Emerging Market Monthly Roadmap

FIM RESEARCH

02 March 2011

Positioning for bad news

Summary

Emerging markets face two mounting interconnected challenges: inflation and the MENA turmoil. It remains unclear when the situation could stabilise on either front, and it may be worth beginning to position for bad news. However, on the FX front, no EM currency is sending an obvious sell signal, and an easier option could be to go long those currencies benefiting from higher commodity prices. On the rate side, it could be worth paying EMEA rates selectively and buying linkers. Meanwhile, safe-haven flows into bonds amid geopolitical risk could result in bond outperformance.

Key macro calls

- MENA contagion: mind oil exporters
- Asia inflation: here to stay
- EM equity: not obviously overvalued
- Russia: CBR to stay behind the curve
- Singapore: MAS to tighten in April

Main strategic calls

- Sell EUR/ZAR
- Keep selling USD/RUB for now
- Keep long KRW and PHP positions
- Pay 5Y PLN IRS
- Long 5Y KRW bond/swap spread

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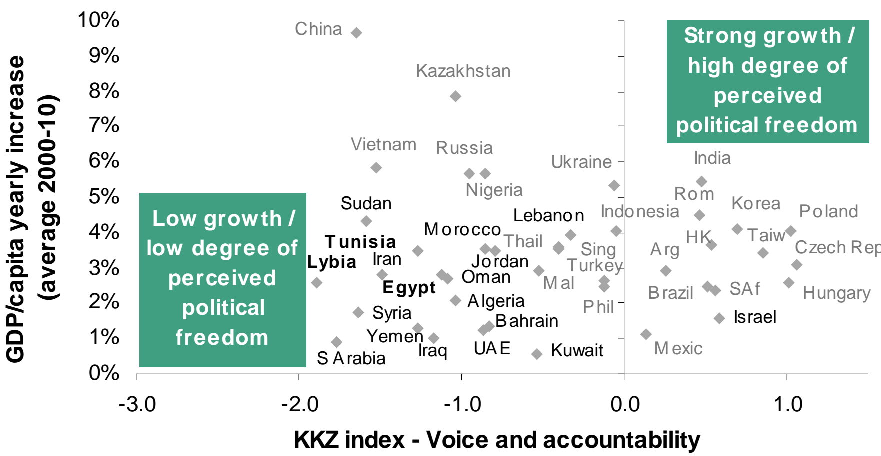
Voice or money: those markets that can offer neither seem vulnerable



Source: Bloomberg, Crédit Agricole CIB

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Emerging markets at a glance: Voice or money

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EMs increasingly face two interconnected challenges. Firstly, inflation is climbing further, and central banks will continue to tighten. Secondly, the situations in Tunisia, Egypt and Libya suggest that people need voice or money. Some countries seem more vulnerable than others to MENA contagion: those where the increase in GDP per capita has been slow, and where perceived freedom of speech and political freedom are limited. They happen to be located in the Middle East. And some of them are huge oil producers.

Two challenges mounting

EM under mounting pressure

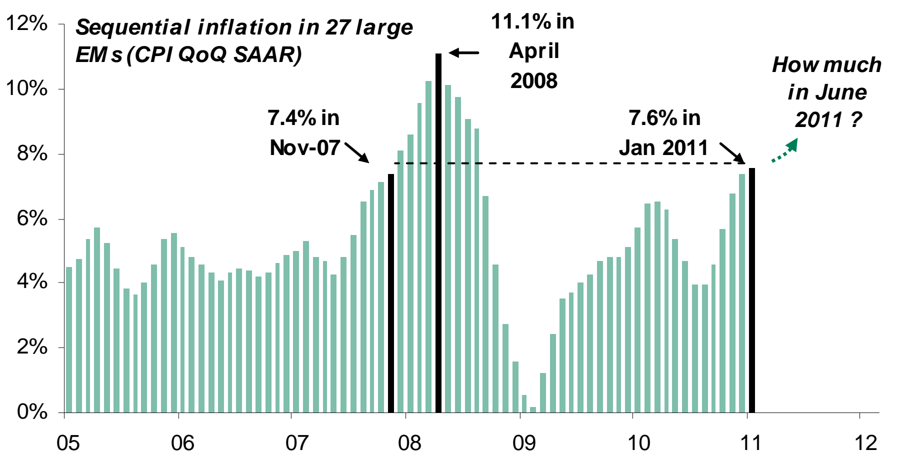
Back in our last *EM Monthly Roadmap* (Food for hawks, published 26 January), we mentioned mounting challenges for EMs. Quite clearly, things have not got better since then, in terms of inflation as well as in terms of MENA political tension.

Inflation climbing further

Inflation: towards record-high levels?

On the inflation front, challenges have intensified further. The EM headline inflation has accelerated further, reaching multi-month record-high levels in many countries, including China, Russia and Brazil. In India, disinflation has been sticky, and too slow to avoid street protests. Our sequential inflation index for 27 large emerging markets has climbed further. The gauge reached 7.6% in January. This level is similar to that reached in November 2007, just five months before the index reached its record level of 11.1%, in April 2008.

Inflation: upward



Source: Bloomberg, Crédit Agricole CIB

Tightening still on the cards

The sharp increase in global food prices between early December and early February (+20%), and the recent spike in oil prices, suggest inflation pressure may not moderate in the coming months. The rather strong data momentum in both the US and Europe suggests that demand is strengthening there – also supportive for food and energy prices. We still believe that most EM central banks will continue to tighten monetary policy … and those that have been reluctant to hike policy interest rates so far (Turkey) may have to reconsider sooner rather than later.

Libya opens Pandora's Box to contagion

Libya shows that oil is not the ultimate shield against social uprising

On top of that, the spread of the MENA political unrest to Libya makes a big difference to the possible regional and even global impact. Tunisia and Egypt are not oil exporters. By contrast, each Libyan person is sitting on about 7,000 barrels of proven oil reserves. This is more than Iran and Iraq (respectively about 2,000 and 4,000) and only marginally less than Saudi Arabia (about 10,000). Almost the same could be said when looking at levels of development. GDP per

capita in Libya is about USD12,200 – much higher than Tunisia (about USD4,100) and Egypt (USD2,700). This has two implications in our view:

- It shows that oil is not an efficient shield against political instability, after all. Therefore, the door is now open to the market contemplating the idea that other oil producers may get into trouble. Hence a risk on the upside for oil prices if this idea spreads.

How exportable is the 'Jasmine revolution'?

- It means that being relatively rich does not mean a country's institutional framework cannot be seriously challenged by its population. This could at the end of the day ring bells in other parts of the world. For instance, some social networking websites claimed to have been temporarily frozen last week by Chinese censorship, and the issue of possible contagion to China has been raised here and there.

Who is vulnerable to contagion?

Trying to gauge vulnerability…

It is actually striking that criticism expressed in Tunisia, Egypt and Libya is targeting both the inability of these regimes to generate sufficient improvement in wealth per capita as well as some frustration vis-à-vis the lack of political freedom and freedom of speech.

In an attempt to illustrate how emerging markets rank according to these two criteria, we chart 42 markets, according to…

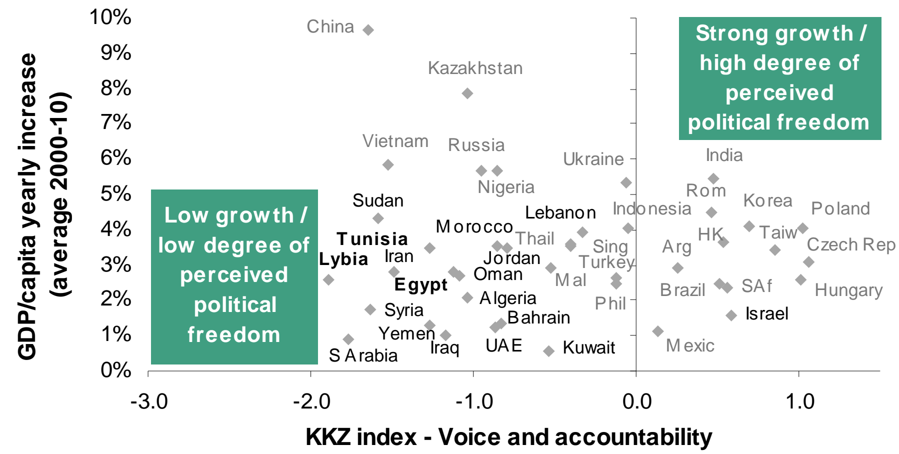
…using some freedom perception indices…

- … the 'Voice and accountability' index of the World Bank's KKZ index (which aims to capture perceptions of the extent to which a country's citizens are able to participate in selecting their government, as well as freedom of expression, freedom of association, and free media), and

…and the capacity to generate growth

- … the average real growth of GDP per capita over the past decade.

Voice or money: those markets that can offer neither seem vulnerable



Source: Bloomberg, Crédit Agricole CIB

The watch list includes: Saudi Arabia, Syria and Iran

Three large Middle East countries are in the bottom-left corner (not the most comfortable position – where Tunisia, Libya and Egypt also stand): Saudi Arabia, Syria and Iran (this could also be said about Iraq and Algeria to some extent). This suggests that the situation in these three countries should be monitored closely. Still, we argue in *Hot topic 1: Is Saudi Arabia next?* (later in this report) that the kingdom faces serious challenges, but also benefits from a series of buffers which have to do with the use of the financial leeway provided by the oil rent.

China is low on perceived freedom, but high on GDP per capita growth

It is also interesting to note that China does not rank well as far as the KKZ index is concerned, but – not surprisingly – has displayed impressively strong growth in GDP per capita over the past ten years. This, in our view, provides an important buffer against possible social or political anger.

Interest rate outlook: EM inflation hawks

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Inflation pressures are intensifying in Asia and EMEA, pushing up rates, while they are less threatening for Latam markets. It is becoming trickier to time the ultimate flattening of curves, depending on how quickly policymakers are reacting to inflation. A way to position for bad news, be it inflation or MENA risks, could be paying EMEA rates and buying linkers. Meanwhile, safe-haven flows into bonds amid geopolitical risk could result in bond outperformance.

Asia: competing with time

Will Asian central banks be quick enough?

Asian rates had been paid up in the past month, quite aggressively in some markets, despite some easing in late February amid heightened geopolitical risk. The curves were little changed in the CNY, INR, SGD, KRW and TWD markets, while the HKD and THB curves flattened over the month. We still expect Asian curves to largely steepen/remain steep in the weeks ahead, but it is becoming trickier to time the ultimate flattening.

Inflation pressure is intensifying, with signs that it has been spreading from the usual housing and food items to broader consumer products. This will push up long-end rates further and steepen curves. At the same time, precisely because of the higher risk of inflation, central banks are becoming more hawkish, potentially stepping up their tightening process and flattening curves earlier. So it is a matter of whether central banks will be able to catch up with or even run ahead of the development on the inflation front.

Geopolitics on bond/swap spreads

Geopolitics to lead to bond outperformance

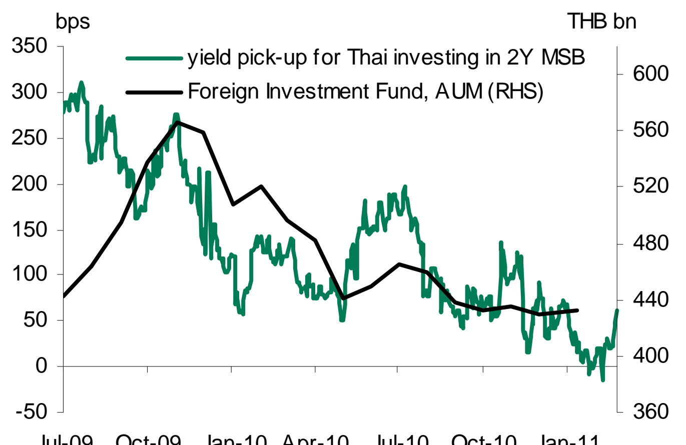
Complicating monetary decisions is geopolitics. It represents an external uncertainty which could impact global growth, affecting prospects for Asia, but oil prices have already risen adding to the inflation threat. Overall we believe more weight will be given to the geopolitical impact through inflation rather than the growth channel, given strong fundamentals in Asia. Central banks are likely to remain hawkish at a time when the bond markets are benefiting from safe-haven flows.

As such, recent developments in geopolitics add to our view that central banks' hawkishness is likely to be reflected more in the IRS market, resulting in bond outperformance. Our long 5Y KTB/IRS position has been resilient and performed. We are looking for similar opportunities in the HKD rate market, with bond/swap spreads seen wider. In the past month, government bond performances relative to IRS have been mixed, with yields falling relative to IRS in the CNY, TWD, INR and front-end THB curves, while bonds have underperformed in the HKD, SGD and KRW markets. We expect bond outperformance to become more obvious in the weeks ahead.

Bond yield moves relative to IRS

Source: Bloomberg, Crédit Agricole CIB

Overseas money returning to Thailand



Source: AIMC, Bloomberg, Crédit Agricole CIB

Asian local factors rule near term

HKD IRS curve to steepen as long end being paid up

In the HKD rate market, we expect some steepening in the month ahead, for a number of reasons. Firstly, former issuance-related receiving flows at the long-end appear to have dissipated. Secondly, liability hedging flows are coming in amid rising inflation – CPI inflation unexpectedly rose markedly to 3.6% YoY in January from 3.5% previously. Price pressures have spread across consumer items, pointing to an extended period of high inflation. Thirdly, the 10Y USD-HKD IRS spread (with 10Y HKD IRS below USD IRS) has widened of late where a technical correction is likely. Meanwhile, increases in front-end rates are constrained by the loose Fed policy, leading to a steeper curve when long-end rates are paid up more aggressively.

Front-end SGD IRS suppressed by SGD appreciation expectations

The SGD curve is likely to remain steep as well, with the front-end anchored by expectations for SGD appreciation and still-low USD Libor. Headline CPI surged to a two-year high of 5.5% YoY in January, driven by the costs of housing and transport. While the MAS (Monetary Authority of Singapore) underlying inflation, which excludes accommodation and private transport, remained benign, we expect it to pick up gradually. Nevertheless, policymakers have to pay attention to surging headline CPI. The MAS is likely to tightening policy at its April meeting by re-centring the SGD NEER band. Expectations for SGD to strengthen will pressure down forward points, suppressing the floating leg of SGD IRS – 6M SOR – which is a synthetic rate implied by FX swaps.

Front-end THB IRS to be pushed up again around Q2/Q3 on returning USD

The flattening of the THB IRS curve over the past month was due primarily to the surges in front-end rates, which in turn was triggered by FX swap trades. We see consolidation in front-end THB rates at current levels, before another round of upward movement around Q2/Q3. With the WHT (withholding tax) in place on Korean bonds, and the narrowing of the KRW basis, the yield pick-up for Thai investing in Korean assets (the so-called Kimchi funds) is diminishing. Given that there are not too many investment alternatives, a portion of the USD is likely to flow back into Thailand and be exchanged into THB when these Kimchi funds mature, clustering around Q2/Q3. Improved USD liquidity then will push up the floating leg of THB IRS – 6M THBFIX – which is a synthetic rate implied by FX swaps.

EMEA: temporary pause in the flattening

The rate market direction across EMEA countries has become less clear, with markets looking for a direction. The conjunction of postmodern monetary policy – Russia is joining the party as well – growing inflation fears and emerging capital outflows is not helping to forge a strong view.

The EMEA flattening may make a temporary pause and resume in the weeks ahead

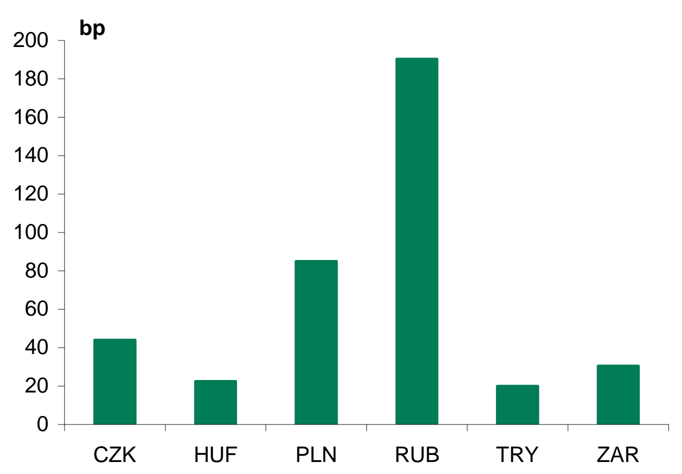
The inflation theme, as we suspected, has become the major source of concern for EMEA rate markets, though to an extent that we were not expecting. The flattening of rate curves has come earlier than we thought. Indeed, since the end of January markets have been pricing many rates hikes even in countries where inflationary pressures are not yet mounting sharply – Czech Republic, South Africa for instance. The relaxation of the official authorities' position regarding FX appreciation has proved to support the rate hike view as well.

The aggressive pricing of rate hikes has come too quickly in our view and we would expect a pause in the flattening move over the month. Nevertheless, the scope for steepening seems limited given the MENA tensions and the associated short-term risk and inflation premium. We still expect a flattening over the medium term.

Swap curve flattening has come quickly

Source: Crédit Agricole CIB, Bloomberg

Rates hikes priced in for the next six months



Source: Crédit Agricole CIB, Bloomberg

EMEA: positioning for inflation and tail risks

The outperformance of emerging markets has been a consensus, or in other words an overcrowded trade. Alongside the rising fears, be it inflation or the MENA turmoil, trade positioning for bad news is increasingly relevant but one should remain very selective.

Positioning for bad news (inflation and geopolitical risks): pay 5Y rates selectively, buy breakevens

Firstly, with higher risk and inflation premiums and the expected rate hikes, paying 5Y rates would make sense but carry could make it costly. Thus, a very selective approach should be made – for instance, Poland or Hungary exhibit affordable negative carry. Still, positioning should not be as overcrowded as in Turkey where the monetary policy's mistake trade is highly fashionable.

Secondly, investors may take long positions in local debt but on a selective basis and at reduced duration. Downside risks are present but they may benefit FX appreciation and safe-haven flows. Still, we continue to favour bonds over swaps as (1) Eurozone debt worries are fading, (2) the EMEA budget issue is improving and (3) liquidity will help local Treasuries to fund their deficit.

Thirdly, buying breakevens may offer value given they have not moved too fast and still remain far from their 2008 levels when commodity prices were reaching highs. The ongoing rise in commodity prices has not yet pushed breakevens to extreme levels. Nevertheless, in terms of real rates, levels are well below their pre-crisis level and room for further downside seems limited. A position in the breakeven space appears so much more appealing (Turkey, South Africa).

Latam: the safe haven?

Brazil: receive 2Y rates. Less value now in receiving short Mexican rates

Comparatively, the Latam rate market exhibits a clearer situation as it is less sensitive to the MENA turmoil, and central banks have already tackled the inflation issue. In Brazil, we still view a further decline as the BCB is building up its credibility after having paused in Q410, and uncertainties concerning rate hikes and the new authorities' policy are dissipating. Nevertheless, one should not overestimate the importance of current inflation figures as the stance on fiscal policy has more and more impact on the behaviour of future inflation and on the yield curve. The new authorities will keep fighting inflation as it hurts the poorest people through spending cuts recently announced. So, we expect only 150bp in hikes for the remainder of the year (including the March hike) versus 217bp priced in by the markets. Assuming that the BCB remains on hold from H211 to 2013, we see value in receiving 2013 DI contracts.

In Mexico, the inflationary pressures appear moderate and the Banxico is comfortable with its current stance. Even if it has decreased, pricing of a first rate hike at the beginning of Q3 is too early in our view, but now we see less value in receiving Mexican front-end rates. Alongside the curve, rates should continue to creep higher on the back of positive Mexican macro data as well as US.

Interest rates: What's priced in vs our forecasts

	Spot	1M view			3M view			6M view		
		Our forecasts	Market	Gap	Our forecasts	Market	Gap	Our forecasts	Market	Gap
Asia										
Korea (7D repo)	2.75%	25	17	8	50	34	16	75	64	11
China (1Y lending)	6.06%	0	-10	10	50	-10	**60**	50	10	40
Taiwan (rediscount)	1.63%	13	24	-11	13	24	-11	38	30	8
Thailand (repo)	2.25%	0	73	-73	25	43	-18	50	85	-35
India (repo)	6.50%	0	10	-10	0	10	-10	25	-14	39
Latin America										
Brazil (selic)	11.25%	100*	114	-14	100	132	**-32**	100	171	**-71**
Mexico (overnight)	4.50%	0	2	-2	0	nm	nm	0	nm	nm
EMEA										
Czech Rep. (14D repo)	0.75%	0	3	-3	25	19	6	50	42	8
Hungary (2W repo)	6.00%	0	3	-3	0	11	-11	0	18	-18
Poland (7D repo)	3.75%	50*	39	11	50	54	-4	50	87	**-37**
Russia (O/N deposit)	2.75%	75	5	**70**	125	140	-15	150	184	-34
Turkey (1W repo)	6.25%	0	0	0	0	127	-127	100	163	-63
South Africa (repo)	5.50%	0	5	-5	0	12	-12	0	30	**-30**

Legend:

The main divergence between our view and the market that we want to highlight:

Where we are more hawkish than the market

Where we are more dovish than the market

nm: No monetary policy meeting during that period

** Polish and Brazilian forecasts are made as at 2 March morning. As a consequence they include the expected rate move due on this day.*

Source: Bloomberg, Reuters, Crédit Agricole CIB

The above table illustrates how many basis points rate markets are pricing in over the next 1M, 3M and 6M (cumulative) for the movements of benchmark money market rates, while our calls are on policy rates. Interpretation of the above should take into account the possibly varying spreads between money market rates. In particular, INR and RUB rates reflect to a large part expectations regarding the liquidity situation. However, in the current form it gives a relevant proxy for the next rate move from the EM central banks.

FX outlook: What doesn't kill you makes you stronger

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Despite rising uncertainty, no EM currency is sending an obvious sell signal. Some could even benefit (RUB and, to a lesser extent, ZAR). BRL and INR may find it difficult to appreciate further/rally. Asian FX should be resilient, supported by gradual CNY appreciation. KRW and PHP may still outperform.

What would be a reasonable way to position on the EM FX market against the current backdrop of rising uncertainties (MENA-related risk aversion, inflation building up, current account balance deteriorating)?

No clear sell signal

Overall, we believe that, among the main EM currencies, there is no obvious candidate to a clear sell signal. True, higher risk aversion and more expensive oil should induce volatility on EM currency markets. However, in our view the underlying medium-term bullish scenario for EM currencies remains robust. Also, higher oil prices suggests that central banks may hike interest rates further, and this fuels the carry attractiveness.

For some currencies, good news is bad news

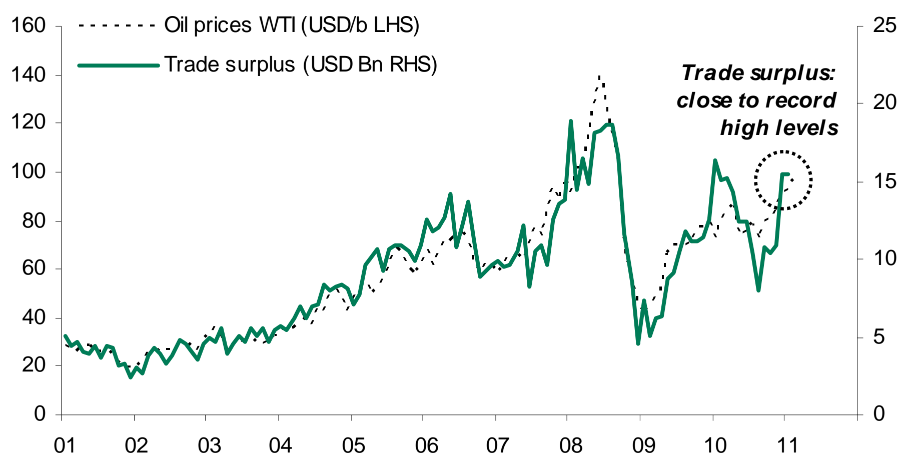
For some markets, bad news even means good news, to some extent (and provided the global rise in risk aversion remains limited). This is the case for those markets that are benefiting as some commodity prices are pushed up because of the MENA-related uncertainty.

RUB may benefit

RUB should benefit from higher oil prices

The RUB is a typical example. True, the RUB was one of the main victims of the 2008 EM crisis. However, the trigger for the RUB depreciation was the sudden fall in oil prices. For the time being, the current crisis seems to be having the opposite impact – rising oil prices. The trade surplus will remain supported in the short term. On top of that, the CBR has clearly kicked off its tightening cycle, and this should add to the RUB's attractiveness. We keep our short USD/RUB position as we believe that the behaviour of oil prices should add to the RUB's bullish short-term story.

Russia: trade surplus supported by oil prices



Source: Bloomberg, Crédit Agricole CIB

ZAR as well, to some extent

ZAR could rally…

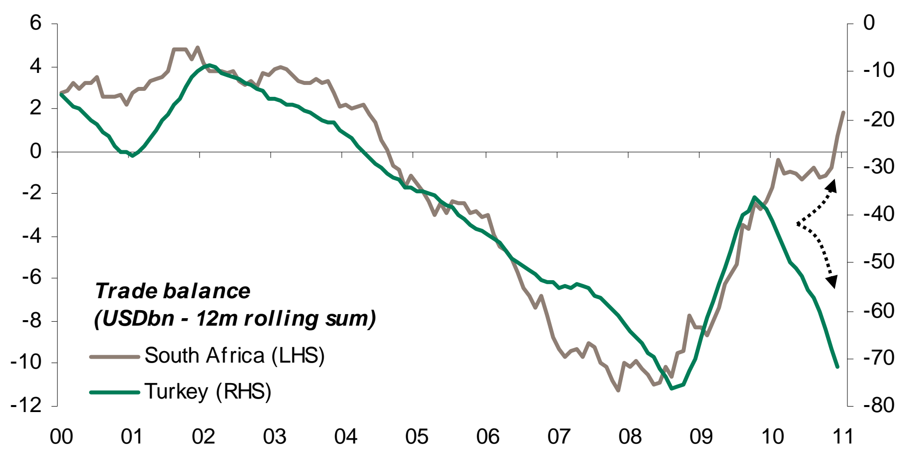
The ZAR could benefit as well, through a different channel. Firstly, ZAR has begun to perform rather well since mid-February, as the underlying ZAR story has become more supportive. Signs of recovery have intensified recently. Retail sales have been rather strong, at 8.3% YoY; GDP was slightly above expectations in Q4; the PMI was also strong in recent months. This renewed

dynamism – even if the recovery will likely be gradual – makes the local market more attractive.

…on underlying improvement, and higher gold prices

Also, it is interesting to note that the ZAR appreciation has not generated a large trade deficit – contrary to what has happened in Turkey for instance (see chart). Limited external imbalances suggest that ZAR may be penalised less than those currencies where there are large current account deficits. On top of that the ZAR may benefit from higher gold prices as the MENA-related uncertainty remains strong.

Trade surplus in South Africa and Turkey: diverging paths



Source: Bloomberg, Crédit Agricole CIB

Current account deficit – FX on a defensive stance

Apart from those currencies that may benefit in the current environment, the bulk of the EM FX universe may see increased volatility. This may be the case in particular for the current account deficit currencies.

TRY to stay on the defensive

For instance, in our view, the TRY may eventually rally on a multi-month basis due to a mix of: higher interest rates, rating upgrades and reasonably strong growth outlook. However, in the short term, the current account deficit may be an obstacle to such a rally.

BRL to stabilise

BRL may find it difficult to appreciate further

It may also be the case for both the BRL and the INR. The BRL has slowly crept higher vs USD over the past few weeks, but the potential for it to appreciate further may be limited. Overall, the net impact of the MENA-related jitters on the BRL may be minimal. But higher risk aversion may eventually make it more difficult to finance the widening current account deficit, and may help to cap the BRL appreciation (on top of the authorities' intervention).

INR seems vulnerable (up to a point)

INR may suffer from higher oil prices – to some extent

The impact on the INR may be more straightforward, as it goes via two channels. Higher risk aversion may cap capital flows to India, and oil prices should widen the trade deficit. Still, even if it seems tempting to short the INR, against such a backdrop, we believe it could be a risky bet. Indeed, the RBI has traditionally used the INR appreciation to cap inflation, and this may happen again in coming months. Also, the RBI will likely continue to tighten monetary policy, and this may provide support to the INR.

Asia: resilient, partly thanks to the CNY

Asia: not that vulnerable

Asia is an oil-intensive economic region. Therefore, one could think of the recent spike in oil prices as a strongly negative factor for currencies in the region. However, it is only partly true; and for the moment we would expect the market to play the 'what doesn't kill you makes you stronger' game. Being oil-intensive also suggests that the recent increase in oil prices will fuel inflation pressure. This

could sound frightening if inflation pressure were intensifying in a context of weak economies. But it is not the case, the growth outlook remains fairly strong, and apart from Vietnam (and to a lesser extent India), we do not expect the main Asian economies to run current account deficits in 2011.

Hence, what the market may read in the acceleration in inflation pressure is the promise of central bank tightening, and not the risk of imbalances derailing economic growth.

CNY appreciating further, partly on inflation-fighting considerations

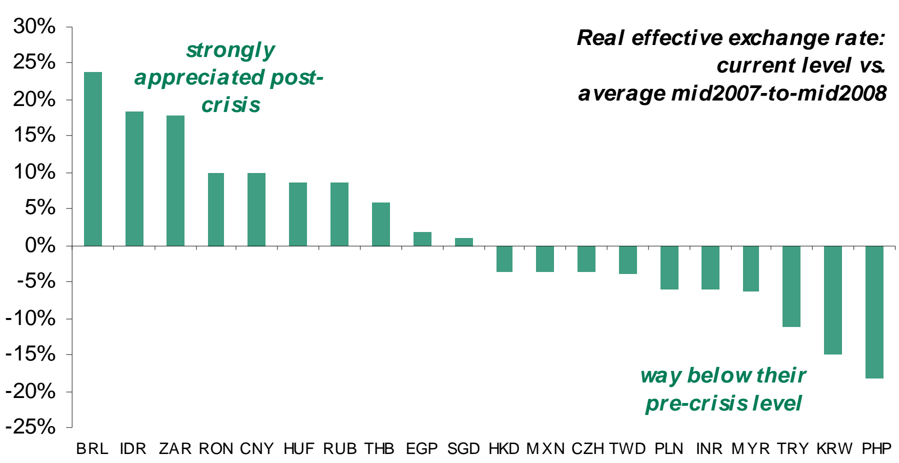
The continued appreciation after the Chinese New Year break has likely also contributed to the resilience of other Asian currencies. In our view, CNY upward pressure will remain significant, due to the current account surplus and current CNY undervaluation. Also, policymakers will allow more currency gains due to higher inflation, which may peak at a level close to 6% in June. As Governor Zhou hinted last week: '… to battle inflation, it's about using all means including … currency'.

KRW and PHP: still some upside

KRW and PHP still look promising

Apart from the CNY, we keep open our long positions on the KRW and the PHP despite rising global uncertainty. Both currencies benefit from rather low valuations, with in particular real effective exchange rates that stand way below their pre-crisis levels (see chart). As far as Korea is concerned, it is also interesting to note that the stock market does not seem overvalued. We present in *Hot topic 2: Are EM equity markets overvalued?* some indicators that help us to gauge whether some of the main equity markets are sending signals of under/ overvaluation. Out of the 11 markets on which we focus, Korea stands out as the one that sends the strongest signals of cheapness.

Real effective exchange rate: current vs pre-crisis level



Source: Bloomberg, Crédit Agricole CIB

FX: What's priced in vs our forecasts

	Spot	3M view: Our forecasts*	3M view: 3M NDF/FWD	3M view: Gap	6M view: Our forecasts*	6M view: 6M NDF/FWD	6M view: Gap	3M rates
Asia								
USD/CNY	6.57	6.48	6.53	0.7%	6.41	6.49	1.2%	4.3%
USD/HKD	7.79	7.76	7.78	0.3%	7.77	7.78	0.1%	0.2%
USD/INR	45.0	44.9	45.8	2.1%	45.2	46.5	**2.9%**	9.8%
USD/IDR	8812	9183	8902	**-3.1%**	9233	9011	-2.4%	6.7%
USD/MYR	3.04	3.11	3.05	-2.1%	3.11	3.06	-1.6%	3.0%
USD/PHP	43.5	43.1	43.6	1.3%	42.5	43.7	**3.0%**	1.6%
USD/SGD	1.27	1.27	1.27	0.0%	1.27	1.27	0.3%	0.1%
USD/KRW	1128	1105	1133	**2.6%**	1088	1139	**4.6%**	3.2%
USD/TWD	29.6	29.9	29.4	-1.5%	29.7	29.2	-1.7%	0.5%
USD/THB	30.5	29.7	30.6	3.1%	29.5	30.7	4.0%	2.6%
USD/VND	20873	20900	21723	3.9%	21067	22374	6.2%	2.6%
Latin America								
USD/ARS	4.03	4.07	4.12	1.4%	4.12	4.24	3.0%	10.5%
USD/BRL	1.66	1.66	1.69	1.9%	1.65	1.73	5.1%	11.9%
USD/MXN	12.14	12.00	12.23	**2.0%**	11.97	12.34	**3.1%**	4.3%
EMEA								
USD/RUB	28.6	29.5	28.8	-2.2%	31.0	29.1	**-6.1%**	4.0%
USD/TRY	1.62	1.50	1.64	**9.3%**	1.49	1.67	**11.8%**	7.2%
USD/ZAR	6.97	6.87	7.07	**3.0%**	6.70	7.17	**7.0%**	5.6%
EUR/CZK	24.3	24.5	24.3	-0.6%	24.3	24.3	0.3%	0.8%
EUR/HUF	273	283	276	**-2.7%**	280	278	-0.6%	6.1%
EUR/PLN	3.98	3.97	4.00	0.9%	3.88	4.03	**3.7%**	3.9%
EUR/RON	4.21	4.30	4.25	-1.1%	4.30	4.30	-0.1%	6.1%

** Obtained by extrapolation from our quarterly forecast grid (included at the end of this report)*

Legend

The main divergence between our view and the market that we want to highlight:

- (green) Where we are more bullish than the market
- (grey) Where we are more bearish than the market

Source: Crédit Agricole CIB

Trade ideas

Rates: We added a pay 1Y CNY IRS position. Our HKD-USD spread and KRW bond/swap trades have performed, while the 2/5Y CNY IRS steepener has suffered from surges in front-end rates. We keep selling 3M USD/RUB swap. We begin to pay 5Y PLN IRS.

FX: We keep long positions in Asia on CNY, PHP and KRW, as well as on RUB. We add a long ZAR position vs EUR.

Interest rate

Recommendation	Entry date	Entry level	Target	Stop loss	Now	Performance
Receive 1Y2Y HKD-USD IRS spread	21/09/10	3bp	-30bp	22bp	-6bp	9bp
frances.cheung@ca-cib.com	***Rationale***: We see upside to both USD and HKD rates. From past observations, USD/HKD IRS spreads tend to be wider (with USD rates higher than HKD rates) when absolute rates are higher. The strong fundamentals in Hong Kong remain appealing in the region. The resumption of CNY appreciation could also attract flows to be parked at the HKD, tempering any increases in HKD rates relative to USD rates.					
Long 5Y KRW bond/swap spread	22/10/10	-26bp	4bp	-41bp	-13bp	14bp
frances.cheung@ca-cib.com	***Rationale:*** MSBs/KTBs still offer relative value even after withholding tax (WHT), against the strong economic momentum in Korea and its resilient fiscal position. We choose to go long KTBs against paying IRS in view of the generally rising interest rate environment. Recent geopolitics could potentially add to bond outperformance.					
2/5Y CNY IRS (7-day repo) steepener	29/11/10	48bp	78bp	33bp	32bp	-16bp
frances.cheung@ca-cib.com	***Rationale:*** We expect a total of 50bp hikes in key policy rates and a 50bp hike in the required reserve ratio (RRR) by mid-2011. Heightened inflation risks and the chance that the PBoC may hike longer-tenor deposit rates more could benefit this trade. The risk to this trade is a much more aggressive effort from the PBoC to mop up liquidity, which will push up front-end rates more.					
Pay 1Y CNY IRS	10/02/11	3.85%	4.25%	3.65%	3.72%	-13bp
frances.cheung@ca-cib.com	***Rationale:*** Restoring the functioning of open market operations is particularly important given the very heavy maturity schedules of PBoC bills in the months ahead. We expect the PBoC has the intention of doing so, by bringing auction yields on PBoC bills nearer to secondary market levels, pushing up rates at the very front end. Historically, 1Y CNY IRS has continued to rise until previous hiking cycles ended. So we still see upside to 1Y IRS, given our call for more tightening.					
2/5Y ZAR IRS flattener	15/12/10	133bp	95bp	152bp	126bp	7bp
guillaume.tresca@ca-cib.com	***Rationale:*** After range-trading the curve has finally started to flatten. The expected rate hikes alongside the acceleration in inflation should continue to favour 5Y vs 2Y. Nevertheless, the curve slope is still hovering at a seven-year high and so it has further room to flatten.					
Pay 5Y PLN IRS	02/03/11	5.61%	5.90%	5.46%	5.61%	
guillaume.tresca@ca-cib.com	***Rationale:*** Paying Polish rates is a tactical trade to benefit from bad news where carry is only slightly negative, 2-3bp/mth. Inflation is back in Poland with real rates just restrictive. Still, the ongoing issue regarding this year's budget deficit may hurt the 5Y. The massive inflows into bond markets which compressed rates last year should not be repeated. 5Y is not cheap from a barbell point of view.					
Sell 3M USD/RUB swap	29/11/10	4.20%	3.60%	4.50%	3.30%	91bp
maxim.oreshkin@ca-cib.com	***Rationale:*** Selling 3M swap in November at 4.2% proved to be excellent idea: average o/n for the past three months equalled 2.5%, bringing total performance of this trade to 1.7% (7.4% annualised gain). Going forward, we will be looking for more opportunities to receive 1M-6M interest rate positions on temporary liquidity squeezes, although they are highly unlikely in the near term as excess liquidity in the domestic banking system still remains very high.					

Recommendation	Entry date	Entry level	Target	Stop loss	Now	Performance
Pay 5Y USD/RUB swap	09/02/11	6.85%	7.40%	6.60%	6.47%	-38bp
maxim.oreshkin@ca-cib.com	***Rationale:*** This trade at the moment has negative carry-adjusted performance of 9bp. Successful placement of 7Y RUB sovereign eurobond, ongoing interest rate hikes that support expectations of more aggressive rate hikes going forward, combined with the macroeconomic story of CBR being behind the curve in fighting inflation will result in further growth of the long end of the RUB curve.					
Sell Brazilian future DI/13-Jan contracts	26/01/11	12.77%	12.20%	13.05%	12.69%	8bp
guillaume.tresca@ca-cib.com *vladimir.vale@ca-cib.com*	***Rationale:*** The front end of the rate curve remains volatile but rates have at last started to decrease somewhat. Uncertainties about the BCB's credibility in fighting inflation are decreasing while the announced spending cut should have the expected negative impact on inflation. The stance of fiscal policy is having more and more of an impact on the behaviour of future inflation and on the yield					

FX

Recommendation	Entry date	Entry level	Target	Stop loss	Now	Performance
Sell USD/CNY (6M NDF)	30/11/10	6.6123	6.3610	6.7387	6.534	1.2%
mitul.kotecha@ca-cib.com *dariusz.kowalczyk@ca-cib.com*	***Rationale:*** CNY appreciation will be increasingly used as a tool to fight inflation, as stressed in recent policy pronouncements by PM Wen and PBoC Governor Zhou. In particular, we expect a pick-up in price pressures in Q2, which is likely to lead the PBoC to allow the continued decline in the USD/CNY exchange rate.					
Sell USD/PHP (6M NDF)	19/01/11	44.58	41.91	45.92	43.62	2.2%
mitul.kotecha@ca-cib.com *dariusz.kowalczyk@ca-cib.com*	***Rationale:*** This idea has performed well and is 1.7% in the money. We keep it open as we see more upside due to the improved trade position of the Philippines. Moreover, we expect a rate-hiking cycle to start in Q2.					
Sell USD/KRW (12M NDF)	16/2/11	1140.34	1070	1175.51	1137.9	0.2%
mitul.kotecha@ca-cib.com *frances.cheung@ca-cib.com* *dariusz.kowalczyk@ca-cib.com*	***Rationale:*** This idea is modestly out of the money. However, we keep it open as KRW should strengthen further on the back of continued monetary tightening as well as equity portfolio inflows into Korea's undervalued stock market. Moreover, KRW stands out among Asian currencies in that it is trading well below pre-crisis levels (about 15%) while most others are above, and there is no fundamental reason for such underperformance.					
Sell USD/RUB	27/9/2010	30.70	28.80	31.80	28.60	8.9%
maxim.oreshkin@ca-cib.com	***Rationale:*** With RUB appreciation starting in December and stronger EUR this trade has performed very well. We keep it open as it benefits from higher oil prices. We expect the current account surplus to exceed USD25bn in Q111 on the back of recent oil price strength, higher gas export volumes to Europe and a positive seasonal effect.					
Sell EUR/ZAR	2/3/11	9.6208	9.0000	9.9200	9.6208	0.0%
sebastien.barbe@ca-cib.com	***Rationale:*** ZAR has suffered along with TRY from its central bank's dovish stance. However, in contrast to Turkey, it does not suffer from a large current account deficit, and this may lead the market to discriminate as global uncertainty remains high. ZAR should benefit from the gradual recovery in 2011, from rate expectations that will gradually become less and less dovish, as well as from higher gold prices amid MENA-related global uncertainty.					

** For NDFs: target, stop-loss and current level (now) calculated on the basis of the remaining maturity.*

Hot topic 1: What is next for Saudi Arabia?

John Sfakianakis: johns@alfransi.com.sa

Markets are beginning to price a shift of contagion from North Africa to some of the Gulf economies, principally Bahrain and Saudi Arabia. The possibility of contagion spreading to Saudi Arabia remains low although markets are pricing a higher risk premium. Bahrain's future is a leading indicator but there is not enough clarity about short-term political outcomes.

Fundamental buffers vs market fears

The worst is far from being likely…but markets could fail to discriminate in the short term

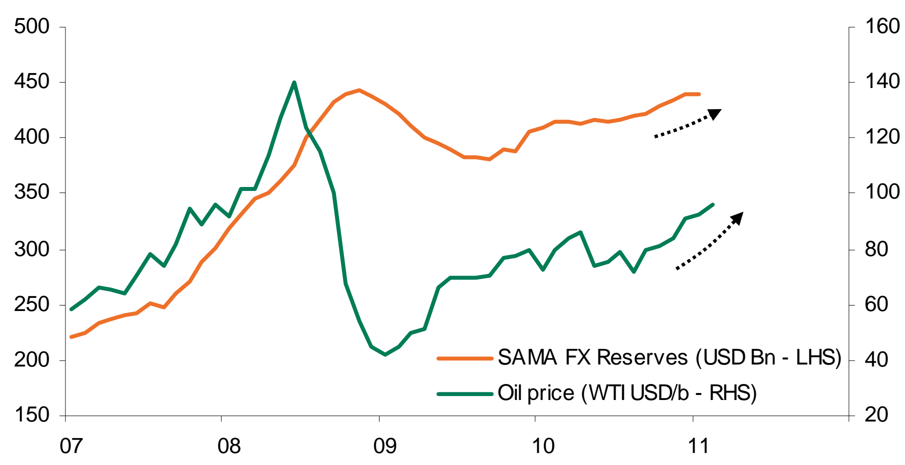
If we learned anything during the most recent financial crisis it is that markets can get it wrong. During the recent Egyptian crisis, oil prices spiked over concerns about the transhipment of oil via the Suez Canal. Markets today are beginning to price contagion effects spreading from North Africa to, principally, Bahrain. Although it is hard to predict the political outcome in the Gulf island, markets are pricing a premium on the risk of contagion to neighbouring Saudi Arabia. Aside from making any definite calls on the future outcome of Bahrain, we remain reassuring about Saudi Arabia. The chances of disruption to oil production remain distant as is the likelihood of major unrest. Markets have a tendency to differentiate less during crises and, as we saw during the Dubai debt crisis in 2009, risk premiums spiked for all. Differentiation took time, however.

Putting its money where its mouth is

Saudi Arabia's impressive reaction: a support plan worth 8.3% of GDP…

Saudi Arabia's ability to carry out distributive policies is obvious, particularly in areas that have important social significance. The government announced an estimated USD36bn spending programme (as much as 8.3% of last year's GDP) on housing, education and social welfare on top of a 2011 budget which is the largest in its history. Saudi King Abdullah recently unveiled a string of financial support measures geared towards citizens through new unemployment benefits that stand to help youths facing double-digit joblessness rates; expansion of social security safety nets set to target lower-income Saudis; and substantial funds allocated to writing off the debts of deceased borrowers and prisoners. The royal order, which includes 19 components, strives to promote job creation, expedite the supply of housing, and improve funding for education, charity associations, cultural and sporting clubs, and professional associations.

Huge reserves providing financial leeway



Source: Bloomberg, Crédit Agricole CIB

Pumping its huge reserves

Moreover, Saudi Arabia has the capacity to underwrite similar distributive policies, without resorting to domestic or external financing. Central bank foreign assets (SAMA) were at USD444.8bn as at December 2010 (102% of 2010 GDP), which provides ample fiscal buffers. The package announced at end-Feb will be financed from these reserves. Hence Saudi Arabia is forecast to witness twin surpluses (fiscal and current account) as oil prices continue their buoyant performance. Hence, the state has the capacity to tap into its huge deep pockets

to support any short- to medium-term emergency spending programmes. We believe that the chance of major unrest within Saudi Arabia is not probable. The economic changes desired and needed are not predicated on calls for a change in the leadership structure. A cabinet reshuffle is a welcome step towards political refreshment. However, the leadership cannot afford complacency and neglect as events in the wider Middle East necessitate change. Events in Bahrain should be closely watched as they could act as a regional 'self-reflection exercise' for the political landscape.

Market volatility could persist

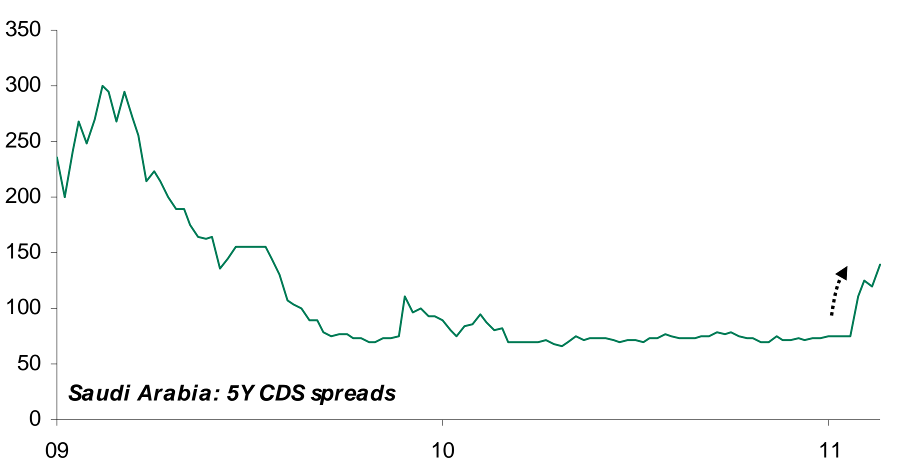
CDS spreads could remain under pressure

There is no doubt that uncertainty about the wider Middle East will continue to impact Saudi Arabia's CDS or could at some point impact SAR forward rates, should uncertainty escalate further. The strength of events in Tunisia, Egypt, Bahrain, Libya as well as Yemen has led most to expect the worst to come for the rest. Differentiation and re-classification of risk is warranted, but it takes time for the dust to settle. Regional stock markets will continue to reflect the higher perceived risks.

Market pressure: there could be more to come

We think that markets will continue to price additional risk premiums despite the arguments put forward about Saudi Arabia's fiscal and political capacity to weather the regional crisis. The CDS spreads have widened recently. However, they remain far below the level they reached during the Dubai crisis (see chart). Spread could remain large or widen further in the short term.

CDS spreads: up (but still way below their 2009 level)



Source: Bloomberg, Crédit Agricole CIB

Saudi Arabia could be a buffer as well as a risk factor for oil prices

Saudi Arabia's systemic role in the global oil market is paramount for the world economy. The kingdom's extra capacity is 4mbpd, which can be put on to the market in a short period of time and is more than twice the total current production of Libya. We think that Saudi Arabia's oil facilities remain under no threat and the country's oil production will remain uninterrupted. However, the market may think otherwise at some point, should tensions rise further in the Gulf.

The US will pay close attention

The role of the US in the Gulf is expected to be more vigilantly active. In the case of Tunisia and Libya, the US's role has remained subdued due to its modest historical and diplomatic ties. However, the role the US would take in the event of Bahrain's political landscape being radically reshaped, as it is the base for the fifth fleet, remains to be tested. There is little evidence to lead us to anticipate Saudi Arabia being the next country to face domestic unrest, turmoil, violence and calls for regime change. We do believe that Saudi Arabia will embark on various economic and reforms that have a wider inclusive and distributive purpose. However, the end-game for the rest of the Middle East is far from clear at this point.

Hot topic 2: Are EM equity markets overvalued?

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We present below four metrics that help us gauge under/overvaluation of EM stock markets, for the purpose of taking into account signals sent by equity markets when setting our EM FX views. These metrics suggest that the main EM equity indices are not overvalued. This argues for some resilience even as risk aversion rises. Korea, Hong Kong and Poland look cheap, in particular. KRW and PLN could benefit from capital flows. In contrast, Brazil and Turkey do not look cheap.

Equity valuation model: PE, margins, and macro

4 metrics to send signals about equity market under/overvaluation

Since EM currencies are obviously strongly impacted by equity inflows/outflows, we try to generate metrics that could send signals of equity market over/ undervaluation. To try to put in place signals of equity market over/undervalution, we have developed four complementary indicators that we calculate for 11 equity markets, for which we believe we have sufficiently reliable data.

1. PE

- The first indicator is the very classical price earnings ratio (PE) based on the coming year's earnings per share (EPS). We adjust it by using a moving average of the current year's EPS and next year's EPS, so as to erase the step from one financial year to another. This indicator, like the other three indicators, is Z-scored.

2. PE vs last decade's trend

- The second indicator is the PE based on the EPS trend over the past decade. It enables us to offset the periods of boom or depression, when the basic PE can be very misleading because the level of EPS is far from what the economy can deliver[1].

3. operating margin exuberance

- The third indicator is the current de-trended operating margin of the index constituents. The rationale is that an index with a significantly higher margin than its history sounds a warning of unsustainably high profits. This indicator is especially useful when the first two point in opposite directions.

4. macro-friendliness

- The final indicator aims to reflect the 'friendliness' of the macro environment, via the gap between long-term rates and nominal GDP growth[2]. The more negative, the better for equities.

Over/undervaluation of equity markets: the higher the score, the more overvalued

	Index	Indicator #1	Indicator #2	Indicator #3	Indicator #4	Overall Indicator
		PE based on next 12M EPS	PE based on long term trend of EPS	Hist operating margin	Macro-environment	
Brazil	MSCI Brazil	-0.22	-0.53	1.64	-0.15	0.41
China	MSCI China	-1.04	-1.18	1.00	-0.15	-0.56
Hong Kong	HSI Index	-0.91	-0.86	0.40	-0.85	-0.85
India	MSCI India	-0.88	-0.99	1.28	0.34	-0.09
Indonesia	MSCI Indonesia	0.13	-0.11	-0.75	-0.17	-0.37
Mexico	MSCI Mexico	0.76	0.04	-0.78	-0.64	-0.10
Poland	MSCI Poland	-1.03	-0.93	-0.56	0.50	-0.85
Russia	MSCI Russia	-0.77	-0.58	0.20	0.15	-0.49
South Africa	FTSE TOP40	0.16	-0.52	-0.79	0.33	-0.39
South Korea	MSCI Korea	-0.84	-0.45	-0.23	-0.88	-1.03
Turkey	MSCI Turkey	0.06	-0.50	1.82	-0.58	0.38

All indicators all calculated as Z-scores between 2006 and 2010. All indices in local currencies except MSCI Russia in USD.

Grey = overvalued; Green = undervalued. Source: Bloomberg, Crédit Agricole CIB

EM not expensive, overall

The table above summarises the results of these valuation indicators. The indices with higher overall scores (in grey) are more overvalued, those with lower scores (in green) are undervalued. As a whole, the overall valuation indices are greenish, meaning valuations are currently not excessive in general. Two months ago, the model would have suggested that the more undervalued EM indices were Russia, Poland, Hong Kong and South Africa. Their average performance has been 1.5% since end-2010. In contrast, the four indices ranked as most

[1] The typical example would be the S&P 500 at the end of 2007. The basic PER based on 2008 estimated profits was around 15x, not sending a strong warning. The PER based on the EPS trend was around 22x, clearly excessive given the slowing US economy at that time.
[2] Average of the past two quarters and the next six quarters (using Crédit Agricole CIB's forecasts).

expensive at the end of 2010 (Brazil, India, Mexico, and Turkey) have performed on average -8% since end-2010.

Korea, Hong Kong and Poland seem cheap

Korea, Poland and Hong Kong look relatively cheap…

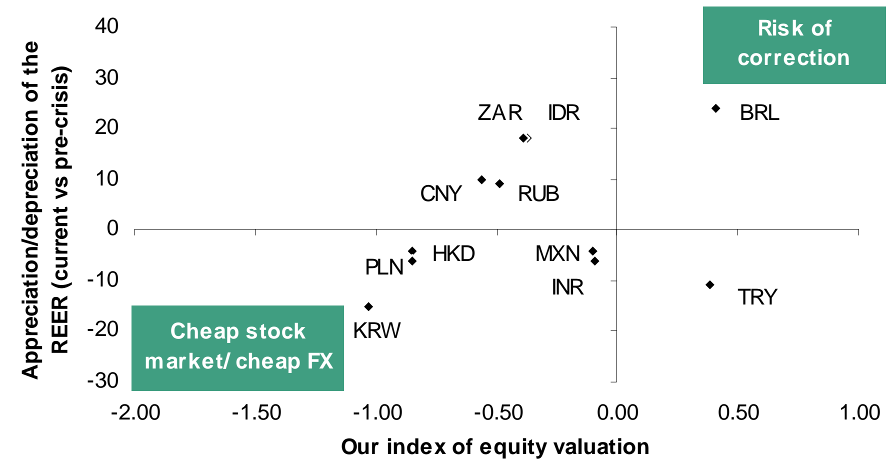
Using our metrics, the cheapest indices seem to be Korea, Poland and Hong Kong. In Korea, analysts' EPS consensus seems very reasonable given nominal growth and margins. When combined with the favourable macro outlook (we see nominal growth of 10% in 2011 and 2012, ie, 5% above long-term rates) and low PE (10x for 2011 expected profits), there seems to be room for repricing.

The Hong Kong HSI index also looks attractive given current prices, with a combination of reasonable PE and very equity-friendly environment, as 5Y rates are far below nominal growth. The HSI potential is high if analysed from the fundamental value angle. Polish equities are also relatively cheap, with modest PEs, based either on historical earnings or 2011 earnings. Operating margins are not yet stretched, which makes the consensus for EPS growth (almost 20% in 2011) relatively plausible.

…not the case for Brazil and Turkey

Following the recent correction in emerging equity indices, we no longer find clearly overvalued indices. Only Turkish and Brazilian equities show a modest overvaluation. In Turkey, the EPS growth consensus for 2011 is modest (+4%), but already-high margins combined with not especially cheap PEs advocate the view of a still-modest overvaluation given current conditions. In Brazil, PEs are relatively low given historical standards and macroeconomic conditions, but the combination of already very high margins with a consensus of 20% growth in EPS in 2011 sounds like the market is probably still a bit too optimistic for Brazil versus other EMs.

Overall equity indicator and REER



Source: Bloomberg, Crédit Agricole CIB

Equity valuations favour KRW, threaten BRL

KRW and PLN benefit from leeway for further appreciation

Interestingly, currencies of countries with undervalued equity markets are precisely those that have lagged the recovery from the crisis. In terms of real effective exchange rates, KRW, PLN and HKD are below pre-crisis levels, which highlights their potential for further recovery. As attractive stock valuations could bring in foreign portfolio flows, some of these currencies could benefit. The HKD will likely remain pegged to the USD. But the outcome of our model is consistent with our medium-term bullish forecast for KRW vs USD and PLN vs EUR.

BRL may be capped

On the other hand, Brazilian equities – the most overvalued among large emerging markets – may pose a threat to BRL. At the same time, BRL has appreciated the most in REER terms among the currencies analysed since before the crisis. Should portfolio flows reverse, Brazil would find it more difficult to fund its current account deficit. This outlook supports our call that BRL will decline 2% this year, to 1.70.

Hot topic 3: CBR to remain behind the curve

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Core inflation in Russia is already near 7.0%, while the CBR is not in a hurry to tighten monetary policy with base rates at only 3.0% after the February rate hike. The CBR is seriously behind the curve in its anti-inflation policies and risks repeating the mistakes of 2007-08. After that, Volcker-style policies will be needed to preserve macroeconomic stability.

Output gap is about to close...

With a closed output gap strong nominal demand growth will fuel import growth and inflation

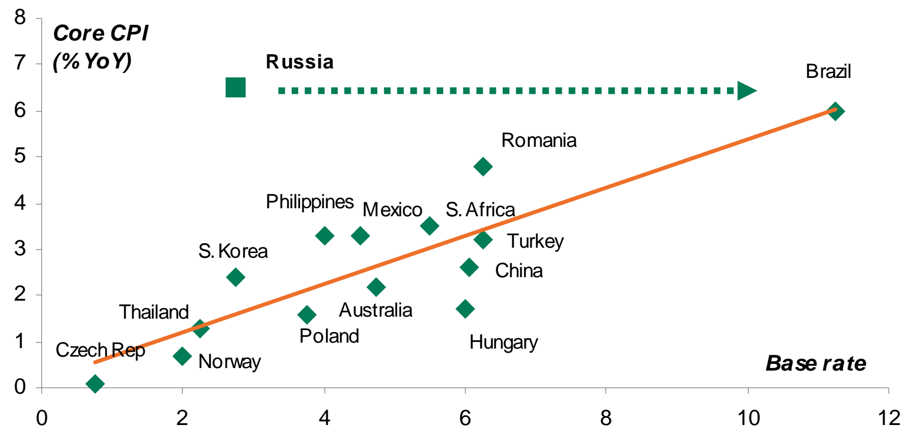
Recent macroeconomic data shows that Russia has successfully recovered from the contraction of GDP in Q310 (mainly attributed to drought and lower gas export volumes to Europe). Q410 GDP data revealed GDP growing by 2.6% on a seasonally adjusted basis (10.8% annualised growth rate). Of course, growth rates will slow down in coming quarters, but the economy will certainly remain on a growth trend. As it is still hard to estimate how much the economy was overheated in 2007-08 and how much the potential level of GDP grew in 2009-10 (the first two years of outright workforce contraction), our preferred way to estimate the output gap is to look at the labour market situation, where unemployment (currently at 6.9% on a seasonally adjusted basis) is about to reach NAIRU, which we estimate at 6.5% (we expect this level to be reached in Q211). The low level of slack in the economy is fuelling import growth (currently nearly 25% pa) and the acceleration of core inflation (ex-food and gasoline CPI), which is about to reach 7.0% YoY.

...but the CBR is stuck with its low interest rate and QE-style policy

CBR is tightening monetary policy, but this is not enough

Following Friday's decision, the CBR has in recent months delivered a total of 50bp in deposit rate hikes and 100/200bp in required reserve ratio increases, while core CPI has accelerated from 6.1% in October to 7.0% now. So, monetary policy still remains in a very easy mode: central bank base rate at 3.0%, RRR at 3.0/4.0% and QE-style policies that fuel excess reserves of commercial banks (which now stand close to RUB1.5trn). Negative real interest rates and excess reserves in the banking system are simultaneously fuelling lending growth, which – despite still-high NPLs on banks' balance sheets (which is still impairing credit channels) – is about to exceed a growth rate of 2.0% per month. Money supply annualised seasonally adjusted growth rates are approaching 50%. A comparison of core CPI/base rates ratio in different countries shows that all countries are very close to a central tendency except one – and that is Russia. Being an outlier on the graph below means a country either needs to sharply adjust base interest rates to a normal level or it will face accelerating core inflation dynamics.

Russian rates are well below the level where they should be



Source: CBR, Crédit Agricole CIB

Inflation story

Food price growth will be replaced by core CPI growth this year

The CBR is giving a lot of attention to the headline CPI dynamics, but CPI growth from 5.5% in July 2010 to 9.7% at the moment is 90% driven by food prices (which represent almost 40% of the Russian consumer basket and should not trigger a monetary policy response under normal policy). The spike in food prices is a combination of world food price growth and severe local drought, which has pushed up vegetable prices (mainly produced locally) by more than 50% in the past 12 months. It seems this food price spike has helped to contain non-food inflation in recent months as high food inflation has resulted in a slowdown in real income growth.

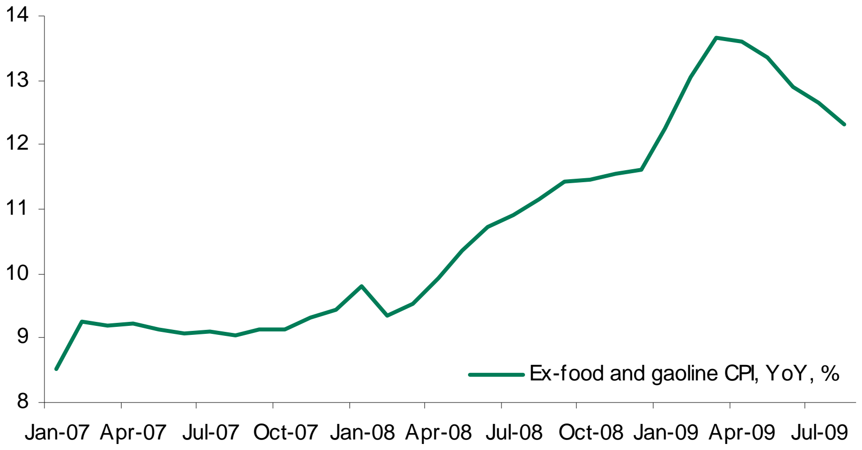
But with the new harvest, food prices will likely start to decline in August and this will push headline CPI from its maximum of 10.5-10.7% in July towards 9.5% by the end of the year (with food inflation declining from 14.2% to 9.7% this year and ex-food and gasoline CPI accelerating from 6.3% to 9.3%). Thereafter the headline CPI will restart its growth trend based on further non-core inflation acceleration. The headline CPI path can play an important role in the CBR's monetary policy decisions as declining headline CPI can help the CBR (taking into account forthcoming elections) to justify a pause in the rate-hiking cycle later this year.

Repeating the mistakes of 2007?

In 2007-08 CBR lost control of CPI dynamics – will it repeat its mistakes once again?

It looks like the CBR is going to repeat its mistakes of 2007-08, when the CBR responded to a large uptick in core CPI with only light monetary tightening, thus pushing real rates lower and lower, which ultimately resulted in double-digit core inflation.

CBR lagged inflation developments last time – will this be repeated?



Source: CBR, Crédit Agricole CIB

We still expect the CBR to deliver only 175bp in rate hikes and increase RRR by another 300bp (which is unlikely to have any significant effect on local liquidity until the autumn – but liquidity dynamics should be watched closely as a relapse of the November rate spike is still possible).

Is Paul Volcker free to chair the CBR after the 2012 elections?

In the end only a Volcker-style approach will help to preserve macro stability in Russia

To preserve macroeconomic stability in Russia after non-aggressive monetary tightening in the coming year (which will eventually end up with double-digit core inflation), the CBR will need to tighten its policy dramatically. It will be very hard to deliver this kind of monetary policy shift from a political point of view, but it will be an absolute necessity from an economic point of view. This will require a Volcker-style approach, as the market will be adjusting its expectations for higher rates and the inflation yield curve will be shifting higher. RUB long-term rates, in our opinion, have already entered a secular upward trend – in this situation one should use any step-back in rates to enter a pay position.

Hot topic 4: Asia inflation – more to come

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Inflation in emerging Asia is increasingly becoming a major problem. It is driven largely by food and housing, and both are likely to rise further on global trends and the delayed impact of residential real estate prices, respectively. This argues for a hawkish monetary policy stance, paying up IRS and supporting Asian currencies.

Food and housing driving Asian inflation

Asia inflation at two-year highs…

Inflation in emerging Asia reached two-year highs in January, becoming an increasingly burning issue for regional economies. In most cases, price pressures are stemming primarily from food and housing, which is a worrying development given that monetary policy does not have an immediate impact on these goods in the current environment. Two other factors are compounding the problem.

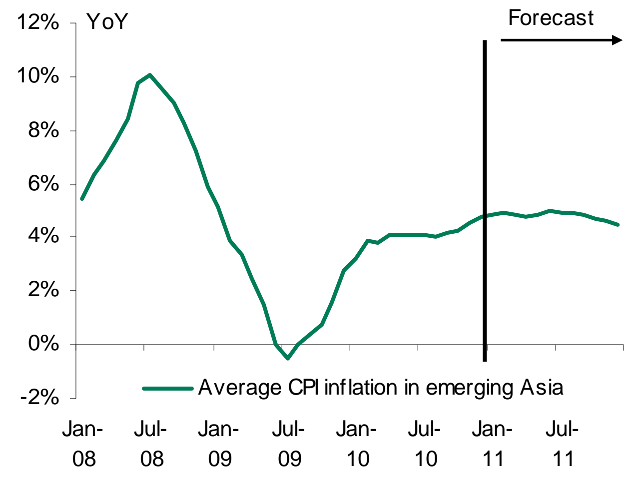
…boosted by purchasing power…

Firstly, after years of high nominal wage growth, the purchasing power of the Asian consumer is high enough to take demand for food and housing to a new level. In consequence, food and housing inflation is clearly leading to increases in overall CPI inflation. In the case of food, gains are also driven by rising global prices, and in the case of real estate by ample domestic liquidity caused by quantitative easing and low rates in G3 markets.

…and high share of food and housing in CPI baskets

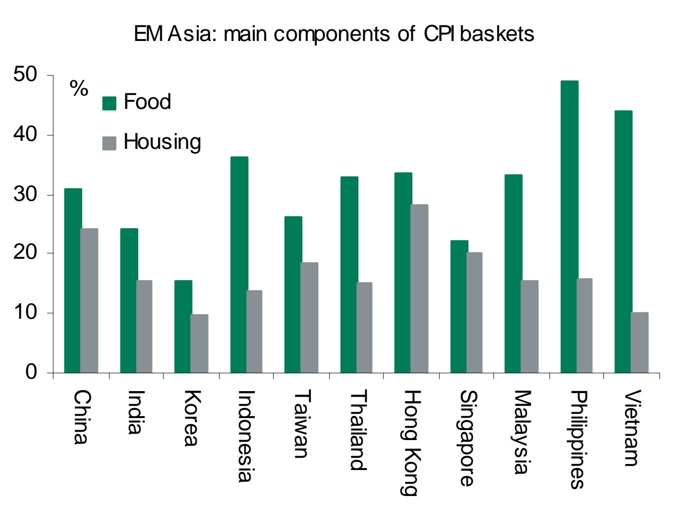
Secondly, given the lower level of development than in G10 countries, housing – and to an even larger degree food – account for a relatively high share of CPI inflation baskets in the region. As a result, changes in their levels disproportionately impact CPI inflation. As both are likely to move higher, so will overall price pressures.

CPI inflation at 2Y high and to remain elevated…



Source: CEIC, Crédit Agricole CIB

…driven by food and housing costs



Source: CEIC, Crédit Agricole CIB

Closer look at housing costs: more gains to come

Taking a more detailed look at the housing component of the CPI baskets, one will notice that usually rentals is the major sub-component, complemented by items like maintenance costs, management fees, utilities charges and even sewage disposal charges, only to leave out house prices.

More to come…

Two problems arise from the design of this measurement by the CPI. Firstly, we observe that rentals lag behind house price movements by at least one to three months. This is not too difficult to understand, and indeed the lag could be even longer depending on how rentals are measured. The terms under a leasing agreement usually remain unchanged for a period of time – for one year in Hong Kong for example. When house prices are rising, rentals will fail to follow, initially

constrained by existing contracts, unless only new leasing agreements are used in the calculation of CPI. Given that house prices in the region continue to rise, the housing component under CPI will have further to go in the months ahead as a catch-up, barring any swift change in sentiment in the property market.

… as rents follow home prices

Secondly, even allowing time for rentals to catch up in terms of the direction of moves, they sometimes fail to match the changes in house prices. This is especially so in the current environment. Rental yields have been falling steadily since the credit crisis, while housing markets in the region are largely booming. In other words, the CPI housing component understates the true picture of property prices.

Price pressures have become widespread, warranting hawkish monetary posture

The main negative repercussion of rising food and housing costs is that price pressures originating in these segments of the economy are spreading to other parts of the CPI basket. Indeed, CPI inflation ex. food and housing is running much closer to pre-crisis levels than overall CPI.

Policymakers should be extra careful

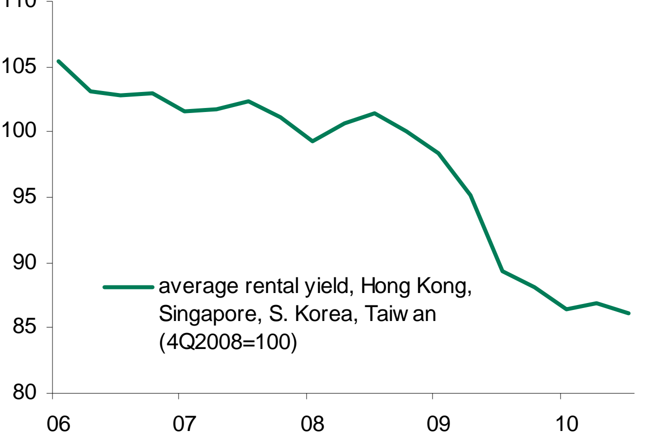
The takeaways for policymakers are:

- Attention should be paid to headline inflation, in addition to core inflation, as food price inflation is no longer solely a cyclical phenomenon; there is a structural element in it.
- The understatement by the CPI measure of how inflation in the economy is evolving should be acknowledged.

Whole Asian curves to move higher

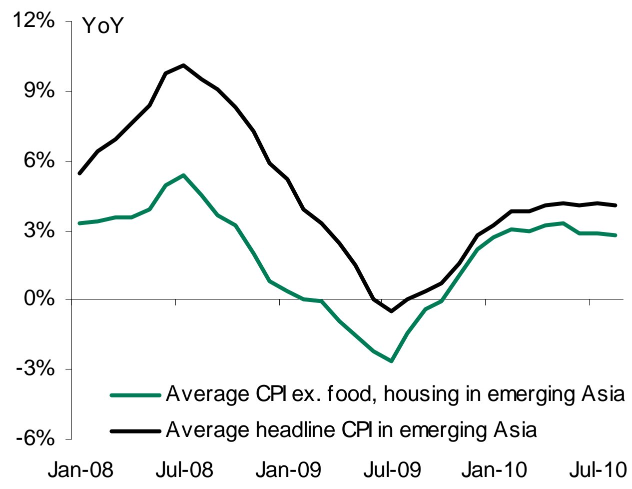
Given that we are seeing an extended period of food price inflation, and the housing component is likely to rise further, we expect regional central banks largely to be vigilant and remain or become increasingly hawkish. More aggressive central bank tightening will push up front-end IRS, while higher inflation and inflation expectations will pay up the longer end. An extended and possibly accelerating upward trend in interest rates bodes well for regional currencies.

CPI understates the true picture



Source: CEIC, Crédit Agricole CIB

CPI inflation ex. food, housing: closer to pre-crisis peaks



Source: CEIC, Crédit Agricole CIB

Hot topic 5: MAS to tighten further in April

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We expect headline inflation to remain above 5% YoY and underlying inflation to pick up gradually to 2.5% YoY in the months ahead, prompting the MAS to tighten by re-centring the SGD NEER. However, there is a possibility that the MAS will choose to narrow the SGD band at the same time, making it a less aggressive move. Appreciation pressure on the SGD is likely to continue, and we see USD/SGD at 1.23 by year-end.

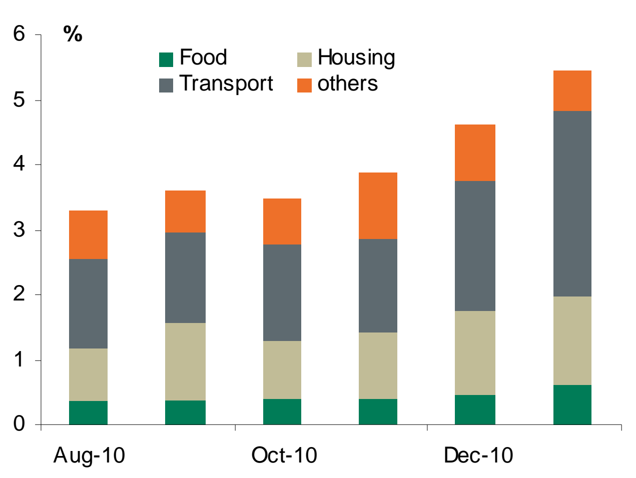
Inflation to remain high in coming months

CPI inflation surprisingly surged to a two-year high of 5.5% YoY in January, driven mainly by the costs of transport and housing. We expect headline CPI to remain above 5.0% YoY, and underlying inflation to pick up gradually to 2.5% YoY in the months ahead. Recent upward revisions to CPI forecasts by the government, together with its hawkish comments about SGD being the first approach to moderate inflation pressure, add to the likelihood that the MAS (Monetary Authority of Singapore) will tighten its policy at the April meeting by re-centring the SGD NEER. However, there is a possibility that the MAS will choose to narrow the SGD band at the same time, to make the overall move a less aggressive but still tightening one.

We expect underlying inflation to rise, as pressure spreads to the broader consumer items

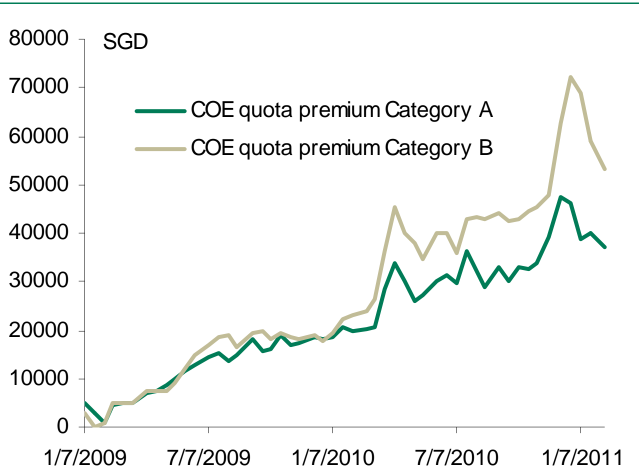
Major contributors to higher CPI inflation have been the costs of transport and housing, which are likely to remain so. There have been some sequential drops in COE (Certificate of Entitlement) premium, a major force behind the rising costs of transport. This development, if sustained, could alleviate some of the pressure on headline CPI. However, we expect inflation pressure to spread across the broader consumer items, as it did in some other places in the region, amid robust economic activity and a favourable labour market, with the jobless rate low at 2.2% in Q410. Therefore, we see MAS underlying inflation, which excludes the cost of accommodation (a sub-component under housing) and private transport (under transport), to pick up gradually and headline CPI to remain high, prompting the MAS to act.

Contributions to CPI inflation by major items



Source: Bloomberg, Crédit Agricole CIB

Respite or reversal?



Source: Bloomberg

Growth to normalise

The final estimate of Q4 GDP confirmed a return to positive QoQ growth from the contraction in Q310. The manufacturing sector saw a significant improvement, expanding by an annualised 0.7% QoQ versus a deep contraction of -48.5% QoQ in Q310. The services sector also grew by a healthy 5.6% QoQ. We forecast 2011 GDP growth at 6.7%. While this represents a marked slowdown from the 14.5% growth in 2010, we see this as a normalisation from previous surges, which set a high base.

With the end of the inventory cycle, it will be difficult for manufacturing expansion to be overly robust. The services sector, in particular wholesale/retail and financial/business services, will become a major contributor to overall GDP growth. The booming tourism and hotel industry will also benefit growth by adding to retail sales and jobs, though the industry itself constitutes only a small part of the economy.

Resilient exports

Exports to regain momentum, adding to current account surplus and thus FX accumulation

On the expenditure side, January NODX staged a strong rebound to +20.9% YoY following two months of high-single-digit growth. The series has been fluctuating, underpinned by the highly volatile pharmaceutical shipments. Nevertheless, signs of sustained global chip sales and healthy demand from major markets do bode well for Singapore's exports outlook in the coming months. The current account surplus is likely to widen further, driven mainly by the goods and services accounts, to 24.7% of GDP for 2011. This will outweigh the capital and financial account deficit, if any, by a wide margin, resulting in rapid accumulation in FX reserves potentially to the tune of USD10bn+ per quarter. This will continue to put appreciation pressure on the SGD, supporting the case for the MAS to tighten.

But will it be too aggressive?

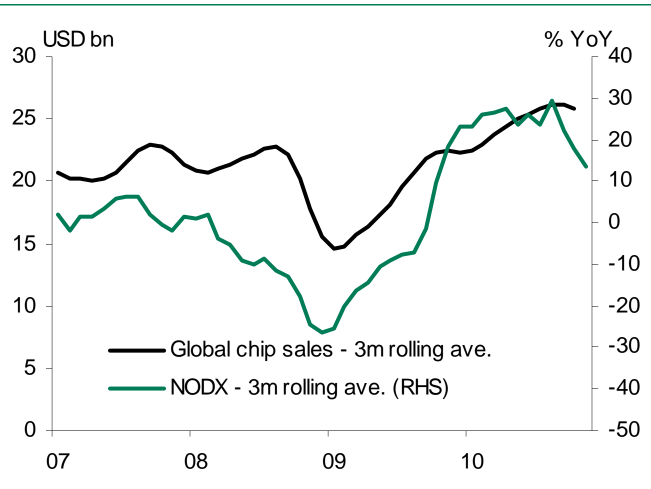
SGD NEER is already well above the central target; a re-centring alone could be a big move

Given that the SGD NEER is trading at more than 3% stronger than the central target, a re-centring could represent a big move depending on market reaction, especially when the policy action marks the third back-to-back tightening. If the SGD NEER is quickly pushed up to the new upper band, as it was following the last October policy change, a re-centring would mean 3% appreciation in a short period of time.

The MAS would possibly choose to make a re-centring less aggressive, by reducing the steepness of the slope or narrowing the SGD band, for example. Keeping a wide SGD band has its own merits, allowing more flexibility for the MAS to manage two-way risks at times of greater market volatility. However, it will be more difficult for the MAS to fight SGD appreciation pressure by maintaining a wide band explicitly. Reducing the steepness of the slope can send a less hawkish signal, but the result of mitigating the impact from a re-centring especially in the near term is not significant. We are more inclined to believe the MAS would narrow the band if it wanted to make a mild tightening move. That said, the combination of MAS moves will depend to a large extent on how the inflation picture pans out in the weeks ahead.

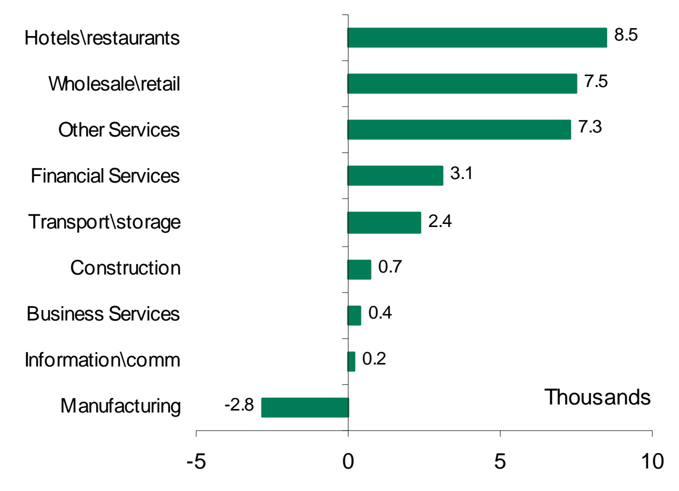
We expect the SGD NEER to be trading meaningfully above the new central target after an April re-centring, on strong economic fundamentals and external positions. We therefore forecast USD/SGD at 1.23 by year-end.

Exports to regain momentum



Source: Bloomberg, Crédit Agricole CIB

Changes in employment by industry, Q410



Source: CEIC

Economic forecasts

	Real GDP (YoY, %)			CPI (YoY, %)			Current Account (% GDP)		
	10	11	12	10	11	12	10	11	12
USA	**2.9**	**3.2**	**3.5**	**1.7**	**1.9**	**1.7**	**-3.4**	**-3.6**	**-3.6**
JAPAN	**3.6**	**1.3**	**1.7**	**-1.1**	**-0.4**	**0.0**	**3.5**	**3.9**	**3.8**
EUROZONE	**1.7**	**1.8**	**1.7**	**1.6**	**2.3**	**1.9**	**-0.3**	**0.3**	**0.5**
Germany	3.5	2.7	2.0	1.2	2.4	2.4	4.5	5.5	5.5
France	1.5	1.5	1.7	1.5	1.8	1.7	-2.3	-2.3	-2.5
Italy	1.1	1.0	1.0	1.6	1.8	1.5	-3.2	-2.9	-2.5
Spain	-0.1	0.5	0.9	1.8	2.8	2.3	-4.8	-3.8	-3.6
Greece	-4.1	-2.9	0.4	4.6	2.2	1.0	-10.0	-9.0	-6.0
Norway	-0.4	1.5	2.8	2.4	2.6	2.4	14.0	15.0	13.1
Sweden	5.3	4.6	3.1	1.3	2.5	2.0	7.0	7.0	7.3
Switzerland	1.6	1.9	2.2	0.7	1.0	1.2	9.5	8.0	9.0
Canada	2.9	2.3	3.2	1.8	1.9	1.9	-2.7	-2.8	-2.1
Australia	2.8	3.1	3.4	3.2	3.5	3.3	-4.0	-4.3	-4.2
New Zealand	1.7	3.2	3.5	2.3	3.7	3.3	-4.8	-5.8	-6.2
United Kingdom	**1.7**	**1.9**	**2.1**	**3.3**	**3.2**	**1.9**	**-2.2**	**-1.6**	**-1.2**
Asia	**9.1**	**8.2**	**8.1**	**4.5**	**5.2**	**4.4**	**3.2**	**2.7**	**2.2**
China	10.0	9.5	9.0	3.4	5.0	3.8	5.2	4.0	2.9
Hong Kong	6.8	6.3	6.8	2.5	4.1	3.8	8.7	10.5	11.2
India	8.9	8.4	8.3	9.1	7.0	6.0	-4.3	-3.8	-4.2
Indonesia	6.3	5.8	5.8	4.9	6.8	6.2	0.9	0.5	-0.1
Korea	6.1	6.1	6.5	3.1	3.5	3.7	2.8	3.0	3.4
Malaysia	7.3	4.1	6.8	1.6	1.9	2.3	10.1	6.9	8.9
Philippines	7.5	5.0	6.6	3.8	4.0	4.8	9.6	8.9	8.1
Singapore	13.6	6.7	7.1	2.5	4.7	4.0	19.4	24.7	25.2
Taiwan	10.0	5.8	6.3	0.9	2.3	3.1	9.3	9.0	9.4
Thailand	8.0	5.3	6.0	3.3	3.6	4.3	3.7	3.9	4.4
Vietnam	6.6	6.5	7.4	9.0	9.1	9.4	-7.8	-8.6	-7.9
Latin America	**6.6**	**3.9**	**4.5**	**6.6**	**6.3**	**6.1**	**-1.4**	**-1.8**	**-1.9**
Argentina	7.0	4.0	4.0	17.0	17.0	17.0	1.5	1.5	1.1
Brazil	7.5	4.2	4.5	5.5	5.0	4.5	-2.7	-3.3	-3.0
Mexico	5.3	3.5	4.8	4.2	4.0	4.0	-0.6	-1.0	-1.5
Emerging Europe	**4.0**	**3.8**	**3.4**	**7.0**	**7.0**	**7.6**	**0.2**	**-1.7**	**-2.0**
Czech Republic	2.0	2.5	2.3	1.5	2.2	2.0	-2.5	-2.8	-3.0
Hungary	1.0	2.3	2.0	4.9	3.4	2.5	0.0	-1.6	-1.8
Poland	3.3	3.5	3.0	2.8	2.8	2.6	-2.5	-3.0	-2.8
Russia	4.0	3.7	3.3	8.8	9.5	11.0	4.8	1.0	0.0
Romania	-1.9	1.7	3.0	6.2	5.2	4.0	-5.8	-6.9	-6.4
Turkey	7.5	5.5	4.5	8.3	7.0	7.0	-6.0	-5.5	-4.5
Africa & Middle East	**4.4**	**4.2**	**4.7**	**5.2**	**5.2**	**5.2**	**4.2**	**4.3**	**4.9**
Algeria	4.0	3.5	4.4	5.0	4.3	4.8	2.0	1.2	2.5
Egypt	5.2	3.7	5.5	11.1	10.0	9.3	0.3	0.4	1.8
Kuwait	3.2	3.5	4.4	4.0	4.2	4.3	32.1	29.1	28.3
Lebanon	7.5	5.5	4.0	4.6	3.8	3.5	-10.0	-10.7	-10.3
Morocco	4.2	3.8	4.9	2.5	2.6	2.9	-8.4	-6.9	-5.9
Qatar	16.1	12.4	10.2	-2.2	2.7	3.9	21.8	26.5	27.6
Saudi Arabia	3.8	4.2	4.4	5.3	4.7	4.1	9.5	9.7	9.9
South Africa	2.5	3.5	4.0	4.3	4.7	5.0	-3.5	-4.0	-4.0
United Arab Emirates	2.0	3.4	3.8	1.0	3.1	3.9	5.5	6.1	7.2
Tunisia	3.4	3.0	3.3	4.5	3.3	3.3	-4.0	-2.5	-2.3
Total	**4.8**	**4.3**	**4.5**	**3.2**	**3.6**	**3.3**	**0.4**	**0.2**	**0.1**
Industrialised countries	**2.6**	**2.4**	**2.7**	**1.3**	**1.8**	**1.6**	**-1.1**	**-1.0**	**-0.9**
Emerging countries	**7.6**	**6.6**	**6.6**	**5.3**	**5.6**	**5.2**	**2.2**	**1.5**	**1.2**

** For UK: HICP; for India: wholesale prices; for China, retail price index; for Brazil: IPCA, for South Africa: CPI-X*
*** For India: Fiscal year ending in March*

Source: Crédit Agricole CIB

Exchange rate forecasts

		02-Mar	Mar-11	Jun-11	Sep-11	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12
USD Exchange rate										
Industrialised countries										
Euro	EUR/USD	1.38	1.37	1.32	1.28	1.25	1.23	1.21	1.20	1.18
Japan	USD/JPY	82	82	85	90	94	96	98	100	102
United Kingdom	GBP/USD	1.63	1.63	1.61	1.60	1.60	1.60	1.59	1.60	1.59
Switzerland	USD/CHF	0.93	0.98	1.02	1.06	1.12	1.15	1.17	1.19	1.22
Canada	USD/CAD	0.97	0.98	0.97	0.96	0.95	0.94	0.93	0.92	0.90
Australia	AUD/USD	1.01	1.02	1.05	1.05	1.06	1.07	1.09	1.11	1.12
New Zealand	NZD/USD	0.74	0.78	0.80	0.80	0.81	0.82	0.83	0.84	0.84
Asia										
China	USD/CNY	6.57	6.51	6.43	6.36	6.30	6.24	6.18	6.11	6.05
Hong Kong	USD/HKD	7.79	7.76	7.77	7.77	7.77	7.77	7.77	7.77	7.77
India	USD/INR	44.96	44.79	45.10	45.33	45.50	45.12	44.74	44.36	43.98
Indonesia	USD/IDR	8812	9150	9250	9200	9150	9100	9050	9000	8950
Malaysia	USD/MYR	3.04	3.12	3.11	3.10	3.09	3.07	3.05	3.03	3.01
Philippines	USD/PHP	43.5	43.3	42.7	42.1	41.5	41.2	41.0	40.7	40.5
Singapore	USD/SGD	1.27	1.25	1.24	1.23	1.23	1.22	1.22	1.20	1.91
South Korea	USD/KRW	1128	1110	1095	1075	1050	1035	1020	1005	990
Taiwan	USD/TWD	29.6	29.9	29.8	29.6	29.5	29.3	29.1	29.0	28.8
Thailand	USD/THB	30.5	29.7	29.6	29.4	29.2	29.0	28.8	28.6	28.4
Vietnam	USD/VND	20873	20900	20900	21400	21400	21900	21900	22500	22500
Latin America										
Argentina	USD/ARS	4.03	4.05	4.10	4.15	4.20	4.25	4.30	4.35	4.40
Brazil	USD/BRL	1.66	1.67	1.65	1.65	1.70	1.70	1.70	1.75	1.80
Mexico	USD/MXN	12.11	12.00	12.00	11.90	11.90	11.85	11.80	11.75	11.70
Africa										
South Africa	USD/ZAR	6.95	6.95	6.70	6.70	6.90	7.00	7.10	7.20	7.30
	TRY/ZAR	4.30	4.63	4.47	4.56	4.76	4.76	4.80	4.83	4.87
Emerging Europe										
Poland	USD/PLN	2.87	2.92	2.95	3.01	3.00	3.04	3.07	3.08	3.14
Russia	USD/RUB	28.50	28.89	30.59	31.71	32.45	31.22	32.69	33.48	34.14
	Basket/RUB	33.42	33.70	35.00	35.70	36.10	34.45	35.78	36.49	36.90
Turkey	USD/TRY	1.62	1.50	1.50	1.47	1.45	1.47	1.48	1.49	1.50
Euro Cross rates										
Industrialised countries										
Japan	EUR/JPY	113	112	112	115	118	118	119	120	120
United Kingdom	EUR/GBP	0.848	0.840	0.820	0.800	0.780	0.770	0.760	0.750	0.740
Switzerland	EUR/CHF	1.28	1.34	1.35	1.36	1.40	1.41	1.42	1.43	1.44
Sweden	EUR/SEK	8.73	8.75	8.70	8.90	9.05	9.20	9.15	9.10	9.00
Norway	EUR/NOK	7.72	8.00	8.00	7.80	7.70	7.80	7.70	7.60	7.40
Central Europe										
Czech Rep.	EUR/CZK	24.32	24.45	24.14	24.00	23.80	23.80	23.60	23.60	23.60
Hungary	EUR/HUF	272	278	272	270	270	270	270	270	270
Poland	EUR/PLN	3.97	4.00	3.90	3.85	3.75	3.74	3.72	3.70	3.70
Romania	EUR/RON	4.21	4.30	4.30	4.30	4.30	4.30	4.30	4.30	4.30

Source: Crédit Agricole CIB

Policy rate forecasts

		02-Mar	Mar-11	Jun-11	Sep-11	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12
G3										
USA	Fed funds	0.25	0-0.25	0-0.25	0-0.25	0-0.25	0-0.25	0-0.25	0.50	1.00
Japan	Call	0.09	0-0.10	0-0.10	0-0.10	0-0.10	0-0.10	0-0.10	0-0.10	0.25
Eurozone	Repo	1.00	1.00	1.00	1.25	1.50	1.75	2.00	2.25	2.25
Asia										
China	1Y lending rate	6.06	6.06	6.56	6.56	6.56	6.81	6.81	7.06	7.06
Hong Kong	Base rate	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.75	1.25
India	Repo rate	6.50	6.50	6.50	6.75	7.00	7.00	7.25	7.25	7.50
Indonesia	BI rate	6.75	6.75	7.00	7.25	7.25	7.25	7.25	7.25	7.25
Korea	Call rate	2.75	3.00	3.25	3.50	3.50	3.50	3.50	3.75	4.00
Malaysia	OPR	2.75	2.75	2.75	2.75	3.00	3.00	3.25	3.25	3.50
Philippines	Repo rate	4.00	4.00	4.25	4.50	4.50	4.75	4.75	5.00	5.00
Singapore	6M SOR	0.26	0.61	0.67	0.67	0.70	0.71	0.76	1.10	1.34
Taiwan	Redisc	1.63	1.75	2.00	2.00	2.00	2.00	2.00	2.25	2.50
Thailand	Repo	2.25	2.25	2.50	2.75	2.75	2.75	2.75	3.00	3.25
Vietnam	Base rate	9.00	10.00	10.00	11.00	11.00	11.00	12.00	12.00	12.00
Latin America										
Argentina	3M deposit	10.51	10.00	10.50	11.00	11.00	11.00	11.25	11.50	11.50
Brazil	Overnight/Selic	11.25	11.75	12.25	12.25	12.25	11.75	11.25	10.75	10.50
Mexico	Overnight rate	4.50	4.50	4.50	4.50	4.50	5.25	5.50	5.75	6.00
Emerging Europe										
Czech Rep.	14D repo	0.75	0.75	1.00	1.25	1.50	1.75	1.75	2.00	2.00
Hungary	2W repo	6.00	6.00	6.00	6.00	6.00	6.00	6.00	6.00	6.00
Poland	7D repo	3.75	4.00	4.25	4.25	4.50	4.75	4.75	4.75	4.75
Romania	2W repo	6.25	6.25	6.25	6.25	6.25	6.25	6.25	6.25	6.25
Russia	O/N Deposit rate	3.00	3.50	4.25	4.50	4.50	5.25	6.00	7.50	9.00
Turkey	1W repo rate	6.25	6.25	6.25	7.00	8.00	8.00	8.00	8.50	9.00
Africa & Middle East										
South Africa	Repo	5.50	5.50	5.50	5.50	5.75	6.50	7.00	7.50	8.00
UAE	Repo	1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.25	1.75
Saudi Arabia	Repo	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.25	2.75

Source: Crédit Agricole CIB

Interest rate forecasts

	02-Mar	Mar-11	Jun-11	Sep-11	Dec-11
USA					
3 month	0.31	0.40	0.40	0.40	0.40
2Y year	0.66	0.80	0.95	1.45	1.70
10 year	3.40	3.40	3.50	3.80	4.00
Japan					
3 month	0.19	0.34	0.34	0.34	0.35
2Y year	0.24	0.20	0.20	0.20	0.22
10 year	1.25	1.10	1.10	1.15	1.20
Eurozone					
3 month	1.05	1.15	1.50	2.00	2.25
2Y year (Ger)	1.53	1.75	2.20	2.75	3.00
10 year (Ger)	3.16	3.25	3.50	3.80	4.00
Korea					
Call rate	2.75	3.00	3.25	3.50	3.50
91D CD	3.17	3.20	3.50	3.50	3.60
3Y IRS	3.98	4.10	4.30	4.50	4.50
10Y IRS	4.47	4.70	4.80	4.90	4.90
Hong Kong					
Base rate	0.50	0.50	0.50	0.50	0.50
3M HIBOR	0.23	0.40	0.50	0.50	0.80
2Y IRS	0.80	0.90	1.10	1.50	1.80
10Y IRS	3.19	3.30	3.60	3.80	4.00
Thailand					
Repo rate	2.25	2.25	2.50	2.75	2.75
6M THBFIX	2.34	1.60	2.00	2.10	2.30
2Y IRS	3.06	2.95	3.20	3.50	3.50
10Y IRS	4.39	4.30	4.50	4.60	4.60
Singapore					
6M SOR	0.26	0.61	0.67	0.67	0.70
2Y IRS	0.84	0.90	1.10	1.60	1.80
10Y IRS	3.03	3.20	3.40	3.60	3.80
China					
1Y lending rate	6.06	6.06	6.56	6.56	6.56
7-day repo	3.00	3.50	3.70	4.10	3.90
2Y IRS (7-day repo)	3.96	3.80	4.00	3.80	3.70
10Y IRS (7-day repo)	4.63	4.45	4.60	4.40	4.30
Taiwan					
Rediscount rate	1.63	1.75	2.00	2.00	2.00
90D CP	0.64	0.70	0.85	0.90	1.00
2Y IRS	1.05	1.10	1.25	1.40	1.60
10Y IRS	1.90	2.10	2.30	2.50	2.60
India					
Repo rate	6.50	6.50	6.50	6.75	7.00
O/N NSE MIBOR	7.00	6.40	6.10	6.75	7.00
2Y OIS	7.59	7.50	7.30	7.50	7.70
10Y OIS	8.18	8.40	8.50	8.30	8.40

Source: Crédit Agricole CIB

Interest rate forecasts

	02-Mar	Mar-11	Jun-11	Sep-11	Dec-11
Czech Republic					
14D repo	0.75	0.75	1.00	1.25	1.50
3M PRIBOR	0.84	0.84	1.10	1.40	1.60
2Y IRS	2.21	2.20	2.40	2.70	2.90
10Y IRS	3.25	3.35	3.55	3.60	3.85
Poland					
7D repo	3.75	4.00	4.25	4.25	4.50
3M WIBOR	4.06	4.30	4.55	4.60	4.80
2Y IRS	5.21	5.15	5.20	5.35	5.40
10Y IRS	5.59	5.70	5.85	6.00	6.05
Hungary					
2W repo	6.00	6.00	6.00	6.00	6.00
6M BUBOR	6.10	6.23	6.20	6.20	6.20
2Y IRS	6.46	6.60	6.70	6.60	6.60
10Y IRS	6.91	7.15	7.25	7.38	7.45
Romania					
2W repo	6.25	6.25	6.25	6.25	6.25
3M ROBOR	6.07	5.00	5.00	4.90	4.90
2Y IRS	5.57	5.70	5.80	5.80	5.80
10Y IRS	5.95	6.00	6.10	6.10	6.00
South Africa					
Repo	5.50	5.50	5.50	5.50	5.75
3M JIBAR	5.58	5.55	5.55	5.55	5.80
2Y IRS	6.59	6.50	6.60	6.80	6.95
10Y IRS	8.32	8.25	8.30	8.40	8.50
Turkey					
1W repo	6.25	6.25	6.25	7.25	8.25
3M TRLIBOR	7.20	7.50	8.00	8.50	8.50
2Y XCCY	7.57	7.80	8.30	9.00	9.70
10Y XCCY	8.55	8.65	9.00	9.30	10.05
Russia					
Deposit rate	3.00	3.50	4.25	4.50	4.50
3M Mosprime	4.00	4.55	5.30	5.75	5.85
2Y IRS	5.95	6.15	7.25	7.60	7.60
10Y IRS	7.75	8.15	8.95	9.30	9.30
Mexico					
Overnight rate	4.50	4.50	4.50	4.50	4.50
TIIE 28D	4.84	4.85	4.85	4.85	4.95
2Y IRS	5.78	5.93	6.08	6.58	6.65
10Y IRS	7.87	7.95	8.05	8.35	8.55
Brazil					
Selic rate	11.25	11.75	12.25	12.25	12.25
2Y DI	12.72	12.70	12.40	11.75	11.75
10Y DI	12.21	12.30	11.80	11.50	11.50

Source: Crédit Agricole CIB

Commodities forecasts

Oil price forecasts

Average prices		2010				2011				2012			
		Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
WTI	USD/bl	79	78	76	85	88	78	79	82	83	73	77	83
Brent	USD/bl	76	78	77	86	97	85	84	86	87	76	80	87

End quarter prices		2010				2011				2012			
		Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
WTI	USD/bl	84	76	82	91	83	79	81	83	78	75	80	84
Brent	USD/bl	80	75	83	93	91	85	85	87	82	78	84	88

Source: Crédit Agricole CIB

Metals forecasts

					2010					2011					2012			Long-term
		02-Mar	Q1	Q2	Q3	Q4	Year	Q1	Q2	Q3	Q4	Year	Q1	Q2	Q3	Q4	Year	Prices
Base metals																		
Aluminium	USD/t	2,578	2,350	2,500	2,400	2,550	2,450	2,400	2,500	2,650	2,750	2,575	2,800	3,000	2,900	2,900	2,900	2,650 (120c/lb)
Copper	USD/t	9,849	8,500	8,800	8,600	9,000	8,725	9,000	9,500	10,000	10,500	9,750	10,750	11,000	10,500	9,750	10,500	4,960 (225c/lb)
Nickel	USD/t	28,755	23,500	24,500	24,000	26,000	24,500	23,500	24,500	24,000	26,000	24,500	25,000	26,000	26,000	27,000	26,000	15,432 (700c/lb)
Zinc	USD/t	2,488	2,300	2,400	2,500	2,700	2,475	2,300	2,400	2,500	2,700	2,475	2,700	2,800	2,600	2,700	2,700	1,764 (80c/lb)
Lead	USD/t	2,569	2,375	2,500	2,600	2,700	2,544	2,500	2,400	2,500	2,700	2,525	2,800	2,900	2,700	3,000	2,850	1,323 (60c/lb)
Tin	USD/t	32,170	24,500	25,500	25,000	25,000	25,000	26,000	28,000	27,000	29,000	27,500	30,000	32,000	31,000	33,000	31,500	15,000 (680c/lb)
Precious metals																		
Gold	USD/oz	1,433	1,350	1,350	1,340	1,260	1,325	1,425	1,500	1,475	1,400	1,450	1,375	1,350	1,325	1,250	1,275	700
Silver	USD/oz	34.7	27.0	29.0	28.0	26.0	27.5	29.0	31.0	29.0	27.0	29.0	27.0	26.0	25.0	24.0	25.5	7.0
Platinum	USD/oz	1,841	1,740	1,760	1,750	1,810	1,765	1,725	1,765	1,750	1,820	1,765	1,850	1,875	1,925	1,950	1,900	1,200
Palladium	USD/oz	820	700	750	800	850	775	700	750	800	850	775	875	925	950	1,050	950	300

Source: Crédit Agricole CIB

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