Economic Research Department

BBVA

Emerging Europe

Weekly Observatory

August 7th, 2009

Weekly Highlights (August 3th – August 7th, 2009)

- **A new round of interest rate cuts: 25 basis points in Russia and Czech Republic; 50 bps in Romania**
- **Generalized appreciation of Eastern European currencies, along with a positive tone in regional stock exchanges.**

Markets

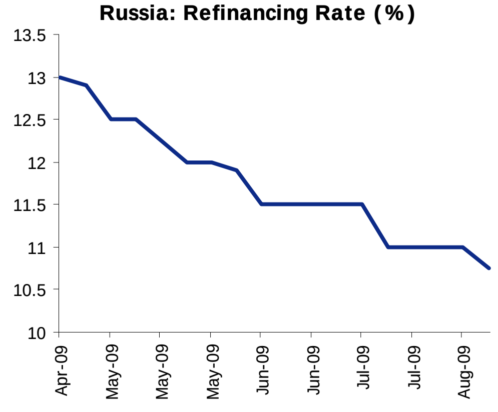
Bulgarian stocks surged, posting the biggest weekly gain in more than four years, on speculation Boiko Borissov's centre-right government will restore economic growth. The benchmark Sofix Index of stocks jumped 6.3 percent to close at 413.22 in Sofia, increasing 16 percent in the week, the most since February 2005. The measure has rallied for seven days, the longest rising streak since October 2007.[1]

Sberbank fell 2.1 percent after the **Russian** central bank's cut, which sent the ruble down 1.1 percent to 31.6191 per dollar. The 30-stock Micex Index slid 1.9 percent to 1,071.65 at 1:26 p.m. in Moscow, the steepest decline since July 28.

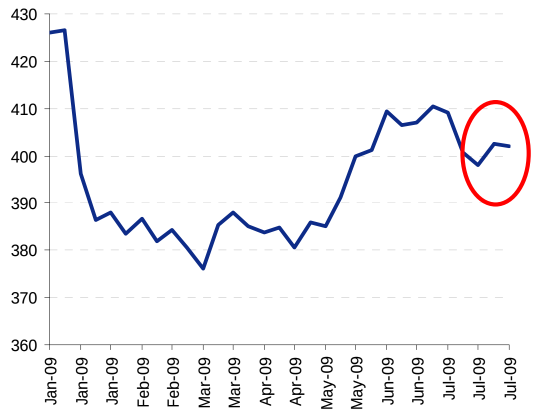
Russia

The Central Bank of Russia lowered the refinancing rate from 11 to 10.75% (change will take place on Monday 10th), This is the fifth reduction on the main reference rate during 2009, and an additional attempt to stimulate the domestic credit market without fanning inflationary pressures. Against much of the usual trend in emerging markets, the global crisis in Russia has not brought along a significant decrease in inflation, and this remains at fairly high levels (12% in July). Thus, and although this last cut is lower than previous moves, most analysts expect that cuts will follow until the rate stands around 10%.

The government has just approved the federal budget guidelines for 2010. The new plan envisions minimal changes from the 2009 budget in nominal terms, which would lead to an expected deficit of 7.5 % of GDP. Social expenditures, one of the main tools for the Russian government to buffer the impact of the crisis, will receive the largest share of the budget, and it is also one of the few accounts that will see an increase allotment of funds for next year. Among the losing accounts, public investments like road construction will see a significant decrease in funding, while expenditures related to health care, education or defense will remain largely unchanged in nominal terms. The financing of the expected deficit will come from both the Reserve and the National Welfare Fund. In addition, the government expects to tap the international debt markets in order to raise about $18 bln. A similar amount is expected to be drawn from the domestic debt market.



Source: Bloomberg



Source: Bloomberg

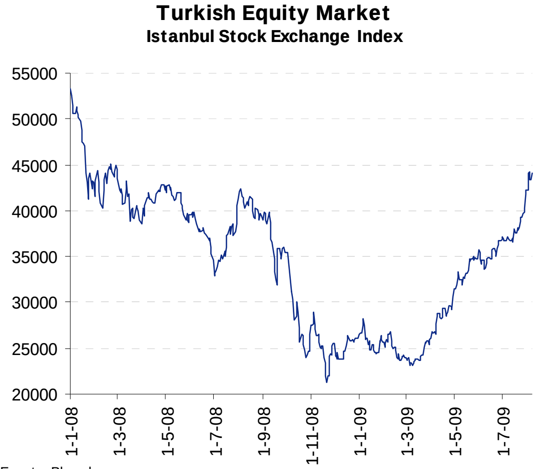
[1] The government, sworn in on July 27, has pledged to cut spending and balance the budget by year-end after growth contracted for the first time in 11 years in the first quarter. The economy may shrink 6.3 percent this year and Bulgaria may approach the International Monetary Fund for a loan in 2010, Finance Minister Simeon Djankov said on July 29. Borissov's government ousted the previous Socialist-led coalition in elections a month ago, promising to stem the deepening recession, fight corruption and apply to join the European Union's exchange-rate mechanism this year.

The central bank of Russia publishes July data on Russia's international reserves. In June, they totalled $412.6 billion. The ruble weakened 0.5 percent to 31.3273 per dollar. The yield on the 6.9 percent government bond due February 2036 was unchanged at 11.58 percent.

Turkey

According to the last economic and business survey published by the Central Bank, inflation forecasts are lower than the latest poll (done two weeks earlier), and move from 6.09% to 5.87%.

Yields on Turkey's sovereign bonds fell to an historic low this week as investors took advantage of extreme dovishness from its central bank and a return of risk appetite in emerging markets.The rally helped the Turkish Treasury sail through some of the heftiest debt refinancings it faced this year. But economists warn that central bank policy will not be sustainable unless Ankara rapidly commits to credible fiscal retrenchment. The exuberance extends to equity markets. Istanbul's main share index hit a fresh 17-month high this week after an extended rally erased not only the losses sparked by the global crisis but also some of those sustained in political instability earlier last year.



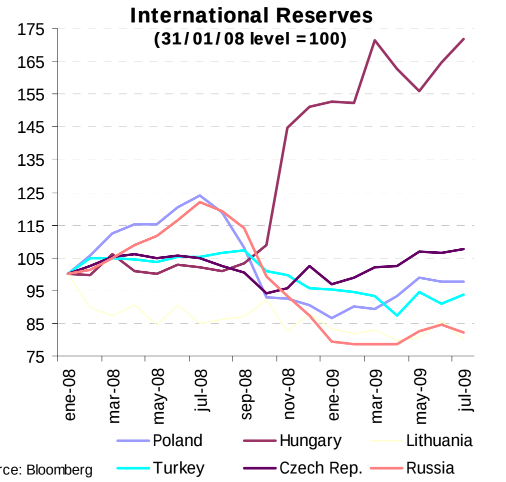
Fuente: Bloomberg

Rest of the region

Easing in Czech Republic and Romania

The reference rate in the Czech Republic reaches its all-time low at 1.25%, after a 25bps cut. Analysts bet this will be the latest reduction, as they expect that monetary policy should change course if the positive growth expectations for the second semester of 2009 finally materialize.

Romania also had its own share of monetary easing: despite inflation has been exceeding the objective range (2.5%-4.5%) for 23 consecutive months (currently at 5.9%), the central bank cut the monetary policy rate by 50 bps., leaving it at 8.5%. with the country immersed in negotiations with the IMF and the EU to solve its fiscal and external disequilibria, the government sees the recourse to monetary easing as the only policy tool at its hands to restore internal demand.



Source: Bloomberg

Czech Republic, Estonia, Latvia, Lithuania and **Poland releases data on their international reserves for July.**

The National Institute for Statistics of **Romania** releases data on industrial production for June. In May, year-on-year output fell 9.8 percent. The Institute also publishes data on **retail sales** for June. In May, year-on-year sales fell 12.3 percent. The leu was little changed at 4.2095 per euro. The yield on the 6.75 percent government bond due in June 2017 was little changed at 10.9 percent.

The Statistics Office of **Slovakia** releases data on industrial production for June. In May, year-on-year production fell 23.9 percent. In June, production likely fell 19 percent, according to the median estimate of four economists surveyed by Bloomberg. The yield on the 4.9 percent government bond due in November 2014 was little changed at 4.3 percent.

Friday, 07/08/2009

Emerging Europe Markets (this week)

EXCHANGE RATE*	Last* 06/08/2009	% Variation (+depreciation and -appreciation) 1 week	YTD	Since Sep 2008	Since Jul 2007
EMERGING EUROPE					
Bulgaria	1,36	-1,90	-3,06	-1,84	-5,83
Czech Republic	18,08	-0,57	-5,86	6,58	-14,82
Estonia	10,91	-1,89	-2,69	-1,06	-5,61
Hungary	189	-0,66	-0,90	12,49	3,54
Latvia	0,49	-1,81	-3,51	-1,43	-4,82
Lithuania	2,41	-1,89	-2,73	-1,07	-5,60
Poland	2,90	-2,14	-2,44	23,31	4,07
Romania	2,94	-1,88	1,63	15,44	27,46
Russia	31,33	-0,55	6,56	22,57	21,70
Turkey	1,48	0,09	-3,84	19,12	12,69
Ukraine	7,99	-0,31	-0,75	67,47	59,08
EURO	**1,43**	**1,93**	**2,79**	**1,08**	**5,94**

*local currency/USD

OFFICIAL INTEREST RATE	Last* 07/08/2009	bp Variation 1 week	YTD	Since Sep 2008	Since Jul 2007
Czech Republic	1,3	-25	-100	-225	-150
Hungary	8,5	0	-150	0	75
Poland	3,5	0	-150	-250	-100
Romania	8,5	-50	-175	-175	150
Russia	11,0	0	-200	0	100
Turkey	8,3	0	-675	-850	-925

*last available data: 07/08/2009

SPREAD EMBI	Ratings LT in foreing currency S&P*	Last* 06/08/2009	bp Variation 1 week	YTD	Since Sep 2008	Since Jul 2007
EMBI+		348	-38	-342	14	175
EMERGING EUROPE		320	-33	-364	31	180
Bulgaria	**BBB**	351	-26	-323	112	279
Hungary	**BBB-**	311	-12	-193	161	239
Poland	**A-**	168	-13	-146	44	107
Russia	**BBB**	345	-23	-397	110	243
Turkey	**BB-**	269	-25	-263	-59	80
Ukraine	**CCC+**	772	-314	-1.963	169	631

*last available data: 06/08/2009
*The spread refers to external debt and therefore to the U.S. currency.

CDS	Last* 06/08/2009	bp Variation 1 week	YTD	Since Sep 2008	Since Jul 2007
EMERGING EUROPE					
Czech Republic	80	-8	-94	32	73
Hungary	224	-36	-196	59	205
Lithuania	359	-26	-237	140	343
Poland	112	-18	-133	40	104
Romania	251	-18	-384	-3	233
Russia	261	-16	-483	93	217
Slovakia	60	-11	-95	13	56
Turkey	200	-11	-211	-76	53

*last available data: 06/08/2009

STOCK MARKETS	Last 06/08/2009	% Variation 1 week	YTD	Since Sep 2008	Since Jul 2007
EMERGING EUROPE					
Bulgaria	389	10,6	8,4	-59,5	-72,9
Czech Republic	1.144	11,0	33,3	-11,4	-38,4
Estonia	324	10,7	17,9	-39,0	-66,0
Hungary	17.851	4,3	45,8	-9,1	-38,4
Latvia	270	5,2	-0,4	-45,1	-61,3
Lithuania	209	9,5	16,8	-49,4	-60,4
Poland	34.979	-0,6	28,5	-10,6	-46,7
Romania	4.108	3,0	41,6	-18,5	-57,4
Russia	1.084	8,2	71,5	-19,2	-43,3
Slovakia	307	4,1	-14,5	-28,2	-25,0
Turkey	43.351	3,6	63,4	18,5	-6,3
S&P 500	1.629	1	12	-18	-31
MSCI World US$	431	2	21	-13	-29
MSCI Emerging markets US$	1.486	3	54	3	-16
MSCI Latam US$	6.705	5	65	-2	-6
MSCI Asia US$	558	2	54	11	-14

Sources: Bloomberg, Datastream and BBVA