

NEWS & RUMOURS

- A unit of **EVN** in **Bulgaria** said yesterday that its parent company was in talks to acquire ENEL's majority stake in a coal-fired thermal power plant in Bulgaria
- **The Czech Republic's** central bank reported that the finance ministry sold CZK 6.5bn of 13-week treasury bills in yesterday's auction at an average yield of 0.84%
- A spokesman for **Hungary's** Prime Minister Orban said yesterday that the government would negotiate with both the EU and other multilateral organisations, including the IMF, over the size of the next year's budget deficit
- **Hungary's** economy minister Matolcsy said yesterday that the government would cut the budget deficit to below 3% of GDP in the coming years from the 3.8% of GDP targeted for this year
- **Poland's** labour minister Fedak said yesterday that the unemployment rate might stabilise in the next few months after an expected fall to 11.6% in June
- Fitch yesterday downgraded the rating of **Poland's Bank Millennium** to A- from A
- According to media reports, **Romania's** government has asked French energy group Areva to advise it on the location of the country's second nuclear power plant
- **Russia's** sugar producers' union said that Russia refined 1.8mn tonnes of white sugar from imported raw sugar in the year to July 19th, up 25.3% y/y
- **Russia's Uralkali** announced that its potash production was 2.4mn tonnes in H110, 2.1 times its size in H109
- **Russia's** central bank reported that it sold RUB 5.1bn of OBR bonds yesterday at an average yield of 3.95%
- **Russia's Petropavlovsk** announced that its gold production rose to 100.7k ozs in Q210 from 65.6k ozs in Q110
- **Ukraine's Agrarian Confederation** announced yesterday that the rapeseed harvest was likely to fall to around 1.5mn tonnes in 2010 from 1.8mn in 2009

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Focus on Russia:

- The rouble weakened slightly against the dual currency basket yesterday but we can see the currency strengthening in the next few sessions
- Nevertheless, we do not expect the rouble to appreciate significantly as we expect the CBR to intervene in the FX market, which should contribute to a further increase in official reserves

Focus on Turkey:

The latest twice-monthly expectations survey released by the CBRT yesterday showed yet another improvement in inflation expectations in the aftermath of the last set of benign inflation data in the early part of this month. The latest expectations survey has year-end inflation expectations at 7.69% y/y, down slightly from 7.73% y/y in the previous survey and recall that the June CPI came in lower than our better-than-consensus projection: -0.6% m/m, 8.4% y/y after a better-than-expected -0.4% m/m, 9.1% y/y reading in May.

Events/Data Calendar

Date	Cty	Data	For	IDEA	Mkt	Last
22/07	RU	Official reserves (USD bn)	16-Jul	469.3A	n/a	467.3
23/07	PL	Retail sales (% m/m)	June	1.5	1.7	3.1
	PL	Retail sales (% y/y)	June	4.5	4.2	4.3
	PL	Unemployment rate (%)	June	11.6	11.6	11.9
	TR	Foreign tourist arrivals (% y/y)	June	12.0	n/a	15.8



Hungary: The forint recovered slightly in the past few sessions after weakening sharply on Monday. Recall that the IMF and the EU over the weekend suspended a review of the EUR 20.0bn loan programme and said that, in order to achieve the 2010-11 budget deficit targets of 3.8% of GDP and 2.9% of GDP, respectively, the government needed to implement sustainable measures (like restructuring public enterprises) instead of reducing the salaries of senior NBH officials or imposing a special tax on the financial sector, worth HUF 187bn this year. In turn, economy minister Matolcsy said on Monday that the government would stick to its plans, adding that it was planning to resume talks with the international lenders in September and that further austerity measures were out of question.

While the economy ministry said on Wednesday that the pressure on the forint would disappear soon after the approval of the government's tax reforms by parliament, we continue to see a serious risk of the currency weakening further in the next few weeks in the absence of a new IMF-led package, which might force the government to come back to the lenders before the autumn and agree with their terms. Recall that, while we do not expect Hungary to default this year, we can see it defaulting in the medium-term due to high levels of its external debt and general government debt (170% of GDP and 79.6% of GDP, respectively, at the end of Q110).

In addition, **the 12-month treasury bill auction yesterday underscored the deterioration in sentiment** with the average yield at 5.75%, 15bps above the market yield and 32bps above the yield in the previous auction 2 weeks ago and the bid-to-cover ratio falling to 1.4 from 2.0 in the previous auction. **The auction has reinforced our view that the government will find it difficult to successfully finance the 2010 budget deficit, which we see exceeding its target of 3.8% of GDP.** In particular, we share the view of the Budget Council, which said on Wednesday that the planned special tax on the financial sector would improve the budget less substantially than the government expects as it would hurt the economy and other budget revenues both this year and in the next few years.

Poland: With today's data releases (June retail sales and unemployment, please see the forecast table) likely to confirm the robustness of the recovery, we would highlight the zloty's supportive fundamentals, bound to be enhanced by the high probability of monetary policy becoming more restrictive in the latter part of the year. Recall that the post-MPC meeting news conference last month was fairly hawkish with new NBP governor Belka stressing that the weaker zloty and higher volatility in the FX market

posed clear inflation risks despite the exchange rate being influenced by external global factors. Finance minister Rostowski also said earlier this week that the zloty's weakness was down to the depreciation of the euro and clouds hanging over Europe, not least the public debt issue.

It is worth remembering that just a few months ago senior officials were actually talking the currency down, including the late/former NBP governor Slawomir Skrzypek who said back in March that the zloty's appreciation was not justified by fundamentals. And both Mr Rostowski and deputy PM/economy minister Pawlak tried to talk down the currency, the finance minister stressing that there was no reason for it to strengthen and the economy minister saying that it would be beneficial to avoid a significantly stronger currency. At the time, several MPC members also expressed concern over the risk of marked currency appreciation with respect to the fragile recovery.

Recently, we have been paying more attention to the official reserves in light of comments stressing that the reserves were sufficient to defend the zloty should the need arise. The reserves were down slightly at EUR 69.97bn at end-June after the May data showed them increasing to EUR 70.29bn from EUR 66.52bn in April but there has been no direct FX intervention in support of the zloty in recent months. This is likely to remain the case for as long as the zloty stays under EUR/PLN 4.20 and we still see the zloty largely trading within our predicted range of EUR/PLN 3.80-4.00, which we see pretty much holding until ERM-2 entry bar temporary bouts of weakness such as recently.

Despite mixed messages in the last few months, we still think that the long-term goal of euro-zone accession is very much on the agenda (but PM Donald Tusk has said that contagion from the debt crisis was likely to delay euro adoption). We have been arguing that 2015 is a sensible target for euro-zone accession but the updated convergence programme does not set an explicit target date. But slippage in the non-existent timetable is inevitable with excuses at the ready, the euro-zone public debt crisis being the most immediate. One obvious way of anchoring the exchange rate would be to enter the ERM-2 exchange rate mechanism but we see this as a non-starter for quite some time, occasional rhetoric notwithstanding (the fact that ERM-2 entry was meant to have taken place last year has long been forgotten). We still see the zloty's eventual ERM-2 central parity being set close to EUR/PLN 4.00 given the high external debt burden and especially the exposure of the household sector to it. And we think that the EU authorities, reluctant to allow a considerably undervalued zloty to be locked in, would support such a stance.

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Technical Strategy**EUR/CZK: Bears now focused on 2500****Major Trend:** Neutral**R3:** 25920****R2:** 25620****R1:** 25400****Minor Trend:** Neutral**S1:** 24960****S2:** 24800****S3:** 24580**

(25.170) Weight remains with bears with focus now on 2499/96. Break risks further weakness to 2481/80 followed by 2458. Resistance is in 2530/40 area. Above 2562 turns the tide targeting 2592 next ahead of 2605.

EUR/HUF: Unwinding the strong bounce higher**Major trend:** Neutral**R3:** 294.25****R2:** 290.00****R1:** 286.25****Minor trend:** Neutral**S1:** 278.00****S2:** 272.25****S3:** 269.50**

(284.09) Strong bounce higher after the downside test through 278 support. Traded through resistance at 286.25 and watch further resistance now at 290.00 through 294.25. Support back at 278.00 through to 272.25.

EUR/PLN: Market churning**Major Trend:** Neutral**R3:** 43000****R2:** 42440****R1:** 41780****Minor Trend:** Neutral**S1:** 40150****S2:** 39850****S3:** 39420**

(4.0950) Market continues to churn. Break of 4015 risks deeper setback but look for support in 3985/3942 area to hold for renewed upturn. Above 4178 signals upside resolution targeting 4244 next ahead of 4294.

USD/TRY: Breaking lower and watch 1.5290/1.5135 support**Major Trend:** Neutral**R3:** 1.6500****R2:** 1.6285****R1:** 1.5935****Minor Trend:** Neutral**S1:** 1.5290****S2:** 1.5135****S3:** 1.5000*

(1.5240) Strong push higher after the test down to support at 1.5525 and reached a high of 1.5933 before losing that impetus. Tracking lower and through support at 1.5525 and look for further levels now at 1.5290 through 1.5135. Resistance now at 1.5933 through to 1.6285.


IDEAglobal Focus on Russia

While the rouble weakened slightly against the dual currency basket yesterday after appreciating in the previous few sessions, **we can see the currency strengthening in the next few sessions**, helped by the ongoing tax payment period. Recall that excise and mineral resource extraction tax remittances are due to leave the system next Monday and corporate income tax - next Wednesday.

Nevertheless, **we do not expect the rouble to appreciate significantly** as we expect the CBR to intervene in the FX market, which should contribute to a further increase in official reserves. Recall that data yesterday showed the reserves rising for the 2nd successive week in the week to July 16th, by USD 2.0bn to USD 469.3bn, driven by positive currency valuation changes.

Russian Market Monitor									
FX Market					FX market turnover (MICEX USD mn)				
	1 day change	1wk	1m	YTD	Y-day	1-week average	1-month average	Spot USD/RUB	
Dual basket *	-0.13	0.23	-0.76	4.98	9336.9	9388.3	9337.5	30.41	
NEER **	-0.19	0.12	-1.45	5.28					
Money Market									
	USD/RUB NDF outright	USD/RUB onshore fwds outright	Balance of CBR transactions (in RUB bn)		o/w rev repo change	o/w deposit change	o/w repo change	o/w unsecured loans change	residual***
1m	30.48	30.46	Y-day	227.4	0.0	55.6	-0.4	0.0	172.2
3m	30.63	30.61	21/07/2010	167.8	0.0	17.1	-0.4	-3.5	154.7
6m	30.91	30.90	20/07/2010	136.7	0.0	19.0	-0.5	0.0	118.2
12m	31.55	31.50	19/07/2010	119.5	0.0	2.4	-0.5	0.0	117.6
Bond Market									
OFZ benchmarks (% yield)						Turnover in government securities & the money market (MICEX USD mn)			
Series	Maturity	Y-day	-2 days	1wk ago	1m ago	Y-day	1-week average	1-month average	
OFZ 25066	06/07/2011	4.28	4.41	4.30	4.39				
OFZ 25069	19/09/2012	5.72	5.85	5.93	5.82	3300.1	2689.0	2656.4	
OFZ 26202	17/12/2014	6.73	6.76	6.87	6.91	Government bond index (MICEX RGBI) % change			
OFZ 46014	29/08/2018	7.11	7.11	7.08	6.86	Y-day	w/w	m/m	
OFZ 46020	06/02/2036	7.54	7.54	7.54	7.43	0.05	0.04	-0.25	
Sub-sovereign benchmarks (% yield)									
MOSZ 39	21/07/2014	7.22	7.37	7.37	7.18	Corporate bond index (MICEX CBI CP) % change			
MOSZ 44	24/06/2015	7.47	7.52	7.41	7.61	Y-day	w/w	m/m	
* Daily FX target ** Operational FX target *** Residual here can be taken as proxy for daily CBR FX market intervention						0.00	-0.02	-0.02	

 IDEAGlobal Focus on Turkey**News and Views:**

- Parliament yesterday passed a law reforming Turkey's juvenile justice system in line with demands from Europe and children will no longer be prosecuted under anti-terror legislation but will be dealt with by juvenile courts and the minimum sentence for anyone taking part in illegal protests has been reduced to six months from 18 months
- Turkish Airlines has said that it would set up a maintenance and repair joint-venture with Zorlu Enerji to be 50%

The latest twice-monthly expectations survey released by the CBRT yesterday showed yet another improvement in inflation expectations in the aftermath of the last set of benign inflation data in the early part of this month. The latest expectations survey has year-end inflation expectations at 7.69% y/y, down slightly from 7.73% y/y in the previous survey and recall that the June CPI came in lower than our better-than-consensus projection: -0.6% m/m, 8.4% y/y after a better-than-expected -0.4% m/m, 9.1% y/y reading in May and 0.6% m/m, 10.2% y/y in April with the PPI printing -0.5% m/m, 7.6% y/y in June and year-to date CPI inflation in the first half of the year thus slowing to 3.6% from 4.2% in May. Year-end inflation expectations were 8.01% y/y a month ago; 8.10% y/y a month-and-a-half ago; 8.60% y/y two months ago; 8.57% y/y two-and-a-half months ago; 8.15% y/y three months ago; 8.06% y/y four months ago but still higher than the 7.55% y/y five-and-a-half months ago and 7.15% y/y six-and-a-half months ago. We continue to see the 6.5% year-end inflation target being missed by around 1.5pps, not least because of the strong recovery in the economy. And consensus expectations of inflation in 12 months' time have also moderated further and are now at 7.20% y/y after 7.24% y/y in the previous survey and 7.35% y/y a month ago; 7.48% y/y two months ago; 7.58% y/y two-and-a-half months ago after staying at around 7.22% y/y for a couple of months having been at 6.91% y/y five-and-a-half months ago; 6.79% y/y six-and-a-half months ago and 6.23% y/y eight-and-a-half months ago.

There has been no change to this year's GDP growth outlook after a series of upward revisions with the consensus still projecting 5.4%, the same growth rate as in the previous survey after 5.2% a month ago; 5.1% a month-and-a-half ago; 4.8% two months ago; 4.6% two-and-a-half months ago; 4.4% three months ago and 3.9% in the preceding five surveys. Not that long ago we revised up our projection and are now looking for 6.0% (5.0% previously) given the robustness of the recovery in recent months. However, it is worth remembering how last year expectations adjusted repeatedly to the marked deterioration in the real economy but only very gradually: GDP in 2009 was seen at -5.6% around eight months ago, contrasting with consensus projections of -4.0% about a year ago and 1.1% in early January 2009. Reflecting the stronger economic recovery and thus higher imports, the consensus forecast for the current account deficit in 2010 has also increased repeatedly, to USD 31.90bn in the latest survey from USD 31.71bn in the previous one; USD 31.05bn a month ago; USD 29.68bn a month-and-a-half ago; USD 28.78bn two months ago; USD 28.14bn two-and-a-half months ago; USD 25.79bn three months ago; USD 25.40bn four months ago; USD 23.37bn four-and-a-half months ago; USD 22.58bn five-and-a-half months ago and USD 21.67bn six-and-a-half months ago. Further deterioration in the projection for the current account deficit is inevitable despite the May current account data being a bit better than our projection, the balance coming in at USD -3.0bn (it was USD -1.7bn a year earlier) after USD -4.4bn in April and USD -4.3bn in March.

The currency remains our biggest point of disagreement with the consensus, which expects the lira to weaken from current levels by year-end, to 1.57 to the dollar, the same cross-rate as in the previous survey, after projecting 1.58 in the previous two surveys and 1.56 two months ago; 1.54 two-and-a-half months ago; 1.55 three months ago and 1.54 six-and-a-half months ago while for quite some time we have held the view that the lira would be trading in a 1.45-1.50 range by year-end because of its carry and the stronger recovery, albeit with greater volatility in the interim, and we still see the lira at under 1.50 by year-end. The last six months have also seen a number of shifts in the assessment of the interest rate cycle with the hitherto volatile projection becoming more dovish. Interest rate expectations have been dropping again, having risen after declining significantly: the consensus is now looking for an overnight rate of 7.79% in 12 months' time after 7.95% in the previous survey; 8.17% a month ago; 8.21% a month-and-a-half ago; 8.51% two months ago; 8.53% two-and-a-half months ago; 8.50% three-and-a-half months ago; 8.33% four-and-a-half months ago and 8.18% five-and-a-half months ago (and 9.56% just over a year ago) and we are now looking for around 8.00% as we see monetary tightening starting towards the end of Q111. Interest rates have been on hold since the 25bp rate cut last November (which took the borrowing/lending rates down to 6.50%/9.00%, respectively, following successive 50bp cuts last June, July, August and September, with total easing since November 2008 amounting to 1025bps) and there has been a 'technical' rate adjustment with the one-week repo rate becoming the key policy rate, kept at 7.00% as part of the central bank's exit strategy, the central bank is very unlikely to start tightening before next year.