Russia & CIS: interesting times

BNP PARIBAS
CORPORATE & INVESTMENT BANKING | The bank for a changing world

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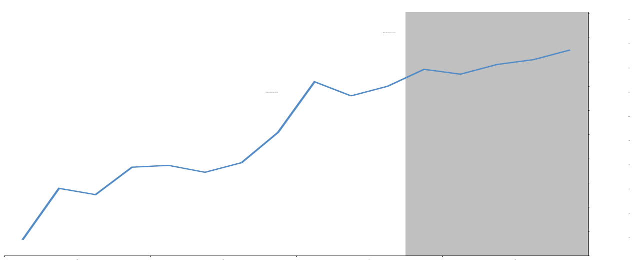
RUSSIA: Hedged by Oil

Positive factor: we remain optimistic on oil prices

- Consensus on oil prices may change in the coming months on the back of global uncertainty
- We are not significantly revising our view on oil prices, which remain very comfortable for Russia
- On the other hand, a wider gap between WTI and Brent/Urals is likely
- With high oil prices, serious challenges are unlikely to economic growth in Russia

Chart 1: Ural Prices Forecast



Source: BNP Paribas

Chart 2: BNP Paribas Oil Prices Forecast

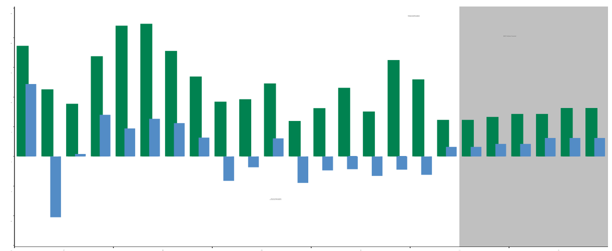
	WTI	Revision[2]	Brent[1]	Revision[2]
Q1 11 (actual)	94.19	2.19	105.20	1.20
Q2 11	106.00	1.00	120.00	3.00
Q3 11	102.00	0.00	116.00	6.00
Q4 11	110.00	0.00	122.00	7.00
Q1 12	111.00	..	123.00	..
Q2 12	115.00	..	125.00	..
Q3 12	118.00	..	126.00	..
Q4 12	122.00	..	128.00	..
2009 (actual)	61.81	..	62.51	..
2010 (actual)	79.53	..	80.26	..
2011	103.00	1.00	116.00	4.00
2012	117.00	6.00	126.00	12.00

Source: BNP Paribas

Negative factor: Capital outflow is likely to accelerate in 2011. No negative surprises in 2012

- Emerging markets are facing capital outflows. Russia is unlikely to enjoy inflows in H2 2011.
- Consequently, we are revising our forecast for net capital flows from USD-30bn to USD-45bn in 2011; this should deduct 0.5pp from Russian GDP.
- We expect capital flows to be moderately positive in 2012 at USD 10-15bn
- Taking into account the shrinking current account surplus, capital inflows are becoming an important driver for the rouble and will be more important still from 2013.

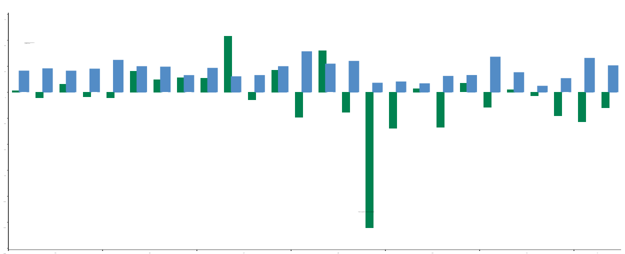
Chart 3: Foreign Direct Investment



Source: CBR, BNP Paribas

FDI is chronically low. Russia's investment climate suggests that quick improvements are unlikely. In Q1 2011, net FDI remained negative at USD 3bn. We expect more sizable FDI inflows in H2 2011 but the improvement is unlikely to be sharp.

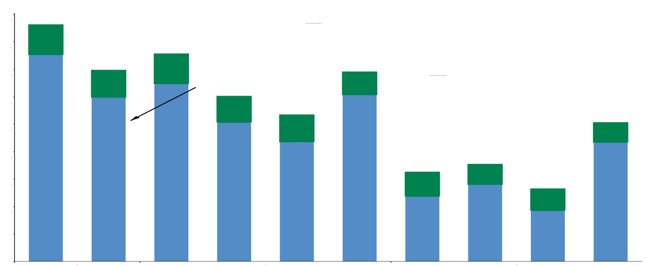
Chart 4: Capital Outflow and Current Account



Source: CBR, BNP Paribas

Net capital outflow of USD 31.2bn was the main negative surprise on the economic side in H1 2011. We expect a new wave of outflow in Q3 associated with global uncertainty and flight to quality. In Q4, capital outflow is likely to remain sizable , as is typical of (pre) election quarters

Chart 5: External Debt Payment Schedule

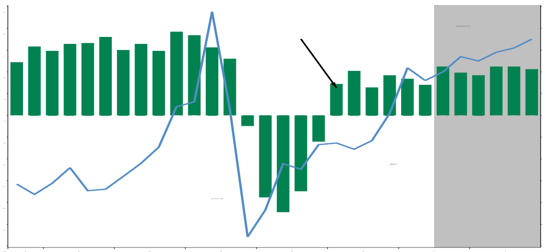


Source: CBR, BNP Paribas

Foreign debt payments are scheduled to spike in Q4'11 to USD 34.5bn. In combination with capital outflows stimulated by elections, this will exert depreciation pressure on the rouble, in our view.

Growth Optimism Moderate: consensus is likely to decline to 4% for the medium term

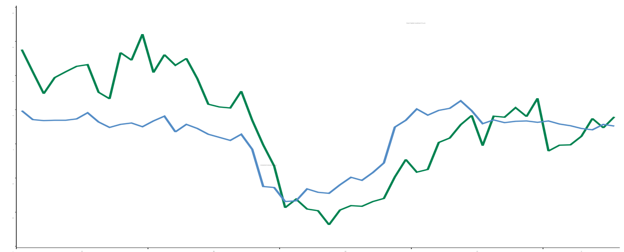
Chart 6: Economic Growth and Oil Prices



Source: FSSS, Bloomberg, BNP Paribas

We remain bullish on oil prices, which should allow for strong economic growth and help to avoid negative surprises in 2012-13. A strong harvest this year adds to our optimism for 2011 overall. Sizable capital outflow limits upside opportunities in 2011 but will not affect 2012, in our view.

Chart 7: Industrial Output and Investment

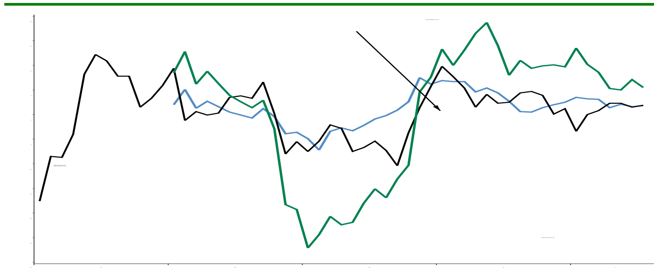


Source: FSSS, BNP Paribas

Although industrial growth slowed to 4.8% y/y Q2 2011 owing to base effects, we expect it to outperform GDP growth in H2'11 (IP +5.7% y/y). Investment rebounded strongly in Q2; we expect growth of 5.8% and 6.5% in 2011 and 2012, respectively, on the back of government spending.

- High oil prices are essential for strong economic growth. We expect oil prices to remain favourable for Russia (USD 114/bbl and USD 125/bbl in 2011 and 2012 (Urals), respectively).
- We remain bullish on the pace of recovery but have revised down our projections for private consumption and fixed capital investment due to capital outflow in 2011.
- We have trimmed our forecast for GDP growth from 5% to 4.5%; for consumption from 5% to 4.5%; and for fixed capital investment from 8% to 5.8% in 2011. We expect GDP growth to average c.5% in the medium term.
- The consensus range for economic growth is 4-5% (4.5% according to July's EE survey) but we expect consensus to go down to 4% for 2011-12
- The government remains the main engine of modernisation and the biggest single investor in the economy. Its role is gradually increasing despite rhetoric on diversification and privatisation.

Chart 8: Industrial Growth Breakdown

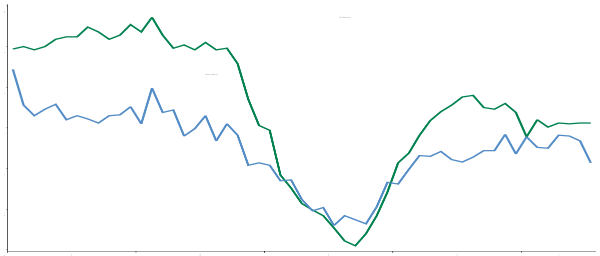


Source: FSSS, BNP Paribas

Manufacturing remains the main beneficiary of higher oil prices. Domestic demand is playing a key part in the sector's rebound. We see manufacturing growth of 9% and 6.7% in 2011 and 2012, respectively. We expect growth in the raw material sector to be sluggish at c.2% y/y, stymied by high tax pressure.

Consumer Universe: still strong due to elections

Chart 9: Retail Sales and Services Volumes

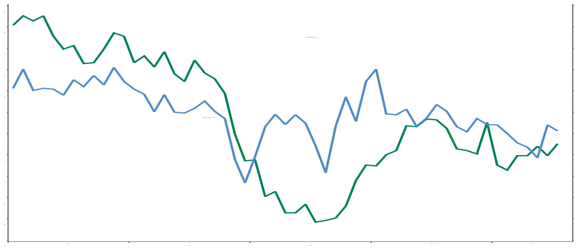


Source: FSSS, BNP Paribas

In H1 2011, retail growth was solid at 5% and driven by credit growth, which accelerated to 22.9% y/y. Income and wage growth was not supportive for consumption but is likely to pick up in H2'11-H1'12 and stimulate further growth in consumer spending.

- Consumption recovered significantly in 2010 and we expect growth to continue. We see retail sales and services sales growing 5% a year in 2011-12.
- The parliamentary and presidential elections of 2011-12 entail a high probability of a new wave of populism, boosting consumption and incomes this year and next.
- Public-sector employees enjoyed a 6.5% increase in salaries from July. Teachers will get a 30% hike in October. Government employees will get an additional 10% in October too. Pensions are scheduled to increase 10% in H2.
- We expect further qualitative and quantitative improvements in the labour market. Lower unemployment (in particular hidden unemployment) is essential to boost consumer optimism and stimulate consumption.

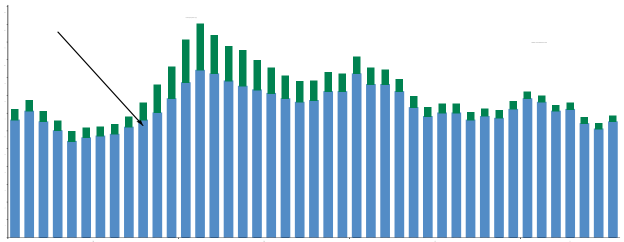
Chart 10: Income and Wages



Source: FSSS, BNP Paribas

Although the trend in real wages and incomes was not particularly impressive in H1, the situation has started to change. We expect acceleration to 5+% on the back of social spending by the authorities. Forthcoming parliamentary and presidential elections are leading to a new wave of populist measures.

Chart 11: Unemployment



Source: FSSS, BNP Paribas

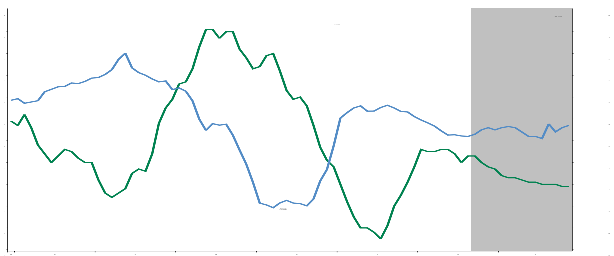
As expected, the unemployment rate has continued to decline, reaching 6.1% of the economically active population in July (partially as a result of seasonal factors). The drop in hidden unemployment is boosting consumer optimism. we expect further improvements in the labour market, with the unemployment rate easing 6.5% and 6.3% by end-2011 and end-2012 respectively.

Consumer Confidence Index (1999-2011)

- The consumer confidence index rose 4pp in Q2 and we expect it to improve further on the back of wage and income growth.
- Pre-election populist measures from the government may make consumers more enthusiastic.
- Optimism is concentrated in the big cities while rural areas are still downbeat.

Monetary Policy: CPI trend makes tightening unlikely

Chart 12: Inflation and Money Supply

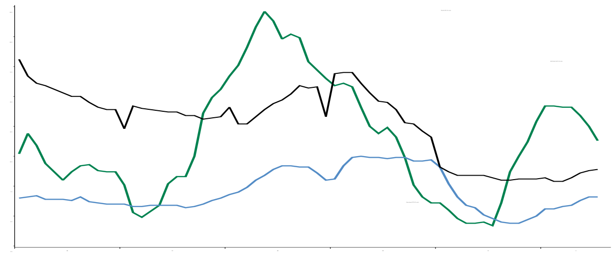


Source: CBR, FSSS, BNP Paribas

With policy limiting rises in utility tariffs until 2012, monetary factors are becoming increasingly important for inflation. Transmission mechanisms are gradually improving, boosting the role of CBR policy. M2 growth remains high (22.2% y/y in July) but is unlikely to exceed 30% in 2011-13

- Money supply growth is unlikely to accelerate above 30% y/y in 2011-13 as capital outflow reduces dollar inflow pressure. The CBR continues to absorb extra dollars from the market but needs to print fewer roubles.
- The official target range is 6.5-7.5%. CPI inflation should ease to 7.5% y/y by end-2011.
- In 2012-13, we see inflation slowing further, paving the way for the refi rate to be cut to 8% by end-2012.
- Solid rouble liquidity (on the back of petrodollar inflows) will keep money market interest rates negative in real terms.

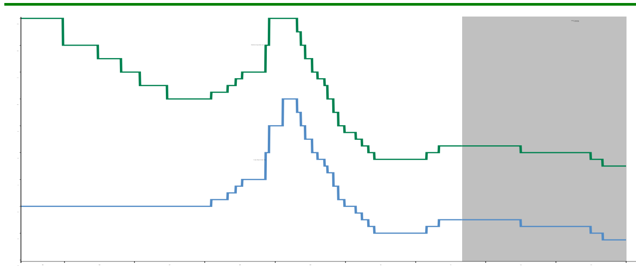
Chart 14: CPI Breakdown



Source: FSSS, BNP Paribas

Good harvests in the CIS region have led to Russia's food CPI decelerating, pulling CPI down. We expect some acceleration in monthly CPI in Q4 on the back of pre-election increases in social spending and a weaker rouble. We have revised our inflation forecast for end-2011 down to 7.5%y/y from 8.5%y/y.

Chart 15: Policy Rates of the Central Bank

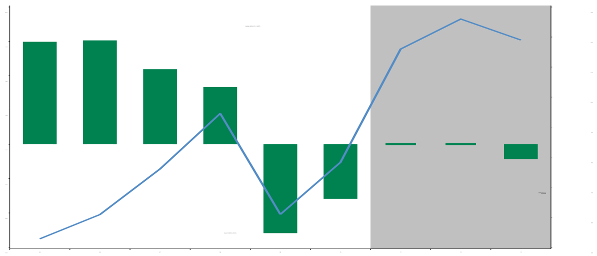


Source: CBR, BNP Paribas

The decelerating trend in inflation means rates are less likely to be hiked again. We expect rates to remain at 8.25% for the next nine months. Monetary easing may begin by June-July 2012 if Russia avoids new external inflation shocks.

Fiscal Performance: zero budget deficit driven by oil

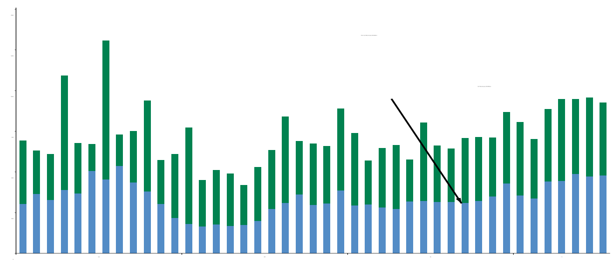
Chart 22: Budget Performance



Source: MoF, CBR, BNP Paribas

Russia is likely to enjoy a balanced budget in 2011-12, although the risk of new hikes in public spending remains high as the election season approaches. Oil revenues account for 50-55% of the federal budget, making high expenditure affordable in the coming years.

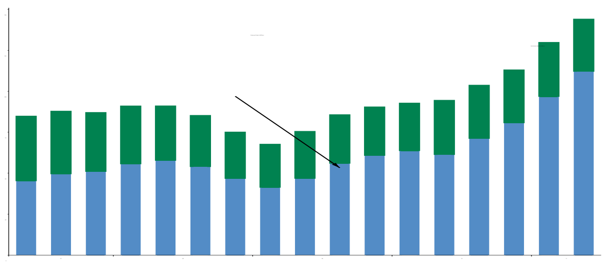
Chart 23: Budget Revenues



Source: MoF, EEG, BNP Paribas

The oil-price threshold for balancing the Russian budget has shot up from USD 18.5/bbl in 2000 to USD 125/bbl (our forecast) in 2012. We expect a non-oil deficit of 11.7% of GDP in 2011, which is high. The high oil price threshold makes the fiscal story unsustainable in the medium term.

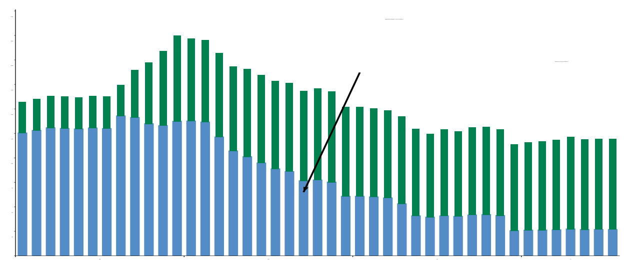
Chart 24: Government Debt



Source: MoF, CBR, BNP Paribas

Gross government debt remains modest at little more than 8% of GDP and is unlikely to rise substantially in 2012-13. With a balanced budget expected, the government's financing needs are falling. We do not expect new Eurobonds in 2012-13.

Chart 25: Sovereign Wealth Funds

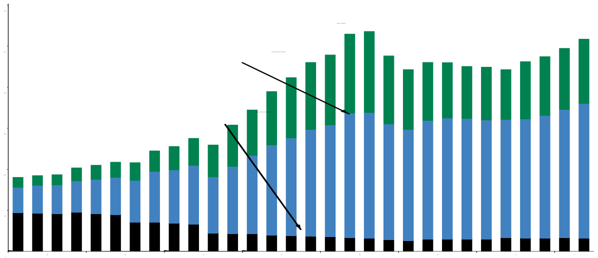


Source: MoF, BNP Paribas

The Reserve Fund is likely to be replenished by USD 3-5bn in 2011-12. The government is likely to preserve the National Wealth Fund, which reached USD 92.7bn in Aug 2011. This important financial cushion reduces fiscal risks in the medium term.

External Balances: low debt, strong balance of payments

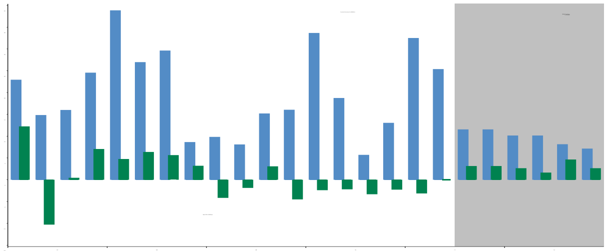
Chart 16: External Debt



Source: CBR, BNP Paribas

Gross foreign debt stood at USD 532.2bn in H1 2011 – easing to 29.4% of GDP vs. 32.4% in 2010. We forecast foreign debt to remain below 40% of GDP in the medium term. As exporters remain the most aggressive borrowers, we do not see risks associated with foreign debt servicing.

Chart 17: Balance of Payments



Source: CBR, BNP Paribas

We expect the current account surplus to rise to USD 75bn (4.2% of GDP) in 2011 and remain positive at 1.7% of GDP in 2012. Net FDI is chronically low. The partnership recently entered into by Rosneft and ExxonMobil may change the picture in 2012 and beyond.

- External balances remain strong on the back of high oil prices.
- However, the current account surplus is shrinking on the back of import growth. The current account balance could turn negative in 2014 and remain so subsequently.
- Capital inflows are increasingly important for external balances and rouble trend.
- We expect more aggressive foreign borrowing by corporates and banks in 2012-13 but economic growth of 4.5%-5% will help to prevent rapid expansion of foreign debt.
- Sovereign debt is likely to remain tiny (below 4% of GDP)

Rouble trend: appreciation in 2012-13…but strong volatility

Arguments for appreciation

- Oil prices: USD 114/bbl (Urals) and USD 125/bbl in 2011 and 2012 respectively
- Current account surplus (4% of GDP)
- Better sentiment on Russia after appreciation in H1 2011
- CBR tolerance of appreciation (to counter inflation)
- The elections this year and next make devaluation unlikely (owing to its political sensitivity)

Depreciation factors

- EUR/USD volatility and risk of oil price volatility
- Sizable capital outflow (USD 31.2bn in H1'11 with USD 45bn expected in 2011 as a whole)
- CBR reduces interventions in the market, strengthening the importance of fundamental and floating factors

Appreciation is possible if capital inflows are supportive

	Q211	Q311	Q411	Q112	Q212	Q312	Q412	Q113	Q213	Q313	Q413
USD/RUB	28.00	27.50	27.30	27.90	28.00	28.10	27.60	28.19	27.75	29.07	27.75
RUB vs. basket	33.67	**33.69**	34.06	**33.55**	33.04	**32.53**	31.95	**32.00**	31.50	**32.99**	31.50
EUR/RUB	40.60	41.25	42.32	40.46	39.20	37.94	37.26	36.65	36.08	37.79	36.08
EUR/USD	1.45	1.50	1.55	1.45	1.40	1.35	1.35	1.30	1.30	1.30	1.30

Source: BNP Paribas

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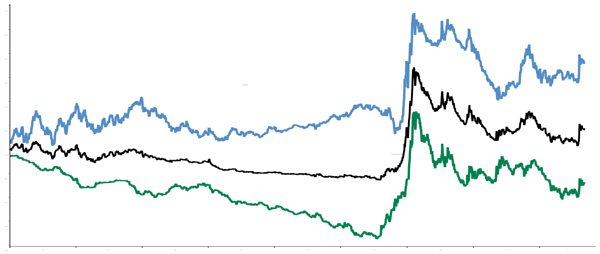
Level of uncertainty remains high

Russia is not an island; high volatility of the rouble is likely.

Fixed Income: stabilisation after August's shock

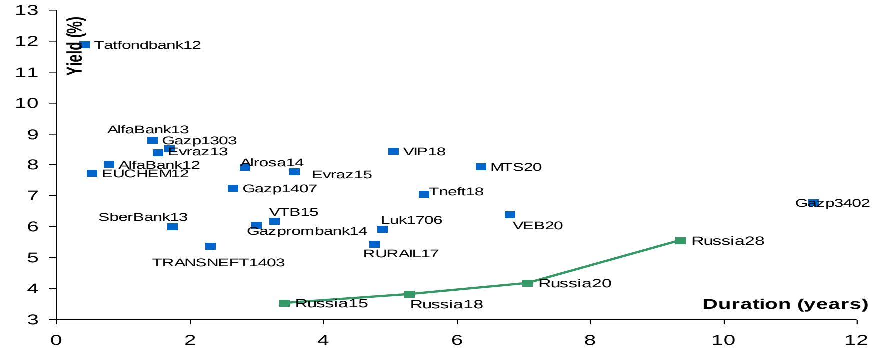
Chart 18: Exchange Rates



Source: CBR, BNP Paribas

We are neutral on the rouble for the coming months. Depreciation pressure is likely to strengthen in Q4, December in particular. The CBR is tolerating rouble fluctuations and continuing to gradually liberalise the FX regime. The rouble basket should still be within the range 34-35 at end-2011.

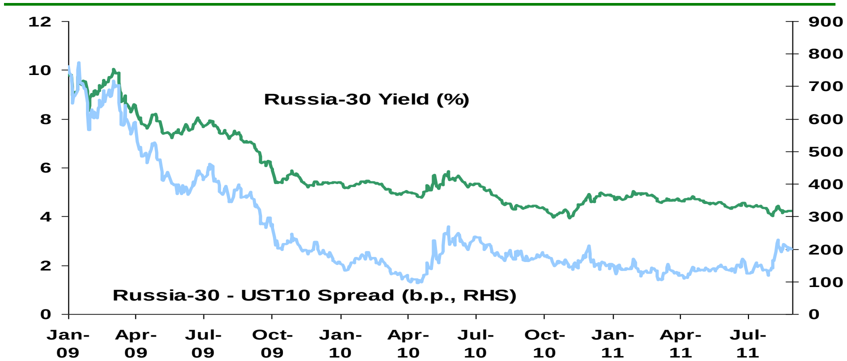
Chart 19: Corporate Eurobonds



Source: CBR, BNP Paribas

Corporate Eurobond yields remain low in comparison with the domestic debt market. We expect the average maturity of foreign debt to gradually increase from five years to seven. We expect more aggressive foreign borrowing in 2012 and beyond if global market conditions improve.

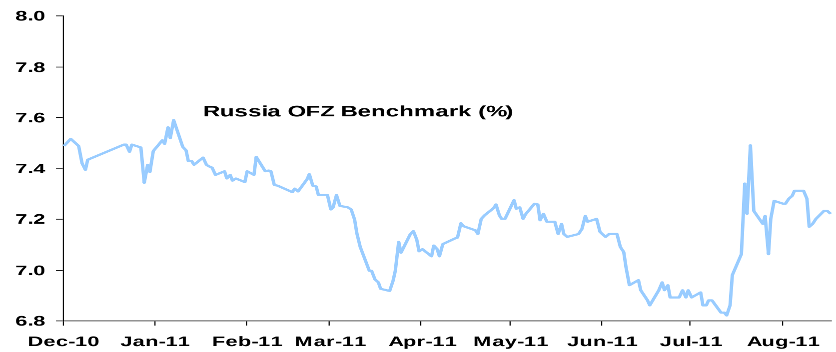
Chart 20: Ru30 Yield & Ru30–UST10 Spread



Source: Bloomberg, BNP Paribas

The spread between Russian sovereign debt and US Treasuries widened to 200bp due to flight to quality. We expect this to compress to 130-140bp by end-2011 and reach its all-time low of 80-90bp in the coming 12-18 months. High oil prices, Russia's low debt burden and modest refinancing needs underpin our optimism.

Chart 21: OFZ Benchmark Yield

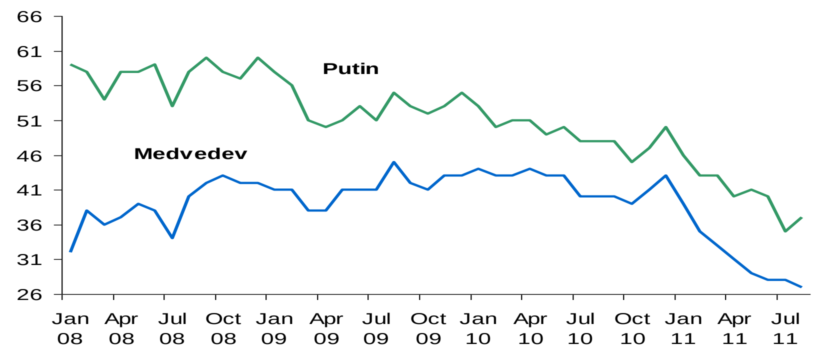


Source: Reuters, BNP Paribas

We see 50bp downside for domestic bond yields on the back of the state's low financing needs and flat policy rates through H1 2012. The corporate debt market, hit by August's sell-off, could perform even more strongly. Domestic debt issues by the government are not affecting corporate borrowers.

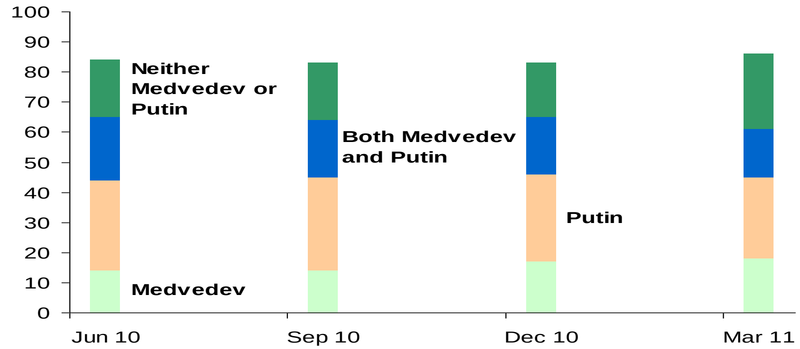
Political Situation: elections hold some intrigue

Chart 26: Public Approval Ratings of President Medvedev and PM Putin (%)



Source: WCIOM, BNP Paribas

Chart 27: Preferred Candidate for 2012 Presidential Elections (%)



Source: Levada Centre, BNP Paribas

- We expect the current ruling group to retain control following the upcoming elections. Although we expect 5-6 candidates to participate in the presidential race in March 2012, only PM Putin and President Medvedev would stand a chance of winning.
- We put the probability that Putin and Medvedev will both stand next March at 20%. We think the probability that Putin will return to the presidency at more than 80%.
- We expect PM Putin/president Medvedev to clarify their plans in October (after the forum of the United Russia)
- A single decision-making locus and high oil prices are likely to make the next presidency stronger than the current one.
- The next president will have to accelerate structural reforms. Differences between Medvedev and Putin would likely be seen in terms of methods – with a larger role for the government and state corporations in the event of a Putin victory.

Table 1: Putin and Medvedev: Comparison Points

Comparison points	Putin	Medvedev
Economy	GDP doubling + Diversification	Modernisation
Reforms	Tax Code Land Code Aquatic Code Budget Code Labour Code	Police Reform Military Reform Judicial Reform
Reforms on agenda (still little progress)	Debureaucratisation Reform Banking Reform Pension Reform Anti-corruption Measures	
Govt. participation in economy	State Corporations	Acceleration in Privatisation
Foreign Arena	Tough rhetoric	Restrained rhetoric
Party Support	United Russia (70% of Duma seats)	Potentially: A Just Russia (8.4% of Duma seats)

Source: BNP Paribas

Russia: Economic and Financial Forecasts

Components of Growth	Year					2010				2011				2012				2013			
	'09	'10	'11 (1)	'12 (1)	'13 (1)	Q1	Q2	Q3	Q4	Q1	Q2 (1)	Q3 (1)	Q4 (1)	Q1 (1)	Q2 (1)	Q3 (1)	Q4 (1)	Q1 (1)	Q2 (1)	Q3 (1)	Q4 (1)
GDP (%q/q) nsa	-	-	-	-	-	-15.0	8.0	10.9	2.7	-15.3	7.3	13.1	2.0	-15.6	8.3	13.1	1.7	-16.4	8.9	13.3	2.0
GDP (%q/q) sa	-	-	-	-	-	1.0	0.7	-1.0	3.7	0.6	0.0	1.1	3.1	0.3	1.0	1.1	2.8	-0.6	1.6	1.2	3.1
GDP (%y/y)	-7.9	4.0	4.5	5.2	4.8	3.5	5.0	3.1	4.5	4.1	3.4	5.5	4.8	4.5	5.5	5.5	5.2	4.2	4.8	5.0	5.3
GDP (USD bn)	1225.8	1465	1807	2009.0	2290	330.0	358.0	384.2	392.3	407.2	441.7	474.1	484.0	452.7	491.1	527.0	538.2	516.0	559.8	600.8	613.4
Private Consumption	-4.8	2.7	4.5	5.2	4.6	0.1	4.6	6.7	0.0	3.5	3.8	5.0	5.5	4.8	5.1	5.5	5.5	5.0	5.0	4.5	4.0
Public Consumption	-0.5	0.7	0.9	3.0	0.3	1.8	0.7	0.2	0.5	0.5	0.5	1.0	1.5	2.0	2.0	4.0	4.0	0.0	0.5	0.0	0.5
Fixed Investment	-16.2	6.0	5.8	6.5	5.5	-4.1	5.3	7.2	9.8	-0.8	4.8	8.0	11.0	5.0	6.0	7.0	8.0	4.0	5.0	6.0	7.0
Exports (%y/y)	-4.7	11.1	10.6	0.5	0.5	18.5	3.9	9.5	12.3	13.0	10.0	8.0	11.5	0.5	1.0	0.5	0.0	0.5	1.0	0.5	0.0
Imports (%y/y)	-30.4	25.4	20.5	15.0	15.0	10.7	20.8	34.8	35.3	12.0	20.0	25.0	25.0	14.0	14.4	15.5	16.0	14.0	14.4	15.5	16.0
Industrial Production	-11.0	8.2	5.6	4.5	4.1	9.5	10.9	6.4	6.5	5.9	4.8	5.8	5.7	3.5	4.5	5.0	4.9	3.5	4.5	4.0	4.5
Savings Ratio (%)	18.8	18.0	18.6	21.0	21.0	12.4	19.9	18.8	20.7	17.0	19.0	19.0	19.5	19.5	20.5	22.0	22.0	19.5	20.5	22.0	22.0

Inflation & Labour	Year					2010				2011				2012				2013			
	'09	'10	'11 (1)	'12 (1)	'13 (1)	Q1	Q2	Q3	Q4	Q1	Q2 (1)	Q3 (1)	Q4 (1)	Q1 (1)	Q2 (1)	Q3 (1)	Q4 (1)	Q1 (1)	Q2 (1)	Q3 (1)	Q4 (1)
CPI	11.8	6.9	8.8	7.2	7.2	7.2	5.9	6.2	8.1	9.6	9.6	8.3	7.7	6.8	6.9	7.6	7.5	7.4	7.2	7.2	7.1
CPI (2)	8.8	8.8	7.5	7.5	7.0	6.4	5.8	7.0	8.8	9.5	9.4	7.7	7.5	6.7	7.1	7.6	7.5	7.3	7.3	7.0	7.0
Unemployment Rate (%)	8.2	7.5	6.8	6.3	6.1	8.8	7.4	6.8	7.2	7.6	6.8	6.2	6.5	6.5	6.5	5.9	6.2	6.3	6.2	5.8	6.0

	Year					2010				2011				2012				2013			
External Trade	'09	'10	'11 (1)	'12 (1)	'13 (1)	Q1	Q2	Q3	Q4	Q1	Q2 (1)	Q3 (1)	Q4 (1)	Q1 (1)	Q2 (1)	Q3 (1)	Q4 (1)	Q1 (1)	Q2 (1)	Q3 (1)	Q4 (1)
Trade Balance (USD bn)	111.6	151.4	150.0	110.0	90.0	46.5	39.2	29.2	36.4	48.2	36.8	32.5	32.5	30.0	30.0	30.0	20.0	30.0	25.0	20.0	15.0
Current Account (USD bn)	49.5	71.1	75.0	35.0	15.0	33.3	18.0	5.7	14.1	31.8	20.5	11.4	11.4	10.0	10.0	8.0	7.0	5.0	4.0	3.0	3.0
Current Account (%GDP)	4.0	4.9	4.2	1.7	0.7	10.1	5.0	1.5	3.6	7.8	4.6	2.4	2.3	2.2	2.0	1.5	1.3	1.0	0.7	0.5	0.5
Net FDI (USDbn)	-7.2	-10.5	5.0	11.0	15.0	-2.2	-2.0	-3.3	-3.0	-1.0	0.0	3.0	3.0	2.5	1.5	4.5	2.5	3.0	3.0	4.0	5.0
Net FDI (%GDP)	-0.6	-0.7	0.3	0.5	0.7	-0.7	-0.6	-0.9	-0.8	-0.2	0.0	0.6	0.6	0.6	0.3	0.9	0.5	0.6	0.5	0.7	0.8

Financial Variables	Year					2010				2011				2012				2013			
	'09	'10 (1)	'11 (1)	'12 (1)	'13 (1)	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1 (1)	Q2 (1)	Q3 (1)	Q4 (1)	Q1 (1)	Q2 (1)	Q3 (1)	Q4 (1)
Gen. Gov. Budget (%GDP)	-6.4	-3.9	0.0	0.0	-1.0	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Primary. Gov. Budget (%GDP)	-5.8	-3.4	0.5	0.6	-0.4																
Gross Gov. Debt (%GDP) (2)	7.5	7.9	7.8	8.2	9.0	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-

Interest & FX Rates (2)	Year					2010				2011				2012				2013			
	'09	'10	'11 (1)	'12 (1)	'13 (1)	Q1	Q2	Q3	Q4	Q1	Q2	Q3 (1)	Q4 (1)	Q1 (1)	Q2 (1)	Q3 (1)	Q4 (1)	Q1 (1)	Q2 (1)	Q3 (1)	Q4 (1)
Official Interest Rate (%)	8.75	7.75	8.25	8.00	7.50	8.25	7.75	7.75	7.75	8.00	8.25	8.25	8.25	8.25	8.25	8.00	8.00	8.00	8.00	7.75	7.50
3-Month Rate (%)	7.05	4.10	4.00	4.50	3.50	4.50	4.00	3.80	4.10	3.96	3.50	3.70	4.00	4.00	4.20	4.40	4.50	4.20	4.00	3.50	3.50
USD/RUB	30.20	30.40	27.30	27.60	27.80	29.00	30.20	30.60	30.4	28.40	27.92	28.80	29.10	28.30	28.00	28.10	27.60	27.00	27.50	27.50	27.80

Footnotes: (1) Forecast (2) End Period

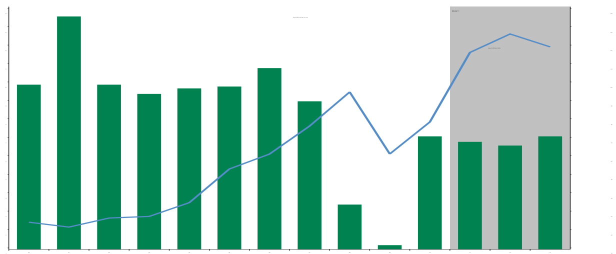
Figures are year-on-year percentage changes unless otherwise indicated

Source: BNP Paribas

KAZAKHSTAN: Robust Growth

Activity Boom: oil stimulates consumption

Chart 1: Economic Growth and Oil Prices



Source: KazStat, NBK, BNP Paribas

High oil prices are buoying economic growth, which reached 7.1% y/y in H1 2011. As a result of our bullish view on the Urals oil price, we expect economic growth to remain in the 6.5-7.0% per annum range for 2011-13.

■We maintain our GDP growth forecasts at 6.7% and 6.5% in 2011 and 2012 respectively. We put potential growth at 7% for coming years but a slowdown in credit growth may subtract 0.5-0.7pp from annual growth in 2011-12.

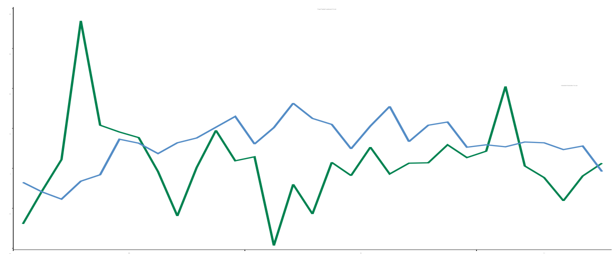
■ A good harvest this year is improving prospects for 2011 economic growth. We expect 19-20mn tons of grain. As the country consumes 8mn tons and prefers to store 3mn tons in strategic supply, it could boost exports by 8-9 mn tones.

■ We expect consumption to remain strong. Economic growth will also increasingly be supported by the recovery of the banking sector. Furthermore, we expect a rebound in investment – current growth is insufficient to support high economic growth rates.

■Diversification from oil and gas has become a key target of the government. It plans to stimulate diversification via higher oil taxation. The government is not planning to hike overall tax rates but to widen the tax base.

■Since May 2011, significant strikes by oil sector employees in the west of Kazakhstan have occurred. Kazmunaigaz has cut its target for production in 2011 by 4% due to the industrial action.

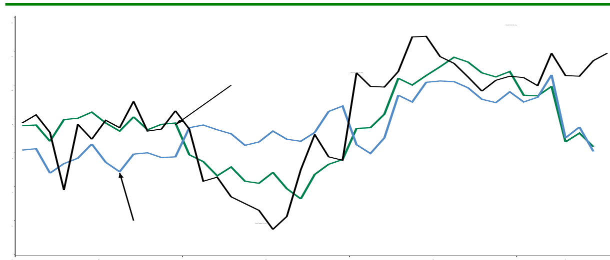
Chart 2: Industrial Output and Investment



Source: KazStat, BNP Paribas

Industrial growth slowed in Q2, with expansion of 4.8% y/y in January-July. Nevertheless, high oil prices are supportive for further industrial expansion although industrial growth may underperform economic growth in 2011. Investment has been recovering but remains volatile, affected by low credit growth (FCI expanded 2.1% y/y in January-July).

Chart 3: Income and Consumption

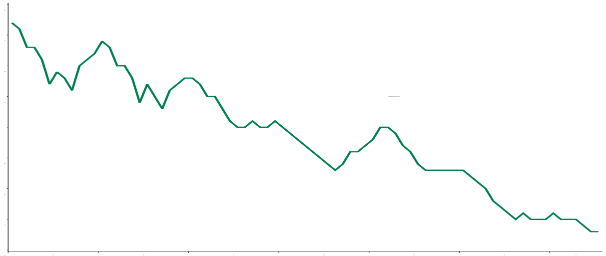


Source: KazStat, BNP Paribas

A substantial rebound in domestic demand, in particular a 12.4% y/y rise in retail sales in H1 2011, has made growth more balanced. A rise in incomes is the main driver of the recovery in consumption (retail loans have fallen in real terms).

Fiscal Policy: oil revenues high

Chart 4: Unemployment

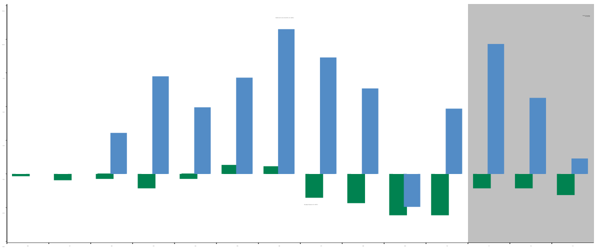


Source: KazStat, BNP Paribas

Faster economic growth has improved the labour market. In July, the unemployment rate dropped to 5.3% of the economically active population (5.6% in July 2010). We expect unemployment to decline to 5% by end-2011. Rising employment is crucial for consumption growth.

- We believe the government wants to cut the size of oil transfers to the budget by USD 8bn a year. The budget deficit is unlikely to exceed 1-1.5% of GDP in 2011-13
- Kazakhstan’s oil price threshold to balance the budget is low at USD 75/bbl (vs. USD 125/bbl in Russia)
- Accumulation of the National Fund is a priority of the government. We expect it to grow by USD12bn a year in the period of high oil prices (2011-13)
- Strong fiscal performance and sizable accumulation in the National Fund make new sovereign borrowing unlikely in 2011-12. The country has no tradable sovereign debt, making sub-sovereign issues important as the country’s benchmark.
- In H2 2012, the government plans to start the so-called People’s IPO, floating shares in companies controlled by the state-owned Samruk-Kazyna. However, the planned sale of USD 300-500mn worth of shares is unlikely to be sufficient to lead to a significant development of the equity market. But privatisation will boost government financing.

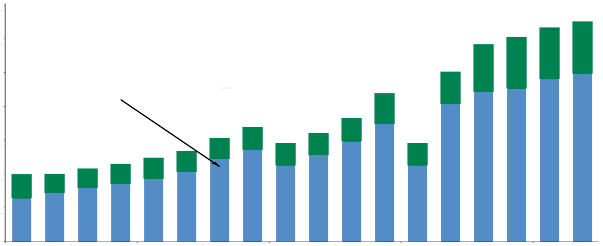
Chart 5: Fiscal Performance



Source: NBK, BNP Paribas

In 2011, the deficit is unlikely to exceed 1% of GDP while the National Fund should increase by an impressive USD 12bn, or 7.5% of GDP. We expect robust fiscal performance in the coming years.

Chart 6: Government Debt

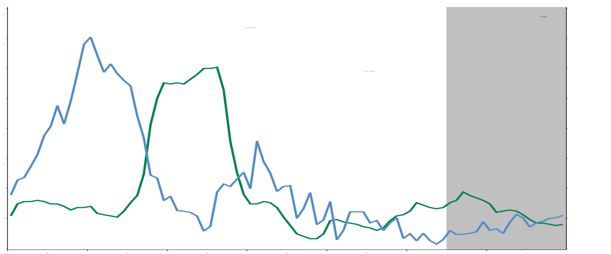


Source: MoF, BNP Paribas

The strong fiscal performance has reduced the need for financing. Domestic debt has enjoyed robust demand from local investors (pension funds) but is likely to remain very illiquid. We expect total government debt to decline from 12.5% of GDP in 2011 to 10.5% in 2013.

Monetary Policy: CPI trend makes tightening unlikely

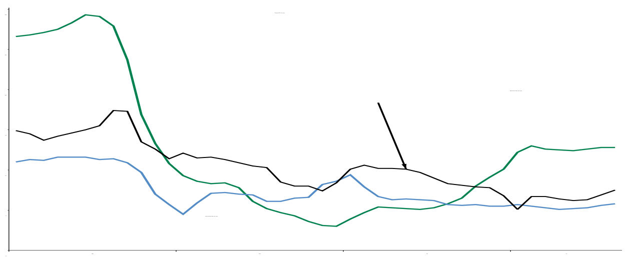
Chart 7: Inflation and Money Supply



Source: KazStat, BNP Paribas

CPI inflation slowed to 9% y/y in August on the back of a sharp decline in food inflation. A good harvest in 2011 (we expect the grain crop to rise 56% y/y) and limits on grain exports from relatively poor infrastructure should help to slow food inflation further.

Chart 8: Inflation Breakdown

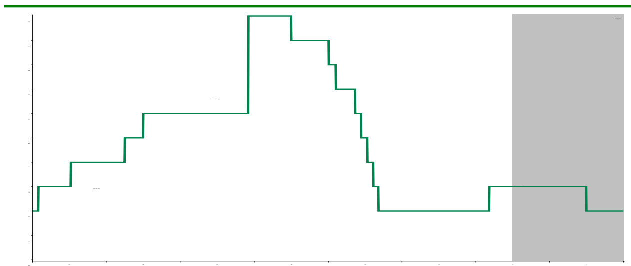


Source: KazStat, BNP Paribas

As food represents 44% of the CPI basket, we expect inflation to slow sharply in coming months.

- Kazakhstan has had 6-8% inflation in the last decade, **but the government's target range this year**
- The relatively modest growth in the money supply (13.6% y/y in H1) supports a slowdown in inflation. We continue to expect inflation to end 2011 and 2012 at 8.0% and 7.0% y/y, respectively.
- The effect of the surging oil prices this year has been already priced in and unlikely to fuel CPI in Q4 2011-Q1 2012.
- As inflation is unlikely to exceed the targeted level, no policy response from the NBK is likely.

Chart 9: Policy Rate

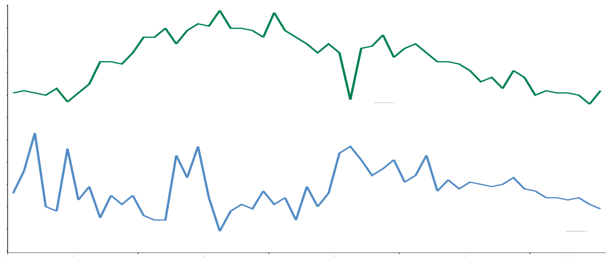


Source: NBK, BNP Paribas

We do not expect any change in rates for the next nine to twelve months. Rather, the NBK is likely to concentrate its efforts on stimulating credit. .

Banking Sector: steady dynamics, sharp acceleration in credit growth

Chart 10: Lending and Deposit Rates

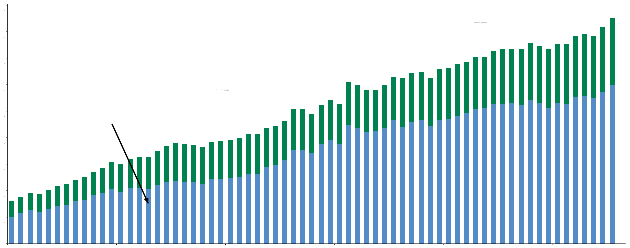


Source: NBK, BNP Paribas

Average lending rates have stabilised at around 13% in the last quarter but should decline to 10% in the coming 12 months due to banking sector recovery and decline in CPI inflation. Deposit rates have been falling (average deposit rate reached 7.9%) and may continue to do so.

- The banking system is recovering. The most problematic parts are localised, but the recovery process is gradual and may take 2-3 more years.
- We expect prudent banking supervision to allow improvements to continue through 2015. Concentration of the supervision function in the hands of the NBK should strengthen it.
- Write-offs remain sizable and are unlikely to substantially decline in the coming years. Cumulatively, the banking system has already written off c.10% of GDP (S&P estimate). Sizable new write-offs are on the horizon.
- Although new qualitative loans are growing fast, write-offs make the picture less transparent, making the final growth figures less impressive.
- The NPL level has declined significantly from 40% at the peak of the crisis but remains very high at 26.9% (as of 1 Aug 2011)

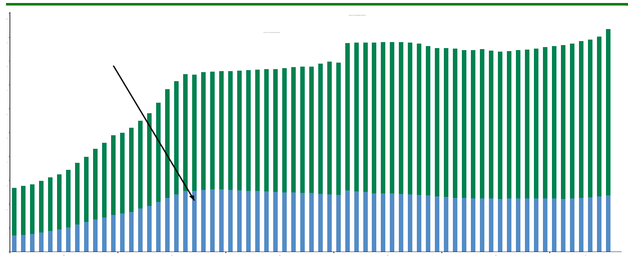
Chart 11: Banking Deposits



Source: NBK, BNP Paribas

Deposit growth was sufficiently strong at c.16.6%.y/y in Q3 (vs. c.12%y/y in Q2). We do not expect deposit growth to remain that high in 2012 (lower deposit rates may not be so attractive), but rebound in savings and confidence in the banking system should support expansion at c.7%y/y.

Chart 12: Banking Loans

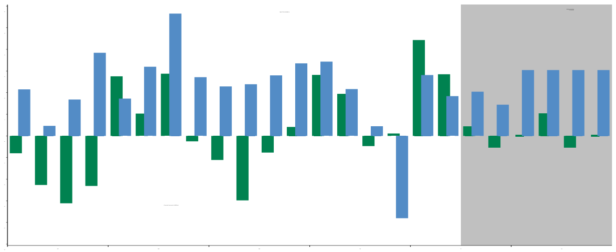


Source: NBK, BNP Paribas

The banking system has not fully recovered but credit growth has drastically accelerated. Retail loan growth accelerated from c.1-2%y/y in Q2 to c.6%y/y in Q3 while corporate loan growth outperformed at c.12.9% y/y in July. We are revising our credit growth forecast from 10% to 15% in 2011-12 (still below pre-crisis rates).

External Sector: oil supported stability

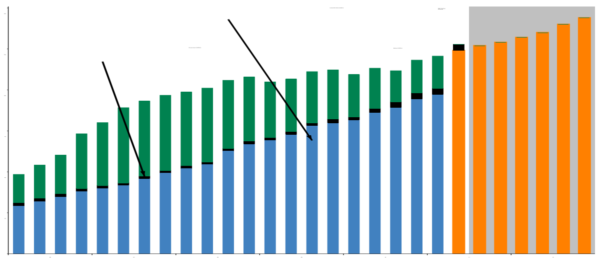
Chart 13: Balance Of Payments



Source: NBK, BNP Paribas

In 2011, we expect higher oil prices to offset import growth, supporting a current account surplus of USD 8bn (4.9% of GDP). We expect a rebound in FDI to 4.9% of GDP this year on the back of new oil optimism.

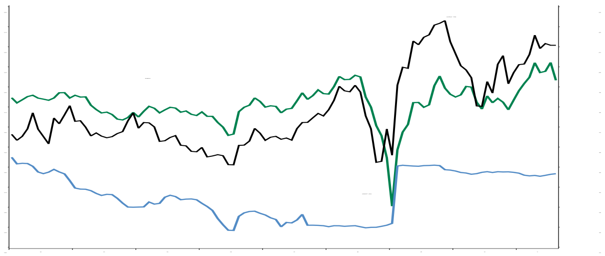
Chart 14: Gross External Debt



Source: NBK, BNP Paribas

We expect better access to capital markets while strong economic growth should help to limit the debt burden in the medium term. Corporate sector is now borrowing more heavily, as expected.

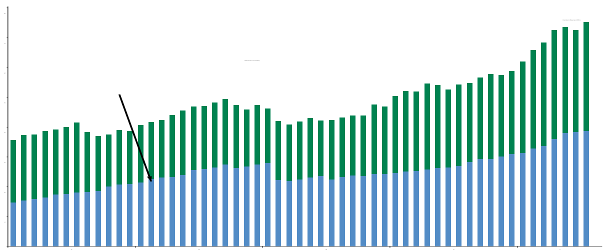
Chart 15: Exchange Rates



Source: NBK, BNP Paribas

The slowdown in inflation also makes a revaluation of the tenge less pressing, and the rouble's recent weak performance does not support such a move. Although fundamental factors (particularly a strong current account surplus) call for appreciation, the NBK could postpone it to 2012 or later.

Chart 16: Reserves and National Fund



Source: NBK, BNP Paribas

International reserves are sizable, standing at USD 35.5bn as of 1 September. On top of this, the National Fund stood at USD 40.4bn (cumulatively, +USD17.1bn from the beginning of the year). We expect FX resources – the fund and reserves – to rise by USD 20bn over 2011 as a whole, with expansion likely to continue in 2012 and beyond.

Kazakhstan: Economic and Financial Forecasts

	Year					2010				2011				2012				2013			
	'09	'10	'11 (1)	'12 (1)	'13 (1)	Q1	Q2	Q3	Q4 (1)	Q1 (1)	Q2	Q3 (1)	Q4 (1)	Q1 (1)	Q2 (1)	Q3 (1)	Q4 (1)	Q1 (1)	Q2 (1)	Q3 (1)	Q4 (1)
Components of Growth																					
GDP (%y/y)	11	7.0	6.7	6.5	7.0	7.1	8.0	6.3	6.4	6.8	7.4	6.4	6.1	5.5	6.5	7.5	6.5	6.0	7.0	7.5	7.5
GDP (USD bn)	116.3	146	162.0	194.0	228.0	29.6	32.4	34.7	49.3	35.2	33.8	39.5	53.5	42.2	40.5	47.3	64.1	49.5	47.6	55.6	75.3
GDP per capita (USD)	7313.6	9182	10256	12064	13491	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-

	Year					2010				2011				2012				2013			
	'09	'10	'11 (1)	'12 (1)	'13 (1)	Q1	Q2	Q3	Q4 (1)	Q1 (1)	Q2 (1)	Q3 (1)	Q4 (1)	Q1 (1)	Q2 (1)	Q3 (1)	Q4 (1)	Q1 (1)	Q2 (1)	Q3 (1)	Q4 (1)
Inflation & Labour																					
CPI	7.3	7.1	8.4	7.0	6.6	7.3	7.0	6.6	7.6	8.5	8.5	8.7	7.9	7.1	7.1	6.8	7.0	6.7	6.5	6.8	6.5
CPI (2)	6.2	7.8	8.0	7.0	6.5	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Unemployment Rate (%)	6.6	5.8	5.2	5.0	4.9	6.2	5.8	5.6	5.5	5.5	5.3	5.1	5.0	5.0	4.9	4.9	5.0	5.0	4.8	4.8	4.9

	Year					2010				2011				2012				2013			
External Trade	'09	'10	'11 (1)	'12 (1)	'13 (1)	Q1	Q2	Q3	Q4 (1)	Q1	Q2	Q3 (1)	Q4 (1)	Q1 (1)	Q2 (1)	Q3 (1)	Q4 (1)	Q1 (1)	Q2 (1)	Q3 (1)	Q4 (1)
Trade Balance (USD bn)	15.2	29.0	36.0	37.0	34.0	8.0	8.5	6.0	6.5	11.3	11.4	6.8	6.5	12.0	10.0	9.0	6.0	10.0	10.0	8.0	6.0
Current Account (USD bn)	-4.2	4.9	8.0	4.5	2.5	2.8	2.0	-0.6	0.7	4.4	2.8	10	-0.2	3.0	15	0.0	0.0	10	10	0.5	0.0
Current Account (%GDP)	-3.6	3.4	4.9	2.3	11	9.5	6.2	-17	14	12.5	8.3	2.5	-0.4	7.1	3.7	0.0	0.0	2.0	2.1	0.9	0.0
Net FDI (USDbn)	10.5	12	8.0	12.0	13.0	3.3	18	0.3	-4.3	2.8	18	2.0	14	3.0	3.0	3.0	3.0	2.0	3.0	3.0	5.0
International Reserves (USDbn) (2)	26.4	28.3	38.0	42.0	45.0	26.6	26.1	27.3	28.3	37.0	37.0	37.0	38.0	38.5	39.5	41.0	42.0	43.0	43.0	43.5	45.0
External debt (USDbn)	111.7	119.0	130.0	144.0	160.0	111.5	114.5	112.8	119.0	124.2	127.0	129.0	130.0	132.0	135.0	140.0	144.0	148.0	153.0	154.0	160.0
External debt (%GDP)	96.1	81.5	80.2	74.2	70.2	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-

	Year					2010				2011				2012				2013			
	'09	'10	'11 (1)	'12 (1)	'13 (1)	Q1	Q2	Q3	Q4 (1)	Q1 (1)	Q2 (1)	Q3 (1)	Q4 (1)	Q1 (1)	Q2 (1)	Q3 (1)	Q4 (1)	Q1 (1)	Q2 (1)	Q3 (1)	Q4 (1)
Financial Variables																					
Cons Gov. Budget (%GDP) (3)	-3.0	-3.0	-10	-10	-15	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Primary Budget Balance (%GDP)	-2.6	-2.6	-0.5	-0.5	-10																
Gross Gov. Debt (%GDP) (2)	9.8	13.0	12.5	11.3	10.5	5.8	8.8	10.2	13.0	13.2	12.8	12.6	12.5	12.2	11.9	11.5	11.3	11.1	11.0	10.6	10.5

	Year					2010				2011				2012				2013			
	'09	'10	'11 (1)	'12 (1)	'13 (1)	Q1	Q2	Q3	Q4	Q1	Q2	Q3 (1)	Q4 (1)	Q1 (1)	Q2 (1)	Q3 (1)	Q4 (1)	Q1 (1)	Q2 (1)	Q3 (1)	Q4 (1)
Interest & FX Rates (2)																					
Official Interest Rate (%)	7.00	7.00	7.50	7.00	7.00	7.00	7.00	7.00	7.00	7.50	7.50	7.50	7.50	7.50	7.50	7.00	7.00	7.00	7.00	7.00	7.00
3-Month Rate (%)	3.0	2.00	3.50	4.50	3.50	2.64	2.00	2.00	2.00	2.00	3.00	3.50	3.50	3.50	4.00	4.00	4.50	4.00	3.50	3.50	3.50
USD/KZT	148.5	147.5	146.5	130.0	130.0	148.5	147.1	147.5	147.5	145.7	146.3	146.5	146.5	145.0	137.0	137.0	130.0	130.0	130.0	130.0	130.0

Footnotes: (1) Forecast (2) End Period (3) Without adjustment to National Fund accumulation

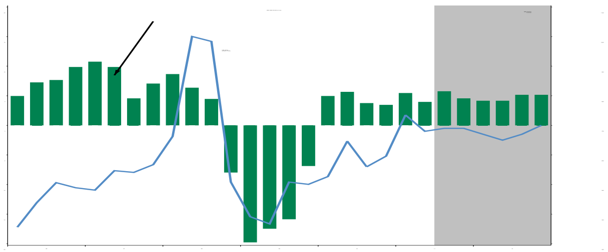
Figures are year-on-year percentage changes unless otherwise indicated

Source: BNP Paribas

UKRAINE: Exceeding Expectations

Economic growth above expectations

Chart 1: Economic Growth and Steel Prices

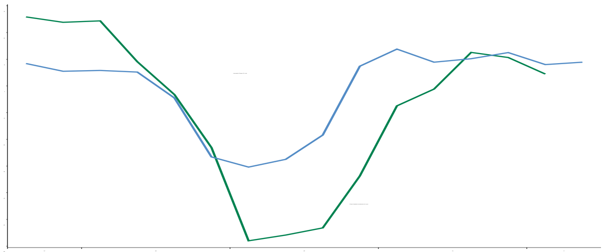


Source: UkrStat, NBU, BNP Paribas

Economic growth has exceeded expectations so far this year with output rising by 5% y/y in January to July. Solid steel prices (above USD 670/tn) and a good harvest (with the crop up by about 30% y/y) support a continuation of robust growth.

- Ferrous metallurgy (c.40% of exports) remains the backbone of the industrial sector. Good steel prices are essential for economic growth.
- In 2011, Ukraine expects a harvest of 50 mn tons of grain (+30%y/y) and plans to export up to 20mn tons – good news for the agricultural sector and overall economic performance
- We have raised our growth forecast from 4.5% to 5.0% for 2011 and continue to expect GDP to rise by 4.5% per annum in 2012 and 2013
- Fixed capital investment and retail sales remained strong in H1 2011 and domestic demand will remain the main driver of healthy economic growth.
- We expect IP to remain solid: machinery and construction materials remain the most dynamic sub-segments, benefiting from faster GDP growth and strengthening domestic demand

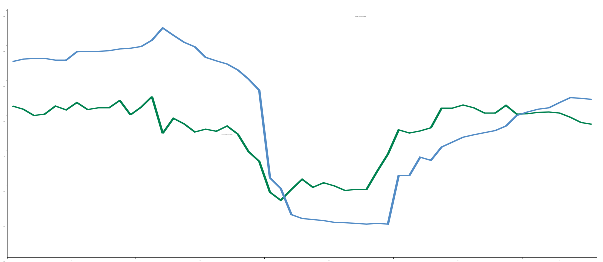
Chart 2: Industrial Output and Investment



Source: UkrStat, BNP Paribas

Industrial growth will remain an important driving force of economic expansion this year. We expect IP to rise 8.5% in 2011. We estimated fixed capital investment growth at 6-7%y/y in Q1'11 and see its acceleration to 9+% in 2011 as a whole on the back of revival of banking credit to companies

Chart 3: Real Wages and Retail Sales

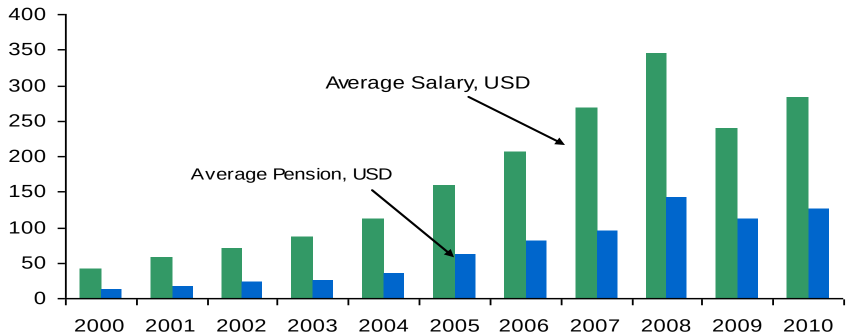


Source: UkrStat, BNP Paribas

Retail sales grew an impressive 15.5% y/y in Jan-May. Despite the slowdown we expect in H2'11, retail sales and private consumption could grow 5% and 4.5% respectively this year - a pace that should be sustainable in the medium term. Higher wages and incomes remain the main drivers.

Cooperation with IMF: reform plan is crucial

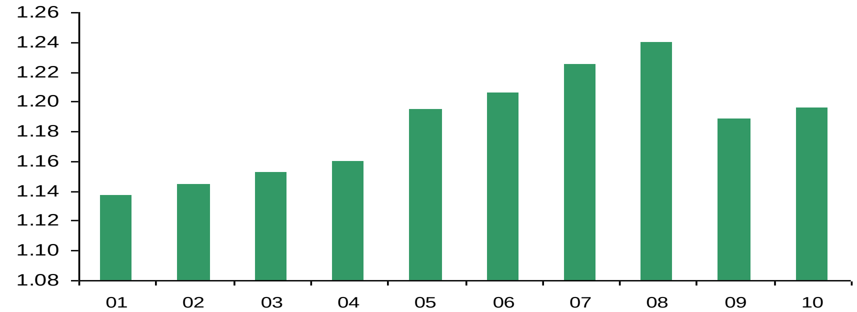
Chart 4: Pension to Wage Ratio



Source: UkrStat, BNP Paribas

The combination of a social contribution rate of 35% (the highest in Europe) and almost parity in the number of employees and pensioners is not healthy. To avoid a sizable pension fund deficit, the average pension should not exceed 35% of the average wage; the current level is 45%.

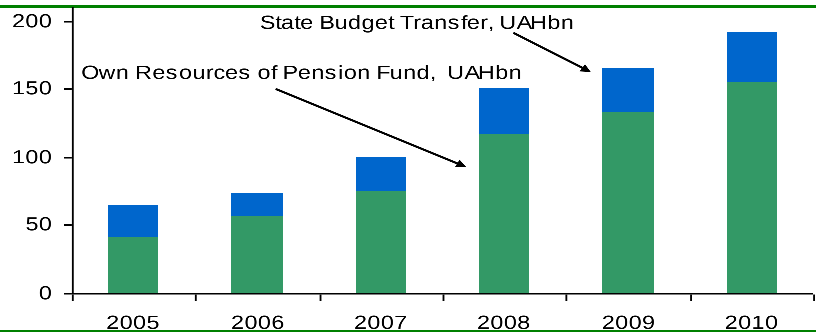
Chart 5: Proportion Between Number of Employees and Pensioners



Source: UkrStat, BNP Paribas

The ratio of employees to pensioners has dropped to 1.18 (1.1 for current payers of the social/pension tax to pensioners). This will make it almost impossible to maintain the average pension at an appropriate level under the current system in the medium term.

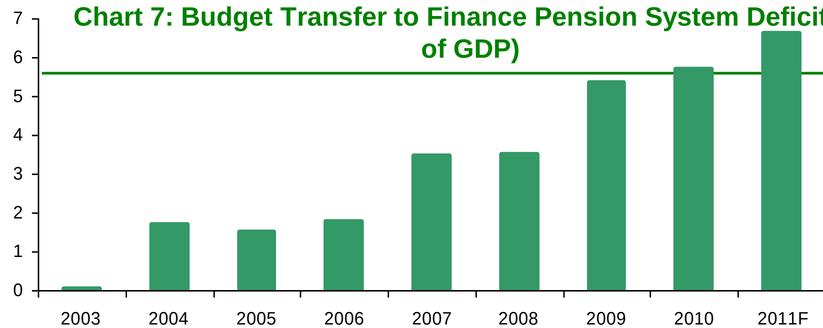
Chart 6: Budget Finance Share in Pension Fund



Source: UkrStat, BNP Paribas

The government's support for the pension system is a very serious burden on the budget, making reform of the system urgent. Indeed, in 2011 the transfer is likely to reach 7% of GDP – the highest support in the CIS region.

Chart 7: Budget Transfer to Finance Pension System Deficit (% of GDP)



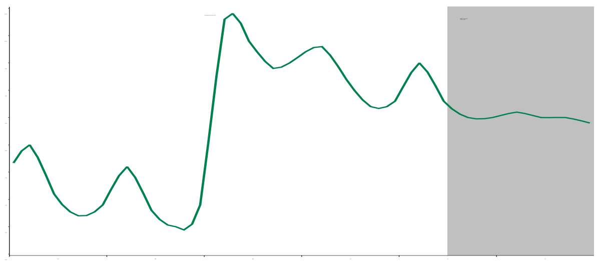
Source: UkrStat, MoF, BNP Paribas

The government expects the reform to help reduce the budget transfer to the pension fund to zero by 2014. We think effective implementation of the announced measures will reduce the fiscal transfer to 2.5-3% of GDP.

The IMF is likely to continue the programme with Kiev and approve tranches scheduled for 2011 after full approval of the reform. We see this happening in October 2011. Further delays in approval would increase risks to cooperation with the IMF

Fiscal Performance: higher deficit stimulates demand for financing

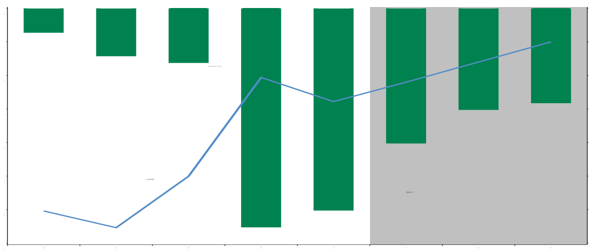
Chart 8: Unemployment



Source: UkrStat, BNP Paribas

The labour market continues strengthening but only very gradually. The unemployment rate dropped to 8.8% at end-2010 and we expect it to remain around this level throughout this year.

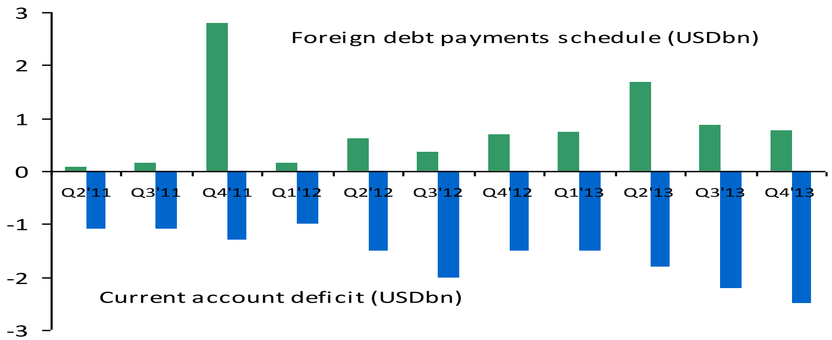
Chart 9: Fiscal Performance



Source: NBU, BNP Paribas

We maintain our budget deficit forecast for 2011 at 4% of GDP as subsidies to Naftagaz will likely exceed the initial plan (no hike in domestic tariffs in 2011) and the government will provide support to banks. Budget revenues are strong, exceeding expectations.

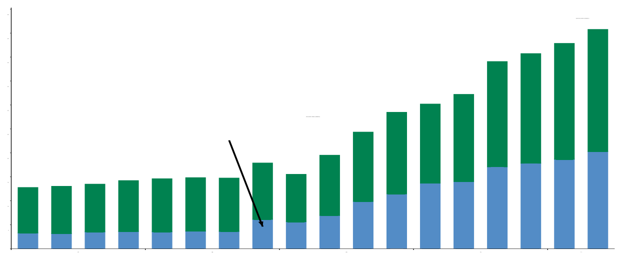
Chart 10: Foreign Debt Payments Spike in 2012-13



Source: MoF, BNP Paribas

The government will not face financing difficulties this year. Greater support from the IMF should help smooth government financing in 2012 and 2013 when sovereign redemptions peak at USD 3.8bn and USD 3bn, respectively.

Chart 11: Government Debt

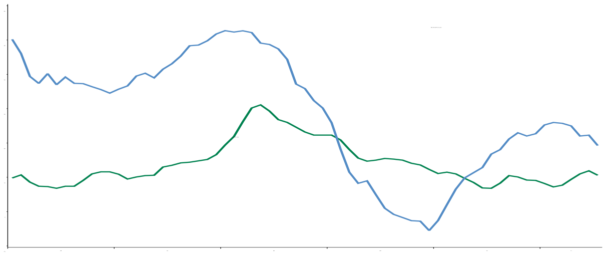


Source: MoF, BNP Paribas

In 2011, foreign borrowing is likely to be significant. We expect new Eurobonds of USD 2bn (on top of the USD 2.75bn already issued this year) if global risk appetite improves. The split between foreign and domestic debt is becoming more balanced.

Slowdown in inflation results in flat rate policy

Chart 12: Inflation and Money Supply

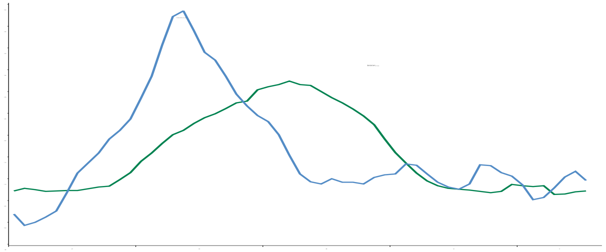


Source: UkrStat, BNP Paribas

Inflation slowed to 8.9% y/y in August, helped by a good harvest. In addition, the 50% hike in the natural gas tariff initially scheduled for 2011 is likely to be postponed, reducing price pressure. We expect inflation to average 9% this year.

- Reform of the energy sector and its pricing may keep inflation risks high in 2012-13.
- In July, M3 growth reached 22.3% y/y and is forecast to accelerate to 25% by end-2011. We see this rate as sustainable for the coming years.
- Solid economic recovery makes monetary factors increasingly important for the inflation trend. We believe inflation is unlikely to slow below 5-6% in the medium term
- The NBU is likely to keep rates flat in 2011-12.

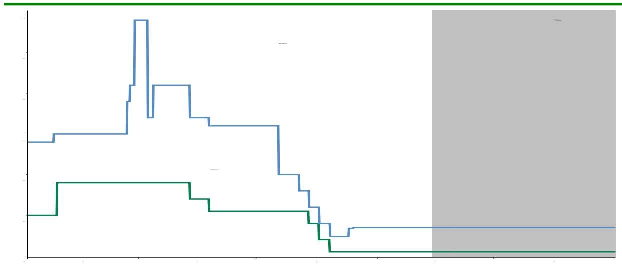
Chart 13: CPI Breakdown



Source: UkrStat, BNP Paribas

As food accounts for 51.6% of the CPI basket, a drop in food prices has been crucial for slowing inflation. With the decline in food prices being seasonal, some acceleration in CPI inflation is likely in Q4 2011.

Chart 14: Key NBU Rates

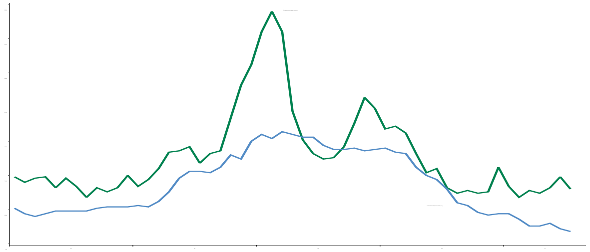


Source: NBU, BNP Paribas

Falling inflation will provide a strong argument for the NBU to keep rates unchanged until 2013, in our view. We expect the Bank to increase its support to the banking sector and inject liquidity into the markets.

Banking sector: credit growth sluggish

Chart 15: Lending and Deposit Rates

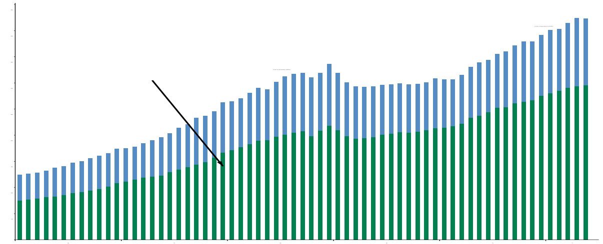


Source: NBU, BNP Paribas

The gap between lending and deposit rates dropped to 3pp in Jul. We see deposit rates continuing to decline faster than lending rates, widening the gap (good for profitability of the sector). Lending rates are unlikely to drop below 11%, in our view.

- Although NPLs remain the NBU’s main headache, we see their level gradually declining (to c.30%) on the back of faster economic growth.
- Retail credit growth remains negative but a rebound is in sight. We expect positive growth in Q4. The recovery in consumption has not been supported by this factor. Nevertheless, we expect consumption and retail sales to rise 10% in 2012.
- Foreign banks have a strong presence, leading to the high dollar share of loan and deposits. Nonetheless, the split between dollar and hryvnya denominated deposits (and loans) remains healthy.
- The high share of sight deposits (c.38% of the total) – which we expect to persist - limits financing for investment.

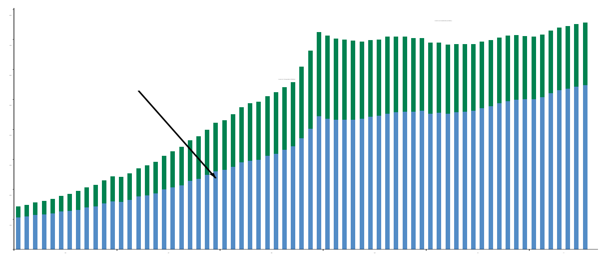
Chart 16: Banking Deposits



Source: NBU, BNP Paribas

Deposit growth has been impressive although it has been declining in Q3, as we expected (27% y/y for retail deposits and 30% for corporate deposits in Jan-Jul). The share of dollar deposits has stabilised at c.42% of the total (still too high) while long-term deposits continue expanding; they now represent 35% of the total.

Chart 17: Banking Loans

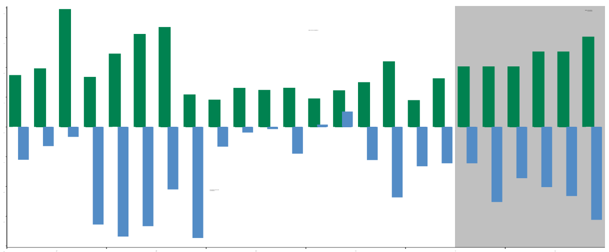


Source: NBU, BNP Paribas

The rebound in lending is significant. Although retail loan growth remains negative at -5.5%y/y in July, we expect it come in at +1-2% y/y for 2011 as a whole. The bounce back in corporate lending (16% y/y in July) is likely to continue. Although NPLs are still high, we see overall credit growth of c.10-15% y/y in 2011 (9.2% y/y in July).

External sector: solid capital inflow offset widening of current account deficit

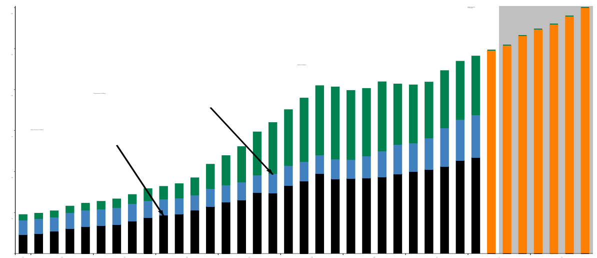
Chart 18: Balance Of Payments



Source: NBU, BNP Paribas

The current account deficit widened to USD 3.3bn in Jan-Jul as import growth accelerated. We expect it widen further as gas prices spike to USD400 tcm in Q4. Although we forecast it a current account deficit of USD 7bn (4.4% of GDP) in 2011, solid FDI inflows are likely to fund it.

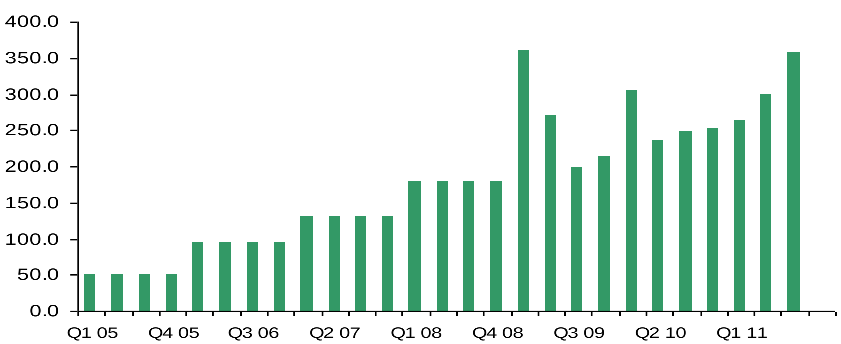
Chart 19: Gross External Debt



Source: NBU, BNP Paribas

Gross foreign debt remains too high (c.90% of GDP) and may well rise further in 2012-13. Refinancing problems are likely in 2011. The sovereign debt burden is light at USD 24.1bn (15.7% of GDP) but the government is likely to increase borrowing in the coming years.

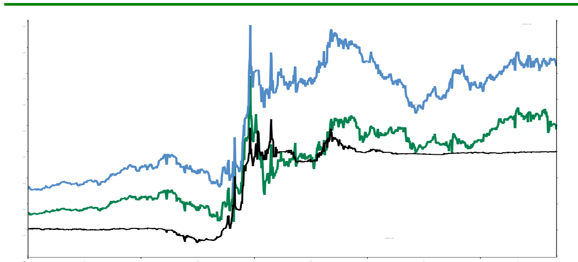
Chart 20: Natural Gas Price Shock Possible



Source: SSC, BNP Paribas

In the absence of a new agreement with Gazprom on pricing, the spike in gas prices from Q4 could lead to a sharp widening of the c/a deficit. Reaching an agreement on gas prices for 2012 and beyond is likely to be tough. The c/a deficit is likely to widen in 2012.

Chart 21: Exchange Rate



Source: NBU, BNP Paribas

We expect the hryvnya to remain stable until year-end and to appreciate in 2012-13. The NBU is continuing its gradual liberalisation of the FX market under the agreement with the IMF. In August, the Bank widened the currency's trading band from 2% to 5%, allowing higher volatility.

Ukraine: Economic and Financial Forecasts

	Year					2010				2011				2012				2013			
	'09	'10	'11 (1)	'12 (1)	'13 (1)	Q1	Q2	Q3	Q4	Q1	Q2 (1)	Q3 (1)	Q4 (1)	Q1 (1)	Q2 (1)	Q3 (1)	Q4 (1)	Q1 (1)	Q2 (1)	Q3 (1)	Q4 (1)
Components of Growth																					
GDP (%y/y)	-15.0	4.2	5.0	4.5	4.5	4.9	5.9	3.4	3.0	5.3	4.8	5.6	4.4	4.0	4.0	5.0	5.0	4.5	5.5	4.0	4.0
GDP (USD bn)	114.1	137.7	159.0	185.3	213.1	28.9	34.7	35.9	38.4	33.0	39.0	42.3	44.7	38.5	47.5	49.0	50.3	44.3	54.6	56.4	57.8
GDP per capita (USD)	2454	3060	3533	4118	4735.6	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-

	Year					2010				2011				2012				2013			
	'09	'10	'11 (1)	'12 (1)	'13 (1)	Q1	Q2	Q3	Q4	Q1	Q2 (1)	Q3 (1)	Q4 (1)	Q1 (1)	Q2 (1)	Q3 (1)	Q4 (1)	Q1 (1)	Q2 (1)	Q3 (1)	Q4 (1)
Inflation & Labour																					
CPI	16.0	9.4	9.0	9.4	7.3	11.2	8.3	8.5	9.5	7.7	10.8	8.9	8.7	9.6	8.2	10.7	9.2	7.8	7.4	7.1	7.0
CPI (2)	12.3	9.1	10.0	8.0	7.0	11.0	6.9	10.5	9.1	7.7	11.9	9.5	10.0	9.1	8.3	8.2	8.0	7.7	7.3	7.0	7.0
Unemployment Rate (%)	9.6	9.1	8.8	8.5	8.2	9.8	9.2	8.7	8.8	9.5	8.8	8.5	8.5	8.6	8.5	8.5	8.4	8.5	8.3	8.0	8.0

	Year					2010				2011				2012				2013			
External Trade	'09	'10	'11 (1)	'12 (1)	'13 (1)	Q1	Q2	Q3	Q4	Q1	Q2 (1)	Q3 (1)	Q4 (1)	Q1 (1)	Q2 (1)	Q3 (1)	Q4 (1)	Q1 (1)	Q2 (1)	Q3 (1)	Q4 (1)
Trade Balance (USD bn)	-4.3	-8.4	-14.0	-16.5	-18.0	-12	-0.8	-2.8	-3.6	-3.0	-3.0	-3.5	-4.5	-3.5	-4.0	-4.0	-5.0	-4.0	-4.5	-4.5	-5.0
Current Account (USD bn)	-17	-2.7	-7.0	-9.1	-9.8	0.0	0.5	-0.8	-2.3	-13	-12	-2.0	-2.5	-17	-2.0	-2.3	-3.1	-2.0	-2.2	-2.3	-3.3
Current Account (%GDP)	-15	-2.0	-4.4	-4.9	-4.6	0.0	15	-2.4	-6.1	-3.9	-3.1	-4.7	-5.6	-4.4	-4.2	-4.7	-6.2	-4.5	-4.0	-4.1	-5.7
net FDI (USDbn)	4.7	5.7	6.5	10.0	14.0	0.9	12	15	2.1	0.9	16	2.0	2.0	2.0	2.5	2.5	3.0	2.0	3.0	4.0	5.0
International Reserves (USDbn) (2)	26.5	34.6	40.0	43.0	45.0	25.1	29.5	34.7	34.6	36.4	37.6	38.5	40.0	40.0	41.0	41.5	43.0	43.5	44.0	44.5	45.0
External debt (USDbn)	103.3	117.3	133.0	150.0	177.0	102.9	104.6	111.6	117.3	120.5	124.0	127.0	133.0	137.0	140.0	145.0	150.0	155.0	160.0	167.0	177.0
External debt (%GDP)	90.6	85.2	83.6	80.9	83.1	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-

	Year					2010				2011				2012				2013			
	'09	'10	'11 (1)	'12 (1)	'13 (1)	Q1	Q2	Q3	Q4	Q1	Q2 (1)	Q3 (1)	Q4 (1)	Q1 (1)	Q2 (1)	Q3 (1)	Q4 (1)	Q1 (1)	Q2 (1)	Q3 (1)	Q4 (1)
Financial Variables																					
Gen. Gov. Budget (%GDP)	-6.5	-6.0	-4.0	-3.0	-2.8	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Primary Budget Balance (%GDP)	-5.6	-4.6	-2.5	-14	-11																
Gross Gov. Debt (%GDP) (2)	34.7	31.1	38.5	42.1	45.9	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-

	Year					2010				2011				2012				2013			
	'09	'10	'11 (1)	'12 (1)	'13 (1)	Q1	Q2	Q3	Q4	Q1	Q2	Q3 (1)	Q4 (1)	Q1 (1)	Q2 (1)	Q3 (1)	Q4 (1)	Q1 (1)	Q2 (1)	Q3 (1)	Q4 (1)
Interest & FX Rates (2)																					
Official Interest Rate (%)	10.25	7.80	7.75	7.75	7.25	10.25	9.50	7.75	7.80	7.75	7.75	7.75	7.75	7.75	7.75	7.75	7.75	7.50	7.50	7.50	7.25
3-Month Rate (%)	30	8.21	8.00	7.50	7.10	7.72	7.40	4.75	8.21	5.13	7.00	8.00	8.00	9.00	8.00	8.00	7.50	7.30	7.50	7.20	7.10
USD/UAH	8.00	7.93	7.99	7.50	7.30	8.00	7.90	7.90	7.93	7.96	7.98	7.98	7.99	7.99	7.80	7.50	7.50	7.40	7.40	7.30	7.30

Footnotes: (1) Forecast (2) End Period

Figures are year-on-year percentage changes unless otherwise indicated

Source: BNP Paribas

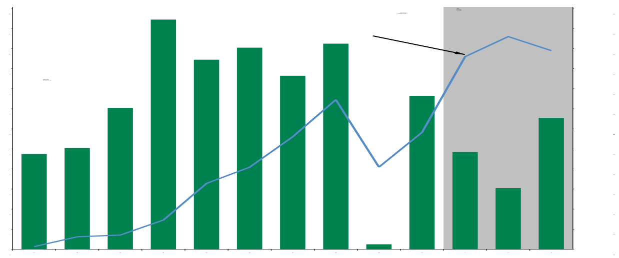
BELARUS: On a Knife Edge

Belarus in 2011-12: challenging times

- Belarus is facing the worst economic crisis in its history, rendering its centrally planned development model unsustainable. We believe the authorities will accelerate the transition to a market economy through policies including an ambitious privatisation programme.
- The sizable devaluation has resulted in a surge in inflation and a drop in living standards. A new wave of devaluation is likely in September 2011. We expect the Belarusian authorities to keep control of the country (partly by stepping up political restrictions). Nevertheless, President Lukashenko’s approval rating has plunged from 44% in December 2010 to 26.2% on the back of economic instability.
- Delays in securing revenue from the sale of state assets constitute the main risk to financial stabilisation. We would not rule out massive social unrest resulting in radical political changes (although this is a risk scenario rather than our base case).

Activity: economic growth to be affected by financial crisis

Chart 1: Economic Growth and Oil Prices

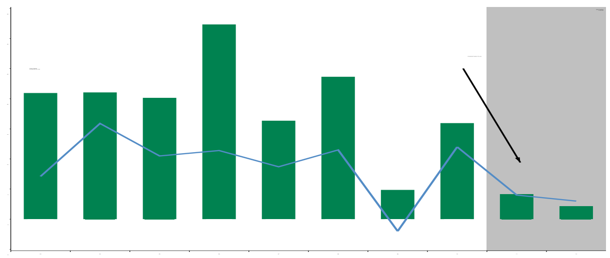


Source: BelStat, NBK, BNP Paribas

Although growth has remained high to date (output rose 9.8% y/y in January-July), we expect it to slow sharply on the back of drastic restrictions on imports. These will undermine production and employment, leading to a fall in domestic demand

- The size of the Russian subsidy to Belarus via low energy tariffs remains essential for Belarus's economic performance. We expect this subsidy to remain at about 5% of GDP (Russia has agreed to keep a significant discount on the natural gas price for Belarus). We see this size of subsidy as optimal as it supports economic growth while maintaining incentives for structural reforms.
- Recession is avoidable in 2011-12 as sectors oriented towards external demand remain competitive and are benefiting from this year's 40% devaluation of the rouble. We expect the economy to expand by 4.8% and 3.0% in 2011 and 2012, respectively
- We see an urgent need for financial support of USD 3bn. We believe the situation will sharply deteriorate unless the government secures such an amount in loans/privatisation revenue in upcoming months.
- The privatisation of Beltransgas by Gazprom could raise USD 2.5bn. Belkaliy is on hold. BelTelecom is unlikely to bring in more than USD 0.5bn in 2012, in our view.

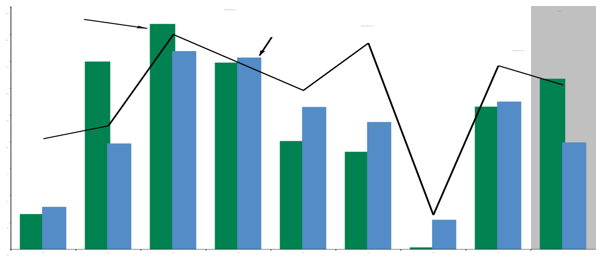
Chart 2: Industrial Output and Investment



Source: BelStat, BNP Paribas

Although industrial growth remained impressive at 11% y/y in January-July 2011, we expect it to slide to 4% in 2011 as a whole due to the lagged effects of the crisis. We forecast investment growth of 4% and 0% in 2011 and 2012, respectively.

Chart 3: Income and Consumption

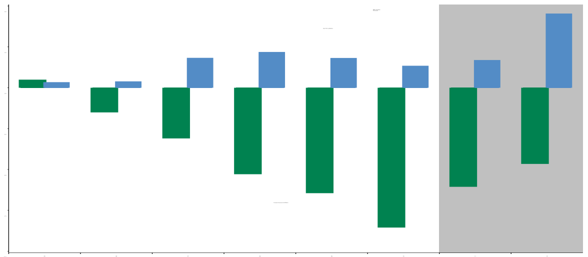


Source: BelStat, BNP Paribas

The FX crisis has undermined incomes. Real wage growth decelerated to 0.2% y/y in July from 15.8% in January-July. Real income growth slowed to 9.9% y/y in H1'11. This will cause a drastic drop in retail sales in H2 '11 – recovery is unlikely in the coming 6-9 months.

External Sector: main headache

Chart 4: Current Account and FDI

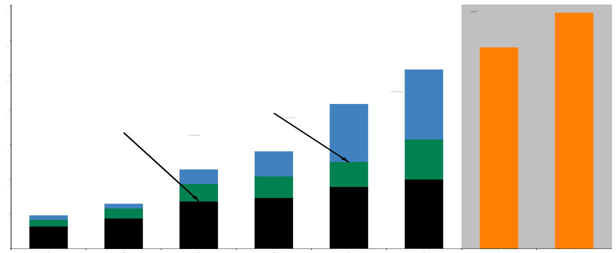


Source: NBRB, BNP Paribas

The current account deficit is likely to remain large at 14% of GDP in 2011 – and may only drop to c.10% of GDP in 2012. Net FDI inflow is expected on the back of privatisation. The country may not be able to to substantially increase foreign borrowing given current conditions.

- Current account deficit of 14% of GDP is likely in 2011. A hike in natural gas prices in H2 will curb the fall in imports. The country remains very vulnerable to any shocks.
- A sizable discount in gas prices for Belarus (30-50%) from 2012 should help to reduce the deficit .
- Although Belarus got support from the Anti-Crisis Eurasia Cooperation Fund (USD 3bn for 2011-13, USD 0.8bn disbursed in June), this is not sufficient for FX and financial stabilisation.
- Belarus urgently needs some USD 3bn to alleviate the crisis and avoid massive street protests. Privatisation revenues are likely to help - but they are unlikely before December 2011
- Russia is likely to insist on thorough execution of the stabilisation programme for Belarus, including privatisation revenues of USD 7.5bn in 2011-13

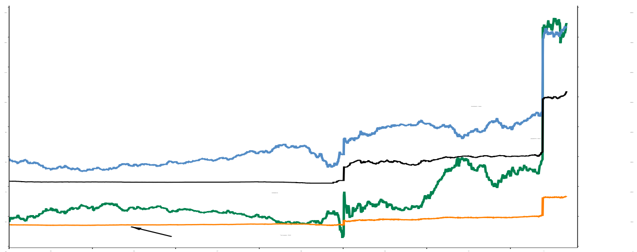
Chart 5: External Debt



Source: NBRB, BNP Paribas

We expect a sharp increase growth in external debt as a proportion of GDP to 65-70% in 2011. The government's debt burden is likely to remain affordable at around 40% of GDP, although risks are growing for the medium term - in particular if structural reforms are delayed.

Chart 6: Exchanges Rates

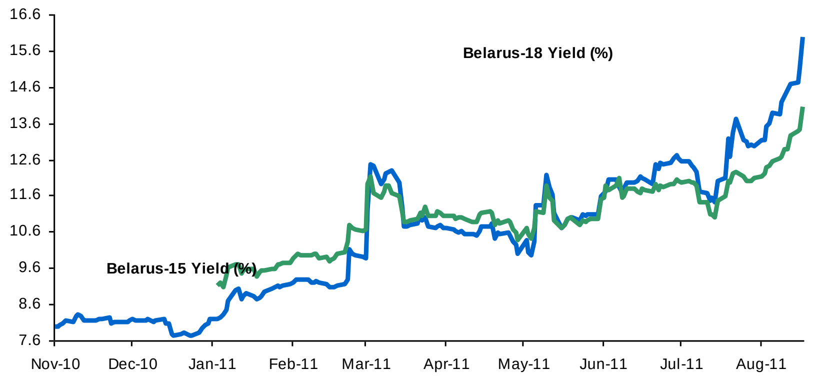


Source: MoF, BNP Paribas

Despite the 40% devaluation in H1 2011, pressure on the rouble remains high, resulting in further weakening. The current account deficit is likely to narrow in 2011, but the country urgently needs USD 3bn of inflows to stabilise the FX market.

Fiscal Performance relatively strong, new CPI acceleration on horizon

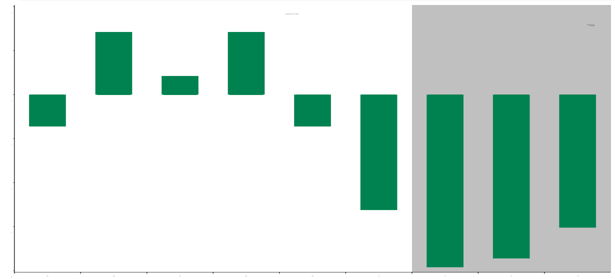
Chart 7: 5Y Bond Yield (%)



Source: Bloomberg, BNP Paribas

Yields have jumped and are unlikely to decline during the intense phase of the crisis. The global market's lack of appetite for Belarusian risk makes Eurobond issuance unlikely. Sovereign debt service is very affordable in 2011-14, making any form of restructuring very unlikely.

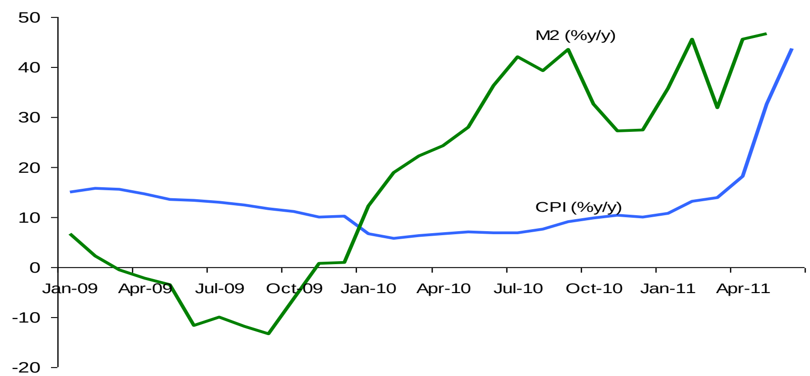
Chart 8: Fiscal Performance



Source: NBRB, BNP Paribas

We expect a significant widening of the budget deficit to 3.9% in 2011 and 3.7% in 2012 on the back of a smaller subsidy from Russia and an urgent need to increase social spending in 2011. Fiscal tightening is likely to be very gradual.

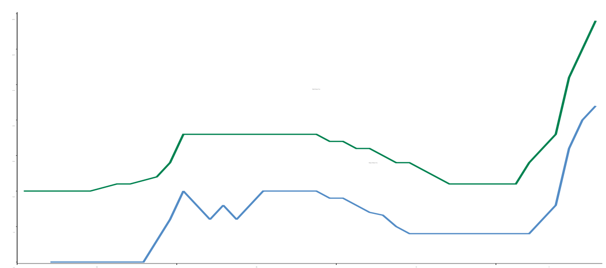
Chart 9: Inflation and M2 (%)



Source: Reuters EcoWin, BNP Paribas

The inflation rate has jumped this year and stood at 46.2% y/y in July after an average of 7.7% last year. The main reason for the surge is the rouble's devaluation. With a new wave of devaluation expected in September, we expect CPI inflation to accelerate to 59% y/y by end-2011 significantly above the government's forecast of 39%.

Chart 10: Policy Rates



Source: NBRB, BNP Paribas

The NBB is likely to continue its aggressive tightening and has increased the size of rate hikes from 2pp to 5pp. We expect at least two to three more moves in 2011 and the policy rate to end the year in the range 34-36%. However, with the NBB expected to seek to support the banking sector, the tightening is unlikely to be sufficiently aggressive.

Belarus: Economic and Financial Forecasts

Components of Growth	'08	'09	'10	'11 (1)	'12 (1)	'13 (1)
GDP (% y/y)	10.2	0.2	7.6	4.8	3.0	6.5
GDP (BYR bn)	129791	136790	162964	233980	313781	359240
GDP (USD bn)	60.7	49.0	54.7	43.0	44.8	513
GDP per capita (USD)	6264	5148	5760	4535	4638	5346

Inflation & Labour	'08	'09	'10	'11 (1)	'12 (1)	'13 (1)
CPI	14.8	13.0	7.7	37.1	30.2	7.5
CPI (2)	13.3	10.1	10.0	59.0	9.3	8.2
PPI	14.7	14.5	13.6	52.5	32.8	110
Unemployment Rate (%)	0.8	0.9	0.7	2.5	3.0	2.5

External Trade	'08	'09	'10	'11 (1)	'12 (1)	'13 (1)
Trade Balance (USD bn)	-6.2	-6.9	-9.1	-7.0	-5.0	-6.0
Current Account (USD bn)	-5.3	-6.4	-8.5	-6.0	-4.6	-5.3
Current Account (% GDP)	-8.7	-13.1	-15.5	-14.0	-10.3	-10.3
Net FDI (USD bn)	2.2	18	13	3.5	4.5	4.0
External Debt (USD bn)	15.2	20.8	25.8	29.0	34.0	37.0
External Debt (% GDP)	25.0	42.5	47.2	67.4	75.8	72.1

Financial Variables	'08	'09	'10	'11 (1)	'12 (1)	'13 (1)
Budget Balance (% GDP)	14	-0.7	-2.6	-3.9	-3.7	-3.0
Primary Budget (% GDP)	17	0.3	-13	-2.4	-2.0	-14
Gross Gov. Debt (% GDP) (2)	9.8	219	24.8	415	43.7	49.0

Interest & FX Rates (2)	'08	'09	'10	'11 (1)	'12 (1)	'13 (1)
Official Interest Rate (%)	10.40	13.90	10.50	35.00	28.00	16.00
USD/BYR	2137	2792	3011	8000	7000	7000

Footnotes: (1) Forecast (2) End Period

Figures are year-on-year percentage changes unless otherwise indicated

Source: BNP Paribas

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