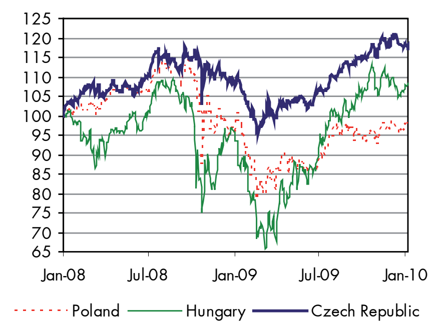
CEE Weekly
Bond Markets Outlook

Issue 1/2010

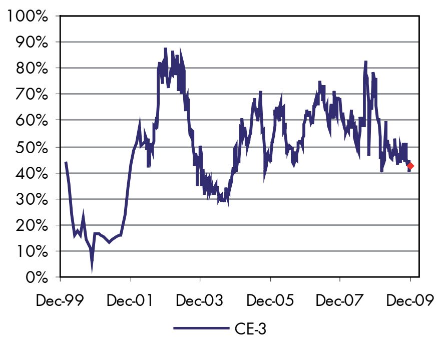
8 January 2010

Performance of 7-10y bond indices



Source: EFFAS, Bloomberg, Raiffeisen RESEARCH

RZB Convergence Index



Composite (GDP-weighted) index for PL, HU, CZ & SK
Source: Thomson Reuters, Raiffeisen RESEARCH

Forecast

	current	Mar-10	Jun-10	Sep-10
Poland				
PLN	4.11	4.20	3.80	3.75
1m-rate	3.5	3.6	3.6	3.8
5y bond	5.8	5.7	5.7	5.9
10y bond	6.1	6.5	6.2	6.3
Hungary				
HUF	269.3	285.0	275.0	275.0
1m-rate	6.3	5.9	5.8	5.7
5y bond	7.1	6.8	6.6	6.4
10y bond	7.4	7.1	6.9	6.6
Czech Rep.				
CZK	26.4	25.8	25.4	24.8
1m-rate	1.0	1.2	1.1	1.3
5y bond	3.2	3.3	3.3	3.7
10y bond	4.1	4.2	4.1	4.4
Romania				
RON	4.2	4.3	4.3	4.2
1m-rate	8.0	9.8	8.0	7.3
5y bond	9.1	9.4	9.1	8.4
10y bond	9.1	8.3	8.1	7.8
USD	1.43	1.45	1.50	1.45

Currencies per 1 EUR
Source: Thomson Reuters. Raiffeisen RESEARCH

Recommendations (1-month horizon)

Buy PLN bonds; Sell HUF bonds; Neutral CZK bonds; Buy RON bonds

Highlights

- ***Poland*** – As the Ministry is offering mostly shorter bonds, we reckon that spreads between the 10-year and 2-year benchmark will decline in the months to come. This may occur mainly in the form of a slow but systematic rise of 2-year bond yields.
- ***Hungary*** – Upcoming macro data should reinforce the view that the Hungarian economy is emerging very slowly from the worst of the recession. Inflation is continuously creeping upward, reaching a plateau of around 6% yoy in December–January.
- ***Czech Republic*** – The Czech koruna has seen high intraday volatility recently, fluctuating between EUR/CZK 26.40 and 26.10. Yields on 10-year government bonds have increased dramatically to above 4.20.

Key upcoming events and data releases

Country	Indicator	Period	Forecast		Range	Last
11-Jan						
HU	Trade balance	Nov	450.0	EUR mn	298/450/500	471.0
CZ	CPI, mom	Dec	1.0	%	0.9/1.0/1.0	0.2
CZ	CPI, yoy	Dec	0.2	%	0.1/0.2/0.2	0.5
CZ	Unemployment rate	Dec	9.3	%	9.0/9.3/9.3	8.6
HR	PPI, yoy	Dec	1.3	%	n.a.	0.2
12-Jan						
RO	CPI, yoy	Dec	4.8	%	n.a.	4.7
HR	Retail sales, yoy	Nov	-13.0	%	n.a.	-15.4
RU	Trade balance	Nov	12.5	USD bn	7.0/11.2/14.0	11.1
13-Jan						
CZ	Retail sales, yoy	Nov	3.0	%	-4.0/-1.0/3.0	-4.7
RO	Industrial output, yoy	Nov	n.a.	%	n.a.	-1.5
14-Jan						
PL	CPI, yoy	Dec	3.6	%	n.a.	3.3
PL	Money supply (M3), yoy	Dec	7.2	%	n.a.	7.9
HU	CPI, yoy	Dec	5.7	%	4.9/5.7/5.9	5.2
CZ	Industrial output, yoy	Nov	0.2	%	n.a.	-7.2
HR	CPI, yoy	Dec	2.8	%	n.a.	1.8
15-Jan						
PL	Current account balance	Nov	-1635.0	EUR mn	n.a.	-991.0
CZ	PPI, yoy	Dec	-0.7	%	-1.0/-0.9/-0.7	-2.4
CZ	Current account balance	Nov	13.0	CZK bn	-7.2/-1.5/13.0	12.4

Bond auctions

		ISIN	Coupon	Maturity	Volume
13-Jan					
CZ	10y T-bond reopening	CZ0001002471	5.00%	11 Apr 2019	CZK 7 bn
14-Jan					
HU	3y T-bond	HU0000402466	7.50%	24 Oct 2013	HUF 25 bn
HU	5y T-bond	HU0000402268	8.00%	12 Feb 2015	HUF 15 bn
HU	10y T-bond	HU0000402433	6.50%	24 Jun 2019	HUF 10 bn

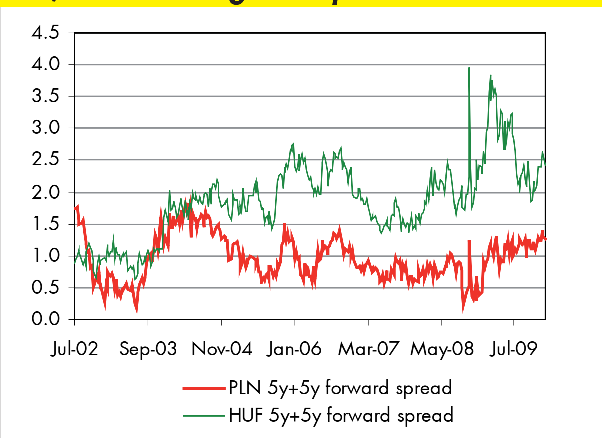
Local currency bonds
Market overview

CEE local currency bond market snapshot

07/01/2009	Maturity	Coupon %	Ask price	YTM %	Spread to bunds (bp)	MDuration
			Poland			
PLN 2y Gov. Bond	25/ Jul 12	0.00	88.14	5.11	383	2.5
PLN 5y Gov. Bond	25/ Apr 15	5.50	98.70	5.79	338	4.6
PLN 10y Gov. Bond	25/ Oct 19	5.50	95.45	6.13	275	7.7
PLN 20y Gov. Bond	25/ Apr 29	5.75	95.79	6.13	204	11.5
			Hungary			
HUF 3y Gov. Bond	24/ Oct 13	7.50	101.51	7.02	525	3.4
HUF 5y Gov. Bond	12/ Feb 15	8.00	103.08	7.25	484	4.1
HUF 10y Gov. Bond	24/ Jun 19	6.50	93.08	7.54	416	7.0
HUF 15y Gov. Bond	24/ Nov 23	6.00	87.70	7.45	347	9.4
			Czech Republic			
CZK 2y Gov. Bond	5/ Oct 11	6.55	108.95	1.28	1	1.7
CZK 5y Gov. Bond	11/ Apr 15	3.80	102.75	3.22	81	4.7
CZK 10y Gov. Bond	11/ Apr 19	5.00	106.15	4.18	80	7.4
CZK 15y Gov. Bond	25/ May 24	5.70	109.25	4.79	82	10.1
			Slovakia			
SKK 2y Gov. Bond	4/ May 12	0.00	94.67	2.40	113	2.3
SKK 5y Gov. Bond	11/ Feb 14	4.90	106.40	3.20	79	3.7
SKK 10y Gov. Bond	12/ May 19	5.30	109.94	4.00	62	7.5
			Croatia			
HRK 5y Gov. Bond	11/ Jul 13	4.50	95.53	5.93	321	3.2
HRK 10y Gov. Bond	8/ Feb 17	4.75	91.53	6.25	287	5.9
			Romania			
RON 3y Gov. Bond	25/ Oct 10	6.00	97.48	9.41	764	0.8
RON 5y Gov. Bond	5/ Mar 12	6.50	94.67	9.34	693	2.0
			Turkey			
TRY 2y Gov. Bond	3/ Aug 11	0.00	87.58	8.83	755	1.6
TRY 5y Gov. Bond	6/ Aug 14	11.00	103.75	10.20	779	3.7

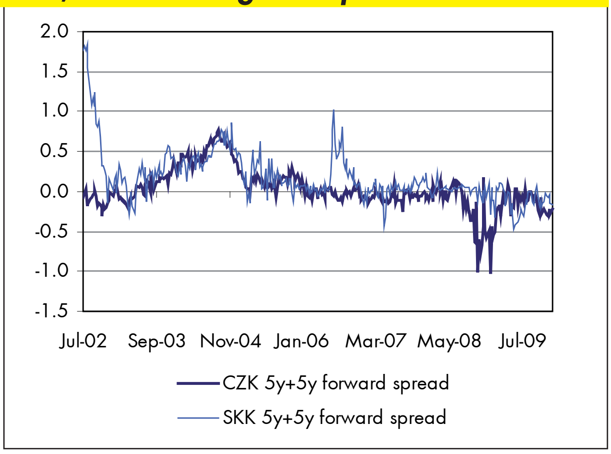
Source: Thomson Thomson Reuters, Raiffeisen RESEARCH

PLN, HUF convergence spread



Source: Thomson Thomson Reuters, Raiffeisen RESEARCH

CZK, SKK convergence spread



Source: Thomson Thomson Reuters, Raiffeisen RESEARCH

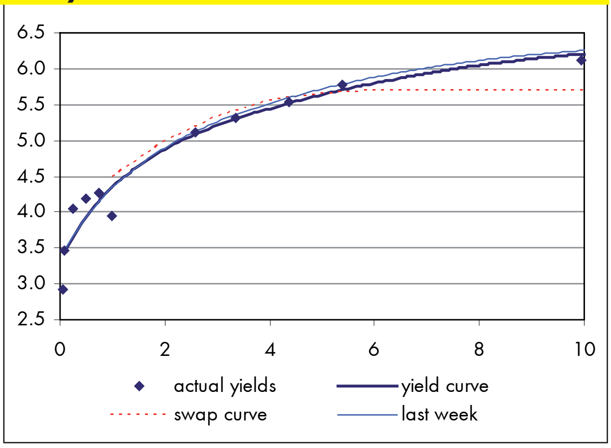
Poland

Short-term bonds to be offered

(P)review of key economic figures/events

14 Jan 10	CPI, % yoy	Dec 3.6 (Nov 3.3)
14 Jan 10	Money supply (M3), % yoy	Dec 7.2 (Nov 7.9)
15 Jan 10	Current account balance, EUR mn	Nov -1635 (Oct -991)

PLN yield curve



Source: Thomson Reuters, Raiffeisen RESEARCH

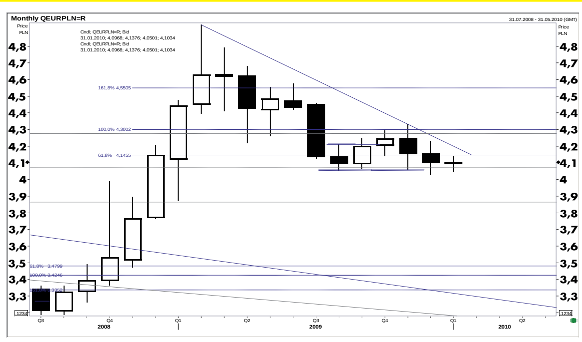
Money market focus

MM rates	***1m***	***3m***	***6m***	***12m***
Actual	***3.46***	***4.05***	***4.18***	***4.33***
Change from last week	-0.09	-0.01	0.03	0.02
Forecast Mar-10	3.60	4.15	4.22	4.50
Forward rates	***3x6***	***6x9***	***9x12***	
	4.34	4.43	4.44	
Change from last week	0.07	0.00	0.02	

Bond market focus

	2y	***5y***	***10y***	***20y***
Actual	***5.11***	***5.79***	***6.13***	***6.13***
Change from last week	-0.03	-0.09	-0.13	-0.07
Forecast Mar-10	5.20	5.70	6.50	6.40
Spread to bunds	***383.2***	***337.6***	***274.9***	***203.6***
Change from last week	-7.6	-24.2	-12.6	-19.4
Spread to swaps	***-11.1***	***-6.9***	***-38.5***	

EUR/PLN



Last: 4,11 sell 4.05 target;: 3.95 - 3.89
Rectangle and downward-trend, the latter to prevail and 4.00 -> 3.93 - 3.85 to follow.

Source: Thomson Reuters, Raiffeisen RESEARCH

Market strategy

Buy PLN T-bonds

Market comment

There has been no economic data published recently that could influence the bond market in Poland. In December, we witnessed a modest increase in yields in all the bond segments, most likely due to the liquidity needs of Polish banks at the end of the year. If this is the case, this move should be restrained in the coming weeks.
This week, the Ministry of Finance released a statement regarding the supply of bonds in the first quarter of 2010. In this period, PLN 26 bn in government paper will be offered. The Ministry is expecting PLN 4-8 bn to be offered in January, mostly concentrated on the shorter end of the yield curve. The supply of bonds has not scared off market participants, at least for the moment.

Market outlook

We currently do not expect major moves on the Polish bond markets. As the Ministry is offering mostly shorter bonds, we reckon that spreads between the 10-year and 2-year benchmark will decline in the months to come. This may occur mainly in the form of a slow but systematic rise of 2-year bond yields. For now, however, we would still stick to bonds with maturities of up to 2 years. The longer end of the curve is offering slightly higher potential returns, but it is also generating risk, which demands constant attention and may be too high for conservative investors.

Analyst: Marcin Grotek (+48 22 585 29 44)

Exchange rate focus

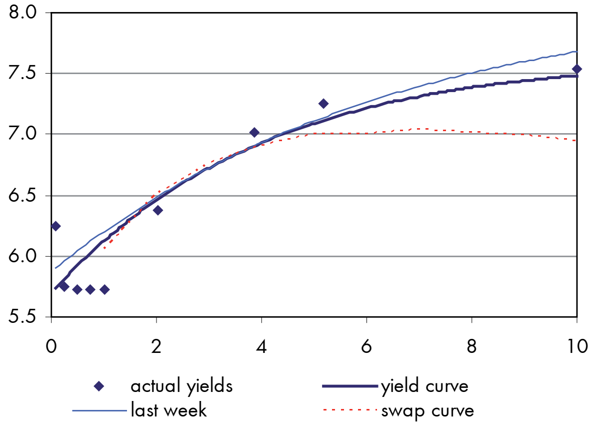
	actual	***Mar-10***	***Jun-10***	***Sep-10***
EUR/PLN	***4.11***	***4.20***	***3.80***	***3.75***
Change from last week	1.8%			
USD/PLN	***2.86***	***2.90***	***2.53***	***2.59***
Change from last week	2.1%			

Hungary
How good is the good budget data?

(P)review of key economic figures/events

08 Jan 10	Industrial output, % yoy	Nov -7.0 (Oct -12.9)	Figure was in line with expectation
11 Jan 10	Trade balance, EUR mn	Nov 450 (Oct 471)	
14 Jan 10	CPI, % yoy	Dec 5.7 (Nov 5.2)	

HUF yield curve



Source: Thomson Reuters, Raiffeisen RESEARCH

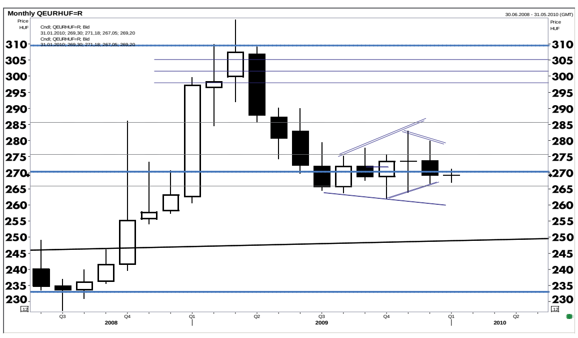
Money market focus

MM rates	***1m***	***3m***	***6m***	***12m***
Actual	***6.25***	***6.16***	***6.10***	***6.01***
Change from last week	0.00	-0.04	-0.07	-0.07
Forecast Mar-10	***5.9***	***5.8***	***5.7***	***5.8***

Bond market focus

	3y	***5y***	***10y***	***15y***
Actual	***7.02***	***7.25***	***7.54***	***7.45***
Change from last week	-0.08	-0.10	-0.16	-0.17
Forecast Mar-10	6.6	6.8	7.1	7.0
Spread to bunds	***524.8***	***484.1***	***416.1***	***347.3***
Change from last week	-36.5	-25.0	-30.6	-32.4

EUR/HUF



Last: 269.20 sell 266.80 target: 265.80 - 264
Diamond-pattern as expected, now either 271.50 -> 274 or bearish confirmation at 266.80 - 250 (med-term).

Source: Thomson Reuters, Raiffeisen RESEARCH

Market strategy

Sell HUF T-bonds

Market comment

EUR/HUF is hovering slightly below the 270 mark amidst poor trading activity at the beginning of the year. There is nothing spectacular going on locally or even regionally, and Greece's sorrows currently do not have the power to move the market. Yields on Hungarian government bonds are cautiously moving southwards, propelled by some remaining buy calls, but again neither the speed nor the level of activity is worth noting.

In the December budget data published by the Ministry of Finance, there was a surplus of HUF 205 bn. This put the cash-based central budget deficit for the year as a whole at 3.6% of GDP, lower than the planned level of 3.8%. Apparently, the Bajnai government's crisis management was fairly successful – even though we suspect that the ministry did some small-scale juggling with the figures.

Market outlook

Upcoming macro data should reinforce the view that the Hungarian economy is emerging very slowly from the worst of the recession, with industry output declining by 7% yoy and the trade surplus expected to remain massive (EUR 450 mn) in November. On the other hand, inflation is continuously creeping upward, reaching a plateau of around 6% yoy in December–January. This leaves the monetary council with one less argument in favour of further rate cuts. Nevertheless, the next rate setting meeting is still far away (31 January). In the meantime, we believe that there is really no reason for the current market optimism to continue. We expect HUF to weaken, and we therefore suggest buying EUR against HUF.

Analyst: Zoltán Török (+36 148 44 843)

Exchange rate focus

	actual	***Mar-10***	***Jun-10***	***Sep-10***
EUR/HUF	***269.32***	***285.0***	***275.0***	***275.0***
Change from last week	1.6%			
USD/HUF	***187.65***	***196.6***	***183.3***	***189.7***
Change from last week	1.8%			

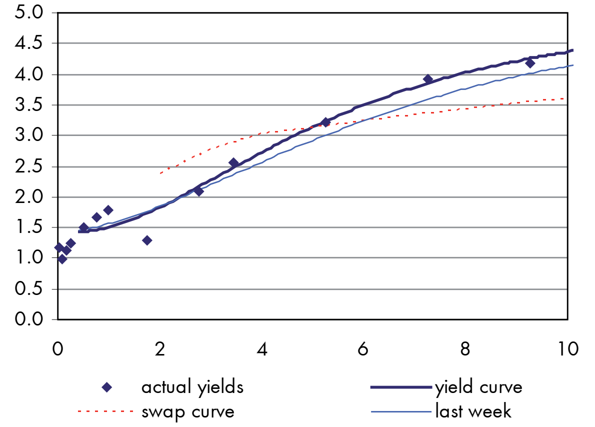
Czech Republic

2009 fiscal deficit worse than expected

(P)review of key economic figures/events

11 Jan 10	CPI, % yoy	Dec 1.0 (Nov 0.2)	Food prices should have boosted inflation
11 Jan 10	Unemployment, %	Dec 9.3 (Nov 8.6)	Recession to cause year-end rise in unemployment
13 Jan 10	Retail sales, % yoy	Nov 3.0 (Oct -4.7)	A jump in car sales should have swung retail sales into plus

CZK yield curve



Source: Thomson Reuters, Raiffeisen RESEARCH

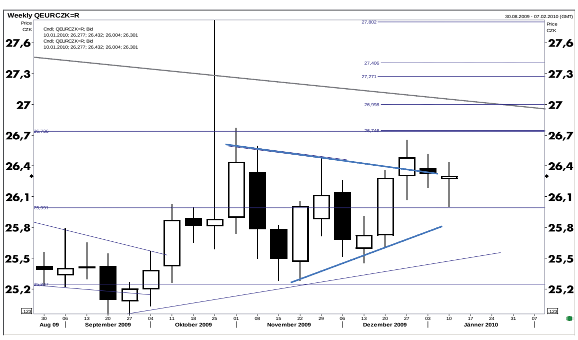
Money market focus

MM rates	***1m***	***3m***	***6m***	***12m***
Actual	***0.98***	***1.25***	***1.50***	***1.79***
Change from last week	-0.04	0.00	-0.02	-0.01
Forecast Mar-10	1.2	1.3	1.4	1.8
Forward rates	***1x2***	***3x6***	***6x9***	***9x12***
	1.27	1.76	2.01	2.14
Change from last week	0.00	-0.04	0.07	-0.07

Bond market focus

	2y	***5y***	***10y***	***15y***
Actual	***1.28***	***3.22***	***4.18***	***4.79***
Change from last week	-0.12	0.12	0.31	0.24
Forecast Mar-10	1.8	3.3	4.2	4.7
Spread to bunds	***0.7***	***81.1***	***80.3***	***81.5***
Change from last week	-22.1	-6.4	16.0	8.5
Spread to swaps	***125.1***	***5.1***	***-40.9***	***n.a.***

EUR/CZK



Last: 26.28 position: neutral
Triangle, bullish confirmation would be: 26.75 -> 27 - 27.50, stop 25.95 -> 25.20

Source: Thomson Reuters, Raiffeisen RESEARCH

Market strategy

Neutral CZK T-bonds

Market comment

The Czech koruna (CZK) has seen high intraday volatility recently, fluctuating between EUR/CZK 26.40 and 26.10. Yields on 10-year government bonds have increased dramatically to above 4.20, already putting them at our forecast target for Q1. The 2009 trade balance surplus exceeded CZK 150 bn in November. In contrast to this favourable performance, public finances are in a worse shape than expected. The MoF used almost CZK 32 bn of its reserves to decrease the budget deficit for 2009. Therefore, the state budget deficit was actually not CZK 192 bn as officially announced this week, but CZK 224 bn. With a deficit of around CZK 30 bn in regional and local budgets, health insurance, etc., the ESA-95 fiscal deficit was around CZK 254 bn, or 6.9 % of GDP (in line with our estimate). On the other hand, the 2010 deficit projection of 5.2% of GDP represents a fairly serious fiscal consolidation. In December, Standard and Poor's confirmed it's rating of the Czech Republic's long-term foreign currency liabilities at "A" with a stable outlook.

Market outlook

The Czech National Bank's (CNB) key rate is at a new all-time low and we do not believe that any more cuts are possible. Instead, we expect the CNB to remain on hold in H1, and to start a rate-hiking cycle in Q3 2010. We believe that the CNB will not perform any pre-emptive hikes if economic performance does not improve. Fiscal considerations and the parliamentary elections scheduled for May could have a significant impact on the CZK and bond yields. We see the key risk to our forecast scenario in a possible repeat of the election stalemate seen in 2006.

Analysts: Pavel Mertlik (+420 221 141 800)
Walter Demel (+43 1 71707 1526)

Exchange rate focus

	actual	***Mar-10***	***Jun-10***	***Sep-10***
EUR/CZK	***26.35***	***25.8***	***25.4***	***24.8***
Change from last week	0.1%			
USD/CZK	***18.35***	***17.8***	***16.9***	***17.1***
Change from last week	0.0%			

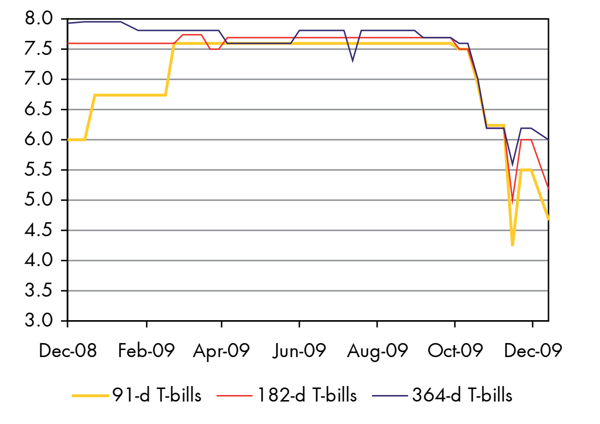
Croatia

Economic decline slows in Q3

(P)review of key economic figures/events

11 Jan 10	PPI, % yoy	Dec 1.3 (Nov 0.2)
12 Jan 10	Retail trade, real, % yoy	Nov -13.0 (Oct -15.4)
14 Jan 10	CPI, % yoy	Dec 2.8 (Nov 1.8)

Interest rates on T-bills



Source: Thomson Reuters, Raiffeisen RESEARCH

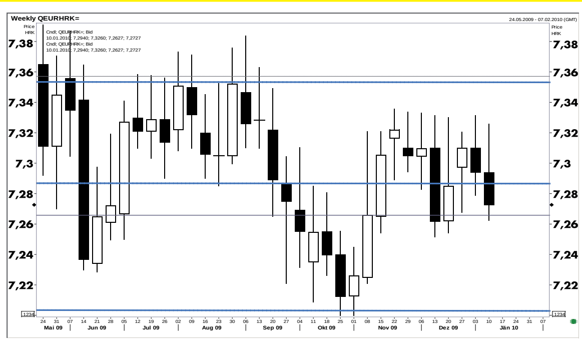
Money market focus

	1m	3m	6m	12m
ZIBOR actual	***1.83***	***3.67***	***5.67***	***6.25***
Change from last week	-0.82	-0.60	0.41	0.08
T-bills actual	***n.a.***	***4.70***	***5.20***	***5.99***

Exchange rate focus

	actual	Mar-10	Jun-10	Sep-10
EUR/HRK	***7.292***	***7.50***	***7.40***	***7.40***
Change from last week	0.2%			
USD/HRK	***5.06***	***5.17***	***4.93***	***5.10***
Change from last week	1.1%			

EUR/HRK



Last: 7.27 position: short target: 7.20
Bearish confirmation 7.2490 -> 7.2340 - 7.20 is likely to follow as 7.34 withstands.

Source: Thomson Reuters, Raiffeisen RESEARCH

Market strategy

Neutral EUR/HRK

Market comment

The final data released by the Central Bureau of Statistics confirmed the expected slowdown in the decline of GDP in the third quarter of 2009. In Q3, GDP fell by 5.7% in real terms compared to the same period of last year (a slight change from the preliminary data, which showed a decrease of 5.8%). With regards to GDP components, there was a significant slowdown in the negative trend in household consumption, which fell by 6.9% yoy (compared to 9.9% in Q1 and 9.4% in Q2). Government spending decreased for the first time in almost six years, indicating the government's willingness to adapt to the current situation in the domestic economy.
The C/A surplus was EUR 1.77 bn in the third quarter of 2009. This represents a significant decrease of 7.5% compared to the same period of 2008, which was expected since tourist season earnings fell by 15.7%. In light of the slowdown in the decrease of GDP, the C/A deficit rose to 6.2% of GDP. A positive contribution to the balance of payments came from the account of commodities, which generated a 31.4% decline in the deficit compared to Q3 2008. With an expected GDP decrease of 6% and a stronger decline of imports than exports, the C/A deficit is likely to fall to 5.5% of GDP.

Market outlook

The beginning of this week was marked by slight appreciation pressures on the kuna. However, the rest of the week passed relatively calmly, with low trading volumes and the FX rate just below EUR/HRK 7.30. For the week ahead, we expect the rate to stay slightly below EUR/HRK 7.30 due to the well-balanced supply and demand for euros. In mom terms, depreciation pressures on the kuna should prevail since the relatively large amount of external debt maturing in January will increase demand for euros (further indebtedness on foreign markets is not expected). On the other hand, a stronger decline of imports than exports will support the kuna.

Analysts: Ivana Juric (+385 1 61 74 349)
Zrinka Zivkovic-Matijevic (+385 1 61 74338)

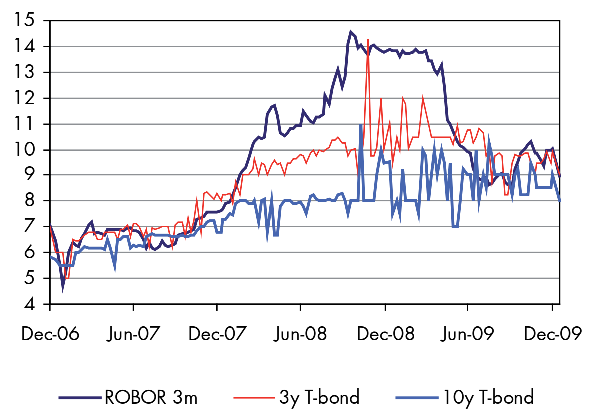
Romania

Uncertainty declines in recent weeks

(P)review of key economic figures/events

05 Jan 10	Monetary policy meeting, %	Jan 7.50 (Dec 8.00)	Unexpected 50bp cut
12 Jan 10	CPI, % yoy	Dec 4.8 (Nov 4.7)	
13 Jan 10	Industrial output, % yoy	Nov n.a. (Oct -1.5)	

ROBOR 3m & T-bond yields (%)



Source: Thomson Reuters, Raiffeisen RESEARCH

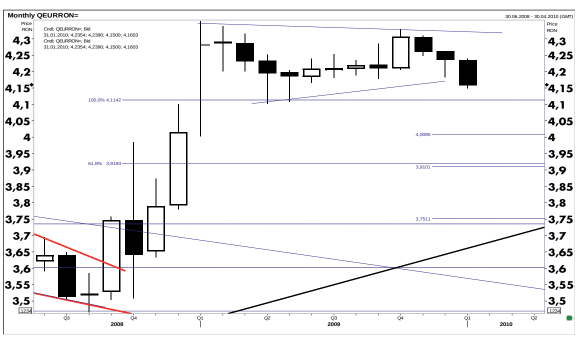
Money market focus

MM rates	***1m***	***3m***	***6m***	***12m***
Actual	***8.49***	***8.97***	***9.05***	***9.04***
Change from last week	-2.01	-1.06	-0.71	-0.71
Forecast Mar-10	9.8	9.9	9.9	9.8
Implicit forward rates	***3x6***	***6x9***	***9x12***	
	9.23	8.94	8.71	
Change from last week	-0.35	-0.66	-0.69	

Bond market focus

	2y	***3y***	***5y***	***10y***
Actual	***9.00***	***9.00***	***9.00***	***8.00***
Change from last week	-0.90	-0.90	-0.80	-1.00
Forecast Mar-10	9.50	9.50	9.40	8.30
Spread to bunds	***772.6***	***723.0***	***659.3***	***462.0***
Change from last week	-100.0	-94.8	-100.1	-114.7

EUR/RON



Last: 4.16 sell target: 4.1025 - 4.0085
Triangle to be confirmed at 4.1025, 3.91 and even 3.70 would be the indicated targets, stop 4.2065.

Source: Thomson Reuters, Raiffeisen RESEARCH

Market strategy

Buy RON T-bonds

Market comment

On Tuesday, the central bank decided to cut the key interest rate by 50bp to 7.5%, even though most analysts expected the NBR to remain on hold (we expected just a 25bp cut). This decision was made possible by the fact that the political situation has returned to normal and there is a good chance that the agreements with the IMF and the European Commission will remain on track. Moreover, the development of economic activity and inflation both argue in favour of lower interest rates. The decision also suggests that the NBR believes that uncertainty in the economy has declined following the establishment of a new government on 23 December and the positive comments made by the IMF representative at the end of last year. The decision to cut the key rate had a positive impact on both money market interest rates and bond yields (which fell), and on the leu (which appreciated). The interest rate and exchange rate moves also reveal that investors' perception of Romania has improved and that they are demanding a lower risk premium.

Market outlook

We believe that market interest rate levels and bond yields incorporated a high risk premium at the end of December. The recent decline in uncertainty in the economy following the calming of political turmoil in the final days of 2009 argues in favour of a lower risk premium. This should be followed by a decrease in market interest rates and yields. We think that if the government succeeds in getting the budget plan for 2010 passed by Parliament next week, the downward trend in interest rates and yields will consolidate.

Analyst: Ionut Dumitru (+40 37 2211269)

Exchange rate focus

	actual	***Mar-10***	***Jun-10***	***Sep-10***
EUR/RON	***4.17***	***4.30***	***4.25***	***4.20***
Change from last week	1.3%			
USD/RON	***2.91***	***2.97***	***2.83***	***2.90***
Change from last week	1.5%			

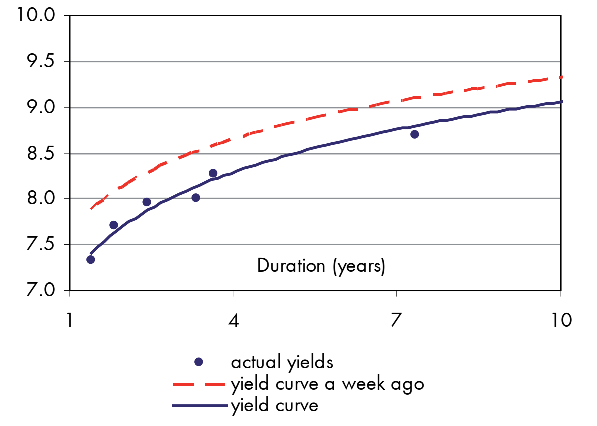
Russia

Low inflation, more rate cuts expected

(P)review of key economic figures/events

12 Dec 09	Trade balance, USD bn	Nov 12.5 (Oct 11.1)

RUB yield curve



Source: Thomson Reuters, Raiffeisen RESEARCH

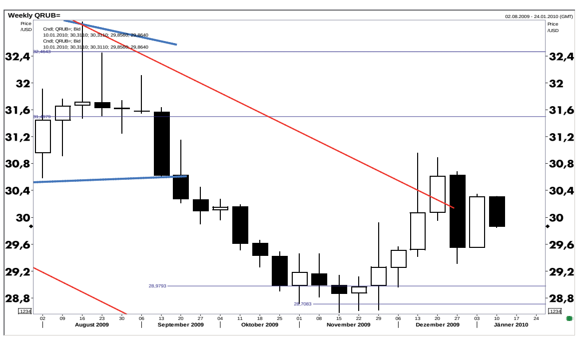
Money market focus

MM rates	1m	3m	6m	12m
Actual	**7.50**	**10.54**	**11.19**	**12.12**
Change from last week	-1.33	-0.85	-0.37	-0.56
Forecast Dec-09	**5.32**	**5.80**	**6.21**	**n.a.**
Forward rates	**1x2**	**3x6**	**6x9**	**9x12**
	10.99	12.04	n.a.	n.a.
Change from last week	-0.39	-0.79	n.a.	n.a.

Bond market focus

	1y	2y	5y	15y
Actual	**7.34**	**7.71**	**8.27**	**8.69**
Change from last week	-0.54	-0.39	-0.14	-0.28
Forecast Dec-09	**6.84**	**7.21**	**7.86**	**n.a.**

USD/RUB



Last: 29.86 sell target: 30.30 - 30.
The downward-trend is being tested, erratic price movement, might trigger 29.81 -> 29.56 - 29.20.

Source: Thomson Reuters, Raiffeisen RESEARCH

Market strategy

The rouble market will remain closed for the long market holidays until 10 January. However, we see some indications from the offshore market that the rouble market will open stronger after the holidays are over. At the moment, the offshore rouble market is quoting the rouble at 35.70 against the dual currency basket, which is above the level seen before the market holidays.

Market comment

The Federal State Statistics Service estimated 0.4% consumer price inflation in December, putting annual inflation for 2009 at 8.8%, which is decisively lower than the 13.3% seen in 2008. The prices for food and market services inflated by 0.6% and 0.5%, respectively, whereas non-food prices increased by just 0.2%. The deep economic recession allowed Russia to achieve a low level of inflation that is unparalleled in its modern history. Furthermore, the medium-term inflation outlook should remain fairly benign despite the low base effect from 2009. We expect average monthly inflation to drop to 0.6% in 2010, compared to 0.7% in 2009, which should result in marginally lower price growth for the coming year. Persistently weak consumer sentiment coupled with the fact that rouble appreciation is preventing unwanted imported inflation should help to keep inflation in check for most of 2010. The manufacturing PMI report painted a fairly discouraging picture, with the seasonally adjusted index falling to 49.4 in December, the weakest reading in the last six months. Both reports may encourage the central bank to increase the scope of monetary easing in Q1. We expect the bank to slash the main interest rates by 50bp in January instead of the 25bp that the bank already delivered in December. The inflation rate in January is unlikely to be indicative since it includes regulated tariff hikes traditionally carried out at the beginning of the year. We foresee a total of 100–150bp in rate cuts during Q1 and about 75bp in rate cuts in Q2.

Analyst: Gintaras Shlizhyus (+43 1 71707 1343)

Exchange rate focus

	actual	Mar-10	Jun-10	Sep-10
EUR/RUB	**42.80**	**42.93**	**42.12**	**41.72**
Change from last week	3.3%			
USD/RUB	**29.86**	**29.60**	**28.08**	**28.77**
Change from last week	3.1%			

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