

# CEE region under pressure

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**Bratislava, 10 March 2009**

Citigroup Global Markets Ltd.

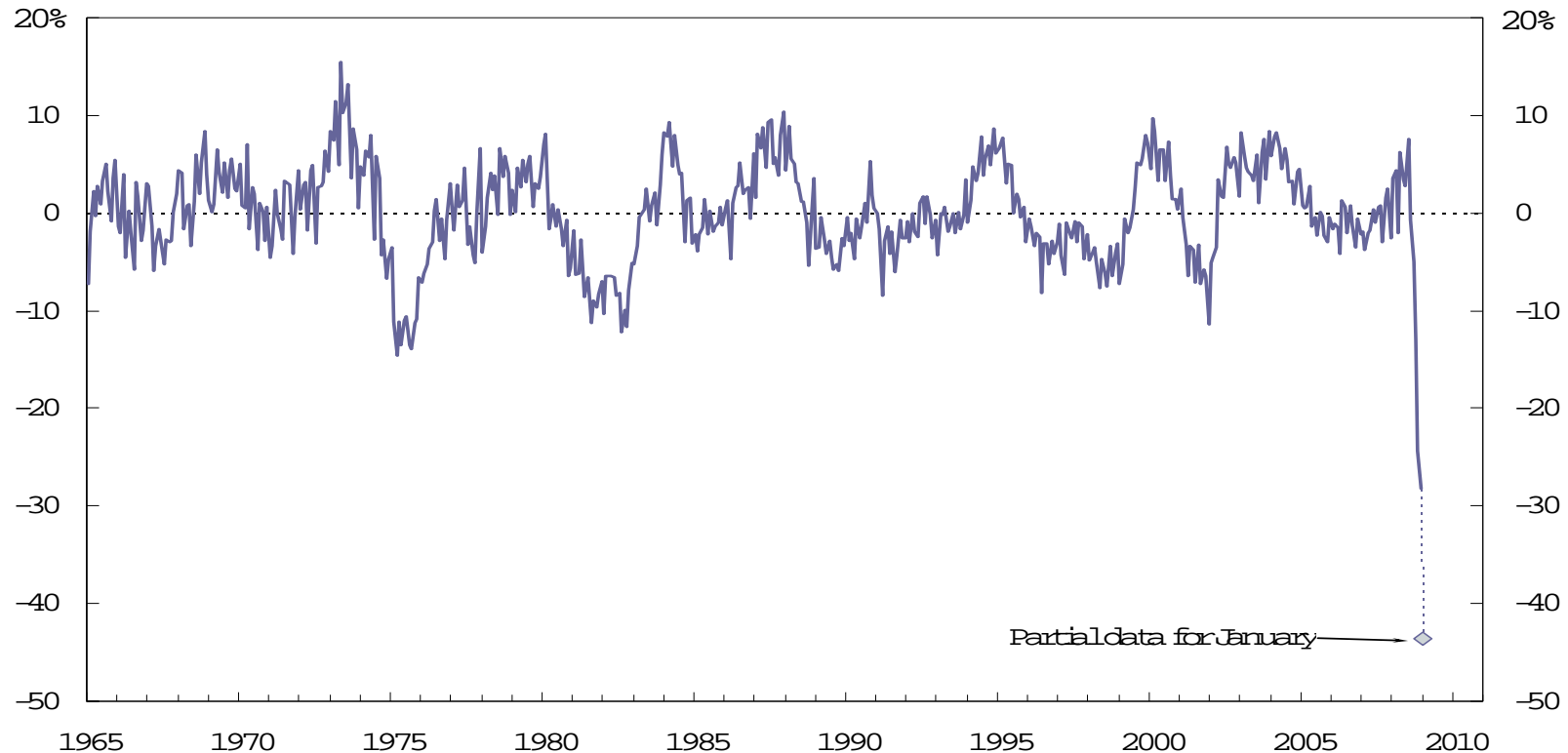
The material in this presentation is based on previously-published research.





# Sharp deceleration in global trade

**Median of deviation of exports from trend for 23 large economies, 1965-Jan09E (Percent)**



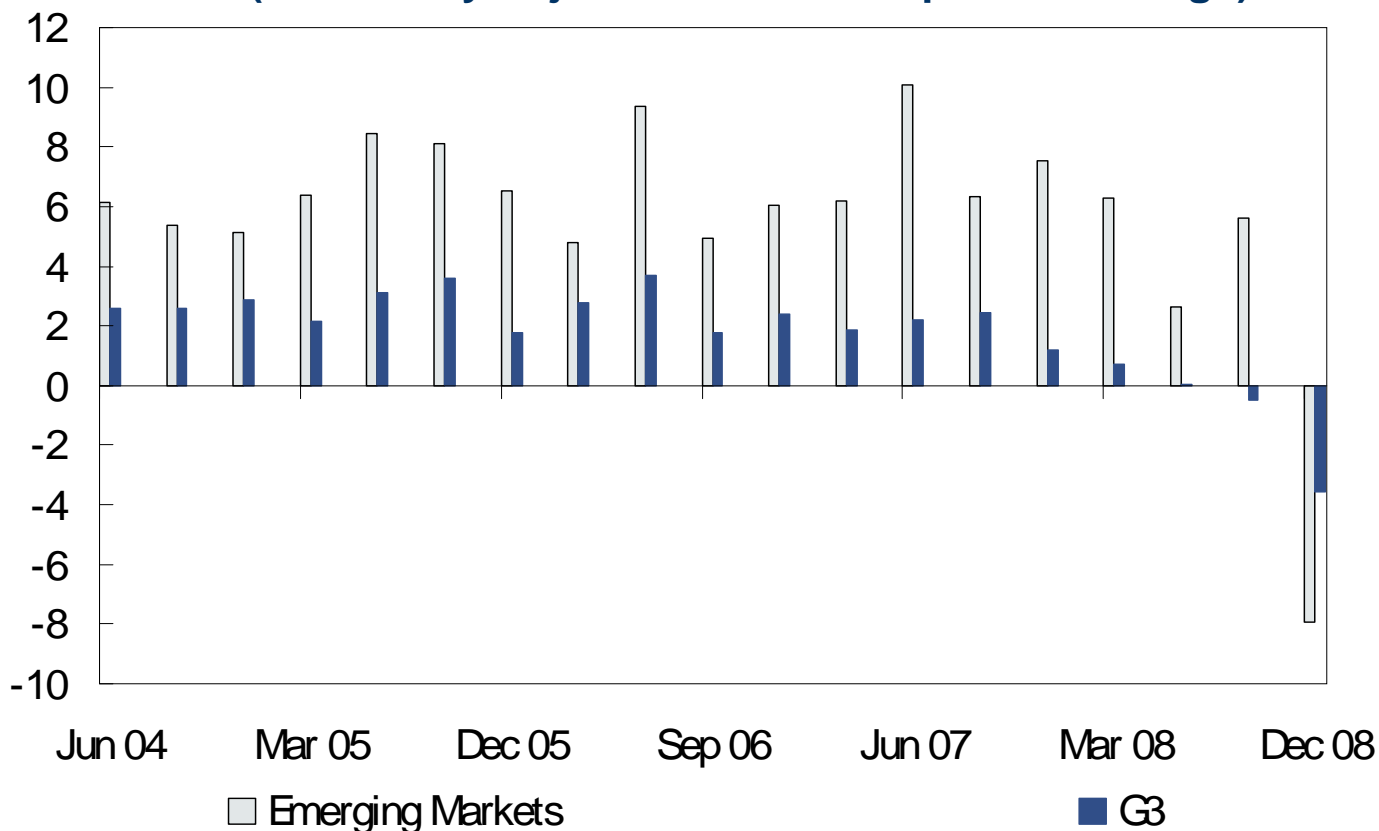
**Note:** Percent deviations of exports, expressed in US dollars, are calculated for 23 countries: the United States, France, Germany, Italy, Japan, United Kingdom, Canada, Australia, China, India, Indonesia, Korea, Singapore, Hong Kong, Taiwan, Poland, Russia, South Africa, Turkey, Argentina, Brazil and Mexico.

**Source:** IMF, Haver Analytics and Citi calculations (Citi's Global Economic Outlook & Strategy, 25 February 2009).



# Drop in domestic demand

**Domestic demand: emerging markets and G3, 2Q04-4Q08  
(Seasonally-adjusted annualised percent change)**



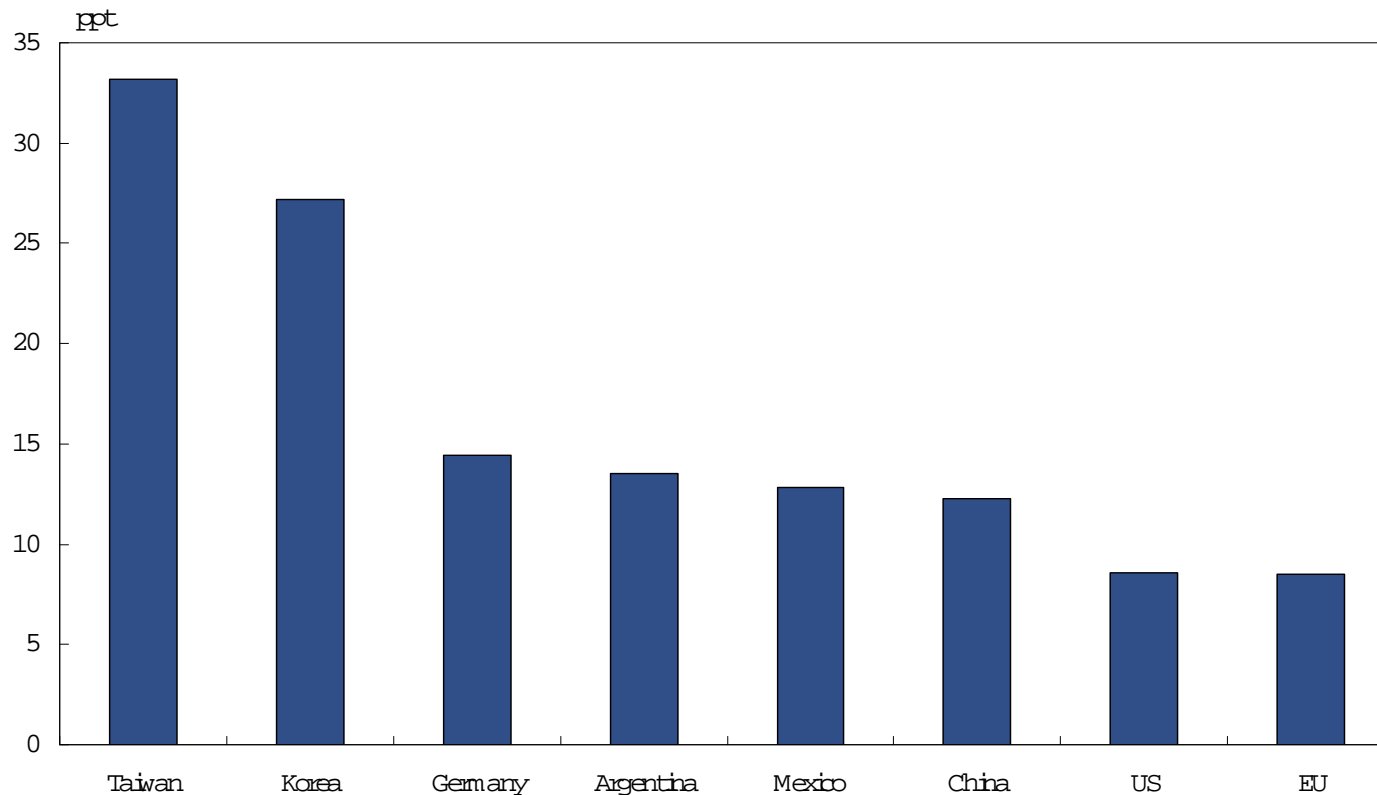
Note: December 2008 data points are proxied by the United States for the G3 and Argentina, Indonesia, Korea, Philippines, Taiwan and Thailand for emerging markets.

Source: Haver Analytics and Citi calculations (Citi's Global Economic Outlook & Strategy, 25 February 2009).



# Larger drop in EM economic activity

Percentage point change in GDP growth (QoQ saar), peak to 4Q08



Note: The peak is defined as the point in the current cycle where the positive output gap is largest.

Source: Haver Analytics and Citi calculations (Citi's Global Economic Outlook & Strategy, 25 February 2009).

# Citi forecasts a global recession in 2009

## GDP and CPI forecasts, 2009-10 (Percent Change YoY)

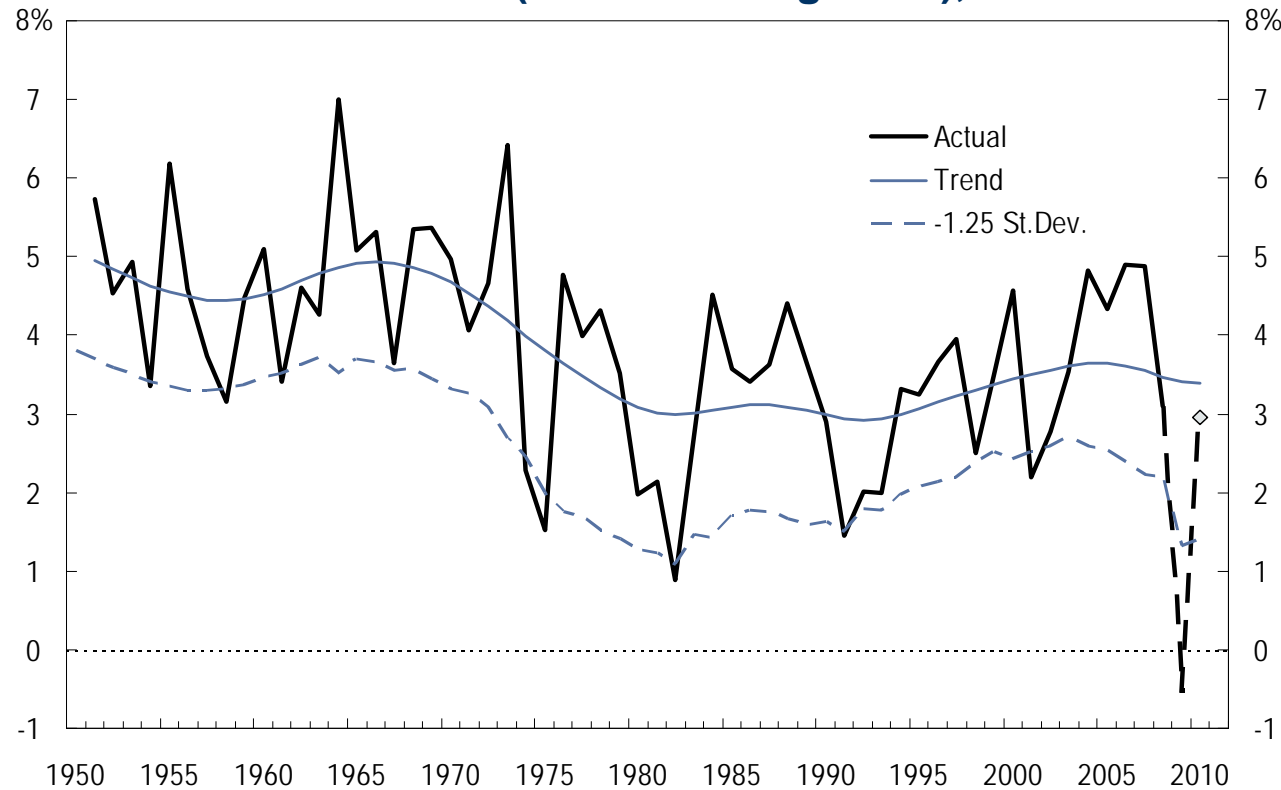
	GDP Growth			CPI Inflation		
	2008	2009F	2010F	2008	2009F	2010F
<b>Global</b>	<b>2.3%</b>	<b>-1.5%</b>	<b>2.3%</b>	<b>4.9%</b>	<b>1.6%</b>	<b>2.6%</b>
Based on PPP weights	3.1	-0.5	3.0	5.6	1.9	2.8
<b>Industrial Countries</b>	<b>0.8%</b>	<b>-3.1%</b>	<b>1.0%</b>	<b>3.3%</b>	<b>-0.2%</b>	<b>0.8%</b>
United States	1.2	-2.7	1.7	3.8	-1.0	0.4
Japan	-0.7	-6.7	0.4	1.4	-1.4	-0.7
Euro Area	0.8	-2.8	0.6	3.3	0.3	1.0
Canada	0.6	-1.0	2.8	2.4	-0.7	1.7
Australia	2.2	-0.3	1.5	4.4	3.4	2.7
Germany	1.0	-3.9	0.7	2.6	0.3	0.9
France	0.7	-2.2	0.5	2.8	0.2	0.9
Italy	-0.9	-3.5	0.2	3.5	0.9	1.7
Spain	1.2	-3.0	-0.3	4.1	0.7	1.9
Netherlands	2.0	-2.7	0.9	2.5	0.2	0.8
United Kingdom	0.7	-3.4	-0.6	3.6	1.0	3.0
<b>Emerging Markets</b>	<b>5.3%</b>	<b>1.6%</b>	<b>4.5%</b>	<b>8.5%</b>	<b>5.1%</b>	<b>5.7%</b>
China	9.0	7.6	8.3	5.9	-0.4	1.5
India	7.1	5.5	6.6	8.5	2.0	4.0
Korea	2.5	-4.8	4.3	4.7	2.5	2.3
Poland	4.7	1.4	3.6	4.2	2.4	1.8
Russia	5.6	-3.0	1.7	14.1	14.8	15.1
South Africa	2.9	0.8	3.2	11.6	6.3	5.7
Turkey	1.0	-2.4	4.2	10.4	8.7	7.6
Brazil	5.6	1.0	4.0	5.7	4.8	4.1
Mexico	1.3	-2.4	2.5	5.1	5.3	3.4

Source: Citi calculations and forecasts (Citi's Global Economic Outlook & Strategy, 25 February 2009).



# The worst global picture since 1950

**Growth in Global GDP (Percent change YoY), 1951-2010F**



Source: Maddison, IMF and Citi calculations and forecasts (Citi's Global Economic Outlook & Strategy, 25 February 2009).

**Is 2010's recovery reliable?**

# EM unlikely to be in recession in 2009, but CEE likely



## GDP, CPI, current and fiscal balances - forecasts, 2008-10 (% YoY, % of GDP)

	GDP Growth			CPI Inflation			Current Balance (% of GDP)			Fiscal Balance (% of GDP)		
	2008F	2009F	2010F	2008F	2009F	2010F	2008F	2009F	2010F	2008F	2009F	2010F
<b>Europe</b>	<b>4.2%</b>	<b>-2.3%</b>	<b>2.5%</b>	<b>11.1%</b>	<b>10.0%</b>	<b>9.8%</b>	<b>-0.9%</b>	<b>-2.3%</b>	<b>0.2%</b>	<b>0.3%</b>	<b>-5.5%</b>	<b>-3.8%</b>
Czech Republic	3.5	-1.0	2.0	6.4	1.9	2.7	-3.0	-2.9	-1.9	-1.6	-3.4	-2.6
Hungary	0.6	-2.6	1.6	6.1	2.3	2.7	-7.4	-4.5	-4.3	-3.3	-2.6	-2.8
Poland	4.7	1.4	3.6	4.2	2.4	1.8	-5.3	-4.7	-3.0	-2.7	-3.3	-3.5
Romania	8.0	-2.5	4.0	7.8	5.8	4.0	-13.2	-8.0	-7.5	-5.2	-4.0	-3.0
Russia	5.6	-3.0	1.7	14.1	14.8	15.1	5.9	0.0	5.1	4.0	-8.1	-4.9
Slovak Rep.	6.6	1.5	3.2	4.6	2.4	3.3	-6.6	-6.1	-3.7	-1.8	-3.5	-2.5
Turkey	1.0	-2.4	4.2	10.4	8.7	7.6	-5.6	-2.3	-2.1	-1.7	-3.7	-2.5
Ukraine	2.6	-8.7	0.8	25.2	17.2	12.1	-6.8	-3.3	-1.7	-1.2	-2.1	-2.7
<b>Africa/Mideast</b>	<b>5.1%</b>	<b>2.1%</b>	<b>3.9%</b>	<b>11.5%</b>	<b>6.9%</b>	<b>6.4%</b>	<b>14.0%</b>	<b>-0.7%</b>	<b>2.5%</b>	<b>11.9%</b>	<b>-1.7%</b>	<b>0.7%</b>
Egypt	7.2	4.0	3.1	18.2	8.1	7.1	1.4	-4.3	-3.7	-6.6	-7.9	-7.2
Israel	3.2	-1.1	0.5	4.6	1.4	2.1	-0.4	-4.9	-1.3	-1.3	-4.5	-3.7
Kazakhstan	3.1	0.7	1.3	17.1	7.7	7.7	6.0	-4.1	0.6	-2.2	-4.4	-2.9
Kuwait	4.8	1.2	2.8	10.5	4.8	3.0	38.1	17.9	21.2	31.6	15.1	15.2
Lebanon	4.5	3.7	4.5	11.7	5.6	5.8	-7.2	-11.3	-14.1	-8.3	-10.0	-11.3
Nigeria	6.6	5.3	6.8	11.6	12.3	8.8	4.4	0.2	6.1	-1.2	-3.4	-2.9
Qatar	10.6	8.7	9.8	15.1	9.5	6.5	41.2	15.2	19.8	15.2	5.1	6.7
Saudi Arabia	4.9	1.7	4.8	9.8	6.5	6.8	31.2	-2.1	2.3	31.2	-2.1	4.5
South Africa	2.9	0.8	3.2	11.6	6.3	5.7	-7.9	-7.5	-7.3	-1.1	-4.0	-3.6
United Arab Emirates	6.7	0.9	2.4	12.2	7.1	8.3	23.2	1.3	3.4	25.3	-1.7	1.6
<b>Total</b>	<b>5.3%</b>	<b>1.6%</b>	<b>4.5%</b>	<b>8.5%</b>	<b>5.1%</b>	<b>5.7%</b>	<b>3.9%</b>	<b>2.2%</b>	<b>2.8%</b>	<b>0.4%</b>	<b>-4.0%</b>	<b>-3.0%</b>

Source: Citi forecasts (Citi's Emerging World, 26 February 2009).



# Citi vs Consensus forecasts (CEE and EM)

## GDP and CPI forecasts, 2009-10 (Percent change YoY)

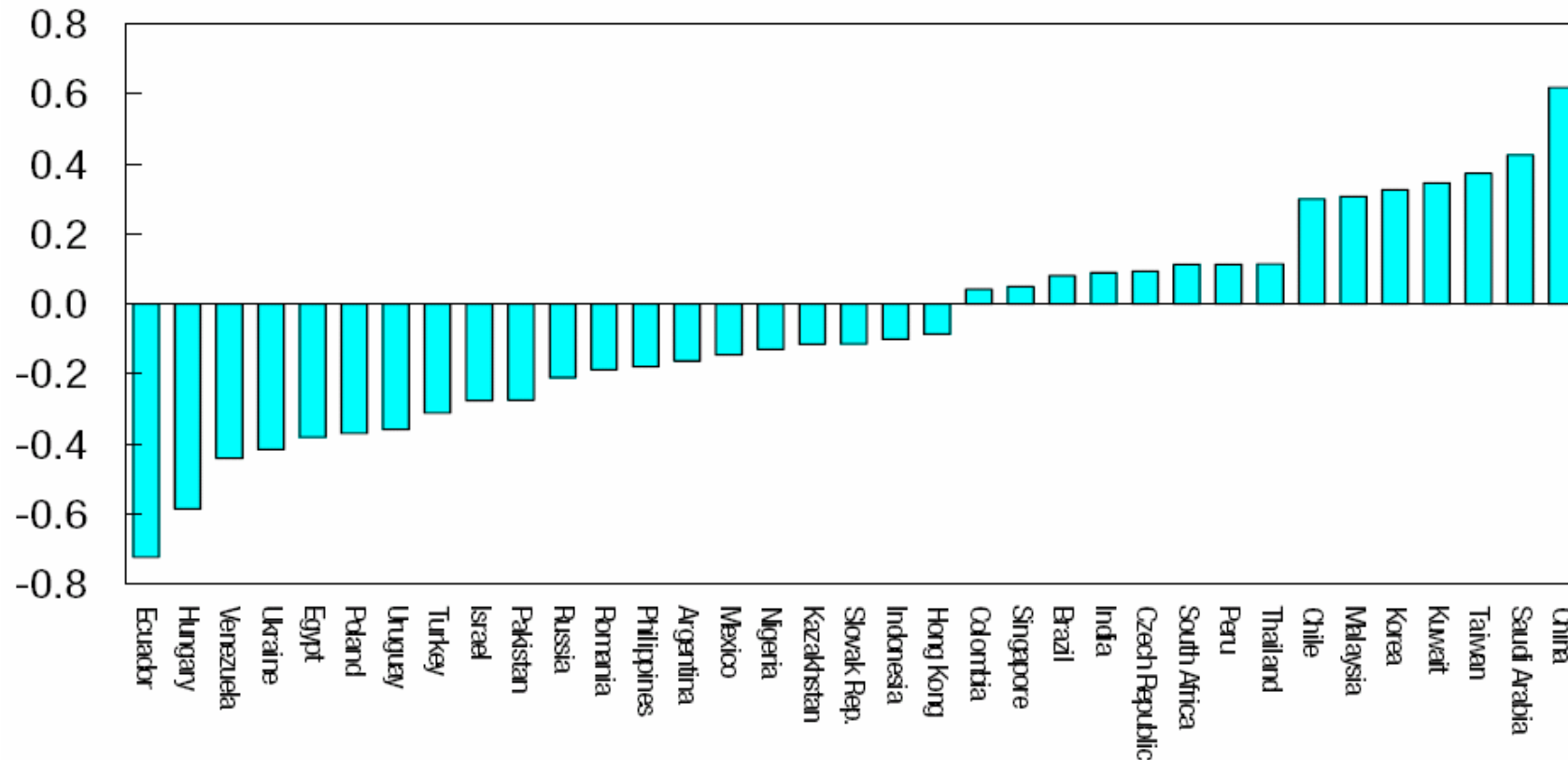
	GDP Growth (% YoY)				CPI Growth (% YoY)			
	2009F	Consensus	2010F	Consensus	2009F	Consensus	2010F	Consensus
<b>Europe</b>	<b>-2.3%</b>	<b>-0.7%</b>	<b>2.5%</b>	<b>2.5%</b>	<b>10.0%</b>	<b>8.5%</b>	<b>9.8%</b>	<b>7.1%</b>
Czech R	-1.0	-0.8	2.0	1.7	1.9	1.6	2.7	2.3
Hungary	-2.6	-3.1	1.6	0.7	2.3	2.6	2.7	2.9
Poland	1.4	1.2	3.6	2.5	2.4	2.5	1.8	2.5
Romania	-2.5	-0.4	4.0	2.1	5.8	5.6	4.0	4.6
Russia	-3.0	-0.6	1.7	2.6	14.8	12.0	15.1	9.6
Slovak Rep	1.5	2.2	3.2	3.5	2.4	3.0	3.3	3.0
Turkey	-2.4	-1.2	4.2	3.0	8.7	7.5	7.6	6.5
Ukraine	-8.7	-5.4	0.8	1.3	17.2	17.6	12.1	11.7
<b>Total</b>	<b>1.6%</b>	<b>2.4%</b>	<b>4.5%</b>	<b>4.6%</b>	<b>5.1%</b>	<b>4.8%</b>	<b>5.7%</b>	<b>4.7%</b>

Source: Consensus Economics and Citi forecasts (Citi's Emerging World, 26 February 2009).



# Big differences among EM countries

Citi Resiliency Index, November 2008



Note: The Resiliency Index scores each country's trade openness, FDI activity, remittances, government debt and the foreign share of that debt, the net international investment position, the debt-to-equity ratio of corporations, banking strength (as measured by loan-to-deposit ratios), the capital adequacy ratio, nonperforming loans, the country's gross financing requirements, foreign holdings of equity, net international reserves, inflation, the fiscal balance, the current account balance, the change in the terms of trade, and governance and regulatory measures.

Sources: IMF, World Bank, Fitch Ratings, Moody's, data collected by Haver Analytics, Citi estimates (Citi's Prospects for Financial Markets, 3 December 2008).

# Huge rise in FX reserves in EM during last decade



## Summary data from emerging economies' balance of payments, 2001-08 (US dollar in billions)

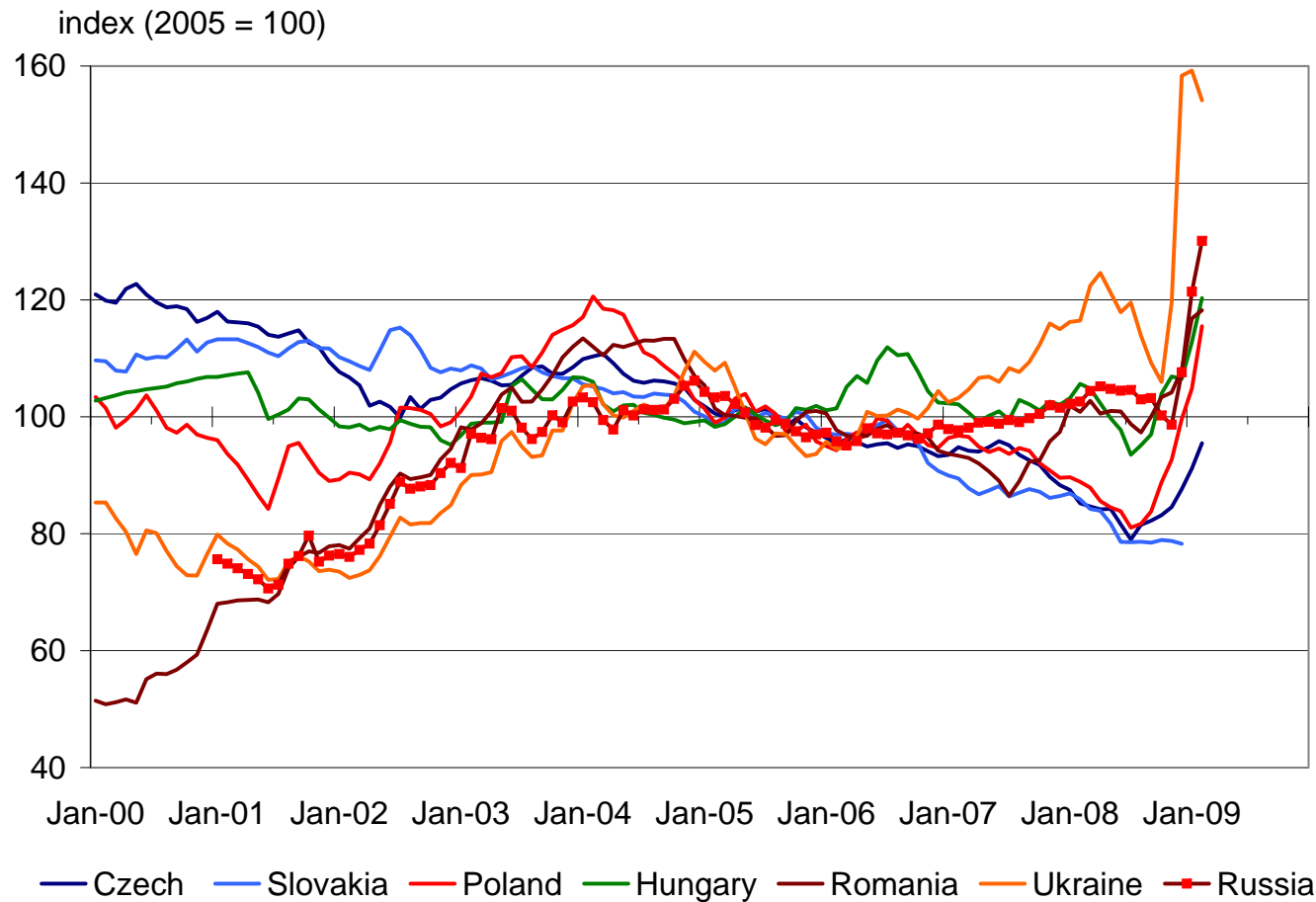
	Africa	Middle East	CEE	Asia	Latam	Total
Change in FX reserves	317	714	803	2895	341	5,069
Current account balance	78	1,381	-14	1,495	20	2,960
Foreign direct investment	180	98	921	828	439	2,465
Portfolio investment	38	-165	100	-219	-6	-251
Other investment (mostly cross-border bank lending)	-51	-147	478	243	-117	406
<b>Reserves increase accounted for by:</b>						
1. Current account surplus	25%	193%	-2%	52%	6%	58%
2. FDI inflows	57%	14%	115%	29%	129%	49%
3. Cross-border bank lending	-16%	-21%	60%	8%	-34%	8%
<b>Memo item:</b>						
<b>Reserves as a share of GDP in:</b>						
2001	12%	18%	12%	22%	7%	15%
2008	26%	24%	24%	39%	12%	28%

Source: IMF and Citi calculations (Citi's Emerging World, 26 February 2009).



# CEE's currencies under pressure

## CEE's currencies against the euro, Jan00-Feb09 (index)



Source: Haver Analytics and Citi calculations.



## Exchange rate policy - themes

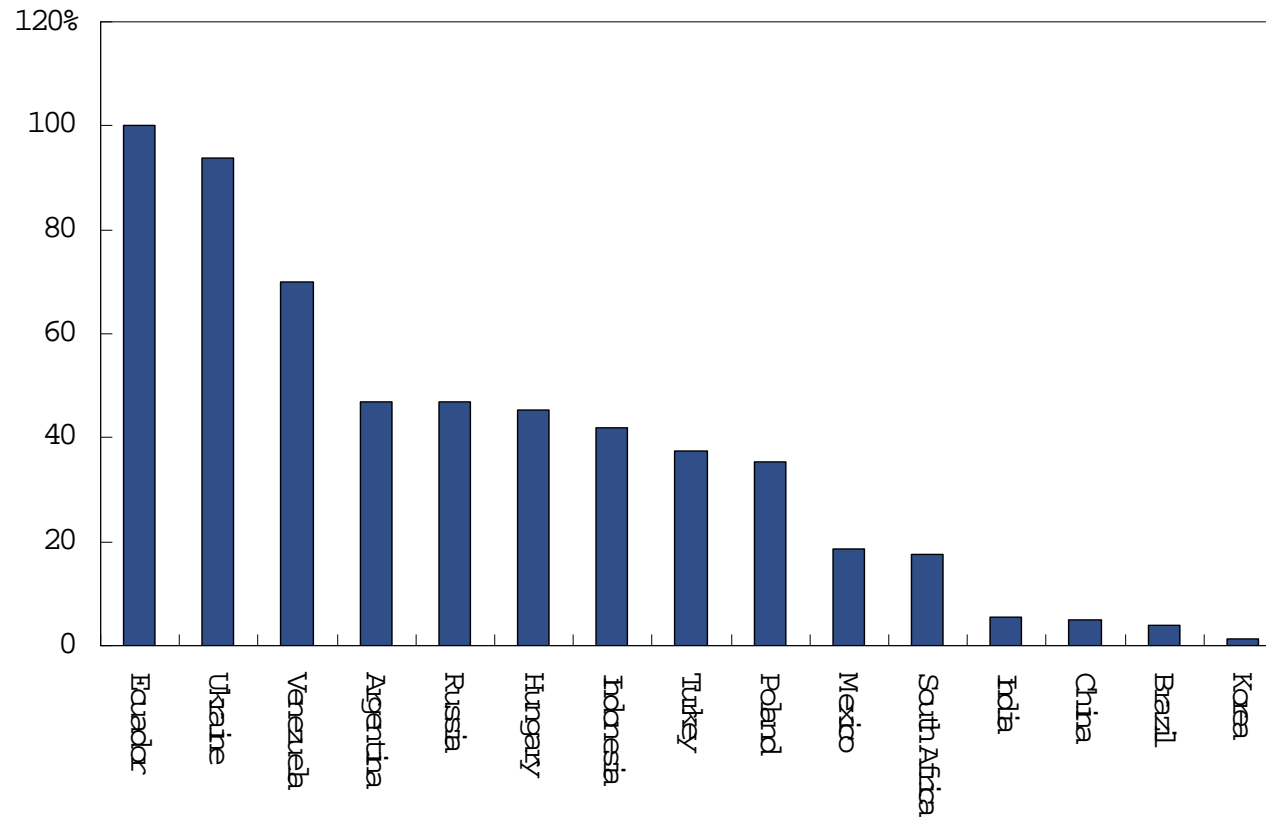
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- ◆ Expenditure switching - adjustment of external imbalance
- ◆ Balance-sheet effect (loans in foreign currencies) does not support a devaluation policy
  - Reliable for households' balance sheets and also for governments with unhedged eurobonds
- ◆ Exporter's hedging against FX risk
- ◆ Central banks as inflation targeters
  - *Relatively strong exchange rate pass-through*
- ◆ Rush to euro area as solution?



# A weaker currency increases debt burden

General government foreign currency and FC-indexed debt as a share of total general government debt, 2009E (Percent)



Source: Moody's.

# Recession suggests larger fiscal deficits

## GDP and fiscal balance - forecasts, 2008-10 (% YoY, % of GDP)

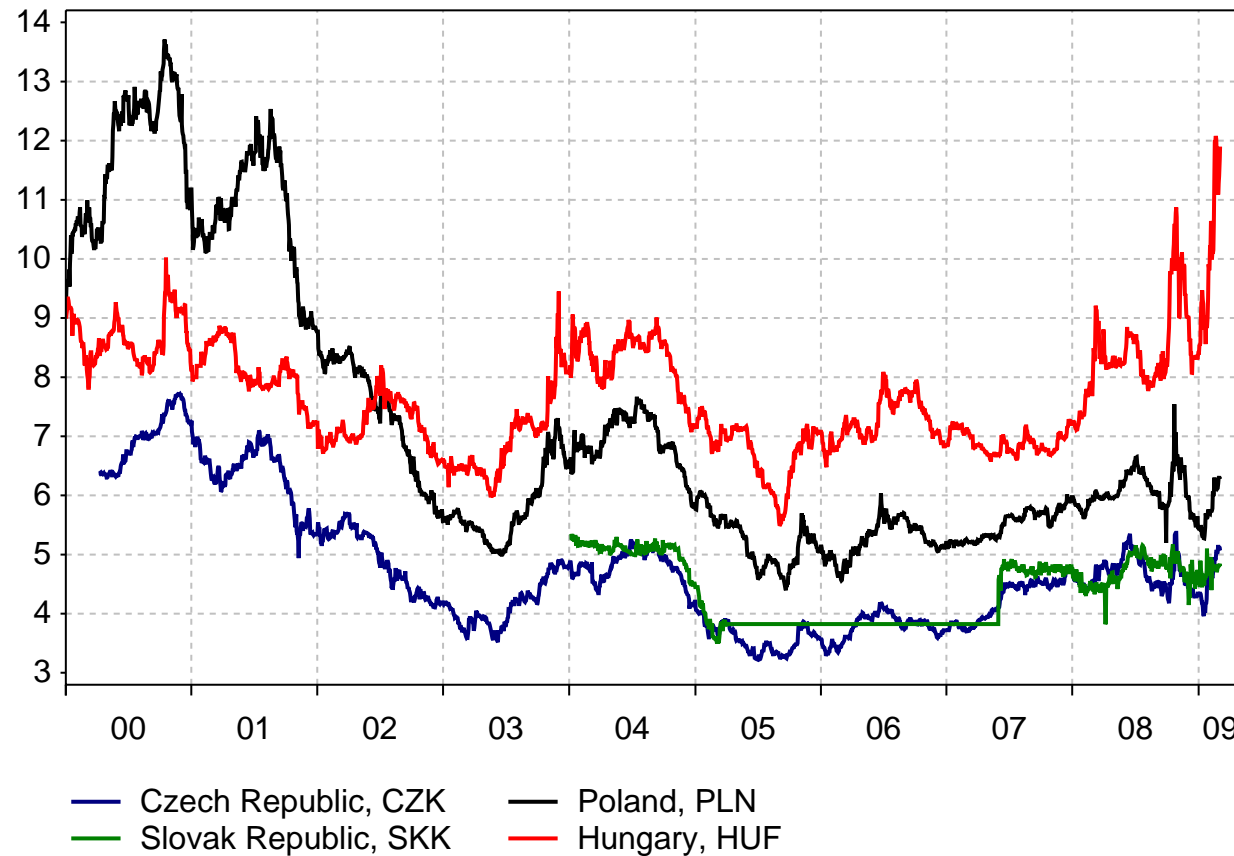
	GDP Growth			Fiscal Balance (% of GDP)		
	2008F	2009F	2010F	2008F	2009F	2010F
<b>Europe</b>	<b>4.2%</b>	<b>-2.3%</b>	<b>2.5%</b>	<b>0.3%</b>	<b>-5.5%</b>	<b>-3.8%</b>
Czech Republic	3.5	-1.0	2.0	-1.6	-3.4	-2.6
Hungary	0.6	-2.6	1.6	-3.3	-2.6	-2.8
Poland	4.7	1.4	3.6	-2.7	-3.3	-3.5
Romania	8.0	-2.5	4.0	-5.2	-4.0	-3.0
Russia	5.6	-3.0	1.7	4.0	-8.1	-4.9
Slovak Rep.	6.6	1.5	3.2	-1.8	-3.5	-2.5
Turkey	1.0	-2.4	4.2	-1.7	-3.7	-2.5
Ukraine	2.6	-8.7	0.8	-1.2	-2.1	-2.7

Source: Citi forecasts (Citi's Emerging World, 26 February 2009).



# With pressure on interest rates

10yr government bond yields, 2000-Feb09 (Percent)



Source: Reuters EcoWin.



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