

Alison Adams, PhD

617-388-9817

research@alisonadamsllc.com

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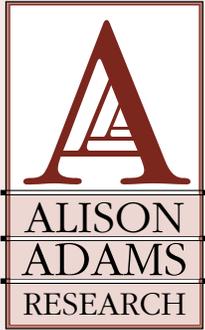
Brazil: election update: *President Lula's hand-picked successor Dilma Rouseff will win the presidential election in the first round, according to the latest polls. AAR continues to be optimistic about another PT presidency for economic stability and responsibility.*

Since last December, AAR has been arguing that Dilma would make a strong candidate and that her economic policies would please foreign investors. I noted that the key support from market favorite Palocci indicated that Dilma intended to continue on the path of economic orthodoxy and responsibility. Promises of a reduced inflation target on an investor trip to New York this summer did much to allay some fears. The recent polls indicate that Dilma is in a good position to win the first round on October 3. First or second round, she will be the next president. The continuity of policy and personnel ought to lessen the normal transition period associated with a new president.

India ONGC and IOC privatization: *In liberalizing gasoline prices and selling stakes in SOE oil companies, the Indian government is reducing its future debt burden by cutting subsidies and providing new capital for its energy sector.*

The government has announced plans to sell stakes in its two national oil companies: ONGC and Indian Oil Corp. The government plans to raise Rs40,000 crore with the sale of the stakes. And

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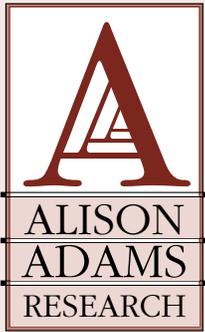
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the government intends to reduce its stake in ONGC by 5% to 69.14% and its stake in IOC by 10% to 64.57%. OIC will then offer fresh equity in a subsequent public offer. The recent decontrolling of the petrol price and price increases for diesel and other petroleum products means that there will be more investor interest. Oil marketing companies are still losing money on diesel as the price increases do not cover their costs. However, the government has indicated that there will be clarity about price increases for diesel within the next three months. For now, the Oil Marketing Committee measures its loss making on selling diesel at subsidy prices based on the previous two-week average of market costs. Petrol prices are being set once a month based on costs.

BIS Quarterly Review: Asia wins and EMEA still losing ground in international lending.

With the exception of Poland, emerging Europe and Russian companies are losing access to foreign bank lending. Not surprisingly, Asian and Latin American companies are enjoying improving access to international financing.

Chinese companies borrowed half of the \$89bn lent to emerging markets in 1Q2010! Cross-border lending increased in the region at a strong pace. Korea increased foreign claims by \$11bn or 5.5%; Indonesia increased foreign claims by 10.2% for \$4.7bn; and Taiwanese companies borrowed \$6.3bn, up 11.7%. The BIS recognizes that some portion of this international borrowing was for the purposes of the carry trade rather than for capital investment. Latin All public sources are available on request. At the time of publication all references and data are believed to be correct. Reproduction is permitted with appropriate citation.



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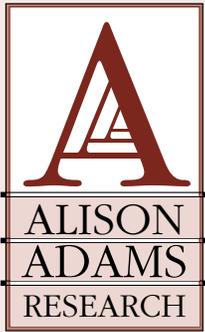
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America enjoyed a similarly strong access to foreign borrowing. Brazil led the way with \$18.7bn and Mexico followed with \$7.3bn. In Argentina, international lending contracted by \$300m during the period.

South Africa and the Left: *The run-up to the ANC annual conference in Durban is highlighting internal divisions in the party, but not between President Zuma and his supposed allies on the left.*

The firebrand Malema, leader of the ANC Youth League, is spouting off again. His comments about mine nationalization and land reform are sure to unsettle investors. But Malema is playing to his own political base rather than trying to change the course of the ANC leadership. Last spring, the party censured Malema and forced him to apologize to President Zuma for his derogatory remarks against the party and the president. But now his following is agitating for an apology from the ANC leadership and Malema's pardon. This is all ahead of the annual ANC party conference. Malema needs to be "reinstated" after his political humiliation. His comments about mining and land reform clearly went against the ANC position. Brinkmanship and difficulty ahead of the conference have an intended end: political payoffs for him and his followers.

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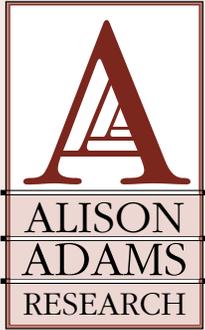
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The role of the Congress of South African Trade Unions (COSATU) and the Civil Servants strike is murky. There are questions about COSATU's political objectives, as well. Is COSATU being difficult and making unreasonable demands so that it can increase its clout in the conference? It's one thing for a union to have high demands that will eventually be talked down, it's quite another to cling to impossible demands for political objectives. The 3-week strike and then its suspension are part of the trouble. Government employees are negotiating. The wage increase and housing allowance should be resolved. But it is clear that the government will not give the 8.6% wage increase and the R1000 allowance. Something less should be possible.

La Niña, inflation, and very different political responses in Russia and China: *Beijing*

orders a massive vegetable planting and Medvedev wants the fertilizer cartel investigated. In China, local governments will be busy planting vegetables and opening wet markets. In Russia, the Duma is refining its language and definitions of price fixing and cartels.

Food price inflation is a threat to both Russia and China as a result of severe weather. The dry soil is delaying the planting of a winter wheat crop in Russia and the high price of fertilizers has prompted the Kremlin to push for an investigation by the AntiMonopoly Service. Coincidentally, the Duma has begun yet another iteration of its laws regarding monopolies, cartels, and pricing. Inflation continues to rise and the private sector believes that inflation could be well above the originally projected 6.5% for 2010. Recent inflation data indicate that food prices will be to All public sources are available on request. At the time of publication all references and data are believed to be correct. Reproduction is permitted with appropriate citation.



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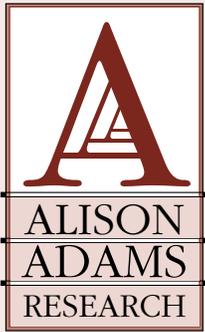
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blame. In Russia, there will be municipal and local elections throughout the country on October 10. There are few political options from the ruling United Russia, but local dissatisfaction and upsets could hurt the Kremlin's image.

Although Russian fertilizer companies claim they sell Russian farmers fertilizer at a discount to global prices, Moscow seems determined to investigate. Potash producers Urukali and Silvinit could find themselves in the sites of the Federal Antimonopoly Service again. Under the new Duma legislation, raising prices in a certain sector without prior notification could result in fines. The final legislation is still under consideration and the language is not set as of yet. Medvedev is quoted as saying about the fertilizer cartel, "If not on paper, then in spoken form, there exists a cartel, and all this must be investigated as part of an antitrust process and punished." *There could be more fines for fertilizer companies.*

In China, Beijing has decided to address the CPI inflation problem by planting more vegetables. Higher interest rates do little to bring down food prices, but more vegetables, more farm credit, and more local markets should do more to help. Food prices comprise 30% of China's reweighted CPI index. In July, food prices increased 6.8% y-o-y but non-food prices increased only 1.6%. From a political perspective, Beijing is far more concerned about ensuring that people can afford to eat. In the past, riots and protests plagued Beijing when food prices rose too

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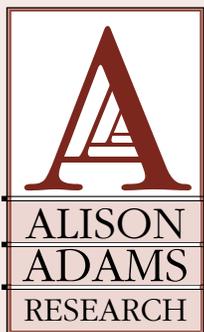
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quickly. Beijing has ordered local and provincial governments to plant more vegetables and deal with local food price expectations.

Kazakhstan, the oil export tax, and China: *The likes of Eni, Lukoil, and Chevron might be forced to pay the \$40 ton export on crude. Even the IMF recommends new sources of government funding. Chinese companies are eager to step in if IOCs are unhappy with new terms. As recently as mid-August, PetroChina vowed to expand operations in Kazakhstan.*

I had a client ask about Kazakhstan, and I realized that others might also be interested. In the past, a threat of an export tariff usually meant that the government wanted something else in exchange. But it looks like it is different this time. The government in Kazakhstan is opaque, (though ostensibly modeled on Lee Kwan Yew's Singapore) and the resource curse derailed what had been a promising beginning of economic orthodoxy and a friendly environment for IOC investments. But the economic crisis and the fall in oil price have forced the government back into a more responsible, balanced economic approach. The government is still opaque and personalitic, but the current economic position of the country and the frail condition of the banks means that all past practices must be reexamined. There are high quality technocrats in the central bank and ministry of finance. To give you an idea, the current governor of Kazakhstan's Central Bank, Grigori Marchenko, rated an invitation to the Fed's Jackson Hole meet.

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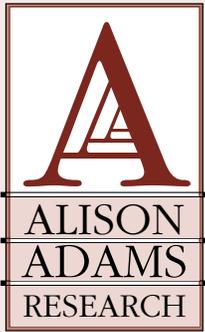
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The banking sector is running on life support now and has not recovered; current deposits are not enough to restore growth or help the local economy grow. The banks were completely dependent on short-term financing from European banks and profits came easily from lending these funds at higher rates to locals. That is over and not coming back. Banks owed 44% of Kazakhstan's total GDP in foreign borrowing at the beginning of the crisis.

1. European Banks don't lend like they used to;
2. The Central Bank has issued new rules that forbid excessive foreign borrowing; and
3. NPLs are running at 26% according to the latest IMF review. Trying to grow on domestic deposits and pay down debt is nearly impossible.

The taxation on oil exports is the best way to get the needed revenues to repair the national balance sheet. Debt service costs will triple over the next 3 years, from 68bn tenge to 238bn. Without other sources of funding, these obligations could be difficult to meet. This is not just grandstanding or ideology. They need the cash and they need to rebalance their sources of foreign currency away from the banking sector. However, they could be open to more leniency or negotiations about further hikes. But promises of more FDI will not prevent a tariff. The charge of \$20 a ton looks likely to stick and up to \$40 a ton next year looks very likely.

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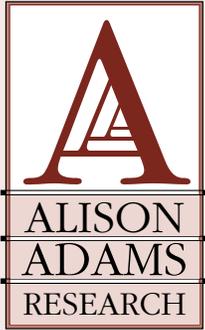
China: 2012 political battles have begun. *It was a strange week in Chinese politics when President Hu and Premier Wen publicly disagree on political reform. Did hardliners try to discredit PBoC governor Zhou with unsubstantiated rumors of his defection?*

There has been a recent wave among Chinese experts about the very different speeches given by President Hu and Premier Wen in Shenzhen. There have been numerous articles about Wen's reformist speech that expressed the need for political reform to ensure the benefits of the economic reforms. President Hu on the other hand gave a far more conservative speech that praised economic progress but gave no indication of political openness to reform. Rather, he talked about social harmony in line with state socialism. Many have asked, "Did Wen go off message?" If so, was his talk deliberate or accidental? (Imagine if this was your day job at the State Department . . .)

It is rare for Hu and Wen to be on different political tracks in such a high-profile manner. Taken together with the unsubstantiated rumors of PBoC Zhou's massive losses on GSE debt and possible defection to the U.S, it was a strange week in politics for China.

The stakes are very high in Chinese politics. The change in presidency ushers into the wings of power the "next generation" of political elites. The issue is not just who is president, it's also who is on the standing committee and the state council. Every one of those officers has his own

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cadre of political loyalists. If your boss doesn't make the cut, then you never will. Mandatory retirement age means that those who can qualify are in their early 50s, and in 10 years it will be too late. Talk about hardliners and reformers is too neat and perhaps even ideologically anachronistic. *This is do or die time.* Perhaps we are witnessing some of the maneuvering.

Alison Adams Research

Mobile: 617-388-9817

Office: 617-475-5295

Email: research@alisonadamsllc.com

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