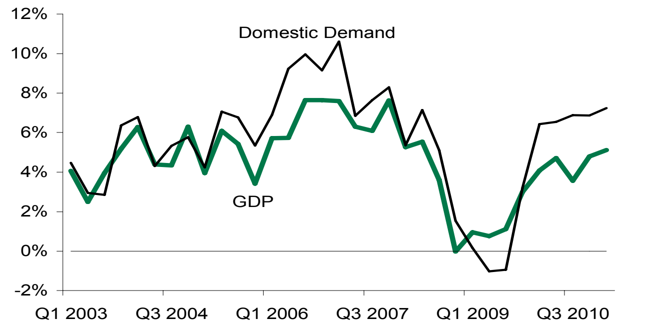
Colombia: Economic Forecasts

	2009	2010	2011 (1)	2012 (1)	2013 (1)
Real GDP (% y/y)	1.5	4.3	4.9	4.1	4.4
CPI (% y/y)	4.2	2.3	3.4	3.7	3.5
CPI (% y/y) (2)	2.0	3.2	3.6	3.9	3.7
Trade Balance (USD bn)	2.5	2.0	1.7	2.3	3.6
Current Account (USD bn)	-5.2	-9.0	-10.7	-11.1	-12.1
Current Account (% GDP)	-2.2	-3.1	-3.4	-3.3	-3.3
Budget Balance (% GDP)	-3.8	-3.6	-3.7	-3.9	-3.7
Primary Budget (% GDP)	0.2	0.3	0.2	-0.1	0.1
Gross Gov. Debt (% GDP) (2)	35.7	36.5	38.4	38.5	37.1
Interest Rate (%) (2)	3.50	3.00	4.50	5.00	5.50
USDCOP (2)	2040	1915	1780	1720	1735

(1) Forecast (2) End Period

Source: BNP Paribas

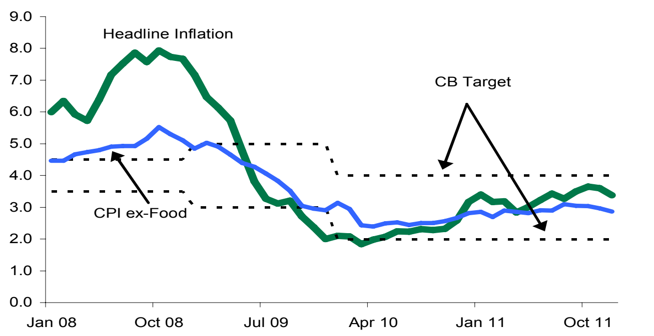
Chart 1: GDP and Domestic Demand Growth (y/y)



Source: Central Bank, BNP Paribas

Thanks to still-accommodative monetary policy and the abundant availability of credit, domestic demand has remained robust, supporting rapid GDP growth.

Chart 2: Inflation: Headline, Core and Target



Source: Central Bank, BNP Paribas

Inflation and inflation expectations remain anchored. Both headline and core inflation are within the CB's target range.

- The government is set to outperform its 2011 fiscal target (a deficit of 4.0% of GDP). The better-than-expected fiscal performance this year has been driven by faster revenue growth than anticipated thanks to more rapid economic growth and better collection of taxes.

Venezuela: Muddling Through

Activity: slow recovery

- President Hugo Chávez's poor health has increased uncertainty about the outcome of presidential election scheduled for 7 October 2012. That said, at the moment he still looks likely to be re-elected.
- The investment climate remains weak due to the risk of businesses being nationalised, high inflation, price distortions, political uncertainty, unpredictable FX policy and electricity shortages. As a consequence, private investment contracted 3.6% y/y in Q2 and 1.0% in H1.
- Private consumption, which accounts for slightly more than two-thirds of GDP, grew by only 3.1% y/y in H1 after a 1.9% y/y contraction in 2010.
- Faster public spending growth (6.7% y/y in H1) has not been enough to compensate for weak private sector spending. Coming out of a deep recession in 2009-2010, the economy rebounded by only 3.6% y/y in H1.
- Oil-financed increases in public spending will support moderate growth in the run-up to the 2012 elections even as the private sector retrenches. Electricity shortages and rising utility costs will further limit growth.

Inflation: high and rising

- Highly expansionary macroeconomic policies together with distortions created by widespread price controls and regulations will keep inflation high.
- Inflation reached 25.8% y/y in August, the highest in the region. We project inflation to rise to about 30% by end-2011 and increase further next year to reflect stepped-up public spending.

Policy: oil-financed and highly expansionary

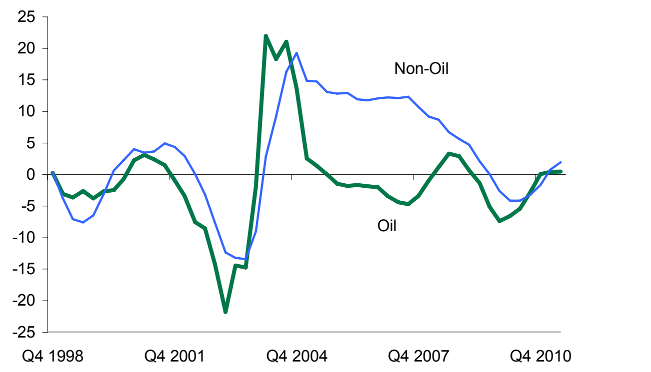
- The Chávez administration will continue to boost wages and public spending to prop up growth and political support in the run-up to elections next year. The government will finance its spending spree using oil revenues and by issuing additional debt.
- By setting an artificially low oil price in the budget, the government has created an oil windfall greater than had been expected in the budget. This "extraordinary revenue" is then transferred to Fonden (National Development Fund) and used to increase quasi-fiscal spending.

Venezuela: Economic Forecasts

	2009	2010	2011 (1)	2012 (1)	2013 (1)
Real GDP (% y/y)	-3.2	-1.5	3.3	1.4	0.5
CPI (% y/y)	30.5	28.7	27.4	34.2	29.2
CPI (% y/y) (2)	25.1	27.2	30.1	39.9	28.0
Trade Balance (USD bn)	19.2	27.2	41.5	44.6	36.0
Current Account (USD bn)	8.6	14.4	25.6	24.3	28.0
Current Account (% GDP)	2.5	6.9	11.9	11.2	7.0
Budget Balance (% GDP)	-6.5	-2.5	-6.5	-2.0	-3.5
Primary Budget (% GDP)	-4.6	-0.5	-4.4	-0.2	-1.7
Gross Gov. Debt (% GDP) (2)	12.8	14.0	17.3	18.3	19.2
Interest Rate (%) (2)	15.0	15.0	20.7	31.1	28.0
USDVEF	2.14	4.29	4.29	4.29	8.80

(1) Forecast (2) End Period
Source: BNP Paribas

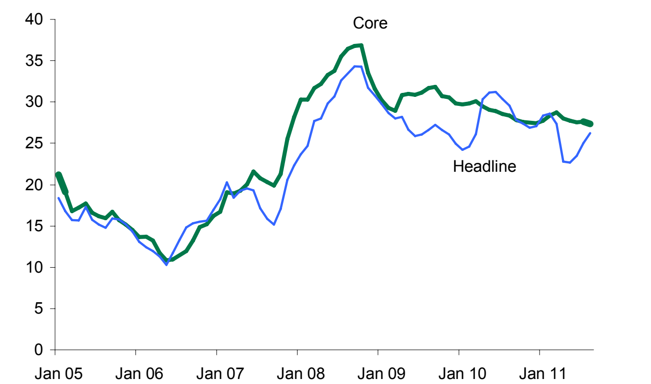
Chart 1: GDP by Activity (4Q/4Q, %)



Source: Reuters EcoWin, BNP Paribas

The economy is growing again after a long and deep recession, However, the private sector continues to retrench as the government asserts its control over the economy.

Chart 2: Venezuela: Headline vs. Food Prices (y/y)



Source: Reuters EcoWin, BNP Paribas

The government's expansionary monetary and fiscal policies are keeping inflation high even as the economy stagnates.

- Foreign exchange is made available through multiple sources (CADIVI, SITME and the black market) at different rates. This distortionary FX regime has high social welfare cost but suits the government's economic and political objectives.

Peru: New Countercyclical Action Likely

Activity: moderating

- Concerns about policy discontinuity have subsided as the new administration has affirmed its commitment to pursuing market-friendly policies.
- However, growth prospects have deteriorated due to less favourable external conditions. As a consequence, we have reduced our 2011 and 2012 growth projections to 6.1% and 5.4%, respectively.
- Private investment growth remained robust in Q2 2011, despite the greater political uncertainty. Strength in private sector expenditure more than offset the retrenchment in public spending, underpinning 6.6% y/y growth in Q2.
- Public spending was held back earlier this year due to the government's decision to prevent the economy from overheating. The timing of elections has also played a role by delaying expenditure.
- Strong credit and employment conditions bode well for continued robust consumption growth.
- We expect rising public spending and continued robust consumption to underpin strong, albeit moderating, growth this year.
- The resilience of domestic demand will limit the overall deterioration of economic activity as global growth slows.

Inflation: set to decline

- CPI inflation has risen sharply since the start of the year. Although much of this increase has been driven by rising food prices, core inflation has also increased.
- However, slowing food inflation and decelerating economic activity are likely to reduce inflation to below the 3% upper limit of the target range in 2012.

Policy: set to support growth

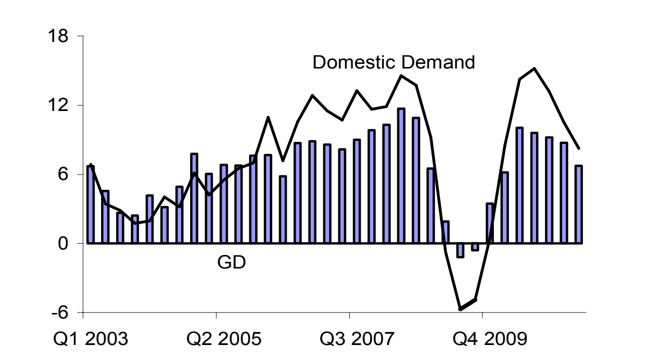
- The BCRP has signalled its readiness to cut rates this year should global conditions deteriorate further. Given that we envisage such a deterioration in the coming months, we think the BCRP could cut the policy rate by as much as 25bp in Q4.
- The government has substantial room to increase spending in H2 2011 without jeopardising its full-year primary surplus target of 1.5% of GDP. The delay in public spending resulted in a primary surplus of 4% of GDP in H1.
- The government is ready and able to launch a countercyclical loosening of fiscal policy should growth decelerate substantially.

Peru: Economic Forecasts

	2009	2010	2011 (1)	2012 (1)	2013 (1)
Real GDP (% y/y)	0.9	8.8	6.1	5.4	6.8
CPI (% y/y)	2.3	1.7	3.2	3.2	2.6
CPI (% y/y) (2)	0.3	2.1	4.0	2.7	2.4
Trade Balance (USD bn)	6.0	6.7	9.4	10.8	11.0
Current Account (USD bn)	0.2	-2.3	-1.9	-2.6	-3.0
Current Account (% GDP)	0.2	-1.5	-1.1	-1.3	-1.6
Budget Balance (% GDP)	-1.7	0.0	0.2	-1.1	-0.8
Primary Budget (% GDP)	-0.3	0.7	1.3	-0.2	-0.1
Gross Gov. Debt (% GDP) (2)	27.2	23.5	23.0	22.5	22.5
Interest Rate (%) (2)	1.25	3.00	4.00	4.25	4.75
USDPEN (2)	2.88	2.81	2.68	2.62	2.64

(1) Forecast (2) End Period
Source: BNP Paribas

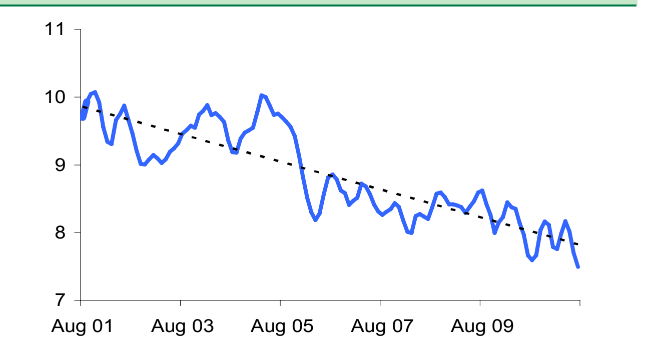
Chart 1: GDP vs. Domestic Demand (% y/y)



Source: BCRP, Reuters EcoWin, BNP Paribas

The strong performance of domestic demand has been a key driver of growth.

Chart 2: Unemployment Rate vs. Trend (s.a.)



Source: BCRP, Reuters EcoWin, BNP Paribas

Labour market conditions have improved significantly over the past decade, increasing consumers' purchasing power.

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