

Economics

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CEEMEA Edition

- **Focus on Nigeria — A critical week for the naira.** Recent reforms to the Nigerian fixed income and currency markets look set to support the naira over the rest of 2011 in our view.
- **Poland — CA deficit likely to surprise negatively.** In our view, the market underestimates the size of the revision as the actual outcome could be as high as 5.1% of GDP, with risks skewed towards even higher number.
- **Romania — Rates likely to remain on hold at 6.25%.** Developments to date suggest the NBR is likely to pursue a more cautious approach and keep rates on hold at 6.25% during the remainder of the year.
- **Turkey — New Parliament gets off to a rocky start.** With the CHP's decision to boycott Parliament's swearing-in, political tensions remain elevated.
- **Industrial Countries — Greece's Parliament roll-call vote on the five-year medium-term fiscal plan.** If passed, the next installment of Greece's 110bn-euro bail-out will be released by the European Union and IMF. **Euro area** data for economic confidence in June will be announced today. We expect a fourth consecutive fall: to 105.0 from 105.5 in May. Moreover, while falling food prices probably capped the increase in the headline HICP, a rebound in energy prices and the passing through of earlier increases in commodity prices probably lead to an increase in the headline June HICP: to 2.8% YoY from 2.7% in May. In the **UK**, we expect to see a flat MoM growth in service sector output in April.

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Figure 1. Event Calendar

Time	Country	Indicator	Period	Actual	Citi	Market	Previous (revision)
Yesterday's events							
08:00	Slovakia	Consumer Confidence	Jun	-24.7	-	-	-24.7
08:00	Slovakia	Industrial Confidence	Jun	-5.0	-	-	8.3
08:00	Slovakia	Producer Prices (%YoY)	May	3.1	-	-	3.1
Today's events							
-	Kazakhstan	GDP (%YoY)	1Q F	-	-	-	6.6
-	Romania	Interest Rate Announcement (%)	Jun	6.25	6.25	6.25	6.25
08:00	Hungary	Unemployment Rate (%)	May	-	11.2	11.4	-
09:00	Slovakia	Current Account (€ mn)	Apr	-	-	-	-151
13:00	Poland	Current Account (€ bn)	1Q	-5.0*	-4.1	-5.3	-

Source: National Sources, Bloomberg, Citi Investment Research and Analysis (CIRA). Note: *after revision

See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

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Focus on Nigeria

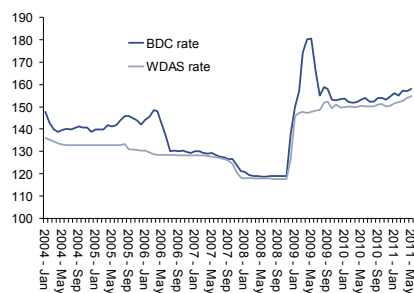
A critical week for the naira

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Our long standing view is that the naira has been under pressure for much of 2010 and 2011 as a result of a high level of demand for foreign currency ([see Nigeria Macro View, Policy Priorities for a New Government](#)). What has been surprising, however, is that with the successful conduct of the elections, along with rising interest rates against the background of high oil prices and steady production, foreign exchange reserves held by the Central Bank of Nigeria (CBN) have not started to increase again. In fact, from mid-March to mid-June the naira has been under some considerable pressure on the market.

Faced with ongoing pressure on the naira, in the last week, the CBN seems to have taken the bold move of liberalizing the fixed income and bond markets. In a 24 June circular (effective 1 July) it abolished the one year holding period on government securities which will allow foreign investors to buy all tenors going forward. We think this was a significant constraint to foreign investment in the government securities market, and expect that inflows into the market could now pick up substantially. From the perspective of the CBN, by increasing inflows onto the market, this should also allow it to rebuild foreign exchange reserves. Moreover, its longer term thinking may well be that with reserves starting to rise, confidence in the naira should start to increase. The overall level of inflows is hard to know at present, but if substantial they may push down interest rates initially. But we still expect that during 2011 inflationary pressures will remain strong and still forecast that the Monetary Policy Rate will rise to 9% by the end of the year, implying that yields on government securities could rebound to some extent in 2H 2011.

Figure 2. NGN:USD1



Source: Citi Investment Research and Analysis

In addition, on 24 June the CBN also issued a circular limiting the amount that Bureau de Change (BDC) can buy from authorized foreign exchange dealers to US\$250,000 a week from a single dealer. Although much less heralded, this move is interesting in that it will force the BDC's to source more foreign exchange from the wider economy (one critical source is cocoa exporters for example). If they cannot find this, then the difference between the BDC exchange rate, and the CBN and interbank rate will start to widen again (see chart). This had narrowed sharply from its recent peak in mid-2009 when the BDCs were granted access to foreign exchange via the CBN's in an effort to reduce the widening differential.

When the CBN initially allowed trade with authorized dealers, the concern was that the widening differential between both the BDC and the official exchange rates was putting pressure on the latter. The opposite thinking may now hold: the lack of differential is encouraging excessive demand for foreign exchange which the CBN is unable to regulate effectively. The CBN may be concerned that BDCs are selling the foreign exchange they obtain onto the parallel market, an easy form of arbitrage facilitating capital flight. As such the CBN would probably happily live with a gap between the two in the order of 5-10% in the short to medium term, especially if this helps curtail some of this outflow.

With the announcement of these moves the naira has already started to appreciate considerably against the USD this week. But the key questions are where does the rate settle and will the impetus provided by these moves usher in a new period of naira stability? At present, we think the rate is likely to settle around N150-152:USD1 and crucially, this is likely to usher in a period of stability and even most appreciation in 2H 2011. But we do not think that the naira will appreciate too strongly over the rest of the year, as the CBN seeks to rebuild foreign exchange reserves. As such, recent comments by the CBN governor of a N145:USD1 level by year end are probably too bold.

Country Analysis

Poland

CA deficit likely to surprise negatively

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Today at 1:00m London time, the central bank will publish the quarterly balance of payments data and although usually this release comes as a nonevent, it seems that this particular publication may attract more attention. That is mainly because for the first time, the data will include a revised net errors and omissions (NEO) deficit and the corresponding change in other accounts of the BoP. Since the NEO deficit amounted to 3.7% of GDP or €13.2bn in 2010, the revision could have impact on the assessment of Poland's fundamental position.

The already published monthly data suggest the 1Q 2011 current account deficit was probably around €3.5bn but we estimate that after revisions it may reach around €5bn. This is more than the market consensus of €4.1bn. Furthermore, the market will carefully watch for any changes in last year's data. The recent Reuters poll shows the market consensus assumes 2010 current account gap will be revised to 4.7% of GDP from 3.4%. In our view, however, the market underestimates the size of the revision as the actual current account deficit could be as high as 5.1% of GDP, with risks skewed towards even higher number. The consensus view seems to be influenced by initial comments of Polish central bankers who suggested the revision would amount to 1% of GDP. However, the 1% revision is likely to account only for underreported car imports and we see a risk of revisions in other import components as well as in remittances.

All in all, the revision implies a wider current account deficit and increases the risk of the CA gap hitting 6% of GDP in 2011. Although the revision implies only a change in the statistical reporting system while actual flows remain unchanged, this move could make some market participants reassess risks related to investment in PLN. At this stage it is impossible to state what exact changes the central bank is planning in the financial account of the balance of payments. We expect that even after the revision the current account will be easily financed but we stick to our view that the structure of financing could change. In recent months the ratio of the FDI to CA was on a declining path and we expect that higher (revised) current account deficit will be financed to a large extent by portfolio capital and bank financing.

All that said, although the BoP data revision seems to be largely priced in by the market, we expect the resulting reassessment of Poland's fundamentals by investors could be, on balance, negative for the zloty, at least in the medium term. In order to avoid increased depreciation pressures the central bank will be probably eventually pushed towards further interest rate hikes, even despite recent dovish comments of MPC members. We also expect the Polish government to be more determined to remain on fiscal tightening path.

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Romania

Rates likely to remain on hold at 6.25%

The NBR faces a major challenge in terms of striking a balance between the need to address inflation risks and the need to support the recovery. On the one hand, there is a need to pursue an accommodative monetary policy to support the fragile recovery. Despite the strong 1Q GDP reading, domestic demand is yet to display a meaningful improvement, with the output gap remaining in negative territory. On the other hand, the rising inflation risks — including the deterioration in forward-looking inflation expectations — may require policy tightening. Where do we go from here? Developments to date suggest that the NBR is likely to pursue a more cautious approach and keep rates on hold at 6.25% during the remainder of the year. We recognize there are risks to our rate outlook. Large deviations from our inflation trajectory and a further deterioration in forward-looking inflation expectations could lead the NBR to consider hiking rates.

Turkey

New Parliament gets off to a rocky start

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In addition to independents (from the pro-Kurdish party), the main opposition also decided to boycott Parliament's swearing-in on Tuesday to protest bans on elected candidates. The CHP (with 135 seats) and independents (with 35 seats) account for more than 30% of the 550 seat Parliament. The MHP (with 53 seats), on the other hand, decided to attend even though the party suffers from a similar hurdle (courts also have blocked an MHP deputy who is detained on charges related to an alleged conspiracy).

Where do we go from here? Despite this development, the AKP can proceed with presenting its program at Parliament and form the new government after which Parliament goes into recess until October 1. Nonetheless, it is clear in our view that the noted backdrop doesn't bode well for political stability going forward, particularly for a government which intends to rewrite the constitution. Moreover, the current situation may also aggravate terrorist activities by the PKK. All in all, we believe that PM Erdogan's approach/receptiveness to proposals for changes to the penal code that will be put forward by the opposition will be crucial in resolving the current crisis.

Selected Market Indicators

Figure 3. Selected Market Indicators

Currency Performance				Local Rates*				Equities			
	Spot (Prev Close)	Change (%) 1 Day	1 M		Last Close	Change 1 Day	1 M		Last Index Level	Change (%) 1 Day	1 M
Europe (vs euro)				Europe				Europe			
Bulgaria Lev	1.96	0.01%	0.01%	Bulgaria	0.53	0.02	-0.02	Bulgaria SOFIX	409	0.38%	-5.43%
Croatia Kuna	7.38	0.10%	-0.80%	Croatia	0.35	0.00	0.01	Croatia CROBEX	2231	0.21%	-0.97%
Czech Koruna	24.4	-0.11%	-0.67%	Czech	0.78	0.05	0.02	Czech PX50	1194	0.18%	-3.66%
Hungary Forint	269	0.12%	0.47%	Hungary	5.30	0.00	0.05	Hungary BUX	22611	0.56%	-1.94%
Poland Zloty	4.01	0.23%	1.04%	Poland	3.87	0.00	0.82	Poland WIG20	2783	-0.18%	-2.91%
Romania Lei	4.21	-0.22%	2.02%	Romania	3.89	-0.23	-0.62	Romania BSE	5452	0.77%	-0.62%
Russia Ruble	40.4	0.01%	0.82%	Russia	3.86	0.05	-0.89	Russia RTS (US\$)	1874	1.74%	0.86%
Serbia Dinar	102	0.31%	5.26%	Serbia	NA	NA	NA	Serbia BELEX15	749	-1.13%	-7.69%
Turkey Lira***	1.64	0.45%	2.45%	Turkey	7.47	0.06	0.49	Turkey ISE	62819	1.40%	0.66%
Ukraine Hryvnia***	7.97	0.19%	-0.28%	Ukraine	2.90	0.00	-4.40	Ukraine PFTS	893	0.00%	-7.54%
Middle East (vs USD)				Middle East				Middle East			
Bahrain Dinar	0.38	0.00%	0.01%	Bahrain	0.52	0.00	-0.03	Bahrain BHSE All-Sh	1328	-0.13%	-1.70%
Egypt Pound	5.97	0.06%	0.14%	Egypt	8.91	0.00	0.28	Egypt HERMES	539	0.30%	-1.93%
Israel Shekel	3.45	0.12%	-0.69%	Israel (1M)	3.27	0.00	0.00	Israel TA-100	1112	1.48%	-2.35%
Jordan Dinar	0.71	-0.01%	0.17%	Jordan	2.71	-0.02	-0.08	Jordan ASE	2093	-0.54%	-3.88%
Kuwait Dinar	0.27	-0.21%	-0.40%	Kuwait (1M)	0.56	0.00	0.00	Kuwait KWSE	6227	-0.43%	-2.04%
Lebanon Pound	1513	-0.03%	0.10%	Lebanon	NA	NA	NA	Lebanon BLOM (US\$)	1347	0.00%	-2.29%
Qatar Rial	3.64	0.00%	-0.01%	Qatar	NA	NA	NA	Qatar DSM 20	8290	0.49%	-1.01%
S Arabia Riyal	3.75	0.00%	0.00%	S Arabia	0.35	0.00	0.00	S Arabia TASI	6531	0.37%	-3.31%
UAE Dirham	3.67	0.00%	0.00%	UAE (1M)	1.08	-0.01	-0.25	UAE ADSMI	2711	0.25%	3.98%
Sub-Saharan Africa (vs USD)				Sub-Saharan Africa**				Sub-Saharan Africa			
Botswana Pula	0.15	0.73%	0.53%	Botswana	NA	NA	NA	Botswana DCIBT	6996	-0.04%	0.53%
Ghana Cedi	1.52	-0.02%	0.66%	Ghana	NA	NA	NA	Ghana GSE	0	#VALUE!	#VALUE!
Kenya Shilling	90.2	-0.86%	5.25%	Kenya	NA	NA	NA	Kenya NSEK	3937	-0.41%	-3.73%
Malawi Kwacha	151	-0.54%	-0.42%	Malawi	NA	NA	NA	Malawi	NA	NA	NA
Nigeria Naira	155	0.34%	-1.19%	Nigeria (1M)	NA	NA	NA	Nigeria NGSE	25039	-0.52%	-3.06%
S. Africa Rand	6.85	-0.40%	-1.18%	S. Africa (1M)	5.50	0.00	0.00	S. Africa JALSH	31292	-18.96%	-22.68%
Tanzania Shilling	1616	1.03%	4.19%	Tanzania	6.85	0.00	0.00	Tanzania	NA	NA	NA
Zambia Kwacha	4860	0.10%	2.32%	Zambia	NA	NA	NA	Zambia	NA	NA	NA
Commodities				FX Volatility				Major Indices			
Gold \$/troy oz.	1504	0.76%	-2.21%	EUR - CZK	5.74	-2.30%	-0.26%	US NYSE	1291	0.87%	-3.00%
Platinum \$/troy oz.	1687	0.90%	-6.31%	EUR - HUF	8.14	-0.12%	1.15%	US NASDAQ	2717	1.05%	-2.87%
Silver \$/troy oz.	33.90	1.40%	-10.34%	EUR - PLN	8.11	-3.02%	0.96%	UK FTSE 100	5779	0.99%	-2.69%
Copper US\$/ton	8959	0.00%	-2.50%	EUR - RON	7.50	0.00%	25.00%	France CAC 40	3852	1.46%	-2.51%
Tin US\$/lb	1138	0.11%	-6.95%	USD - RUB	10.02	-1.64%	-0.72%	Germany DAX	7172	0.90%	0.12%
Natural Gas US\$	4.25	0.00%	-2.52%	USD - ZAR	14.71	-3.48%	-0.29%	Japan Nikkei 225	9649	0.74%	1.33%
Oil US\$ Brent Crude	108.1	1.58%	-6.19%	USD - TRY	12.99	-2.73%	7.27%	FTSE Global	381	0.89%	-3.31%
CRB All Commod	332	1.13%	-3.98%	USD - ILS	10.11	-4.53%	17.50%	FTSE Emerging	672	0.50%	-1.11%

Source: Bloomberg, Citi Investment Research and Analysis. Note: Equities are local currency unless otherwise stated; FX Volatility is the mid price At-the Money (ATM) 1M term; * Overnight unless otherwise stated. **Weekly data on 3 month rates except S Africa. *** Turkey Lira & Ukraine Hryvnia are against the US dollar.

Economic & Market Analysis

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