
CEE: A time of change

Carlos Ortiz, CEE Economist, UniCredit Bank London



OUR FOOTPRINT

Local access – global reach
Leadership positions in Italy,
Germany, Austria and CEE
Presence in over 50
countries around the globe
Local banks in 20
European countries

OUR CORE CLIENT OFFER

1. Corporate Banking and Transaction Services
2. Structured Finance, Capital Markets and Investment Products
3. Access to Western, Central and Eastern Europe

OUR MAIN ACHIEVEMENTS

#2 Lead Manager All EMEA Bonds in EUR*
#1 Bookrunner EMEA Corporate Loans in EUR*
#1 Cash Mgmt. House in CEE, **#2** in Italy
and **#3** in Germany (*Euromoney Poll*)
#1 Trade Finance Bank in Italy, Austria and
CEE (*Global Finance Magazine*)
Best FX Provider 2013 in Austria,
Italy and Poland (*Global Finance Magazine*)

* This reflects FY 2012 league table positions by volume, source: Dealogic

Topics

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- CEE – impact from higher growth on developed markets
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Eurozone: we are above consensus. Periphery plays catch-up

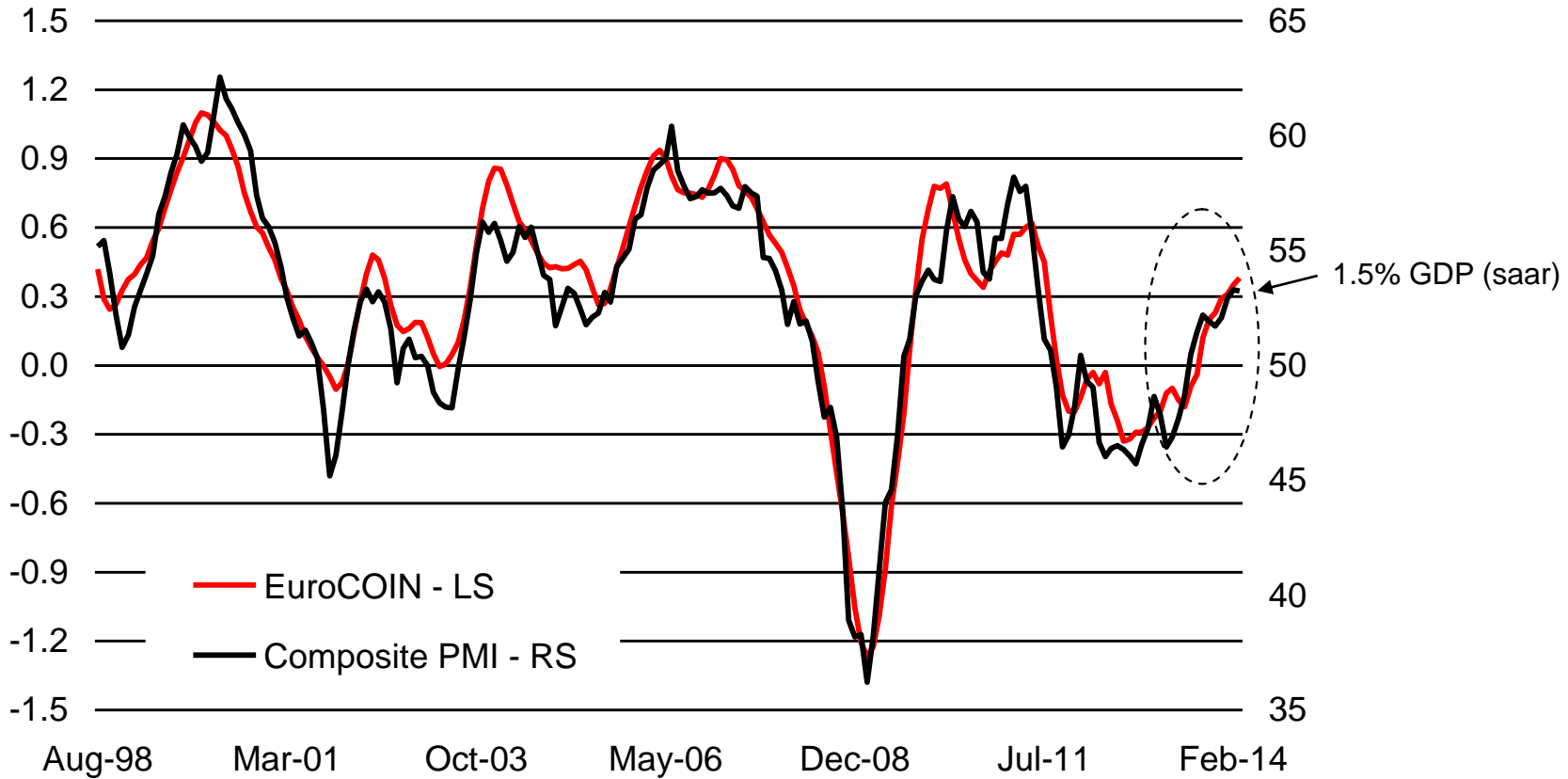
GDP Forecasts

	UniCredit (Mar-14)			IMF (Jan-14)		OECD (Nov-13)		Consensus (Mar-14)	
	2013	2014	2015	2014	2015	2014	2015	2014	2015
EMU	-0.4	1.5	1.7	1.0	1.4	1.0	1.6	1.1	1.4
Germany	0.5	2.5	2.5	1.6	1.4	1.7	2.0	1.8	2.0
France	0.3	1.1	1.4	0.9	1.5	1.0	1.6	0.8	1.2
Italy	-1.8	0.9	1.4	0.6	1.1	0.6	1.4	0.5	1.0
Spain	-1.2	1.0	1.4	0.6	0.8	0.5	1.0	0.9	1.5
Periphery*	-1.6	0.9	1.4	0.7	1.2	0.6	1.3	0.7	1.3

* Weighted average of Italy, Spain, Greece, Portugal and Ireland

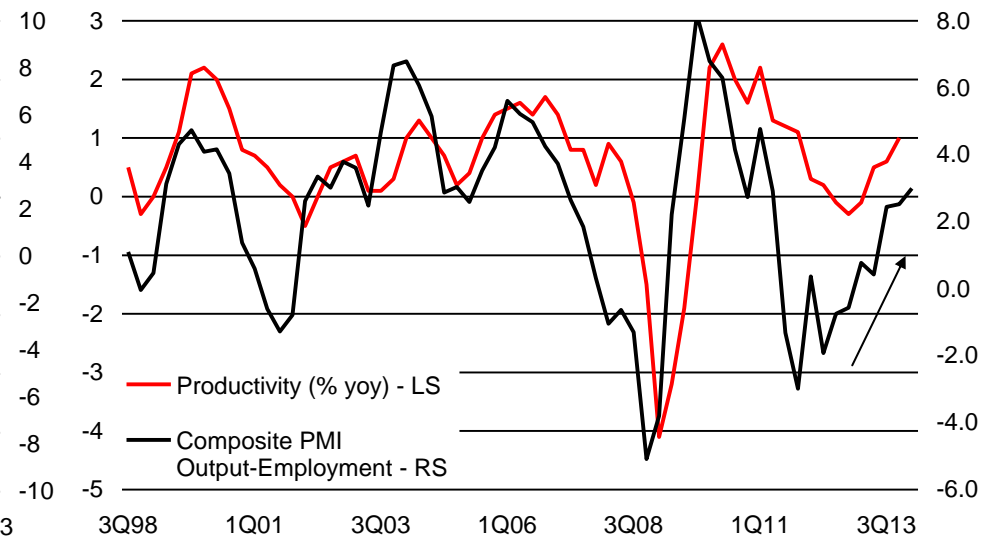
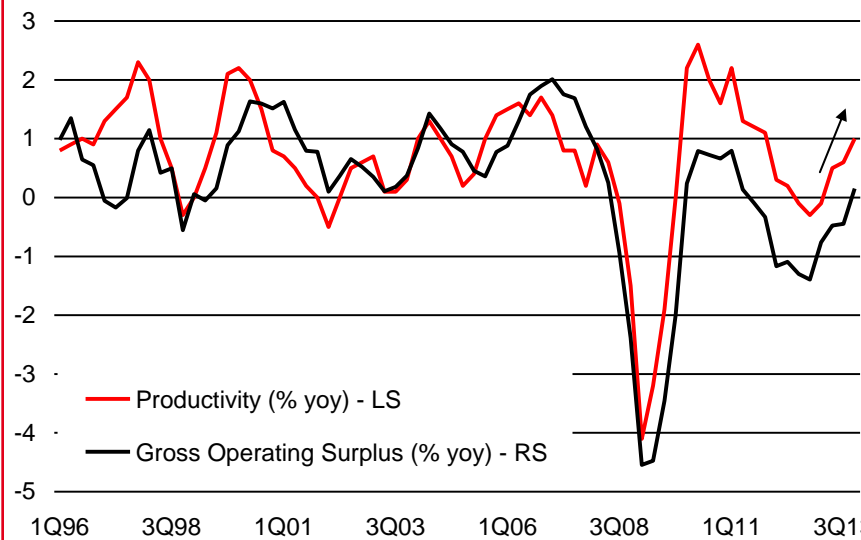
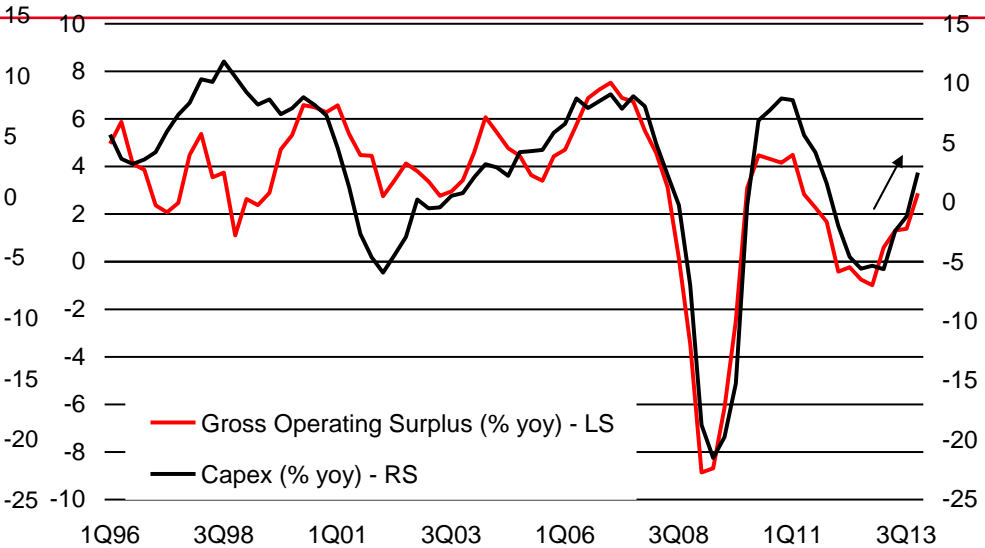
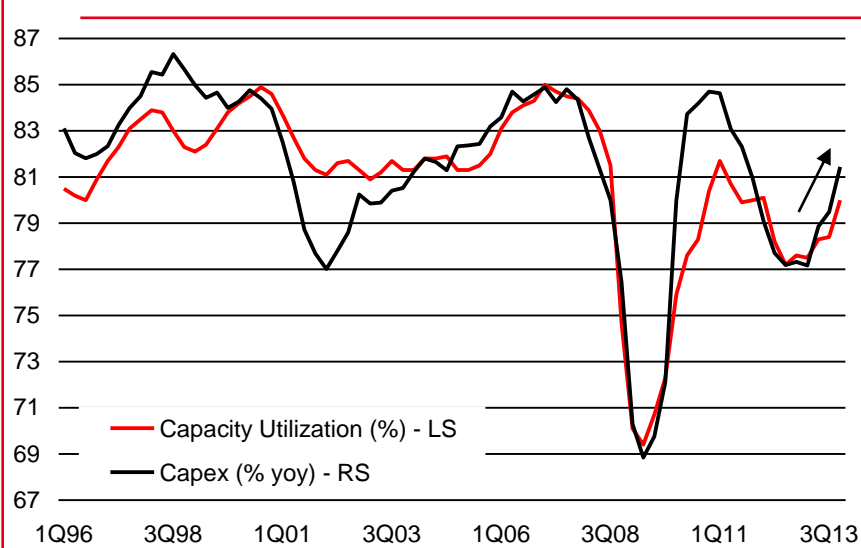
Source: Consensus, IMF, OECD, UniCredit Research

The eurozone recovery looks good, so far

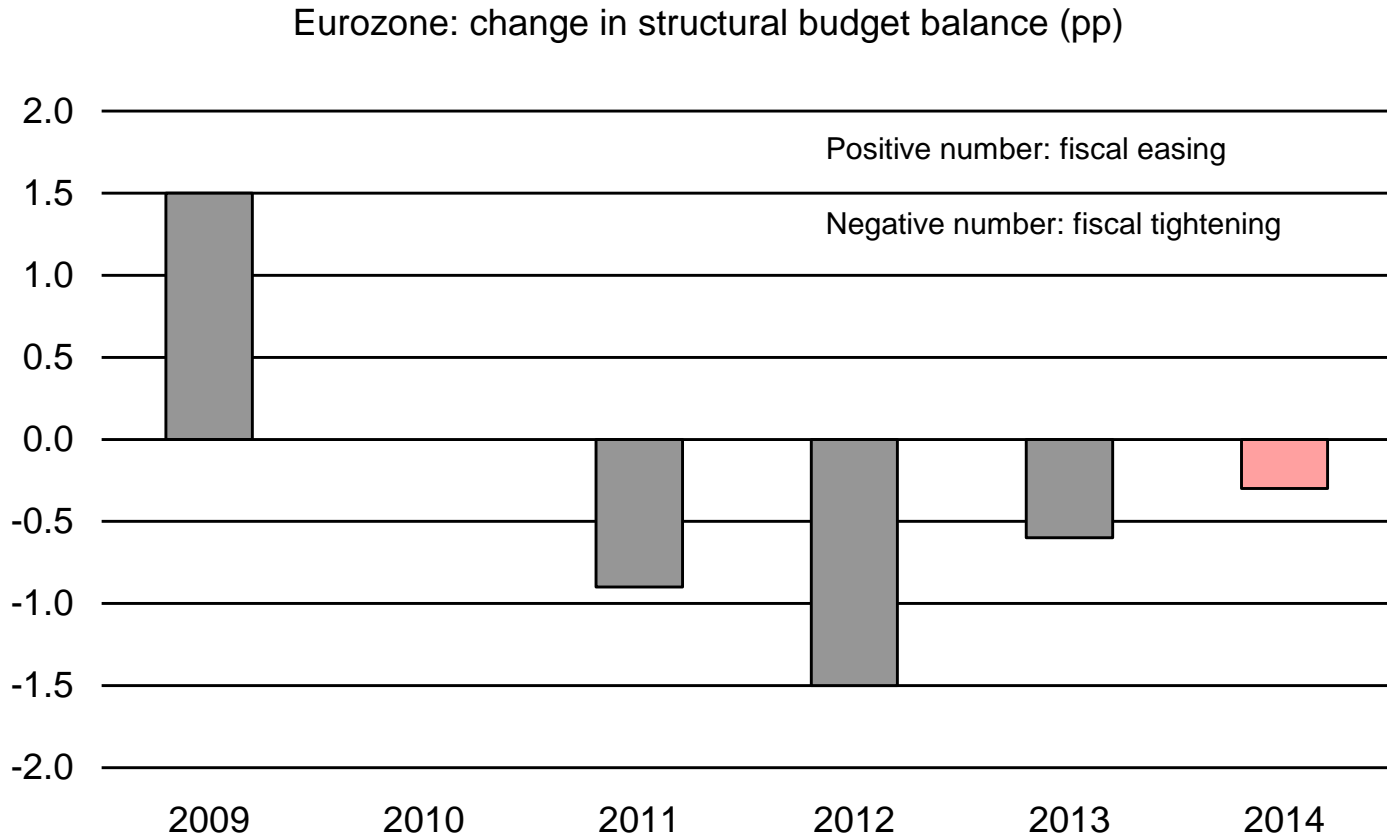


Source: Bol, Markit, UniCredit Research

Capex recovery to gain traction as firms' fundamentals improve

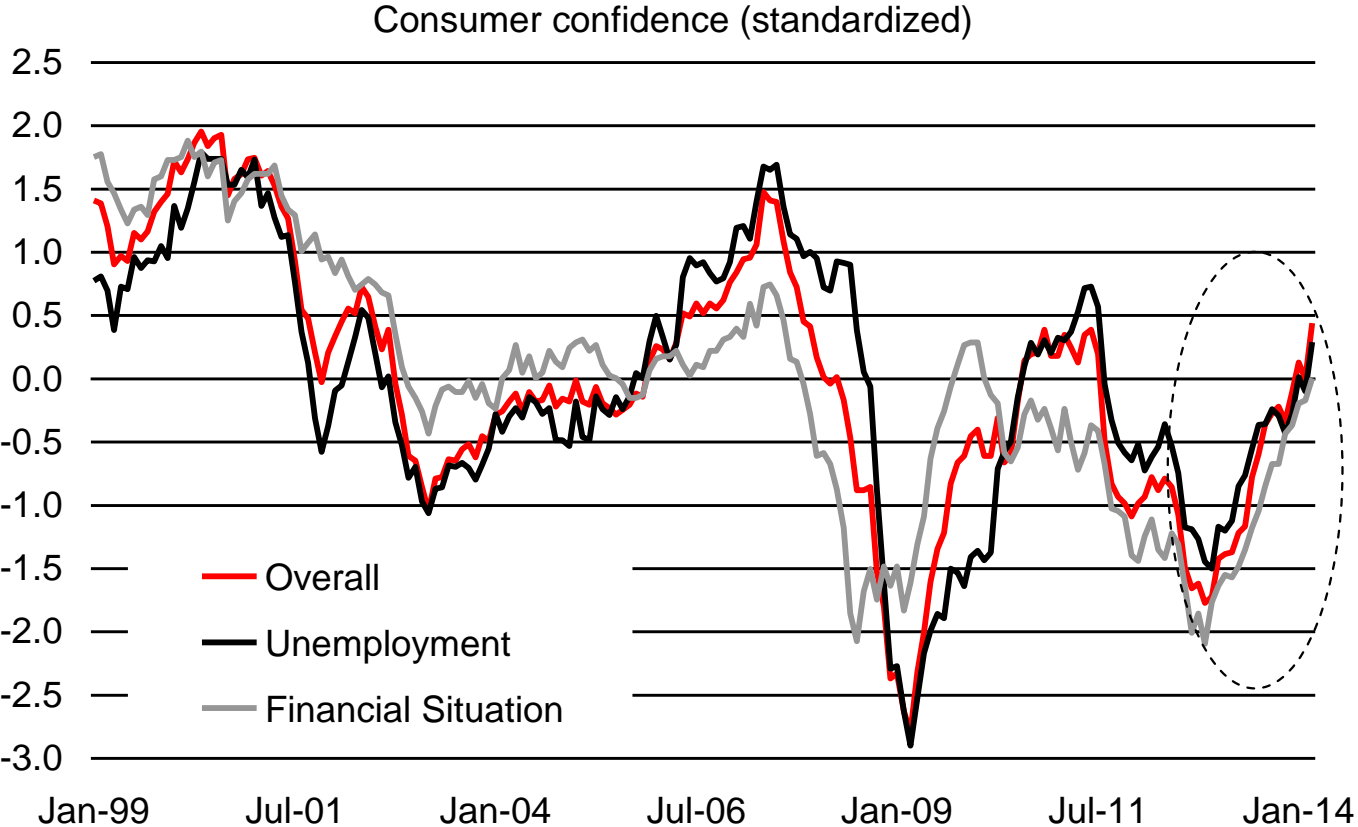


Slowing fiscal consolidation helps sequential GDP growth



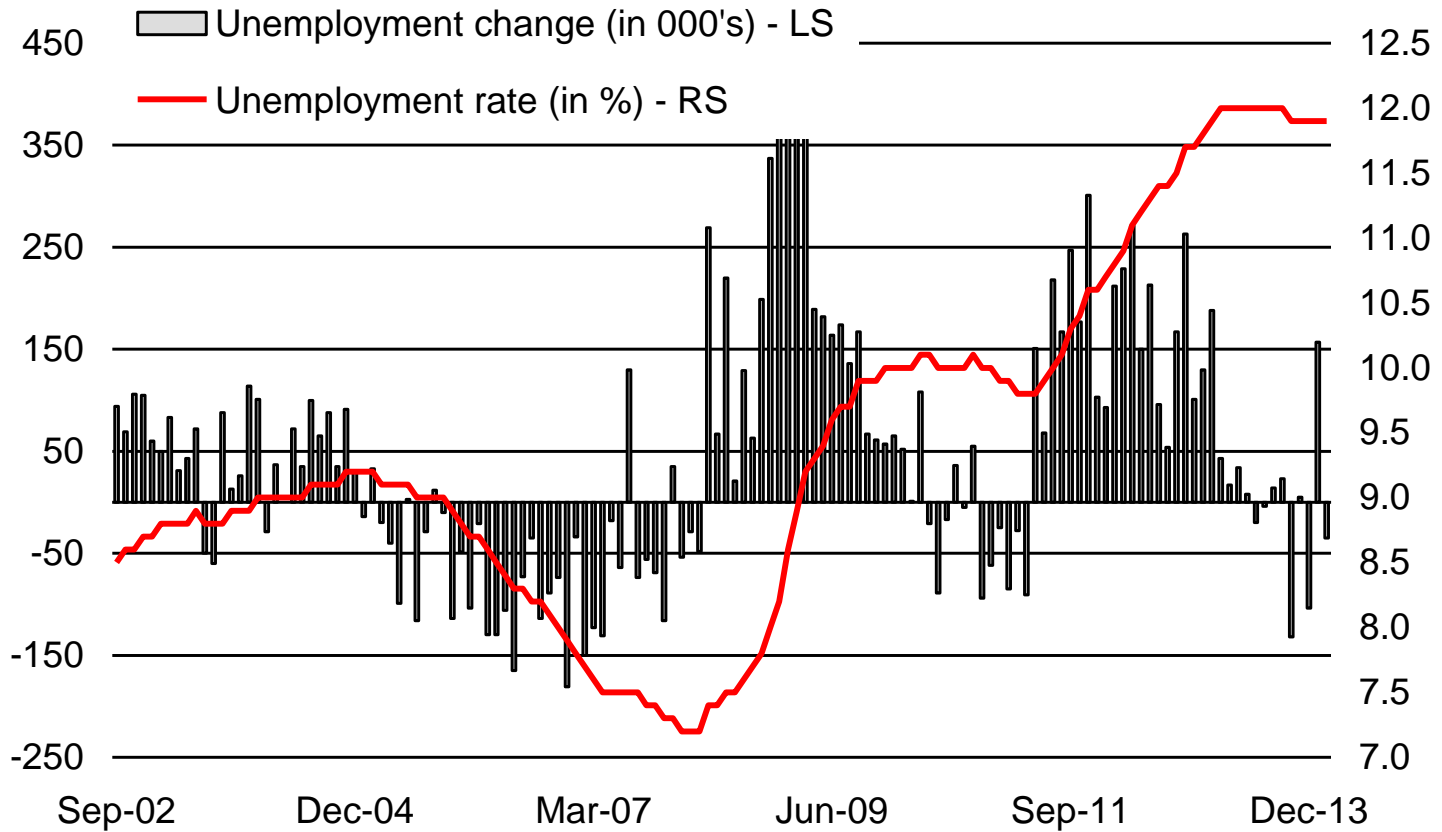
Source: EC, UniCredit Research

Low inflation supports consumer confidence (and spending)



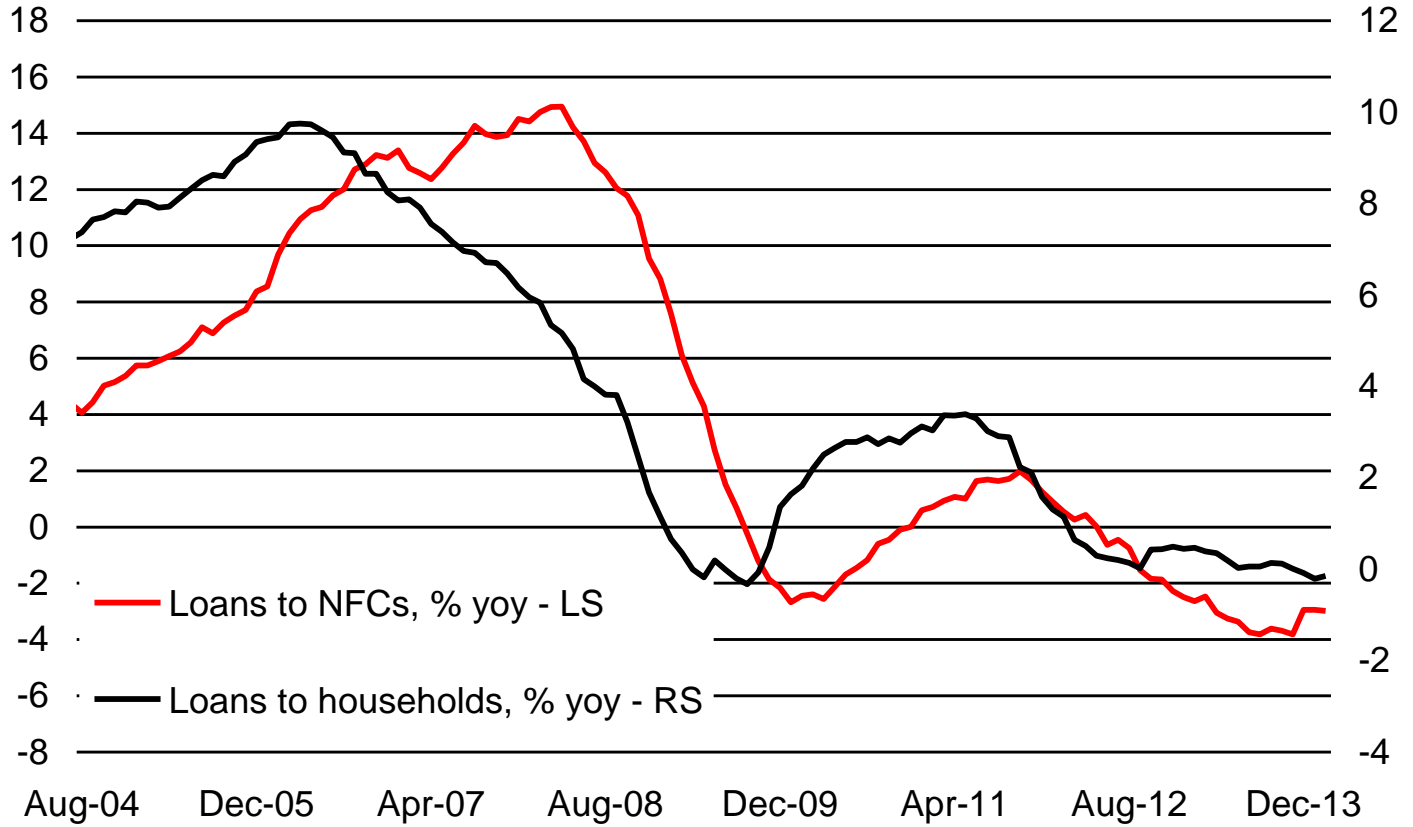
Source: EC, UniCredit Research

Labor market: at a turning point...



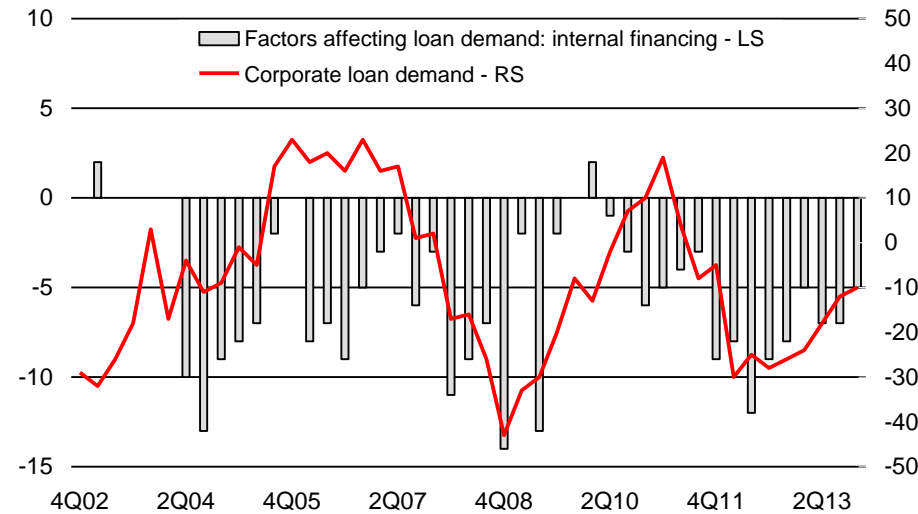
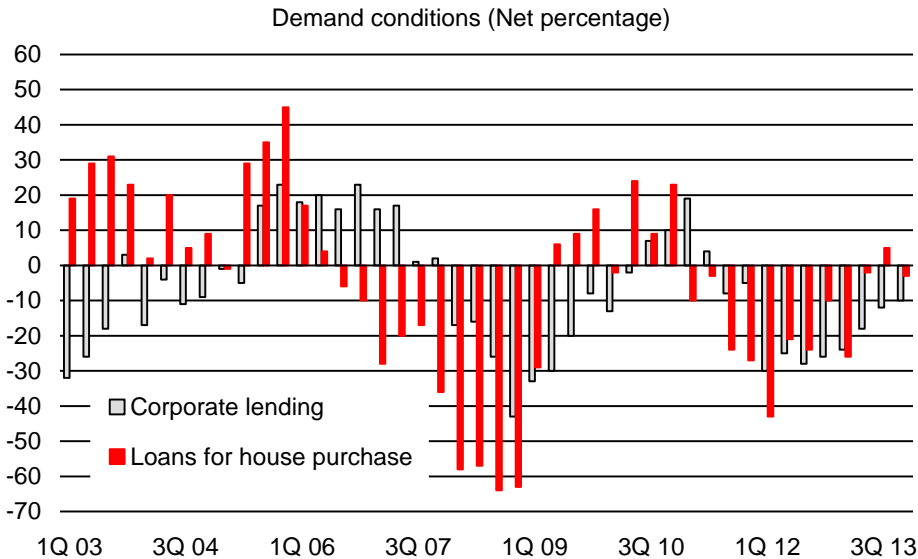
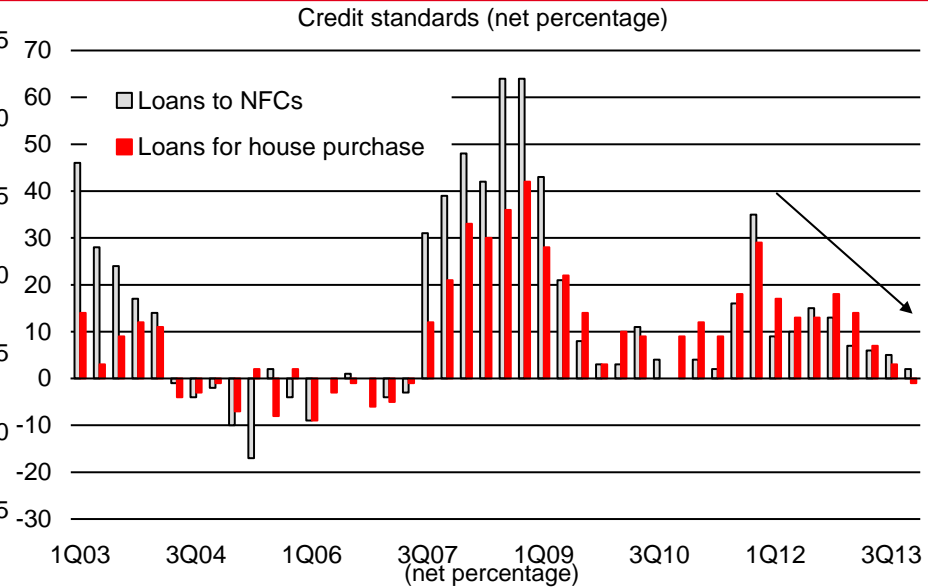
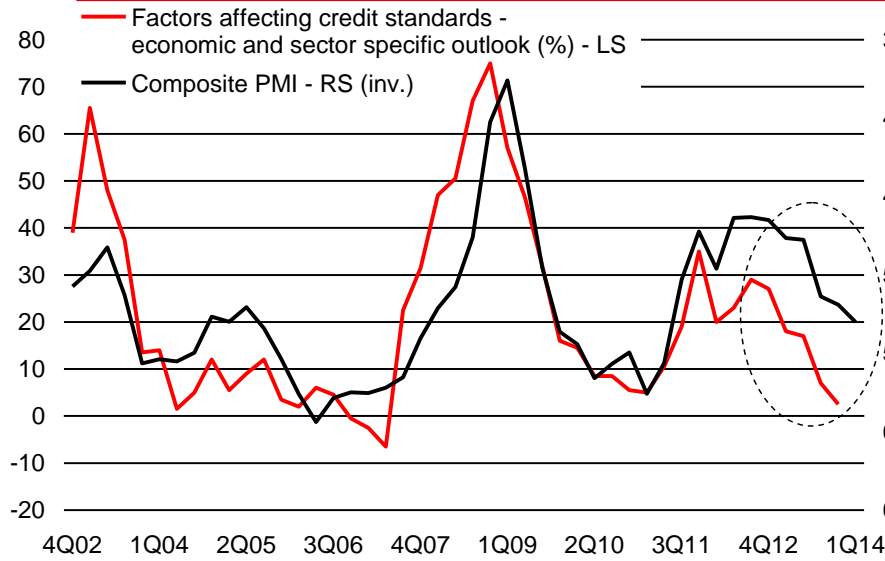
Source: Eurostat, UniCredit Research

Lending cycle: still weak...



Source: ECB, UniCredit Research

...but the BLS suggests there may be light at the end of the tunnel

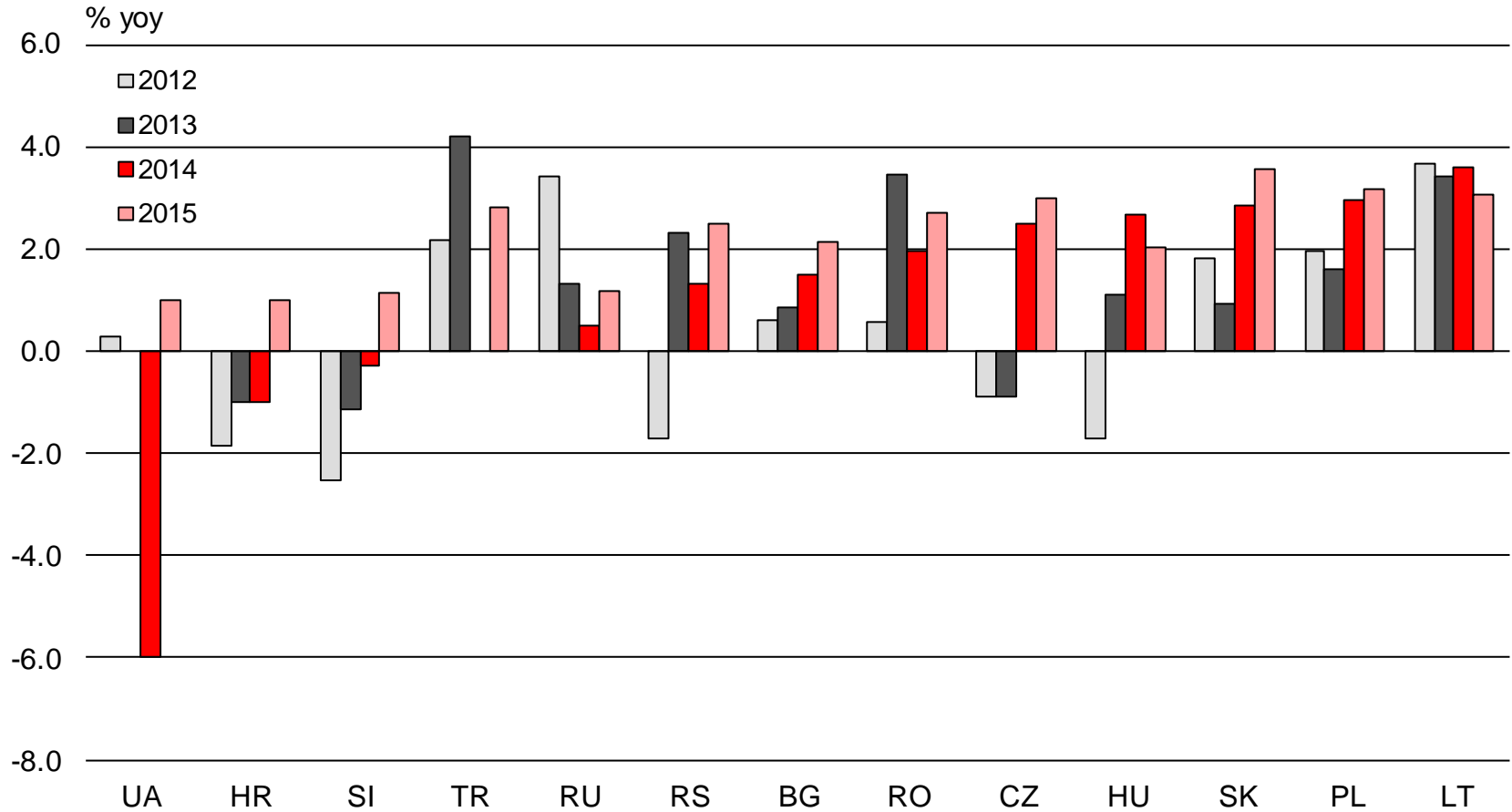


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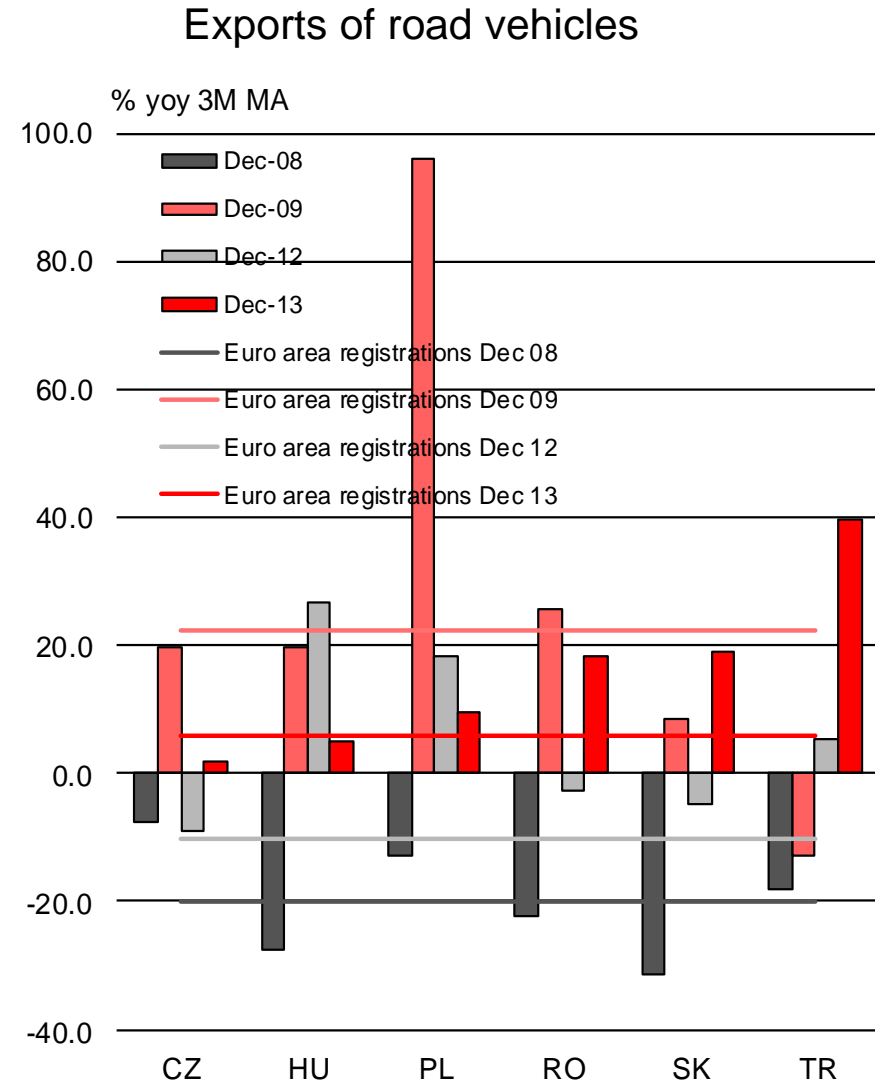
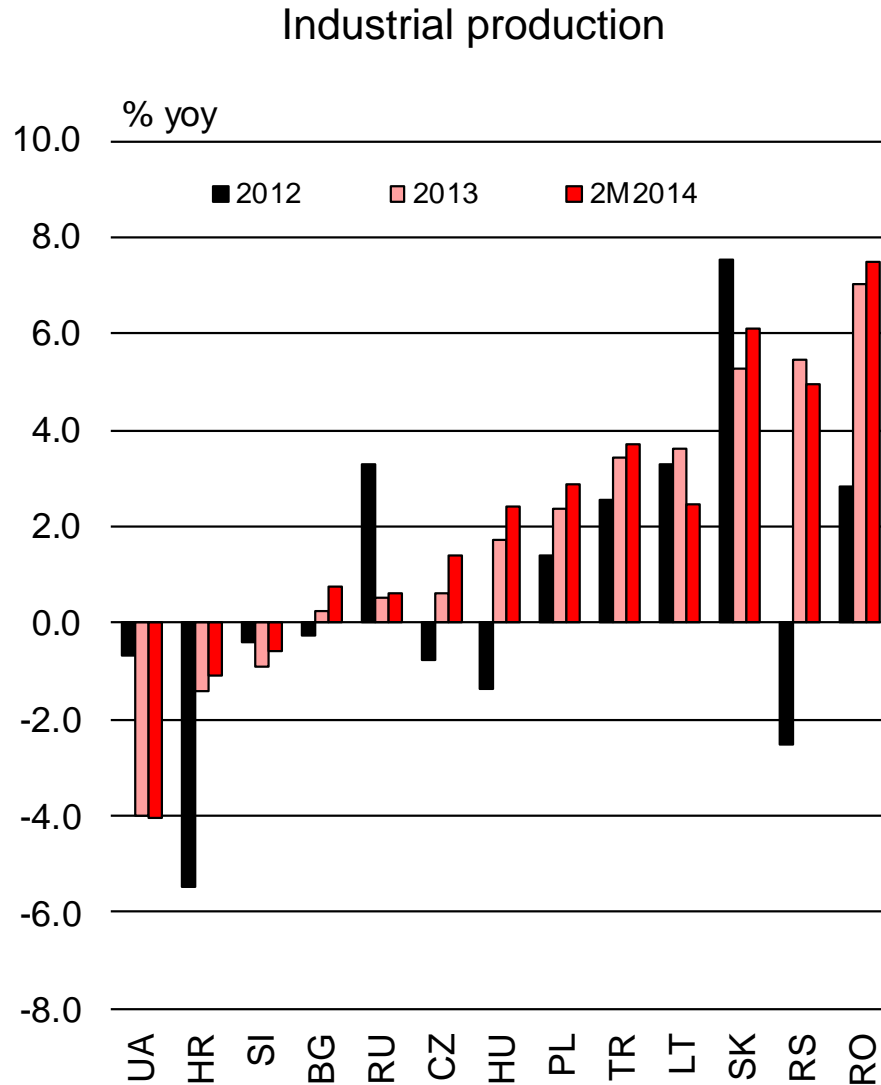
CEE: 1. The recovery is underway and will gather pace...

GDP growth expected to improve gradually...



Sources: National Statistical Offices, Have Analytics, Unicredit Research

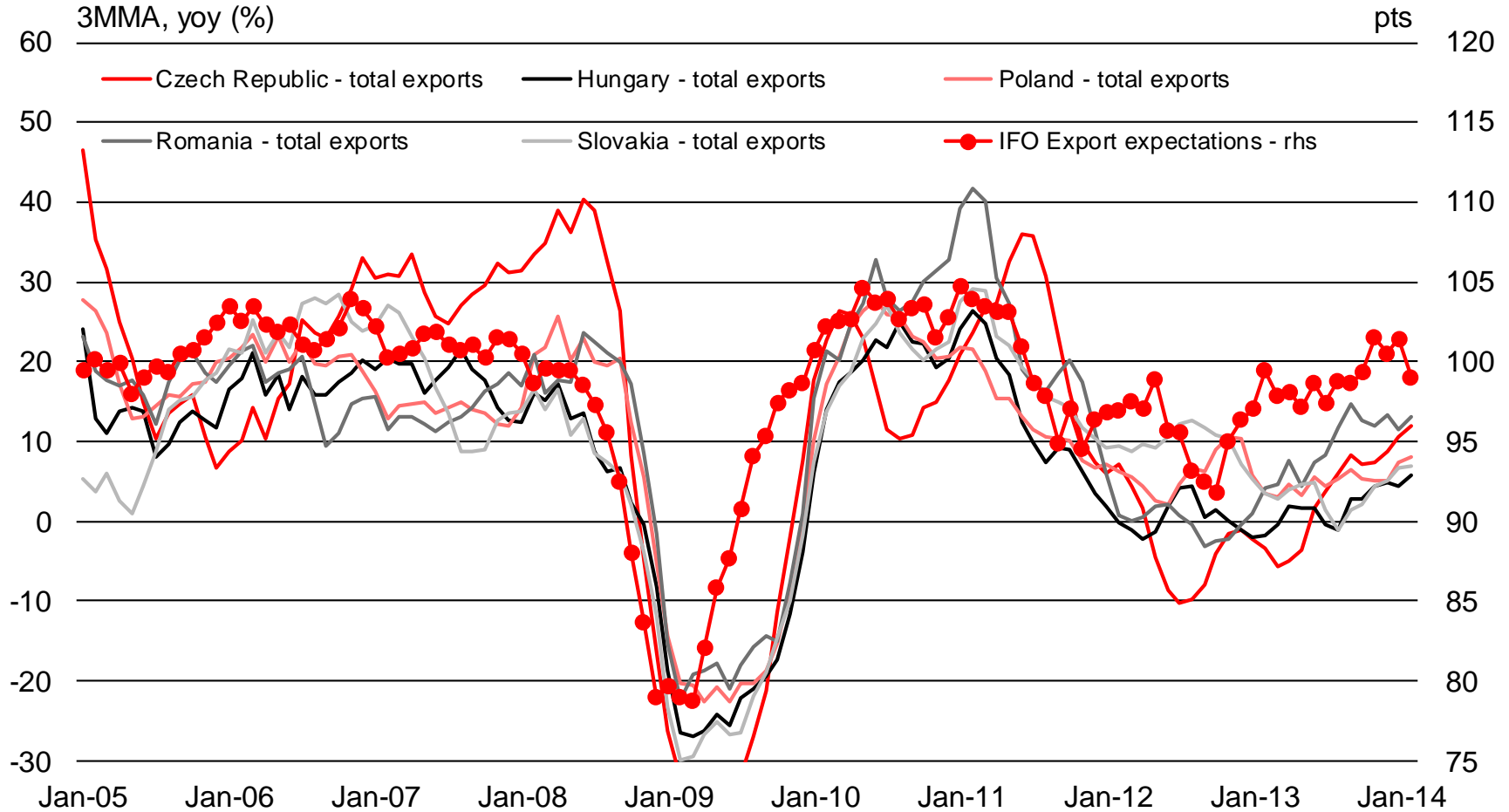
.... helped by industrial production...



Source: Eurostat, UniCredit Research

... via external demand

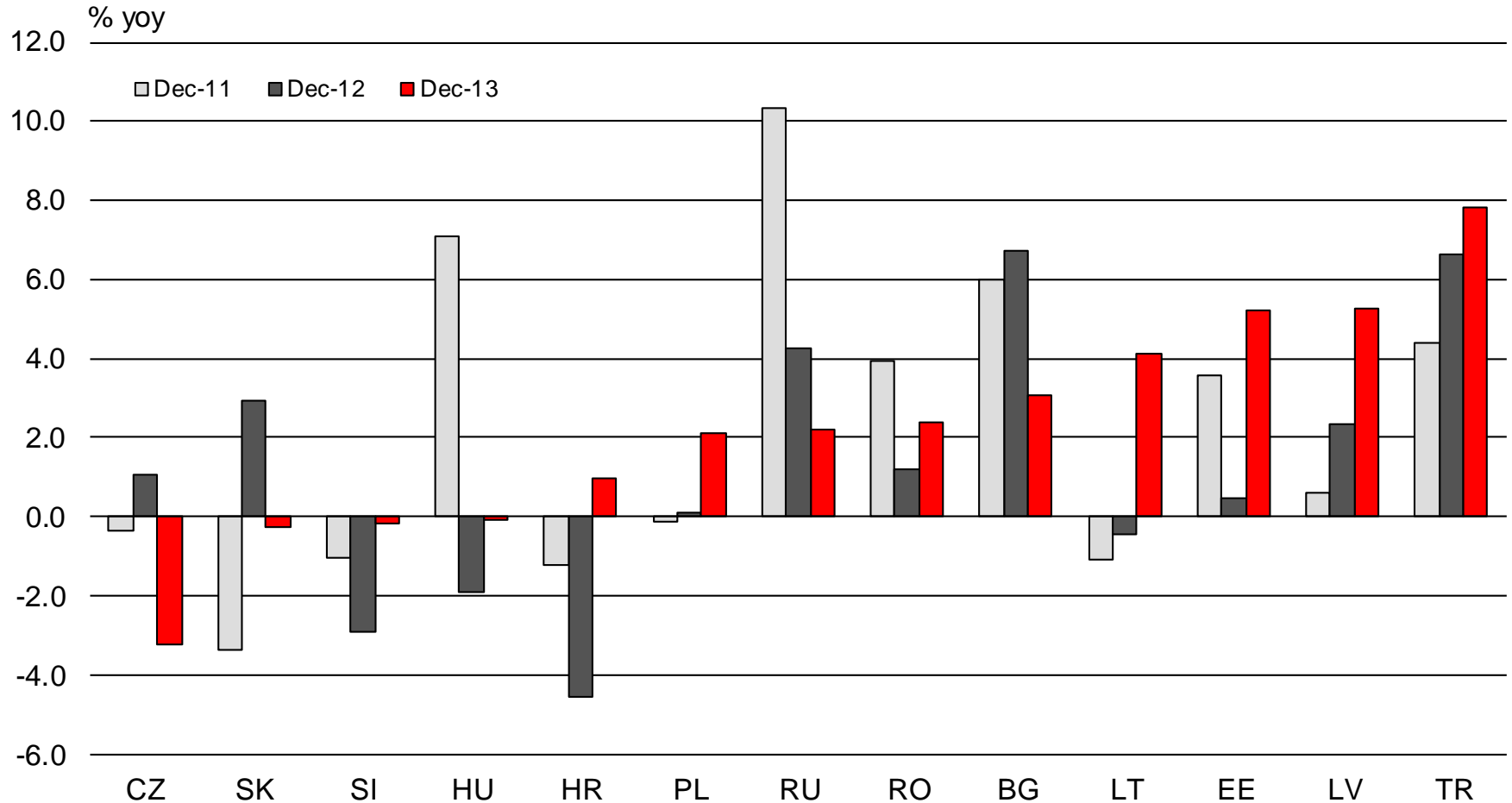
CEE exports are correlated with German export expectations



Sources: National Statistical Offices, Have Analytics, Unicredit Research

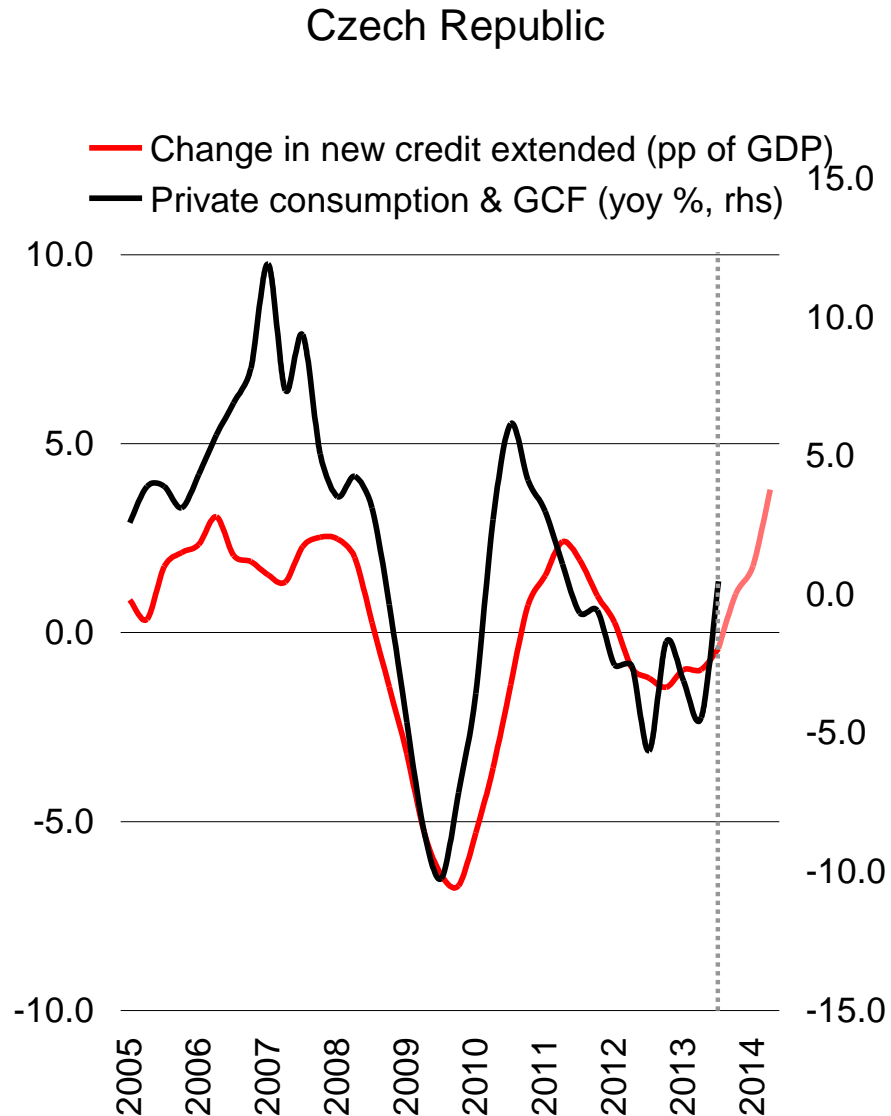
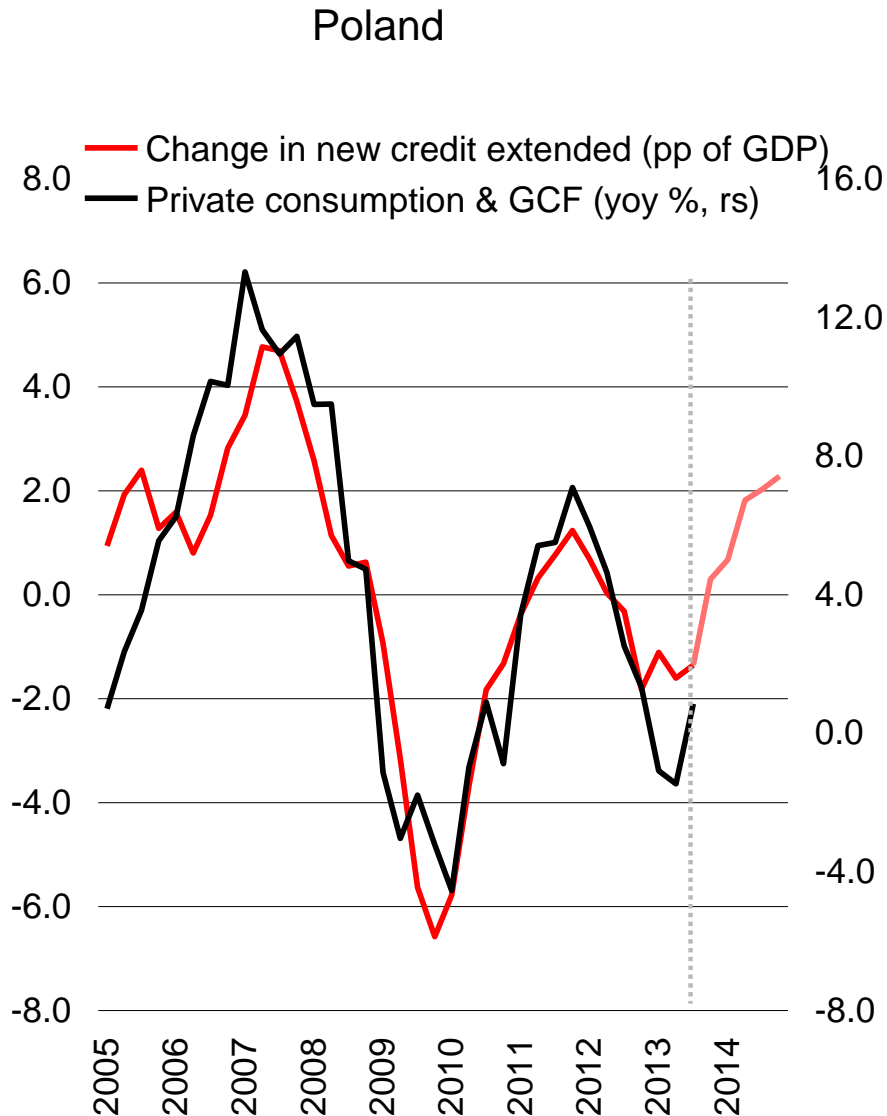
CEE: 2. Domestic demand recovering, helped by real wage growth...

Real wage growth is boosted by low inflation and recovering industrial production



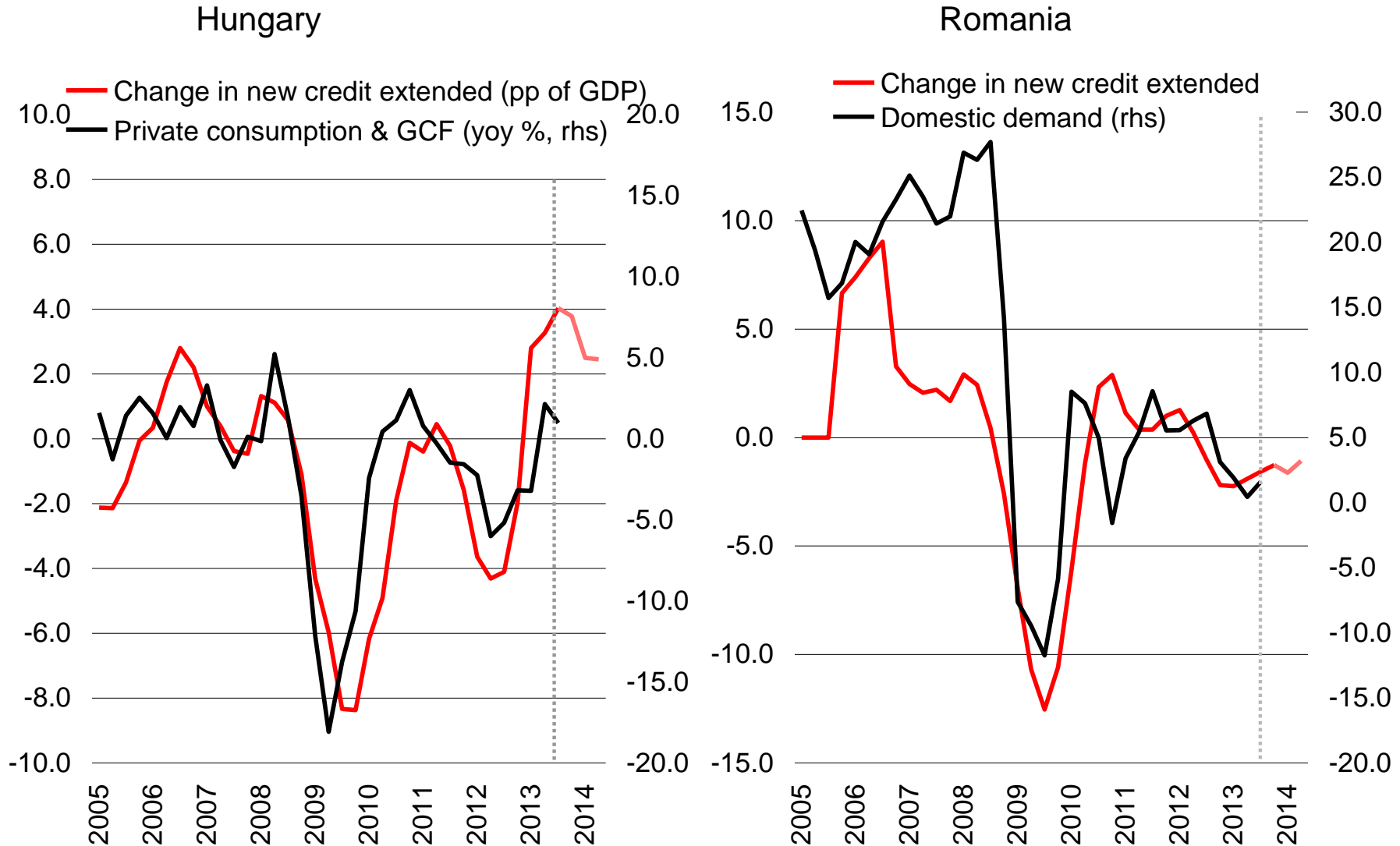
Sources: National Statistical Offices, Have Analytics, Unicredit Research

... while the credit impulse is positive in some countries...



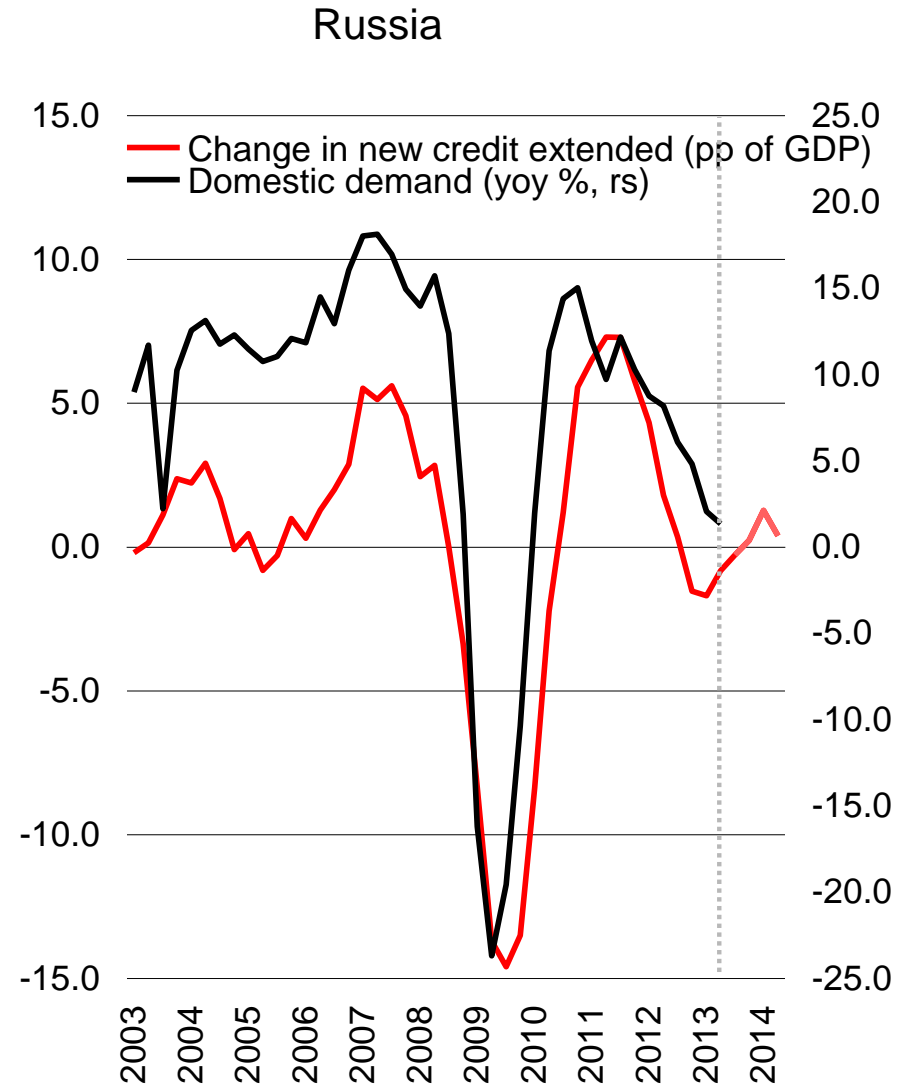
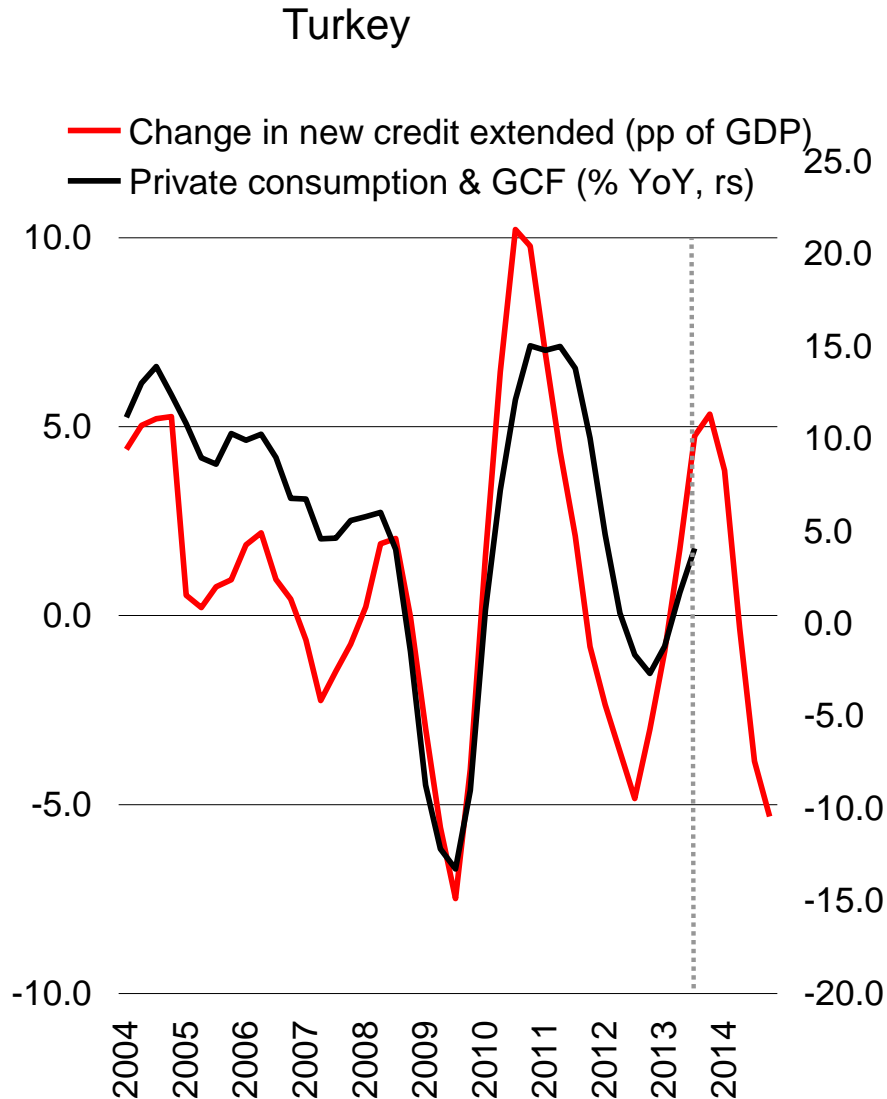
Sources: Central banks, Statistical Offices, UniCredit Research

... mildly positive or neutral in others...



Sources: Central banks, Statistical Offices, UniCredit Research

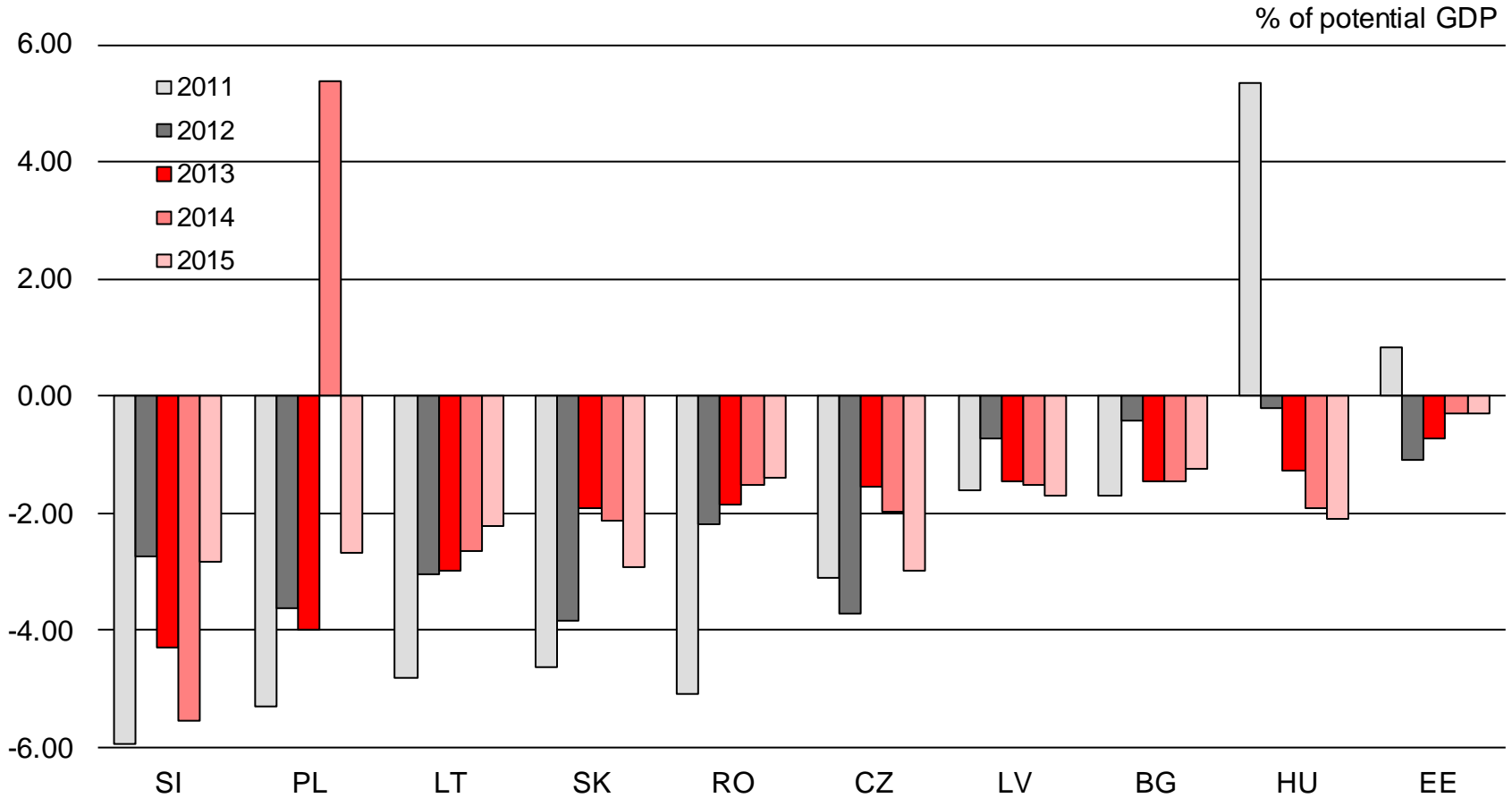
... but negative in the largest economies



Sources: Central banks, Statistical Offices, UniCredit Research

CEE: 3. The fiscal tightening is done in most countries

Structural deficits in CEE – EC forecasts



Sources: Eurostat, UniCredit Research

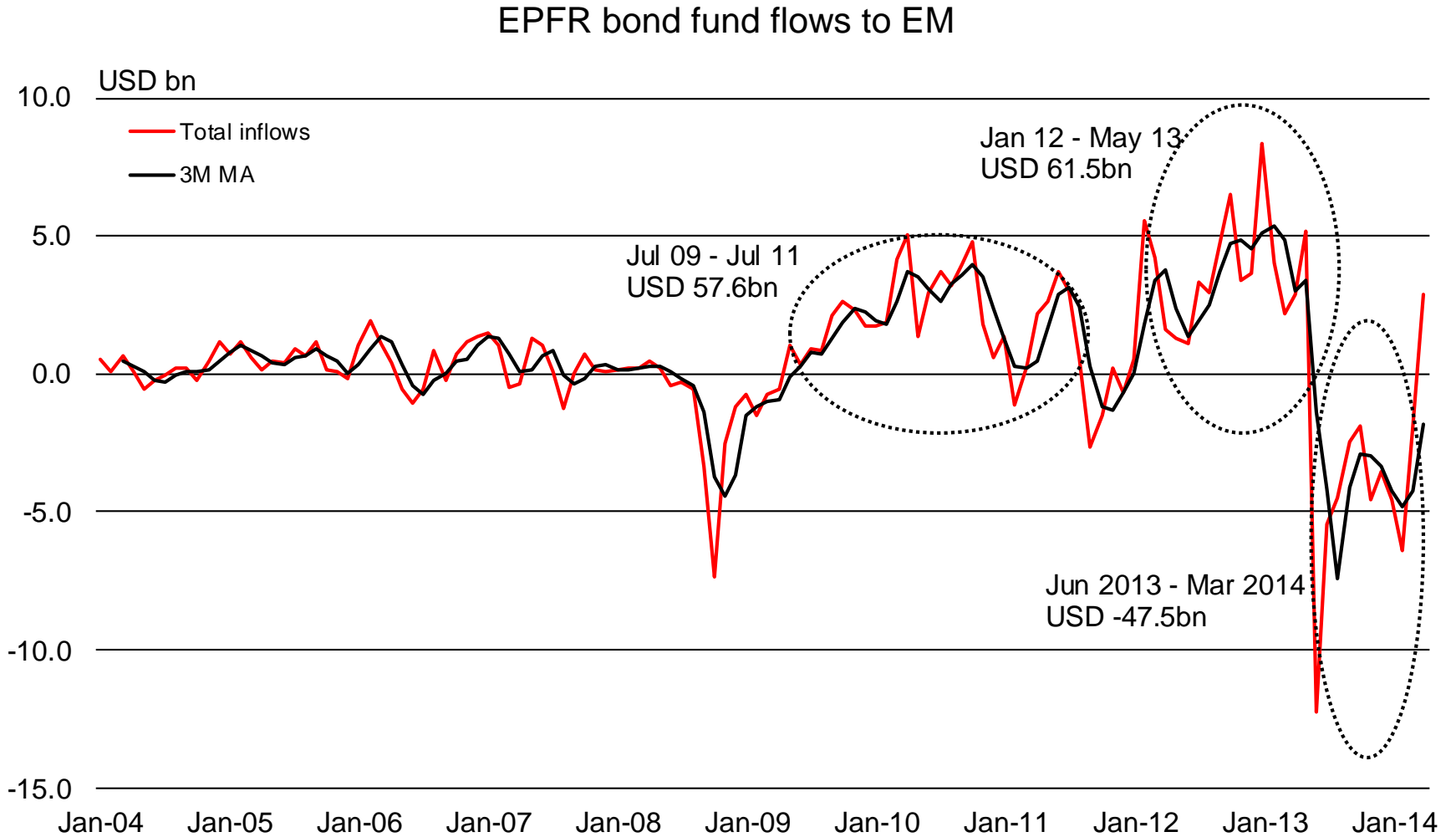
... yet elections might lead to policy (including fiscal) slippages

	Date	Country	Type
2014	15&29 March	Slovakia	President
	16 March	Serbia	Parliament, Belgrade
	30 March	Turkey	Local
	6 April	Hungary	Parliament
	11-25 May	Lithuania	President
	22-25 May	CEE	EU Parliament
	2 August	Turkey	President
	4 October	Latvia	Parliament
	5 October	Bosnia & Herzegovina	Parliament
	2&16 November	Romania	President
2015	26 February	Ukraine	President
	March	Estonia	Parliament
	June	Poland	President
	June	Turkey	Parliament
	25 October	Ukraine	Kiev
	October	Poland	Parliament
	December	Slovenia	Parliament

Topics

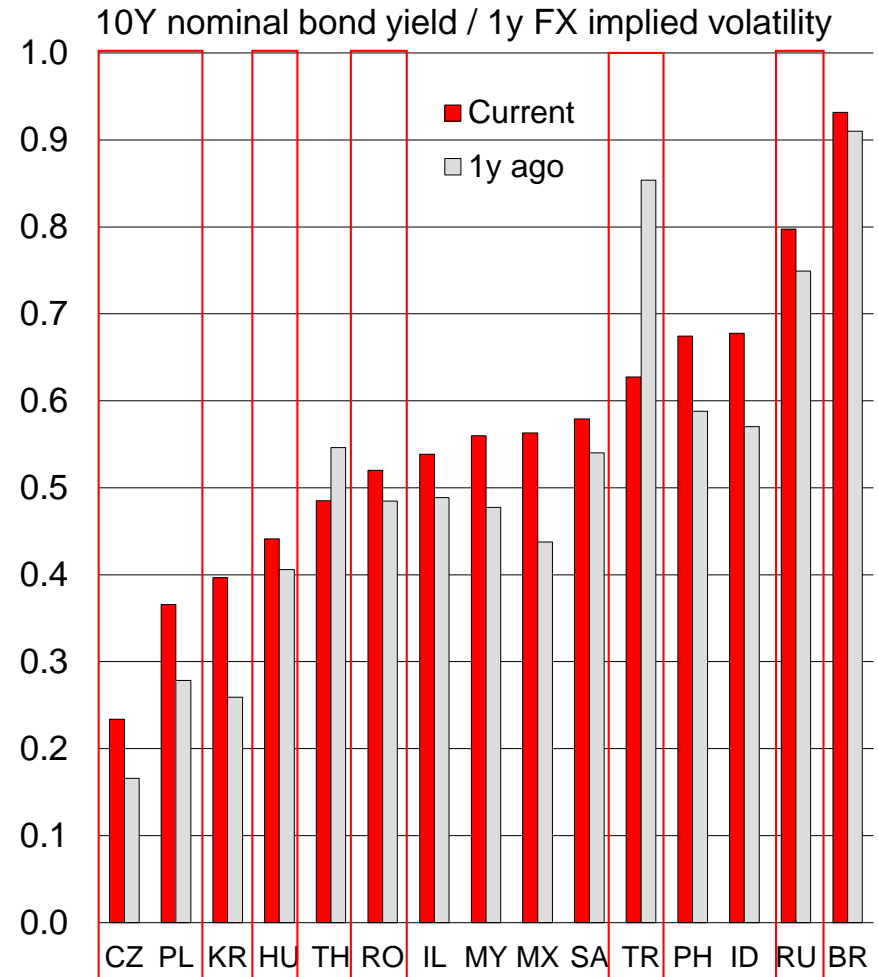
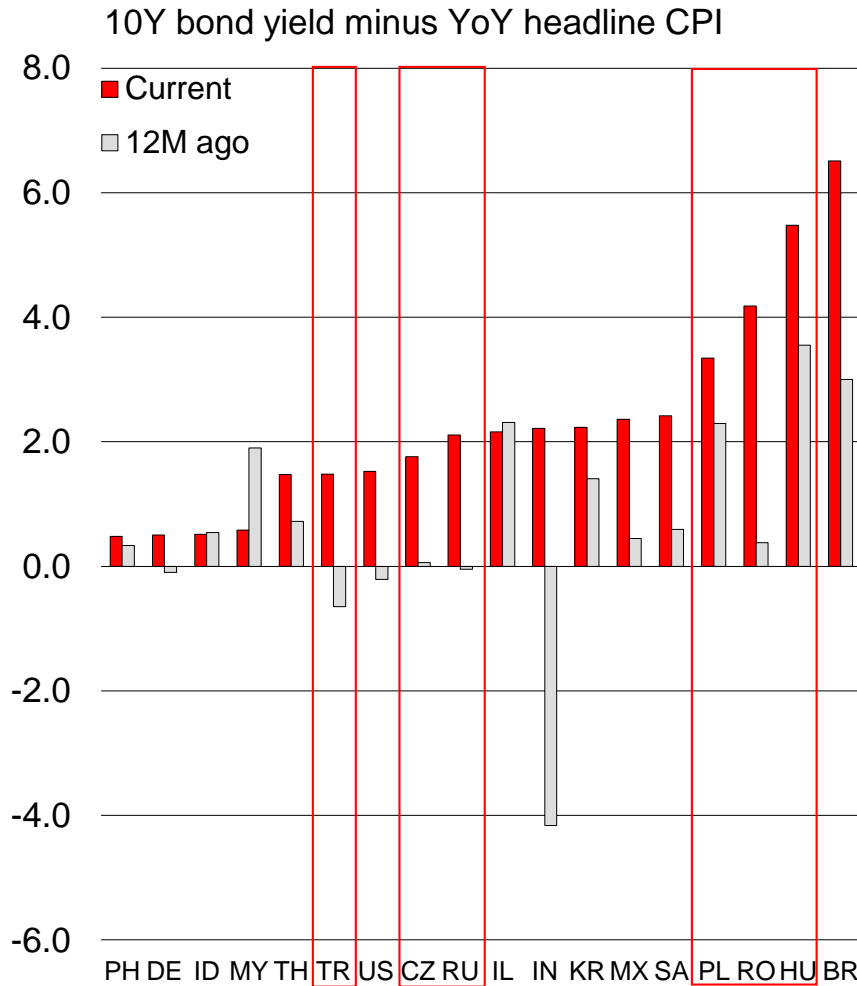
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Capital outflows from EM amid lower risk appetite...



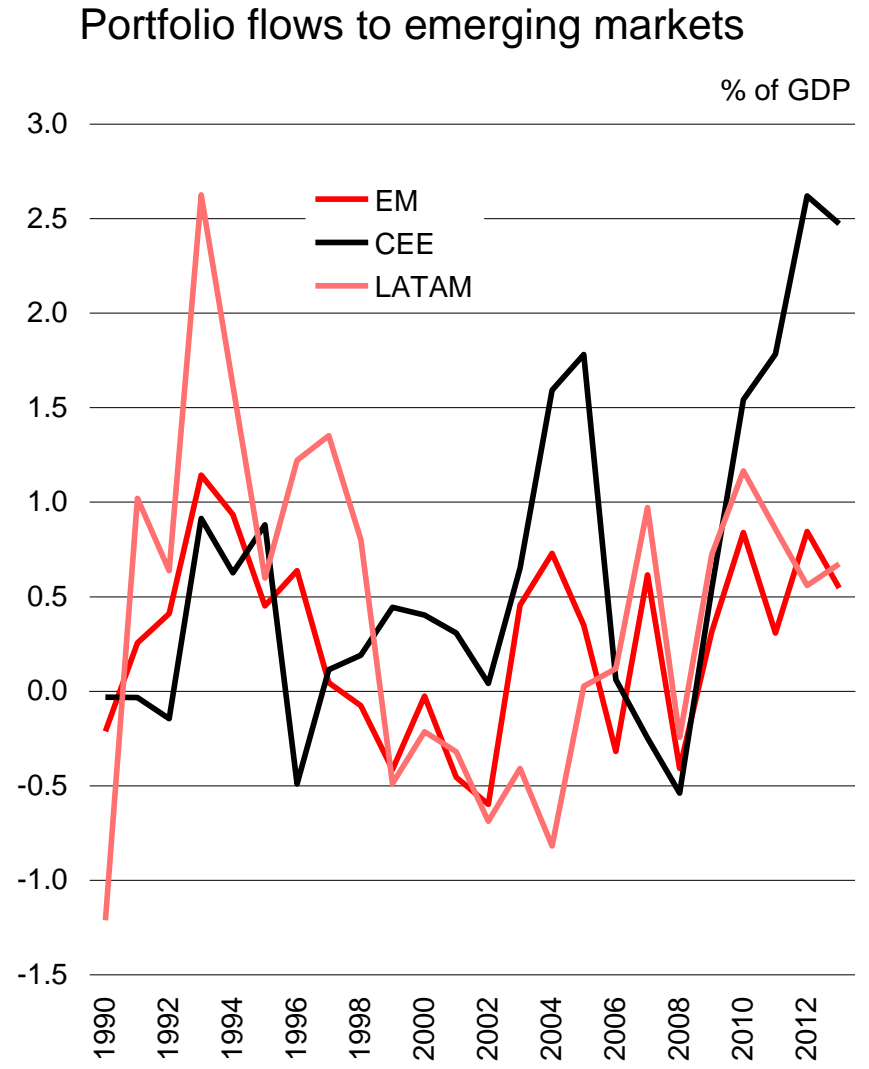
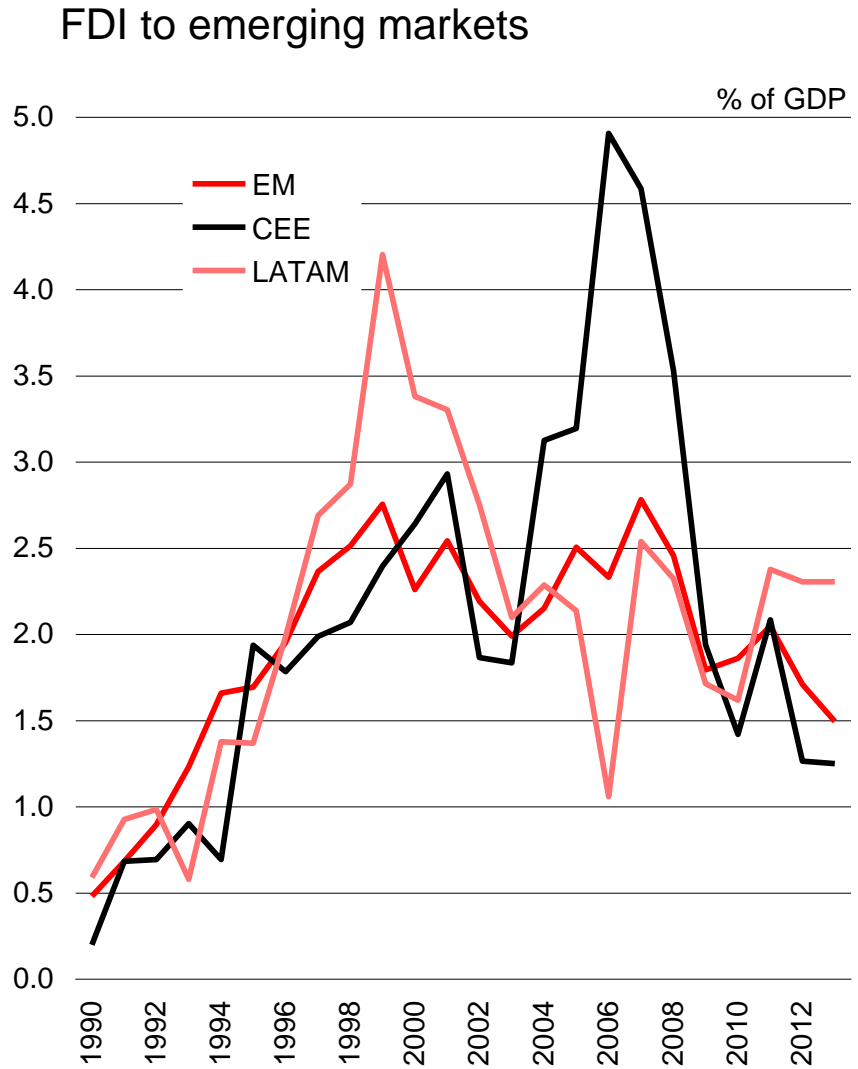
Sources: EPFR, UniCredit Research

... affecting CEE yields but not more than other EM.



Sources: Bloomberg, UniCredit Research

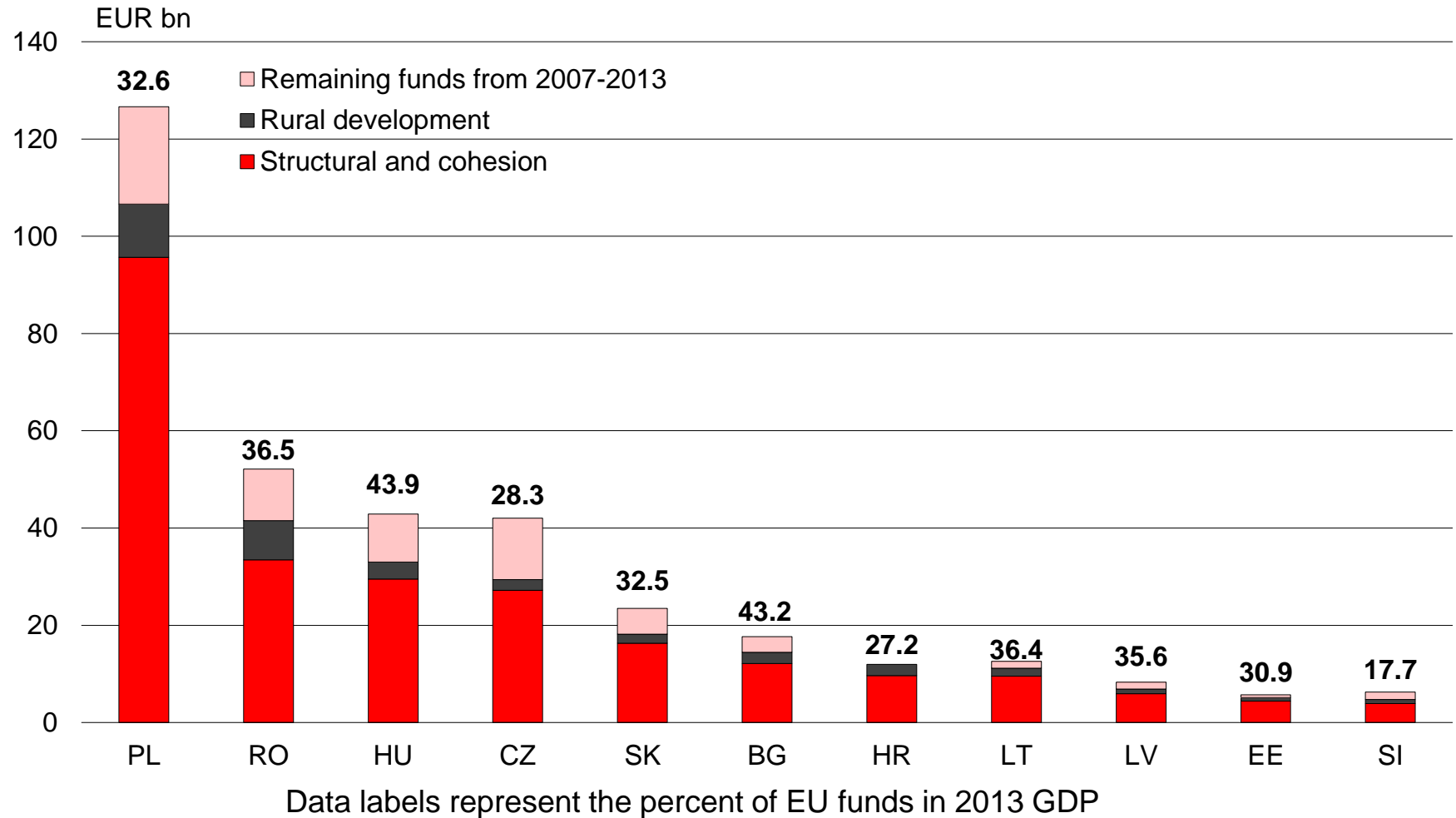
FDI remains subdued...



Source: IMF, UniCredit Research

... but can be replaced by EU funds...

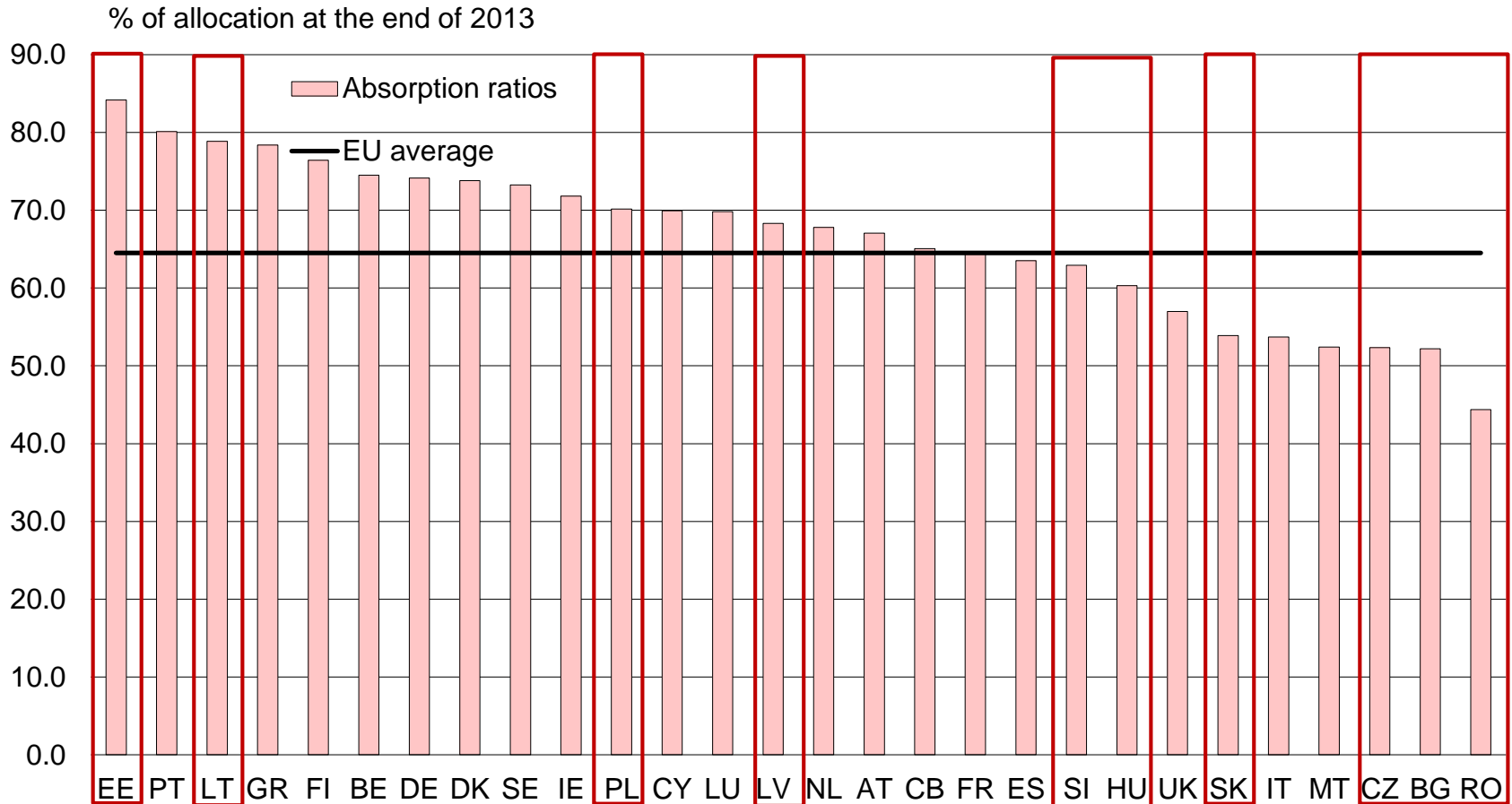
In a low FDI environment, CEE countries that are members of the EU rely on EU funds



Sources: European Commission, national management authorities, UniCredit Research

(although absorption rates vary greatly)

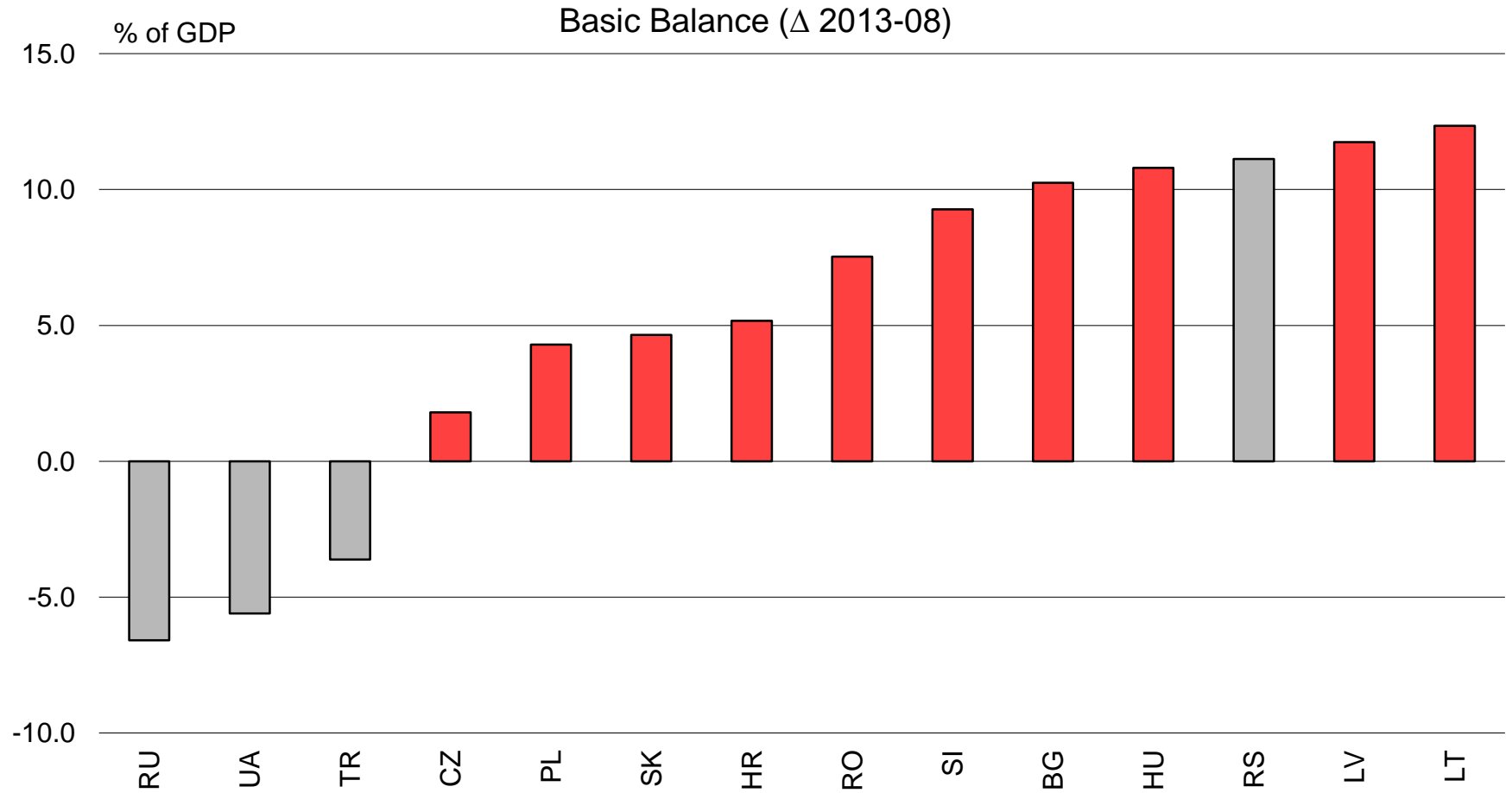
While absorption will pick up beyond 2013, many countries risk losing significant funding. In Romania's and Bulgaria's cases, the government failed to absorb money in line with the private sector.



Sources: European Commission, national management authorities, UniCredit Research

... leading to supportive basic balances for EU members

Basic balance = C/A + FDI + EU funds



Sources: National Statistical Offices, Have Analytics, Unicredit Research

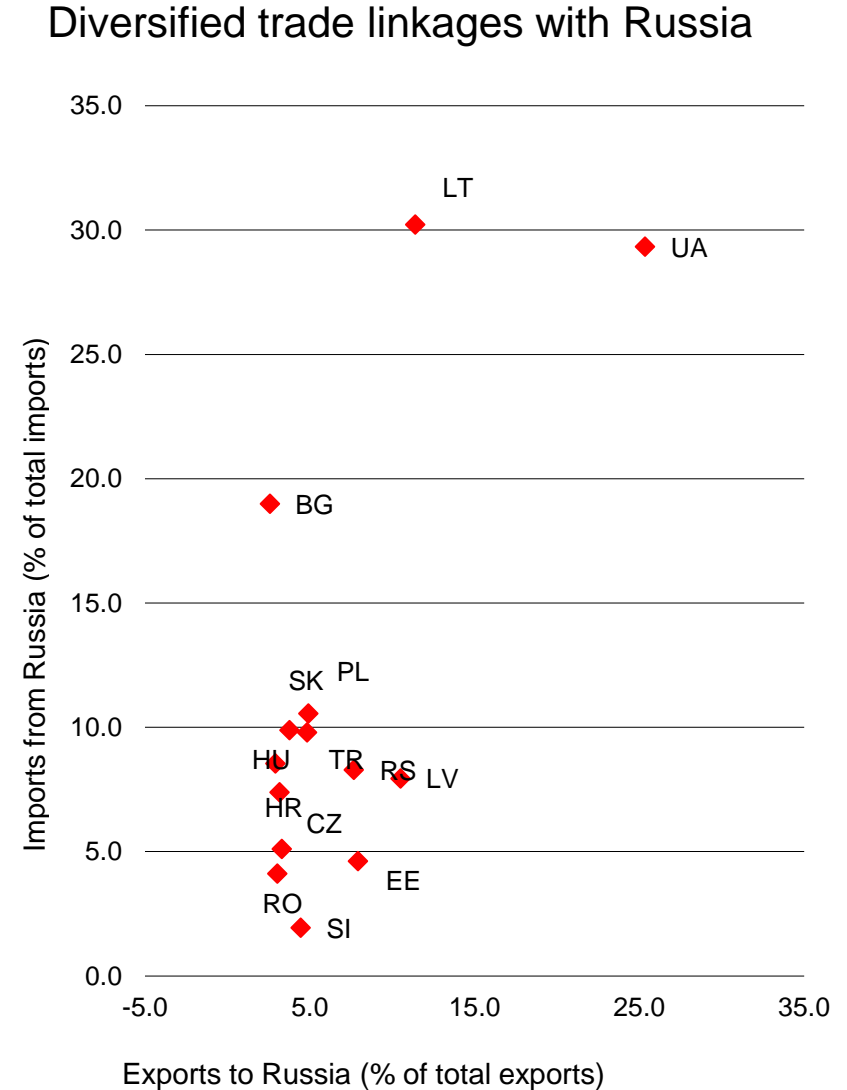
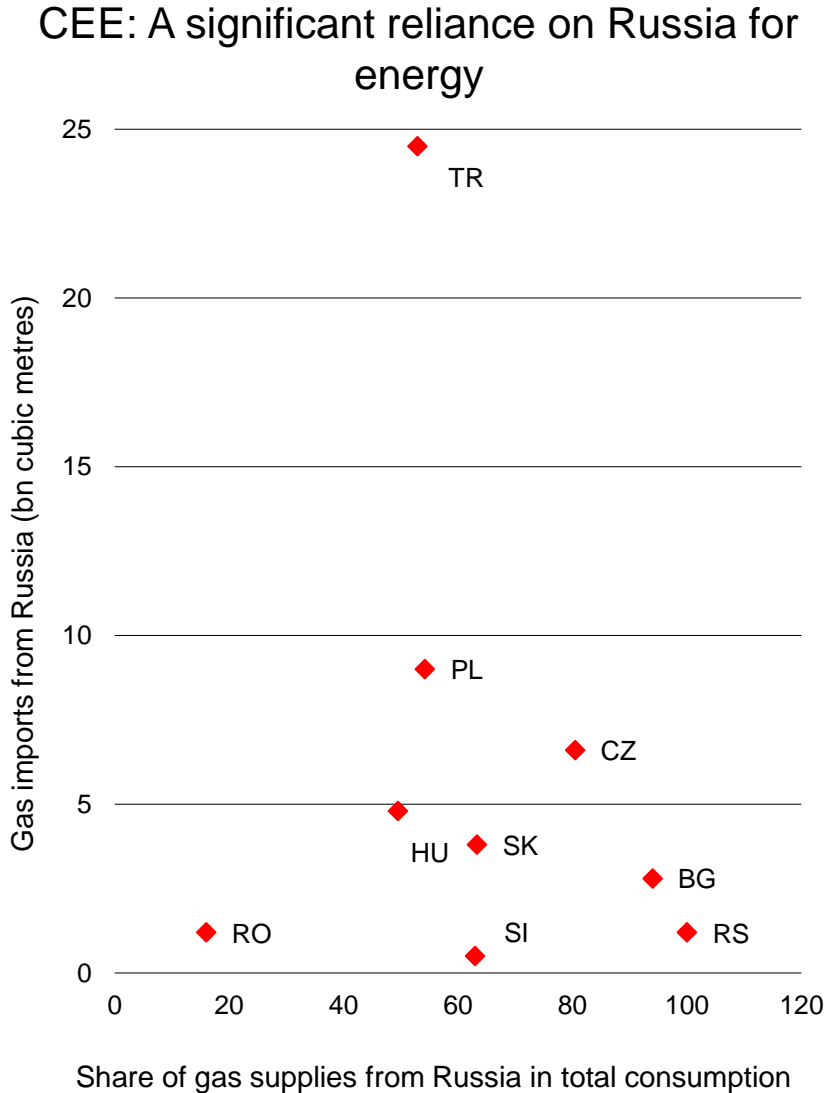
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Russia & Ukraine : A primary risk to CEE (I)

- The escalation of financial sanctions against Russia threatens economic activity and financial stability in the region. This risks forcing a more severe downward revision of our forecasts for CEE.
- The risk comes from a halt of gas exports by Russia. This would benefit neither East or West, but if it materialises CEE would be hit via 3 channels.
 - **Trade:** Excluding Romania, CEE countries import $\geq 50\%$ of all gas from Russia. A halt in exports from the region to Russia would neutralize a large part of the gains in exports to EMU, particularly for Central Europe and Turkey.
 - **Financial integration:** An escalation of tensions could put at risk investments by corporate Russia in CEE, which has accelerated in the past years (e.g. Southstream in Serbia, nuclear plant in Hungary).
 - **Portfolio outflows:** Global risk aversion would resume and generate the potential for significant round of portfolio outflows.
 - Turkey remains the most vulnerable...
 - ...but Central Europe is also at risk of seeing an acceleration in the pace of outflows from domestic bond markets

Russia & Ukraine : A primary risk to CEE (II)

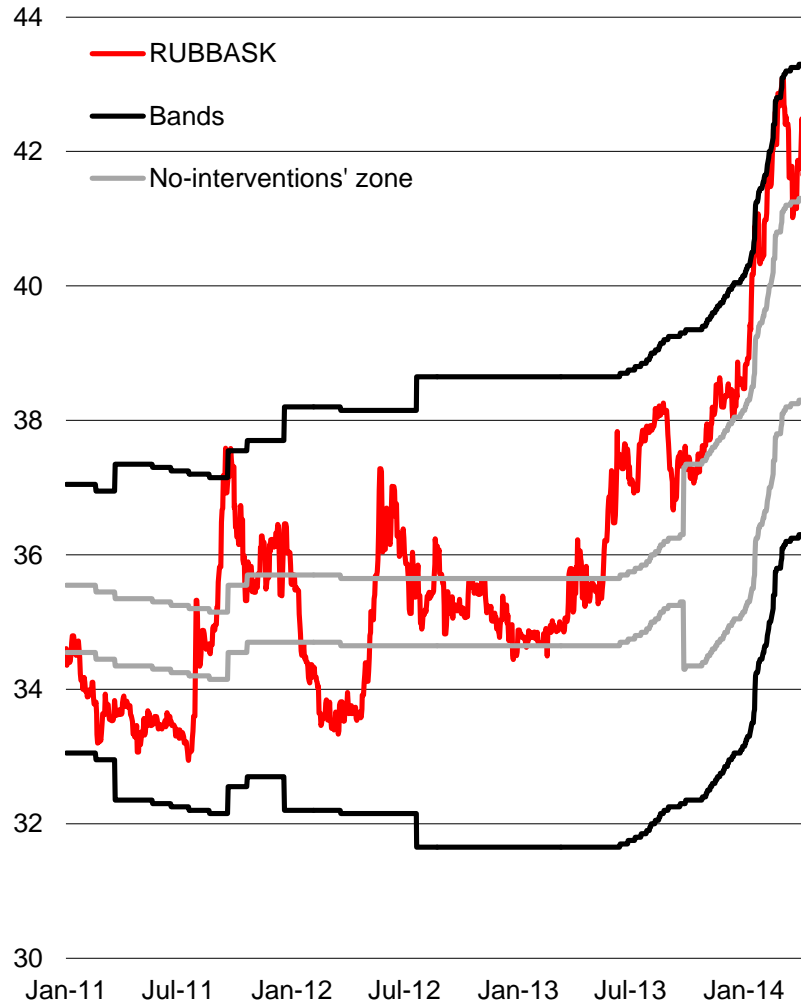


Russia : On the brink of recession (I)

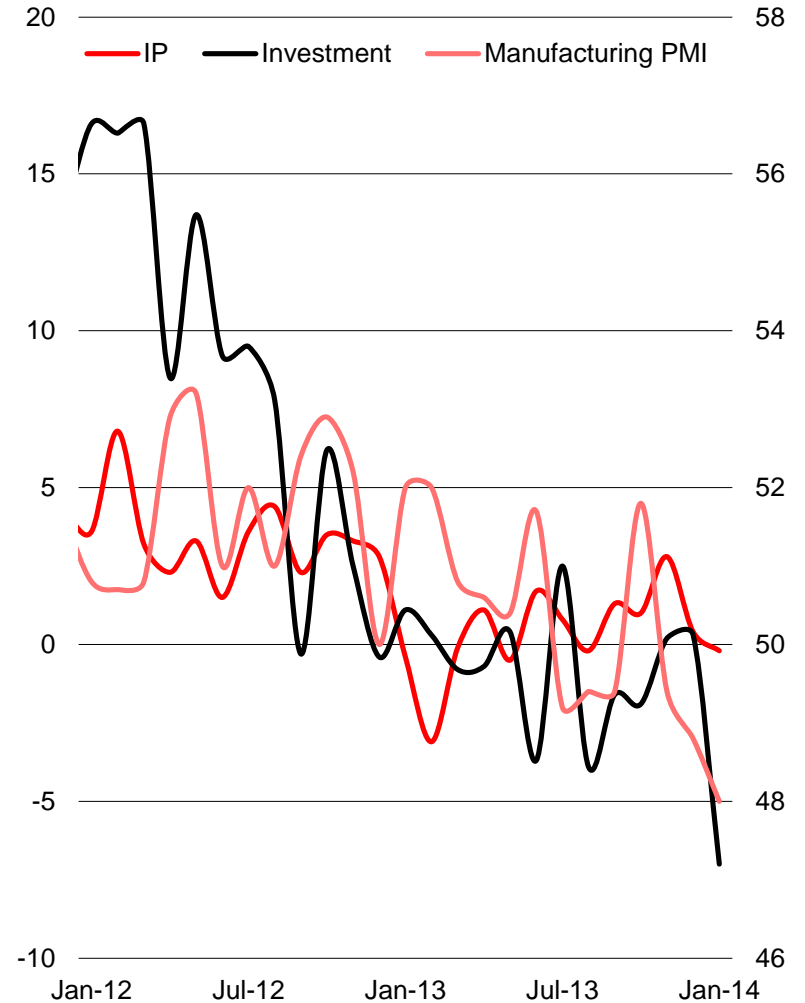
- GDP growth forecasts have been revised down for 2014-15, but are at risk of downward revision should sanctions by the West escalate further (2014F: 0.5% yoy; 2015F: 1.2% yoy).
 - Macro indicators have worsened...
 - IP remains at a standstill while manufacturing PMI is a clear underperformer across the region (March PMI at 47.8, lowest since May-09).
 - Fixed investments have slowed down and turned negative in January (-2.2 % yoy).
 - Consumer continues to outperform industry, but is experiencing a slowdown. Retail sales have slowed down, in line with the CBR measures to slow retail credit.
 - ...while RUB continues to depreciating in a high inflation environment.
 - RUB down 9.8% YTD despite strong FX interventions (USD 40bn).
 - Inflation remains well above target despite 200bp in rate hikes by the CBR (March inflation at 6.9% yoy, 2pp above target).
-

Russia : On the brink of recession (II)

The RUB remains fundamentally weak despite strong FX interventions...



...as the economy continues its structural slowdown



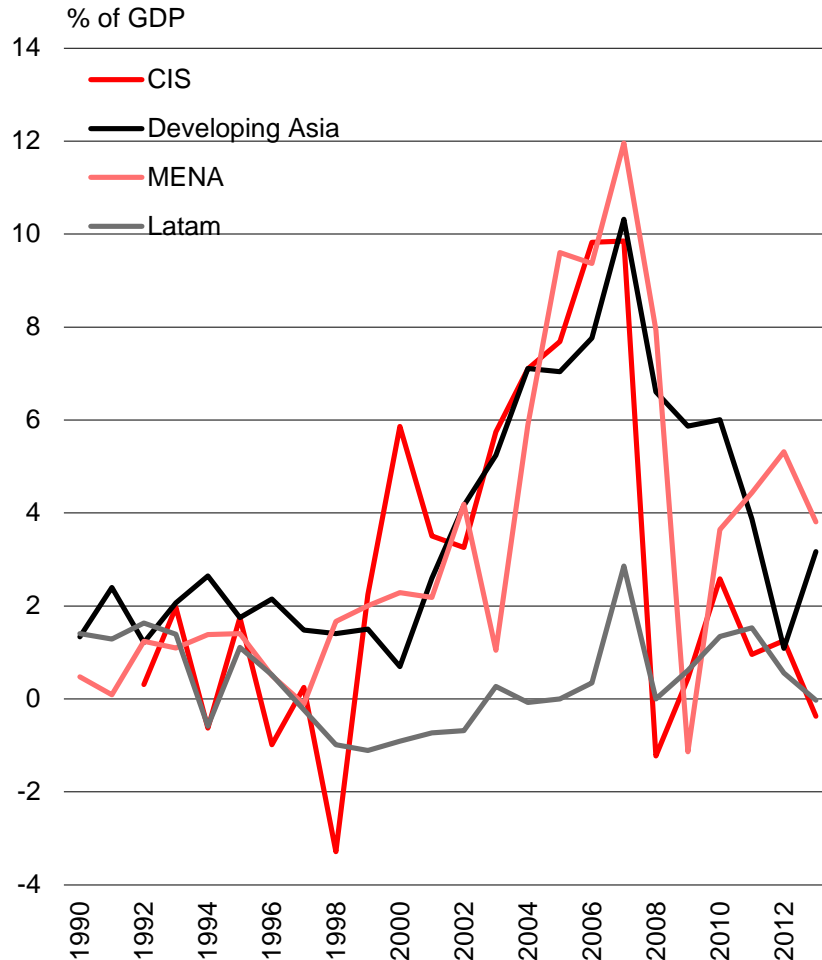
Sources: Rosstat, CBR, UniCredit Research

Russia : Financial conditions are deteriorating (I)

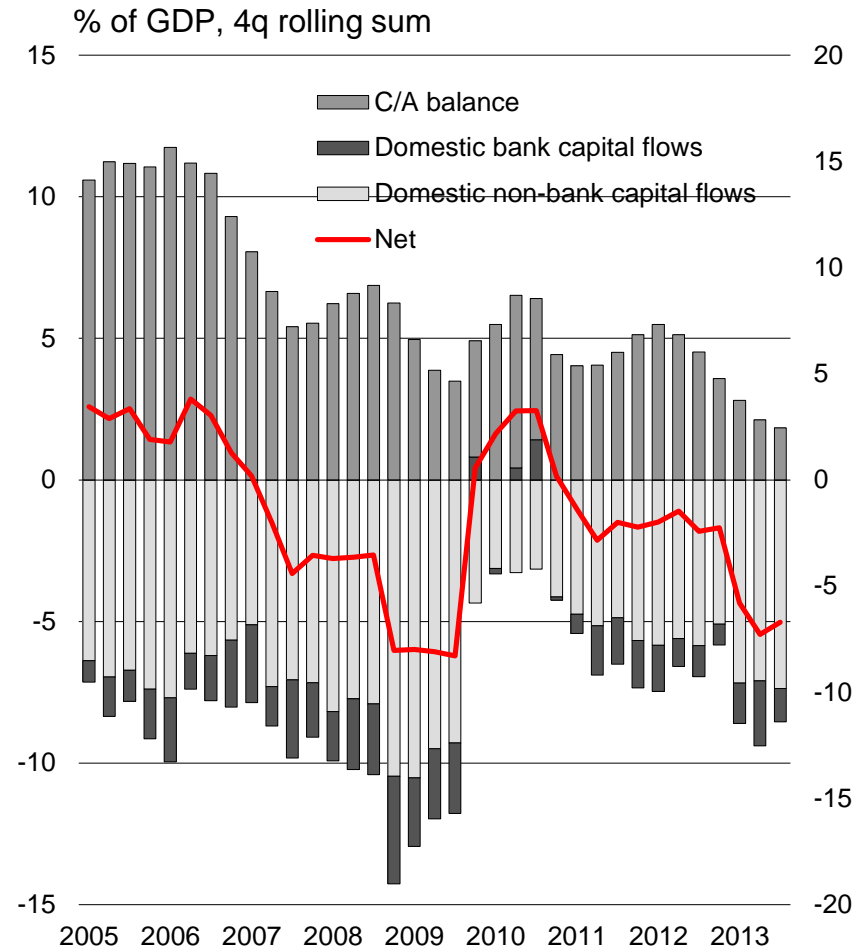
- Portfolio outflows from Russia are accelerating at a rapid pace, and at risk dampening growth further.
 - Private capital outflows in 1Q14 reached USD 60bn (vs. MinFin FY14 forecast of USD 35bn).
- Domestic household deposit conversion of RUB deposits into FX is at risk of accelerating, in line with historical periods of stress...
- ...while FX reserve accumulation by the CBR has seen the steepest reversal within EM since 2008, and has now turned negative in Russia.
- Reliance on foreign capital is large at a time where external funding is turning its back to Russia...
 - The economy as a whole is facing USD 166bn of external debt coming due in the next 24 months.
 - Russian corporates remain absent from external markets while facing USD 130bn of external debt (principal) due before end-1Q15 (o/w banks USD 50bn, corporates USD 78bn).

Russia : Financial conditions are deteriorating (II)

FX reserve accumulation: CIS has seen a larger shift than elsewhere...



...while Russia's C/A surplus is at all-time lows and capital outflows are accelerating



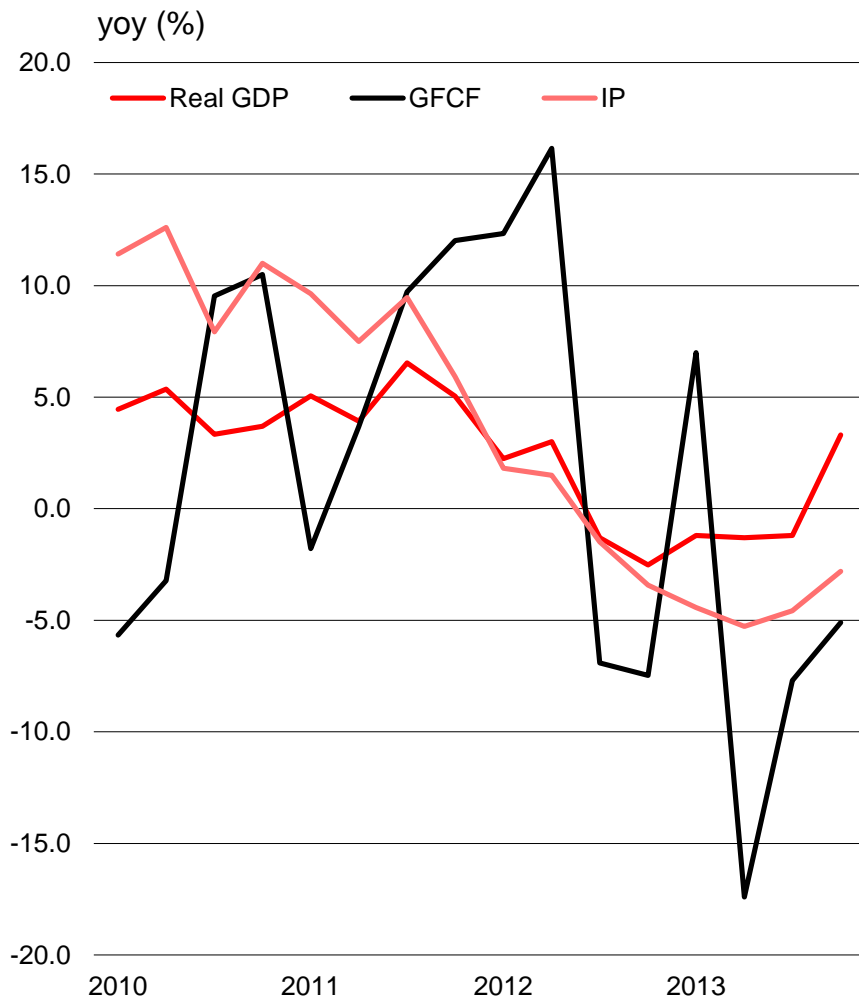
Sources: Rosstat, UniCredit Research

Ukraine : Time for change

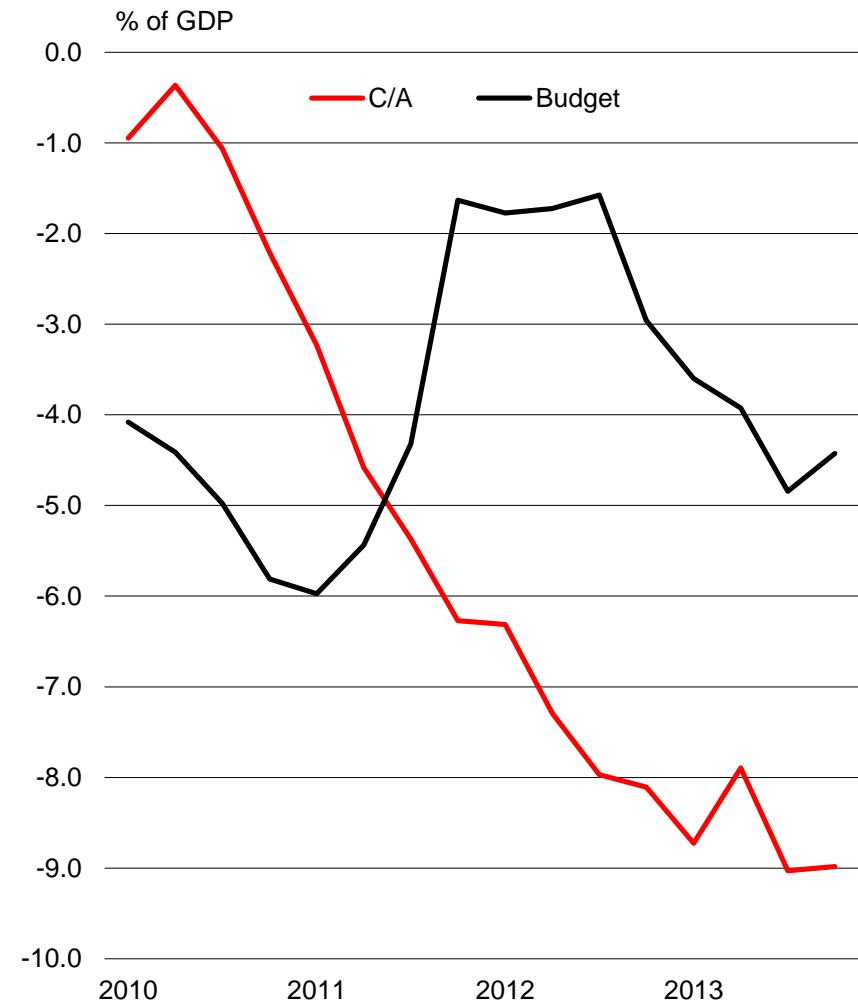
- Economic activity is expected to take a severe hit this year even under a benign scenario where tensions with Russia do not escalate further.
 - GDP contraction in 2014 projected at 6% (vs. MinFin forecast of 3%)
 - Adherence to an IMF Programme and the EU's DCFTA is also assumed, but will require advancement on three fronts:
 - FX: The IMF has long favoured a flexible currency. YTD depreciation is a step forward (40% drop YTD), but we expect the IMF to push for further UAH depreciation to aid adjustment.
 - Fiscal policy: Budget deficit to likely to widen to at least 8% of GDP if the shortfall for Nafto and other arrears are included. Public debt expected to widen by 20pp to 60% of GDP this year.
 - Banking sector: There is a need of a thorough stress test of the banking system as NPLs are reported in double digits while 1/3 of all loans are in FX.
 - Financing needs have increased considerably (funding gap for an IMF deal estimated at USD 41bn until end-2015), particularly after Gazprom's gas price hike and request for immediate gas repayments (total cost USD 3bn).
-

Ukraine : An exceptionally weak macro backdrop

A weak starting point for activity...



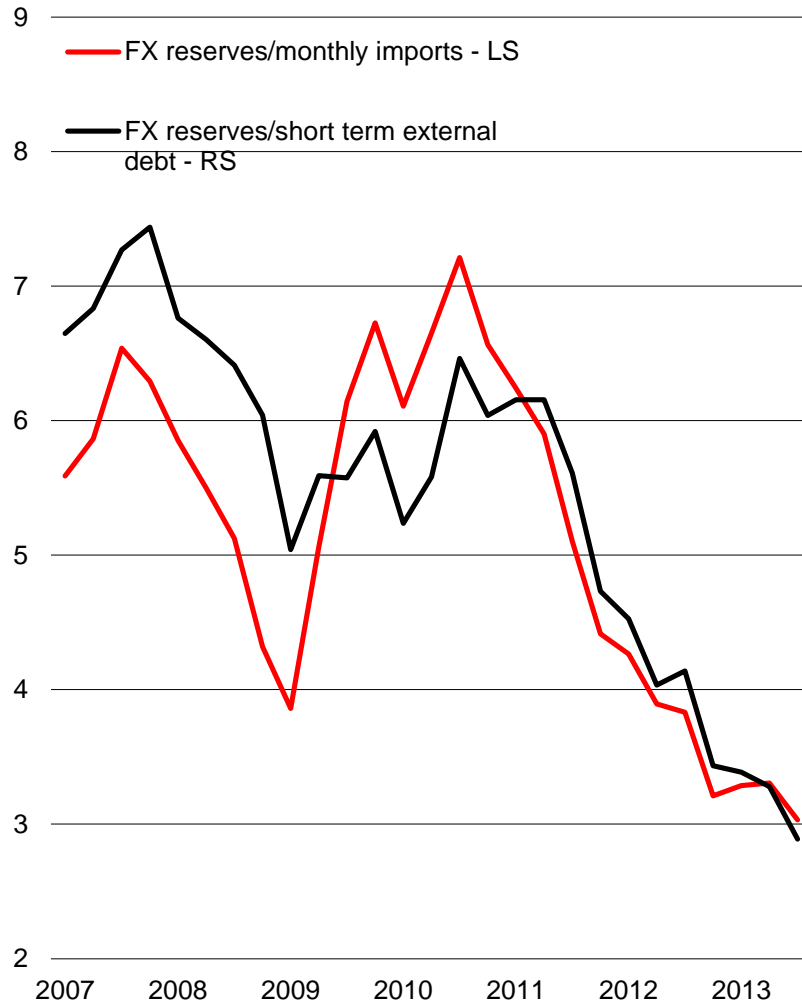
...amidst wide twin deficits



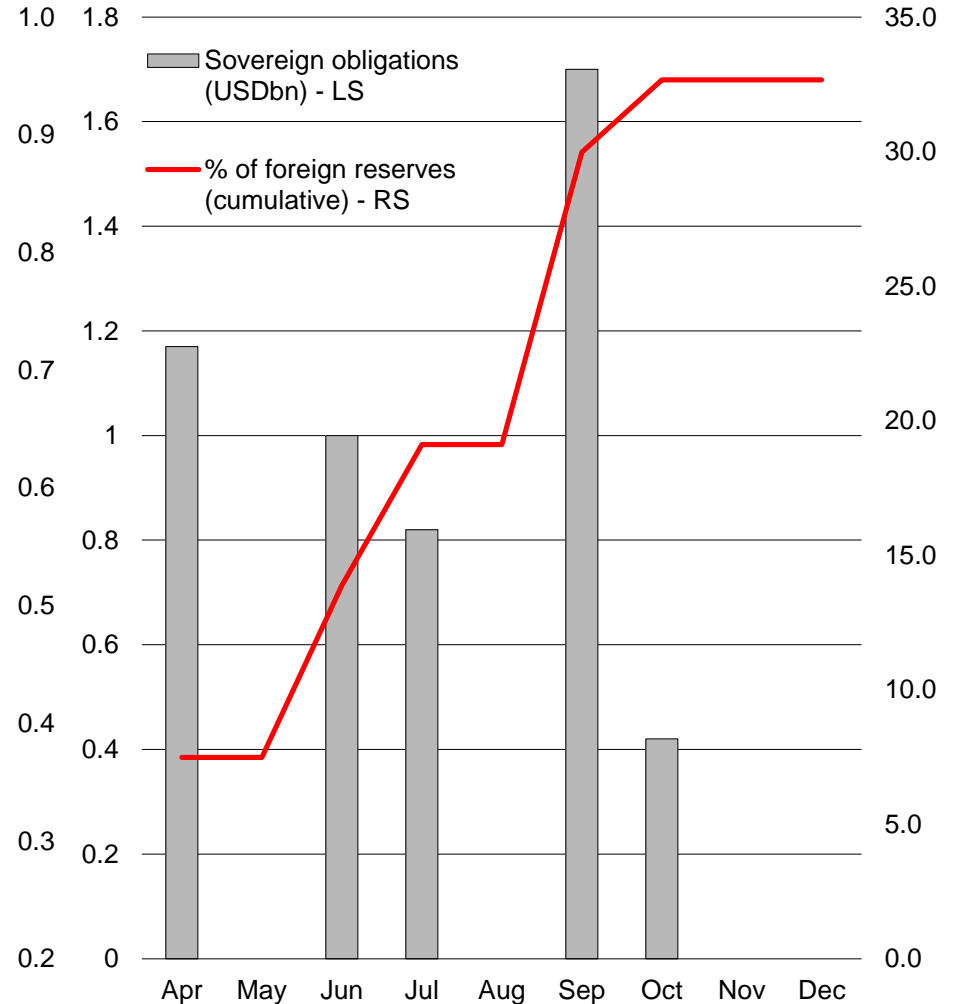
Sources: NBU, National Statistics Office, UniCredit Research

Ukraine : External financing challenges are significant

FX reserves have fallen to unmanageably low levels...



...and face further declines ahead



Sources: NBU, IMF, Bloomberg, UniCredit Research

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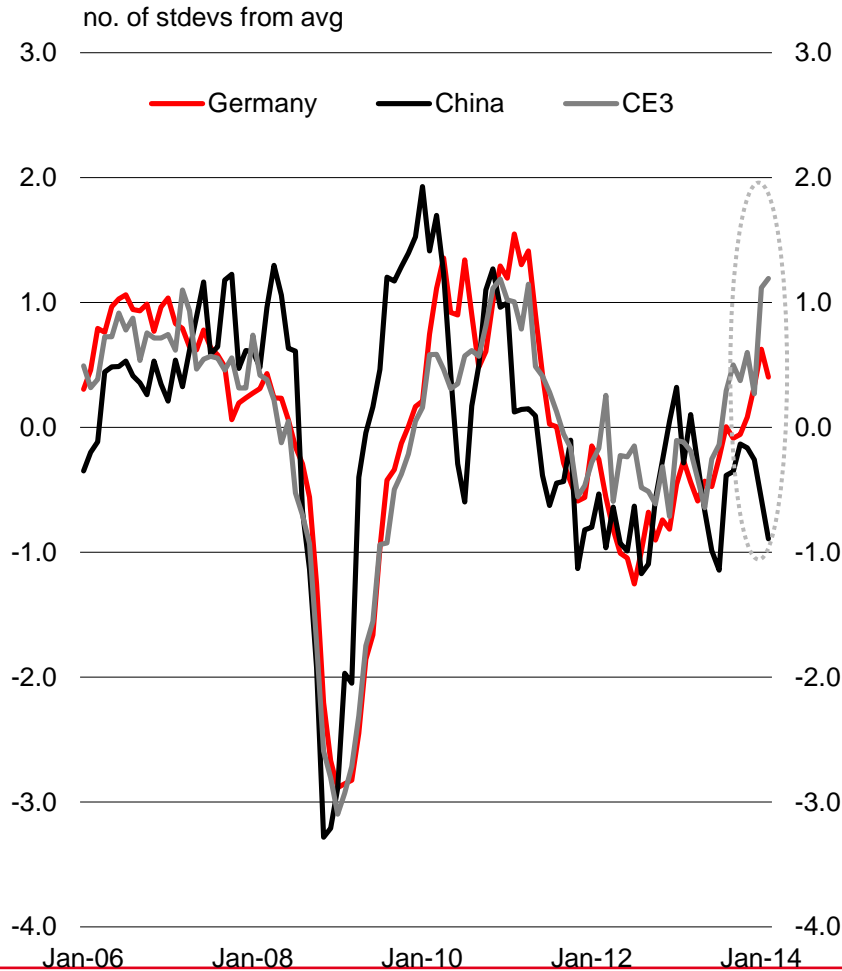
Central Europe: Recovery Underway (I)

- Industry and external demand remain central to the improvement in economic activity
 - Momentum captured in manufacturing PMIs (in contrast with other EM regions)
 - IFO export expectations and,
 - The European Commission's survey showing strong export orders' volumes.

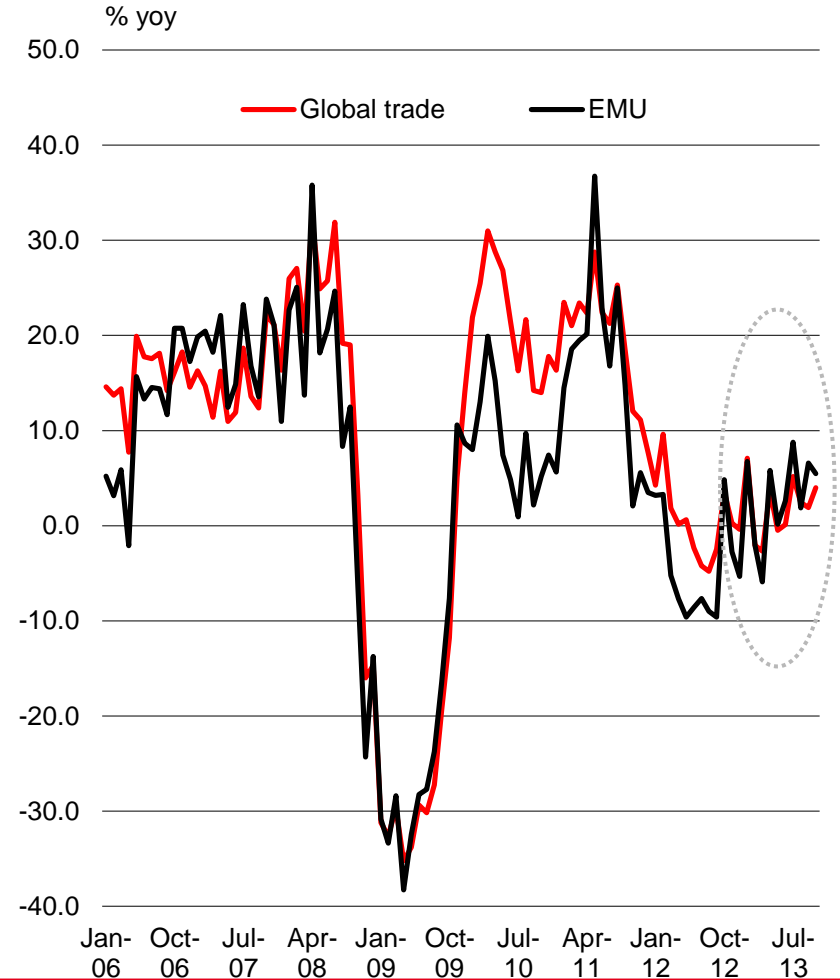
- The recovery is visibly spilling over into domestic demand and should continue to do so...
 - The drag from a multi-year period of fiscal consolidation is easing
 - In some countries the fiscal impulse has turned positive (e.g. HU)
 - Below target inflation in many countries helps to boost consumer purchasing power
 - Unemployment has stabilised and in some countries is ticking downwards

Central Europe: Recovery Underway (II)

Industry is supporting a recovery in activity



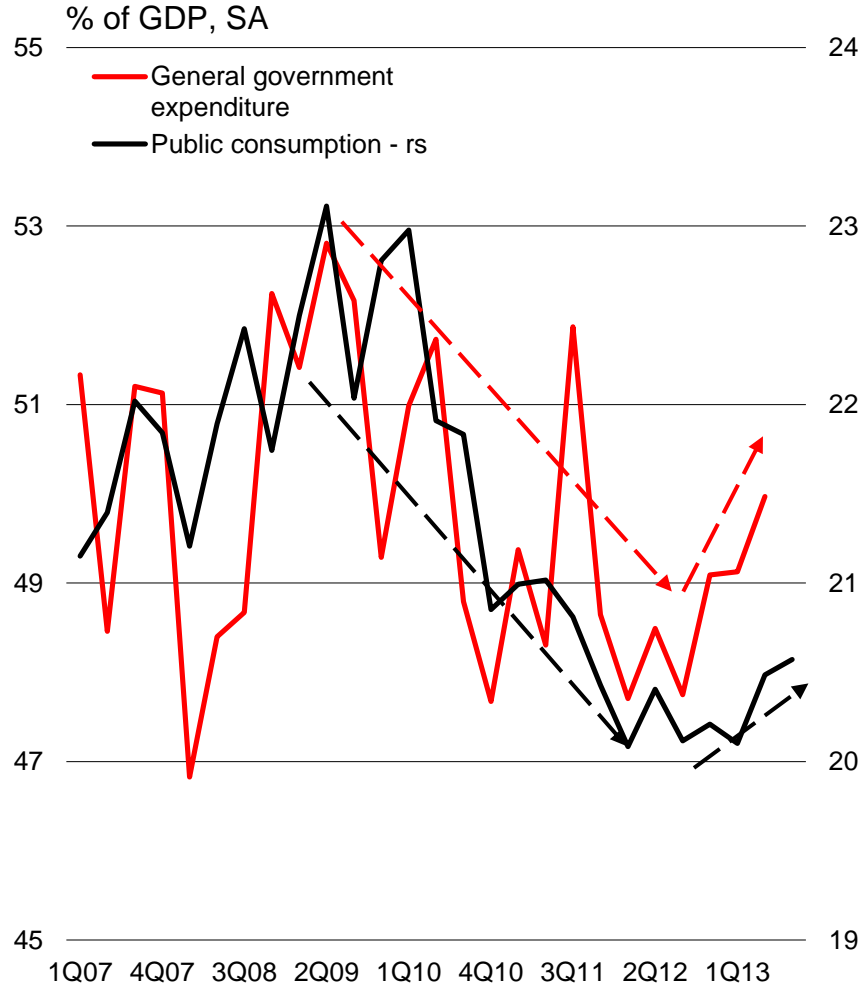
Global trade: Recovering to a lower equilibrium growth rate



Sources: National Ministries of Finance, EC, UniCredit Research

Hungary: Good growth momentum, public finance under pressure

Government expenditure is up again to offset weak private investment...



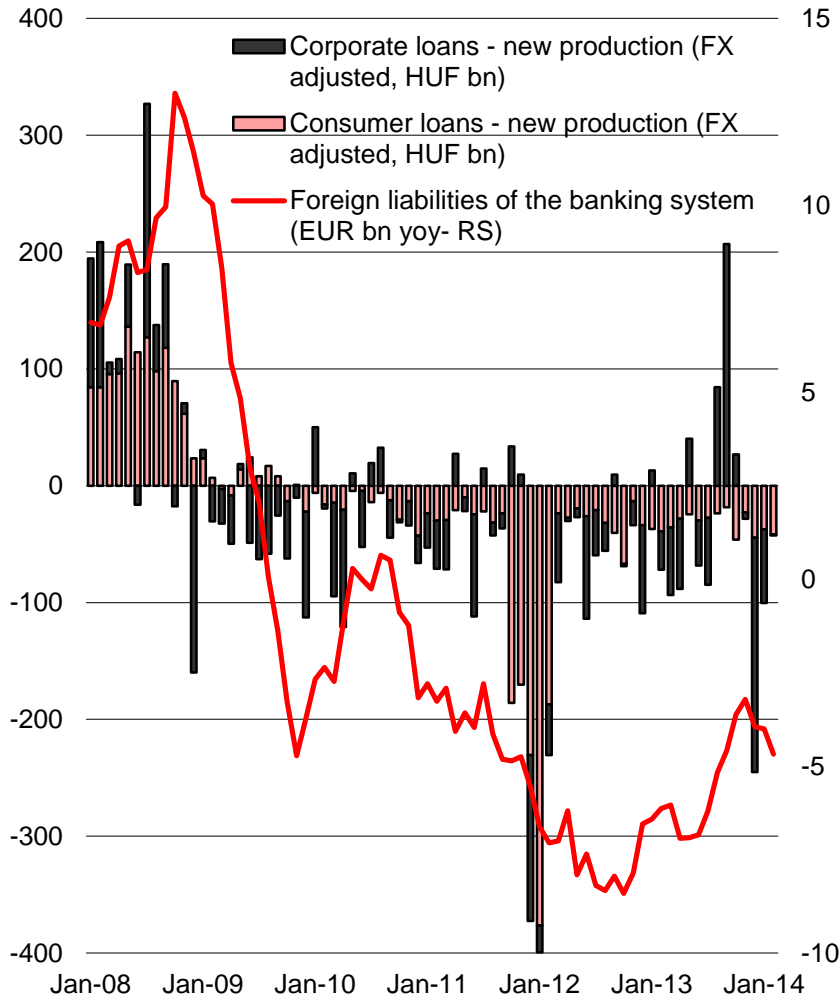
...but the sovereign faces sizeable redemptions in 2014 and 2015



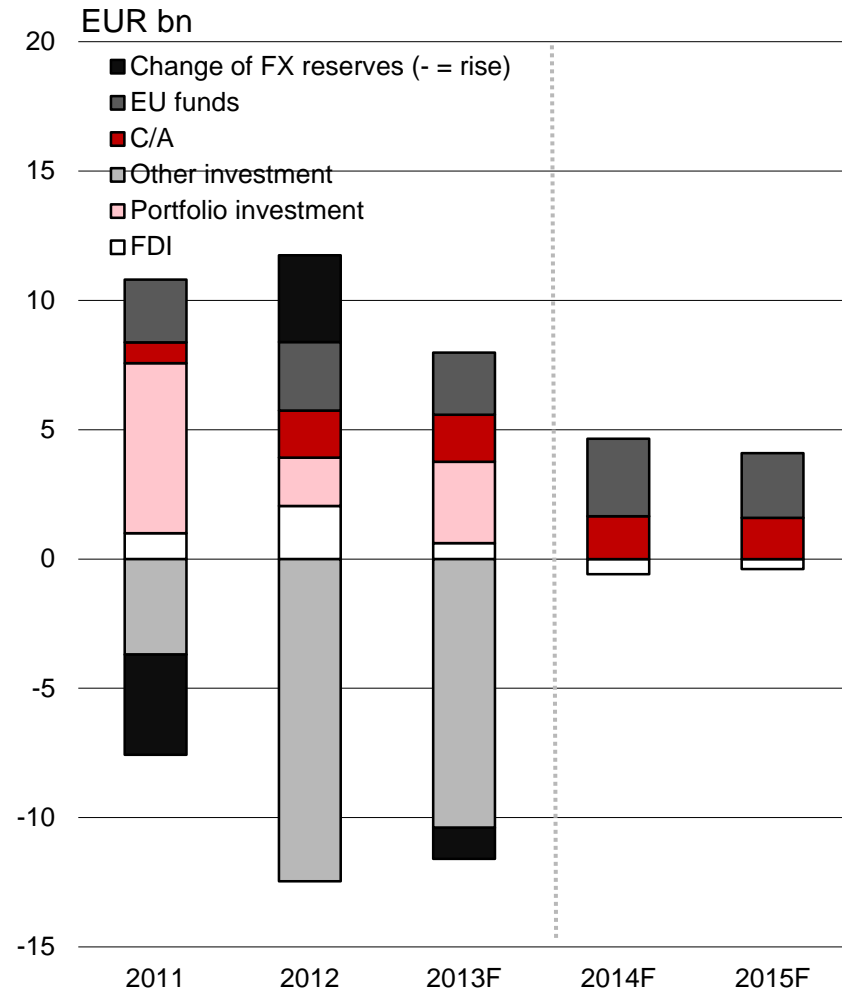
Sources: NBH, MinFln, UniCredit Research

Hungary: Private sector deleveraging continues

Bank outflows continue amid a contraction of credit...



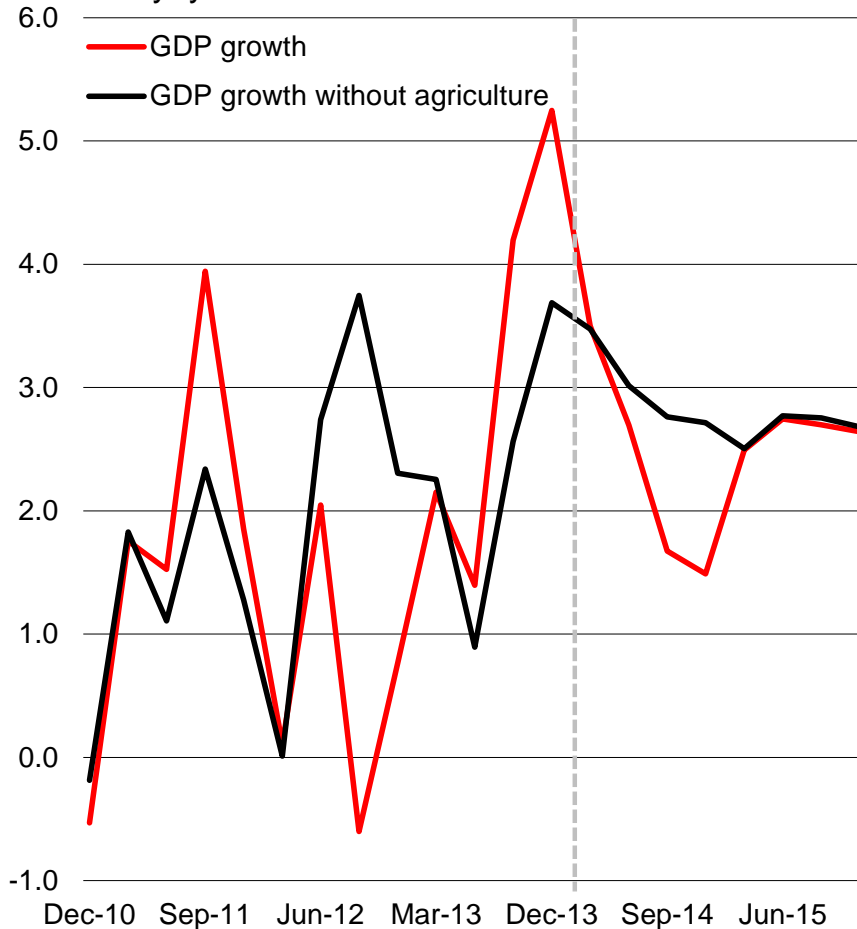
...but EU funds are keeping C/A funding manageable



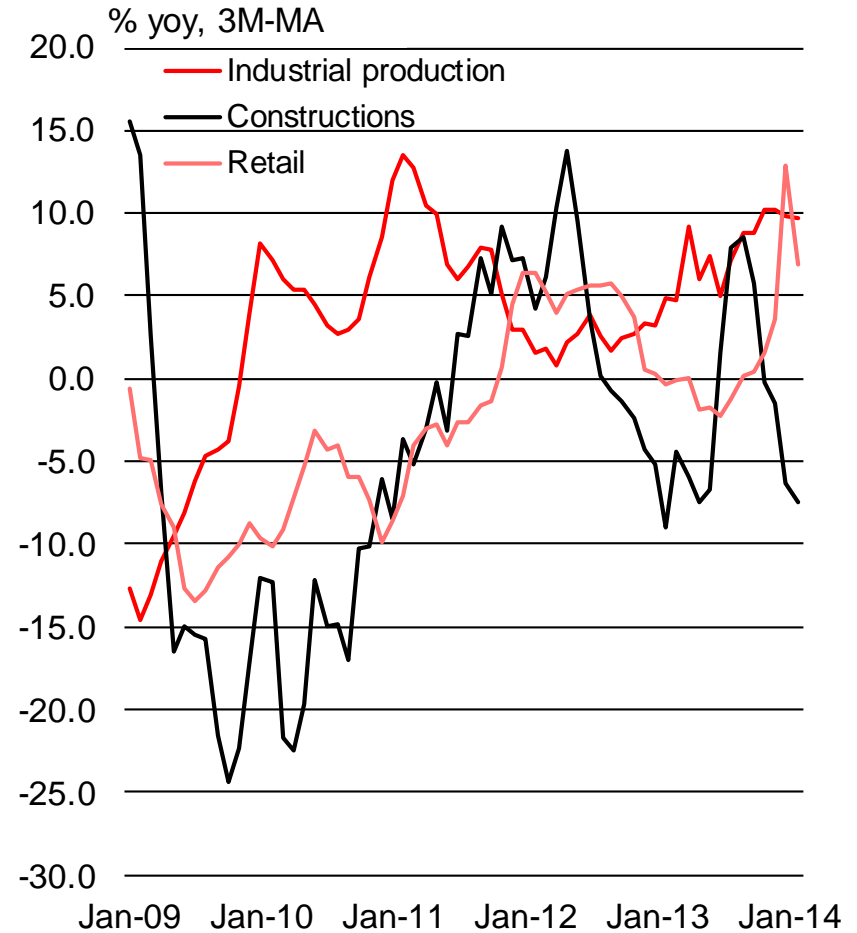
Sources: NBH, MinFin, MinFin, UniCredit Research

Romania: GDP growth – looking for a broader base

GDP growth without agriculture could accelerate to 2.7% yoy in 2014 and 2.8% yoy in 2015 from 2.4% yoy in 2013



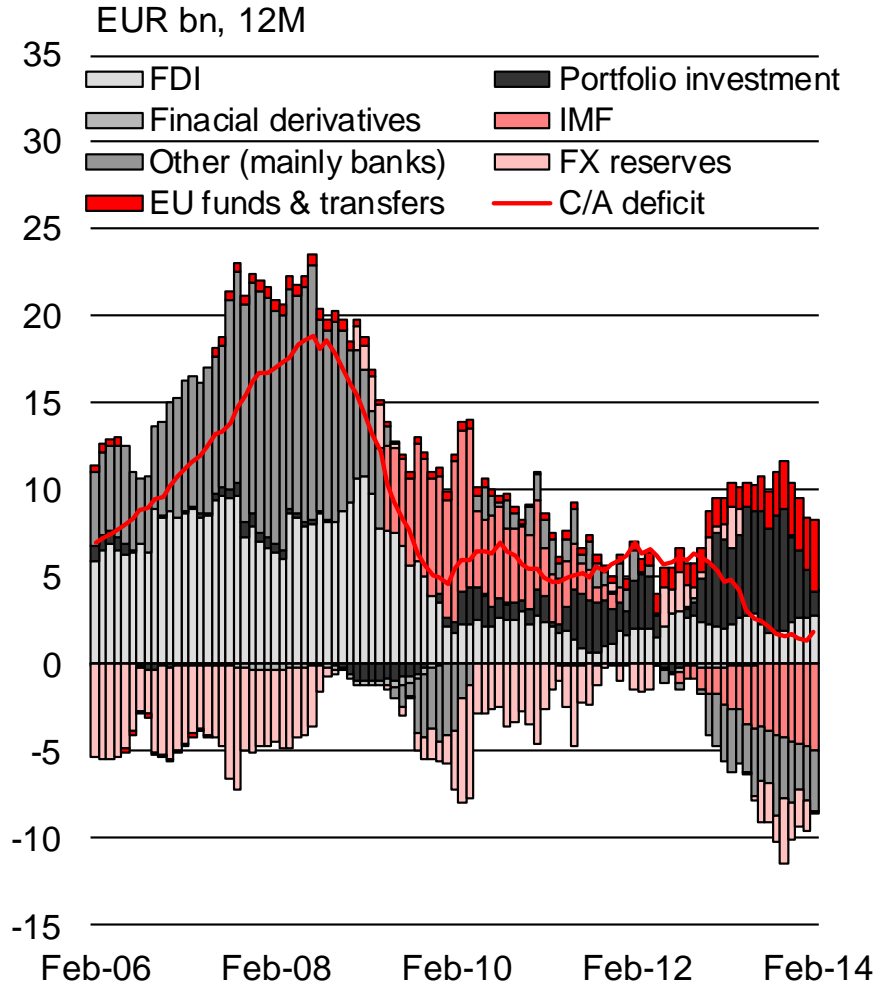
No underlying growth for domestic demand outside public spending and exports



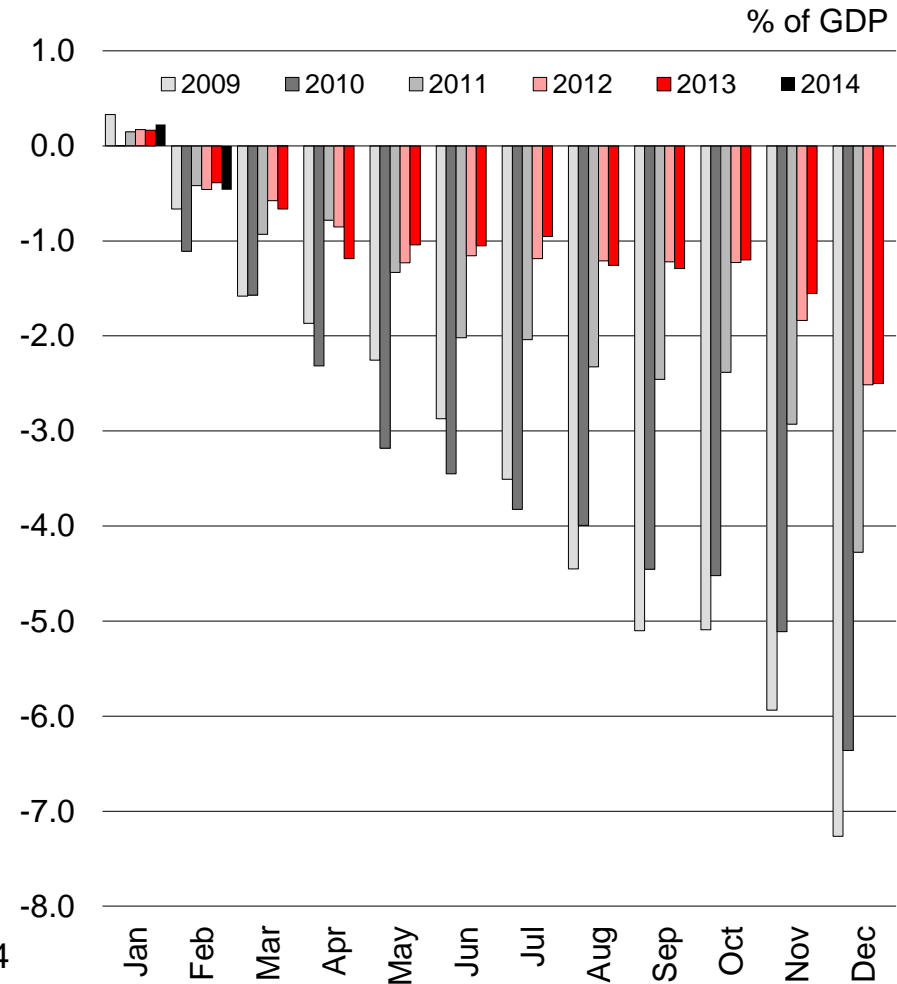
Sources: BNR, INS, Eurostat, UniCredit Research

Romania: Past imbalances have been addressed

EU fund inflows accelerate, reducing the reliance on portfolio investment



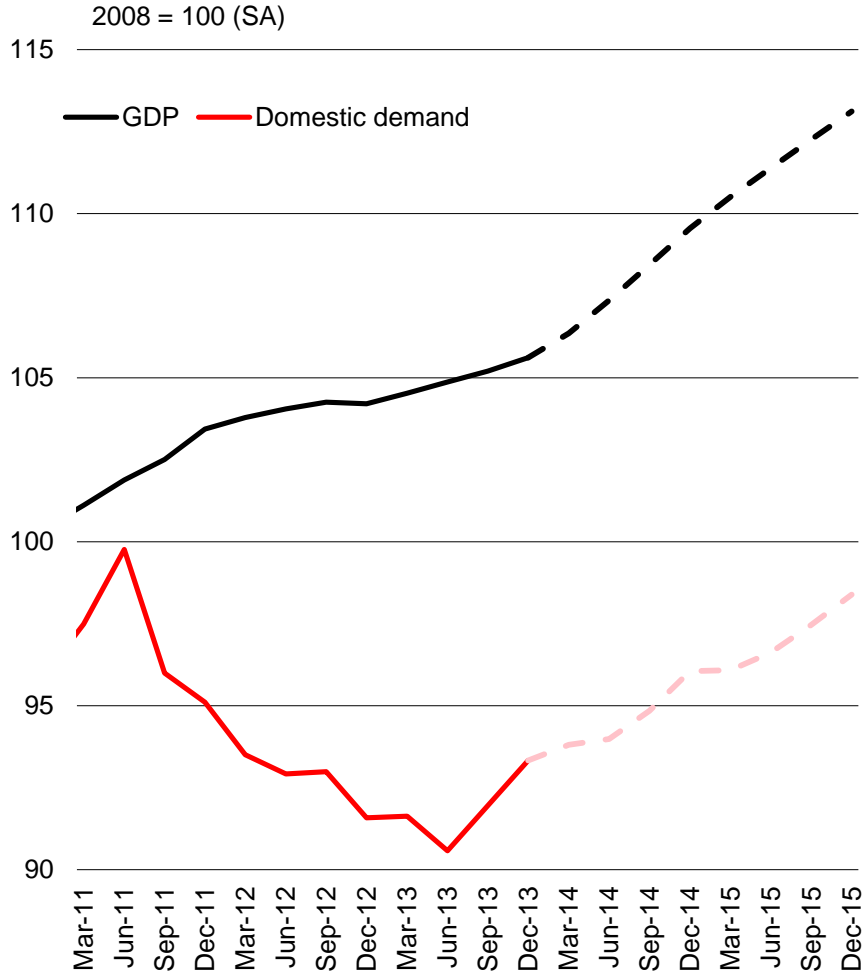
The budget deficit is well below 3% of GDP



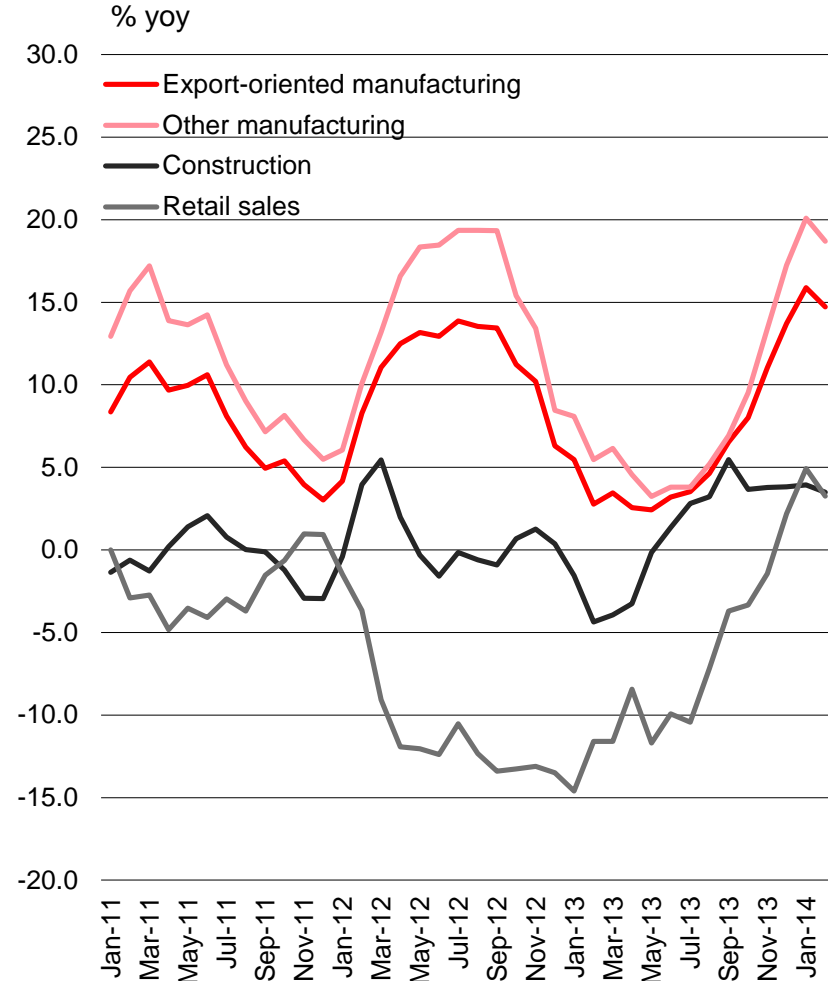
Sources: BNR, INS, Eurostat, UniCredit Research

Slovakia: Domestic demand weak, growth driven by external demand

GDP driven by net exports, while domestic demand lagging behind



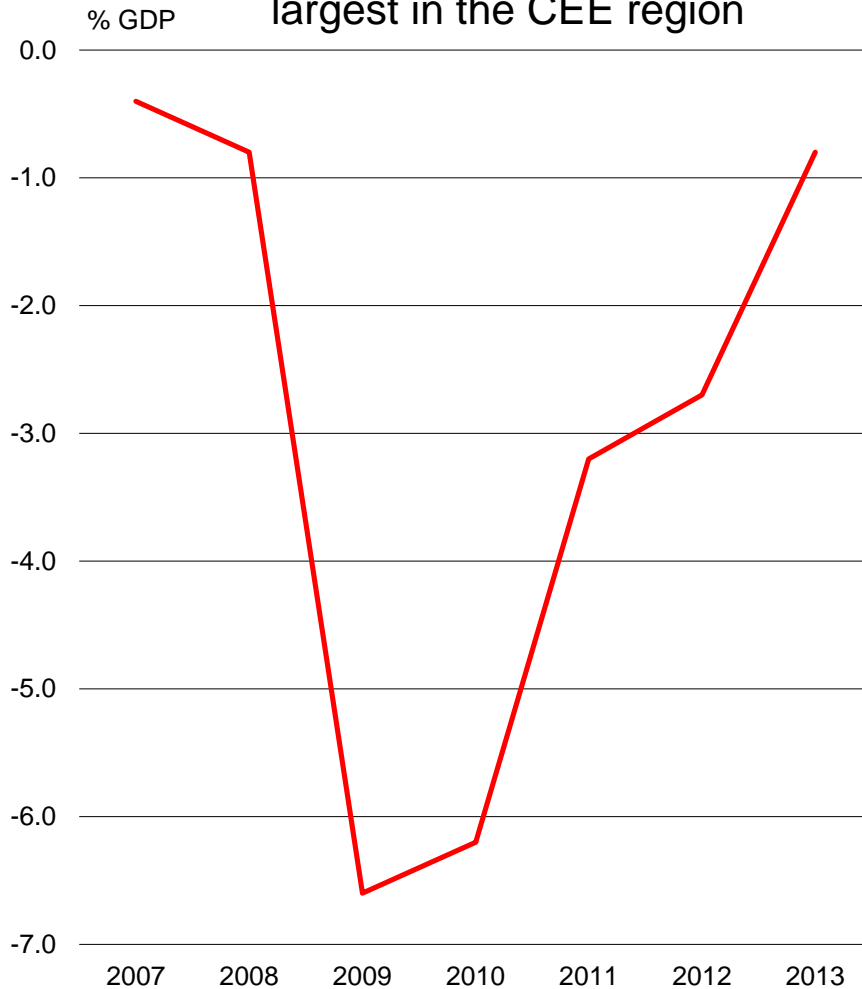
Export-oriented manufacturing only underlying growth driver in economy



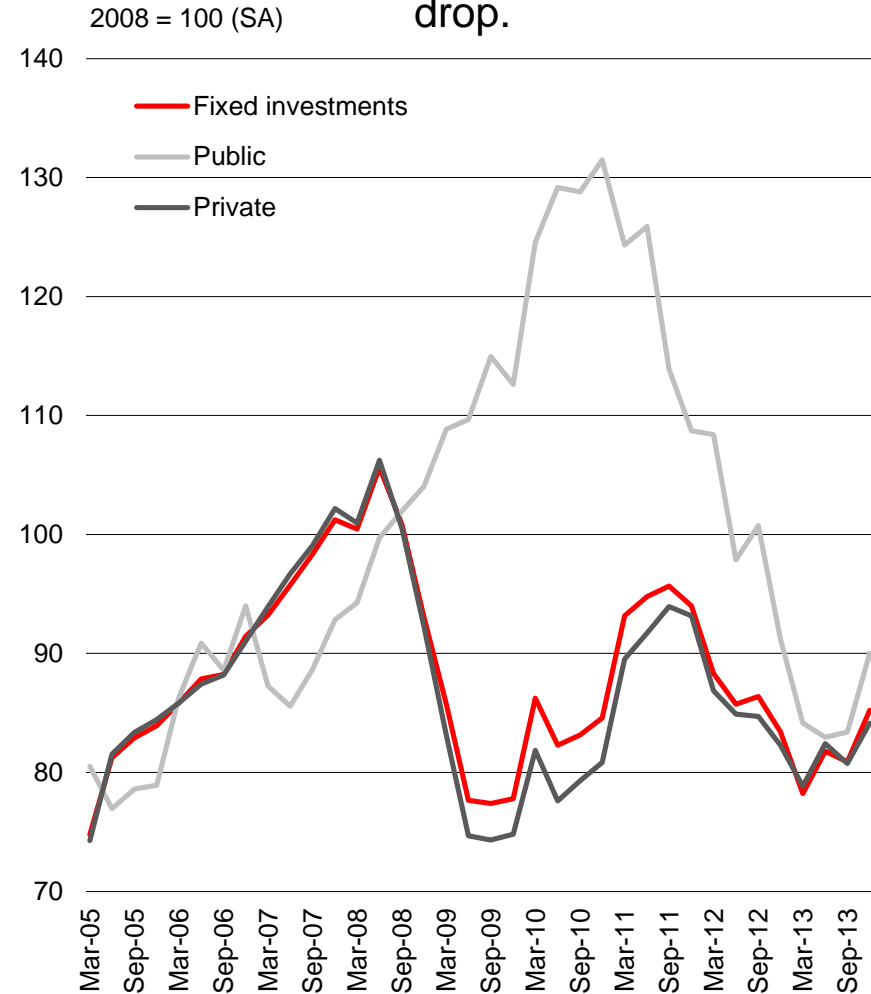
Sources: Statistical Office SR, UniCredit Research

Slovakia: Public debt on rise, fiscal tightening to continue

Primary deficit has narrowed and already touched pre-crisis levels, but remains 4th largest in the CEE region



Low industrial confidence and fiscal tightening responsible for investment drop.



Sources: Statistical Office SR, UniCredit Research

Topics

- Brief outlook for the global economy
- CEE – impact from higher growth on developed markets
- CEE and the interest rate normalisation process
- Country specifics
 - Russia & Ukraine: A primary risk to CEE
 - Central Europe: Recovery underway (HU, RO, SK)
 - The Balkans: More work to be done (SI, RS, HR, BG)

The Balkans: More work to be done (I)

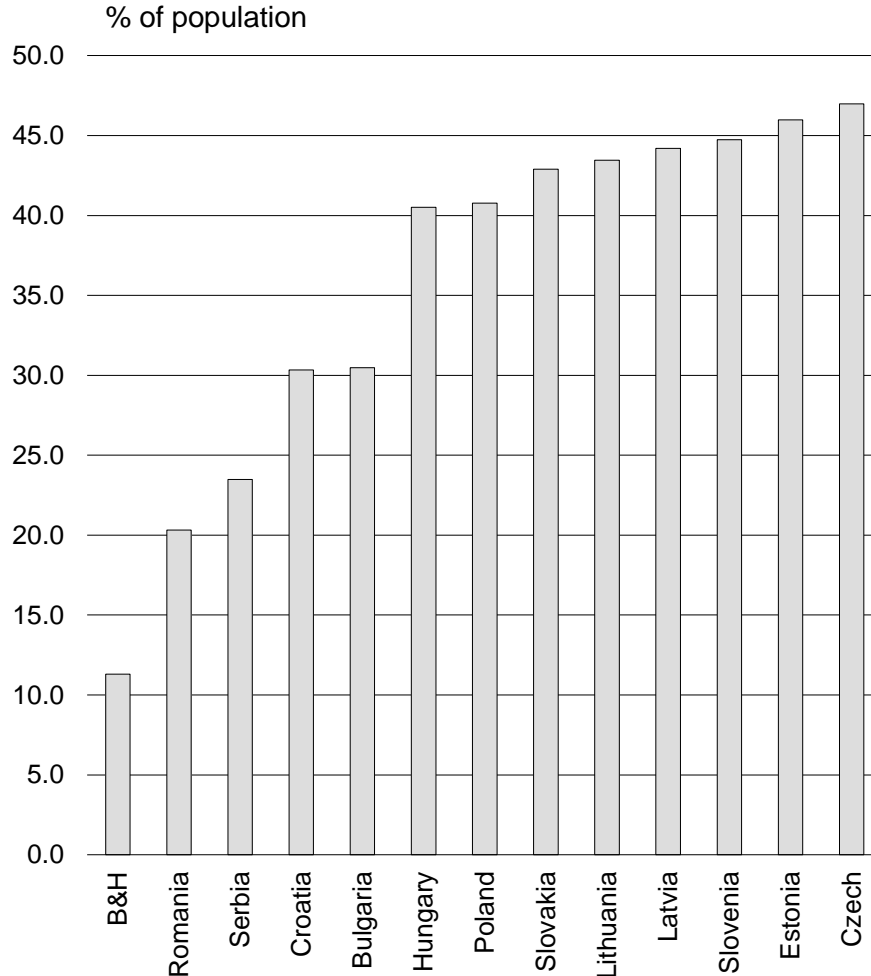
- Growth within the Balkans continues to lag Central Europe
 - Croatia and Slovenia fail to show GDP gains.
 - In Bulgaria and Serbia momentum is improving, but growth below 2% this year (Central Europe: 2.5%).

 - With the exception of Bulgaria, there is a strong need for fiscal consolidation
 - Serbia's public debt has doubled since 2008, while this year's budget deficit is set to remain at 7% of GDP. IMF deal remains crucial.
 - Croatia has entered EDP, forcing authorities to pass fiscal consolidation but these measures were largely revenue-based.
 - Banking sector recaps in Slovenia have soared public debt, while suspension of the real state tax risks augmenting the deficit further.

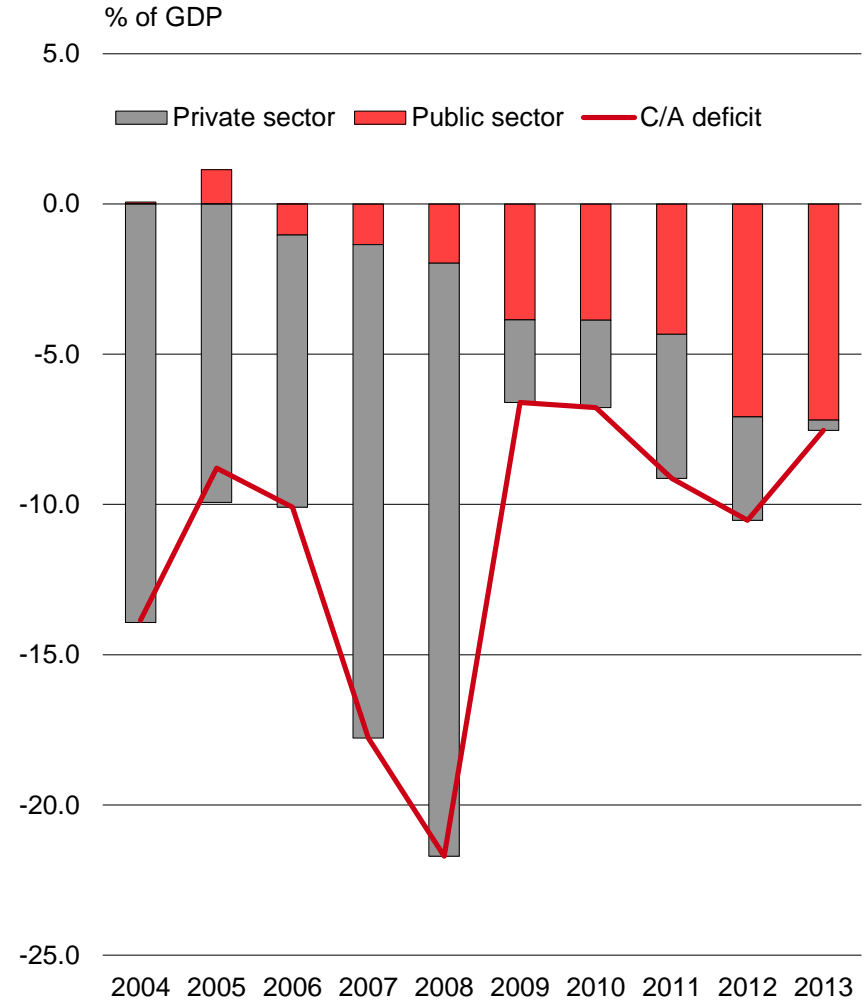
 - Besides the high level of public expenditure, employment levels are at region lows.
 - Bosnia & Herzegovina ≈10%; Croatia and Bulgaria ≈30%
-

The Balkans: More work to be done (II)

The labour market: An obvious source of much needed structural growth



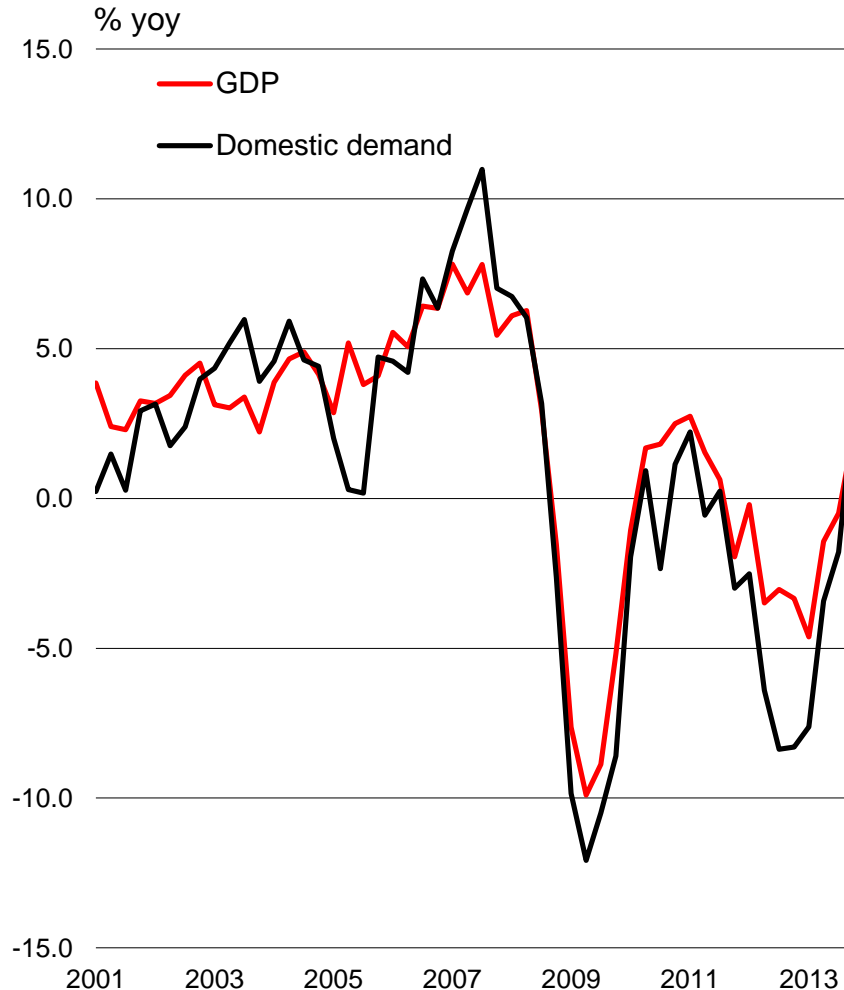
Serbia: Public sector crowds out private sector



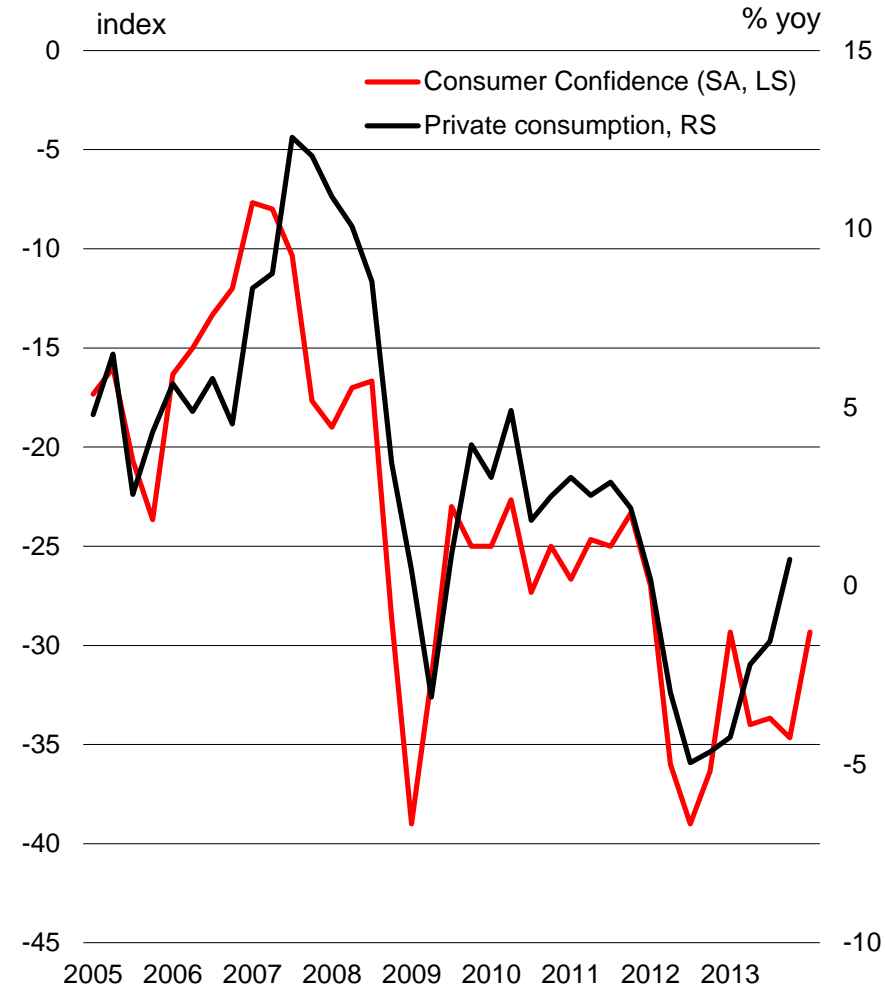
Sources: National Ministries of Finance, UniCredit Research

Slovenia: Economic activity is slowly catching-up

Domestic demand is showing signs of recovery ...



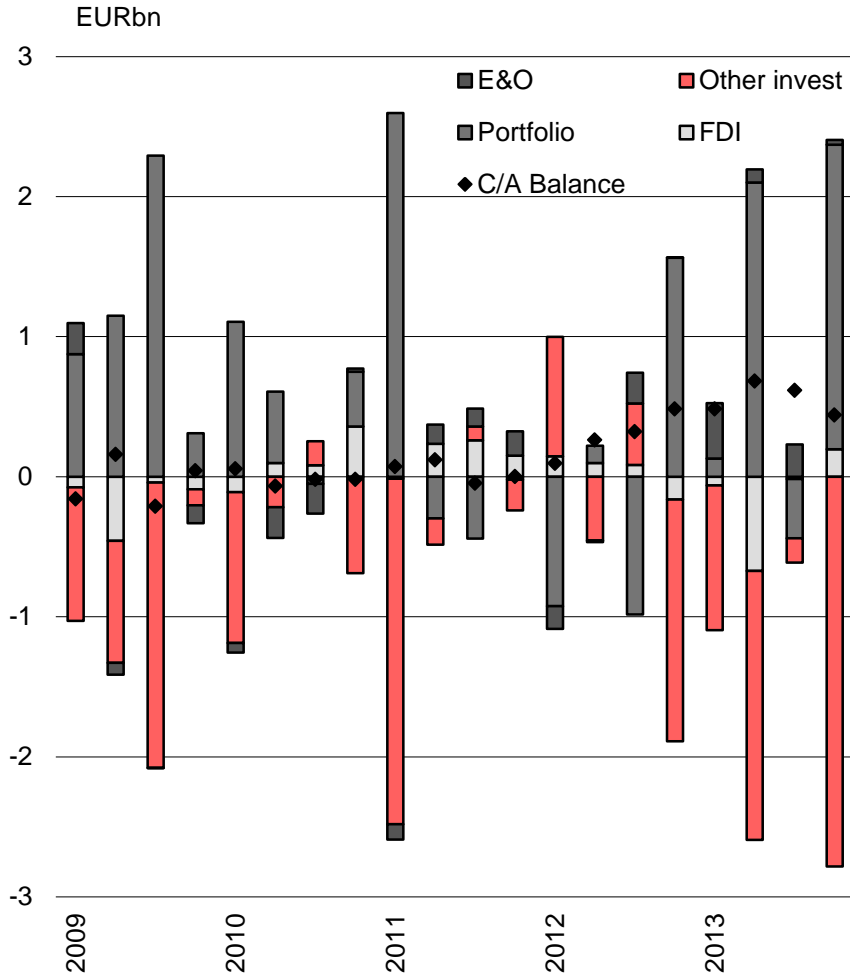
... on the back of improving consumer confidence and private consumption



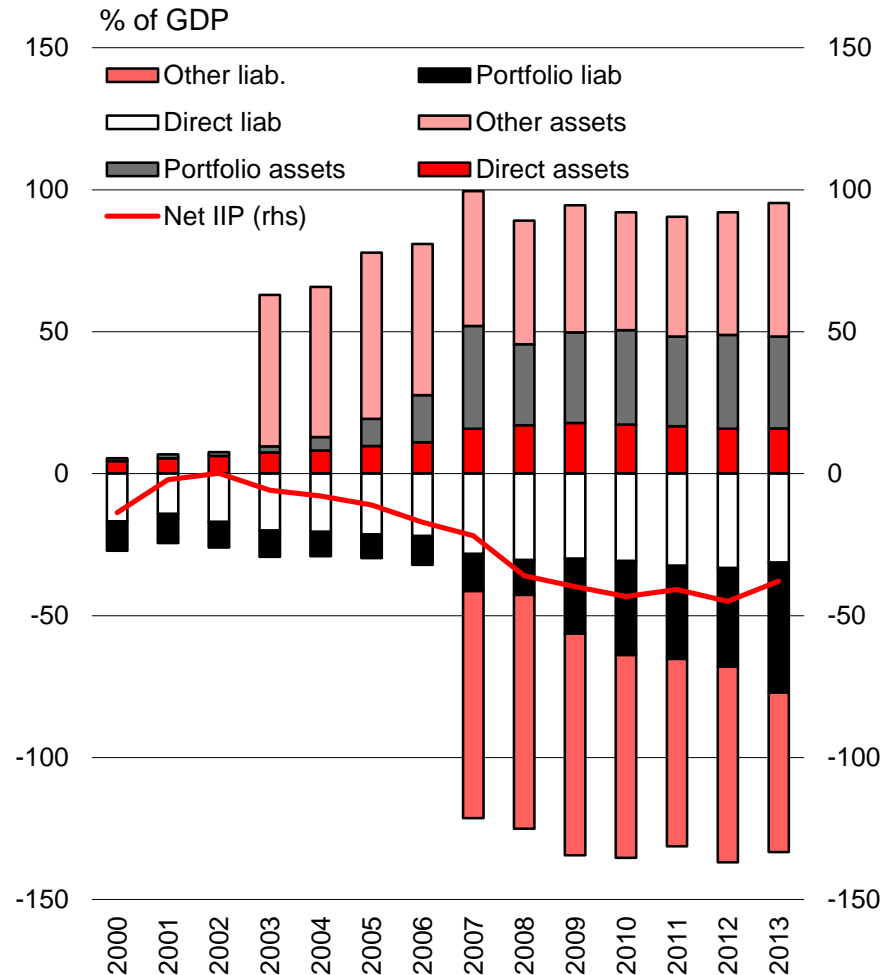
Sources: MinFlin, NBS, UniCredit Research

Slovenia: External imbalances are not severe

Strong portfolio flows are keeping C/A funding manageable



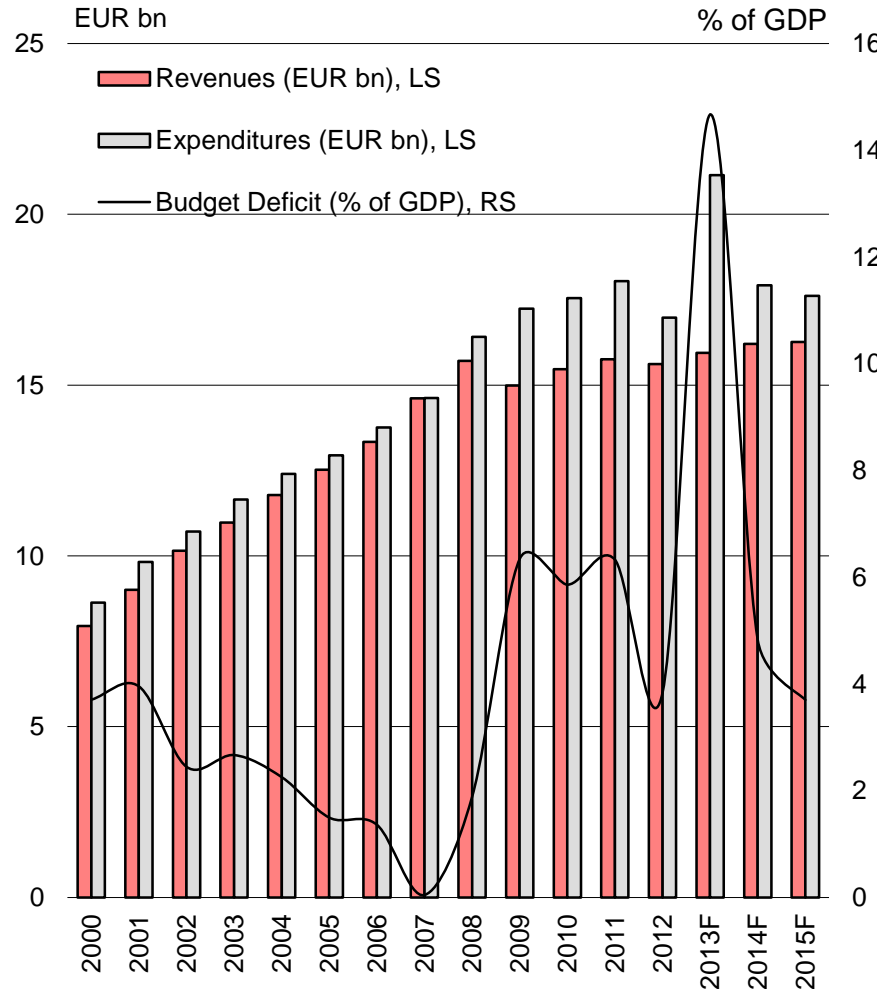
...while Slovenia's negative IIP trend is reverting



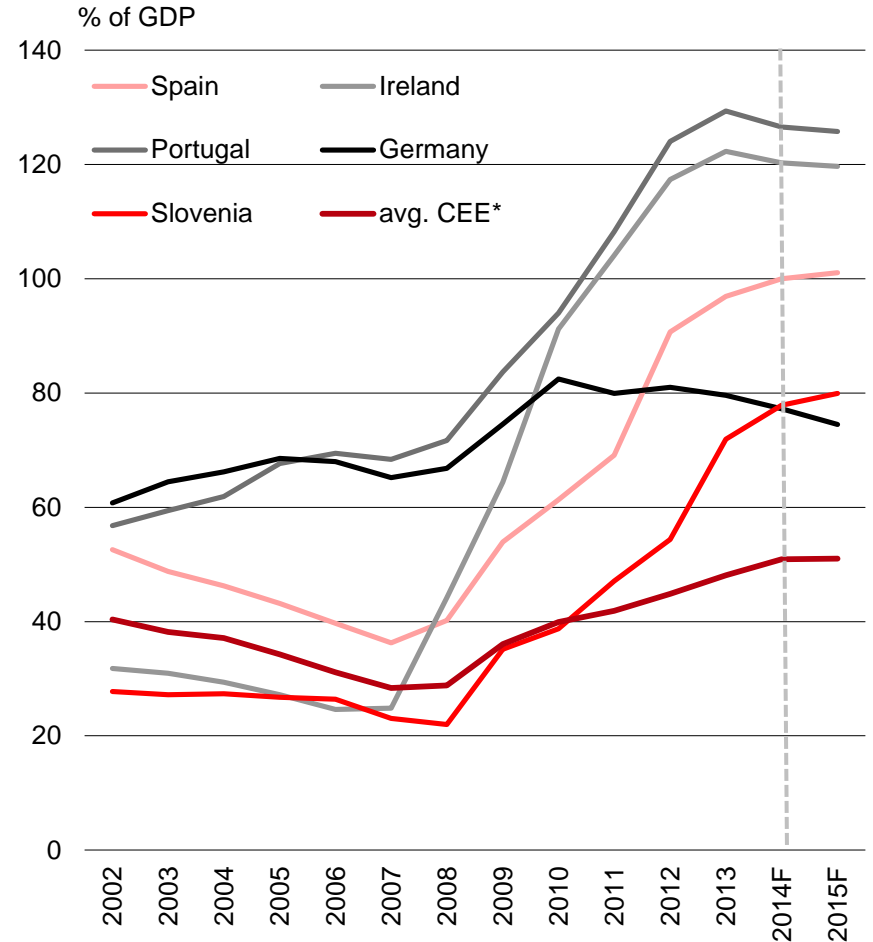
Sources: MinFin, NBS, UniCredit Research

Slovenia: Public finances are in need of strong consolidation

Recapitalisations to domestic banks behind the large budget deficit increase...



...and the strong deterioration in public debt metrics

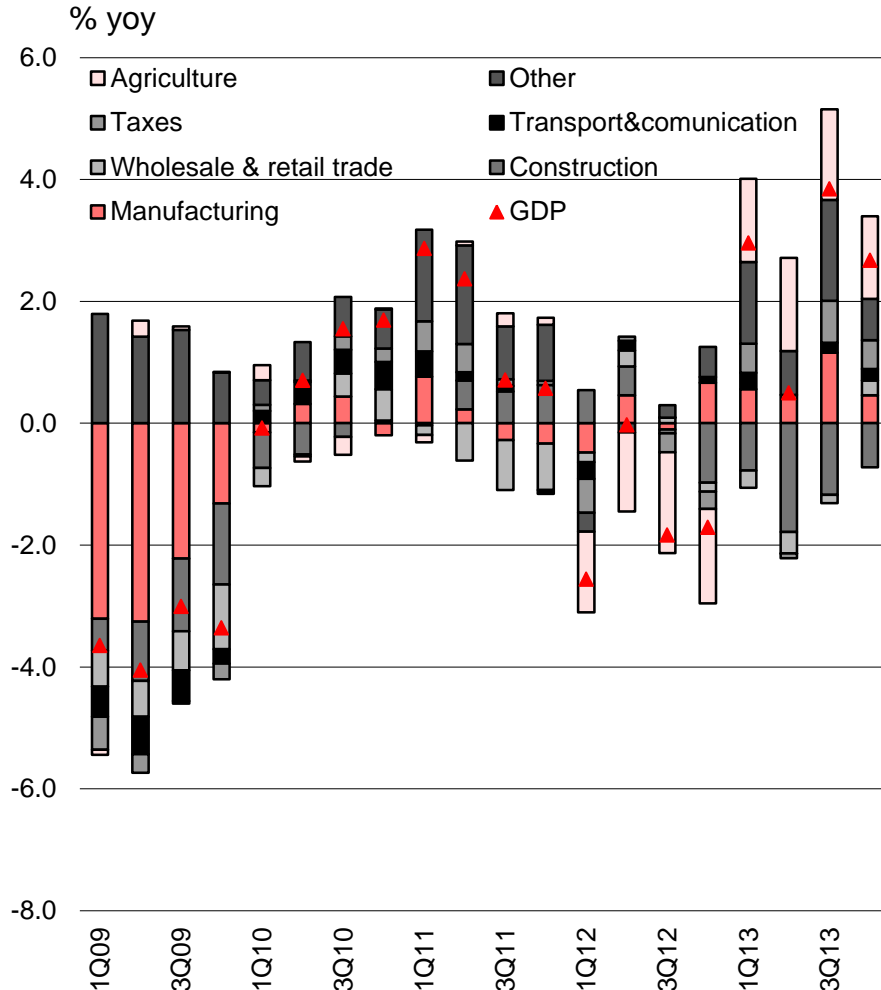


*Excludes CIS and Baltics

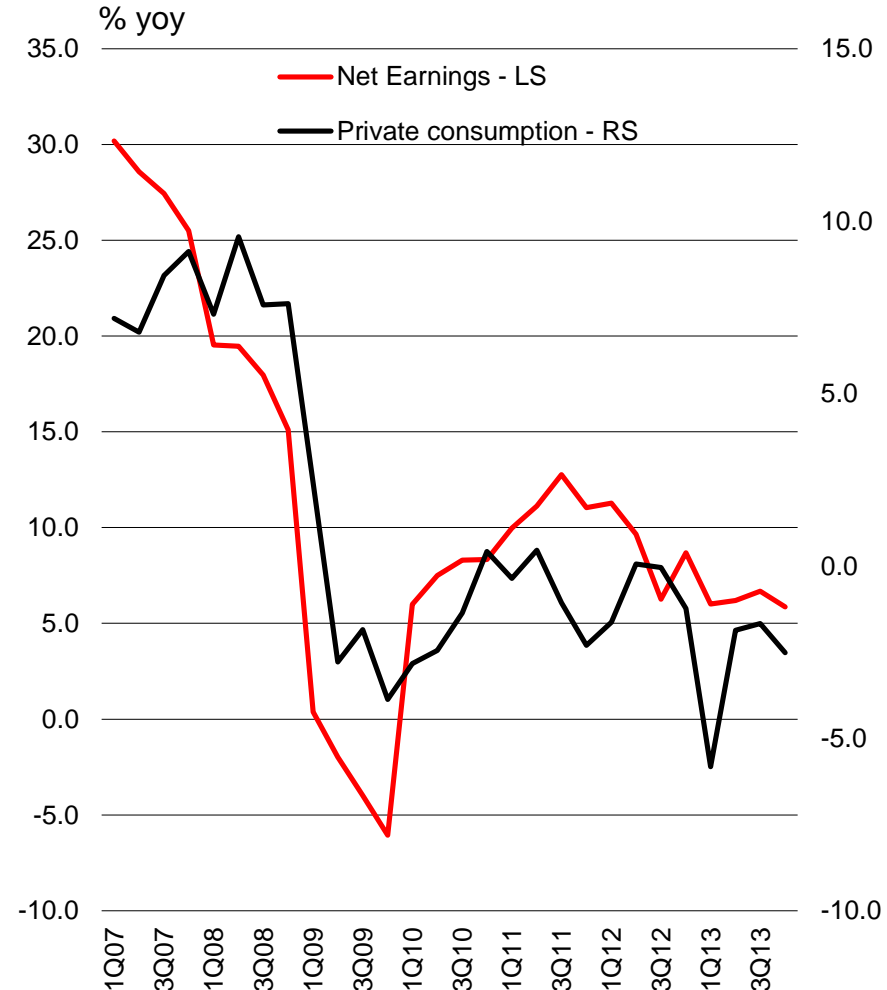
Sources: EC, MinFln, UniCredit Research

Serbia: GDP growth constrained by weak private demand

Manufacturing and agriculture are supporting GDP growth...



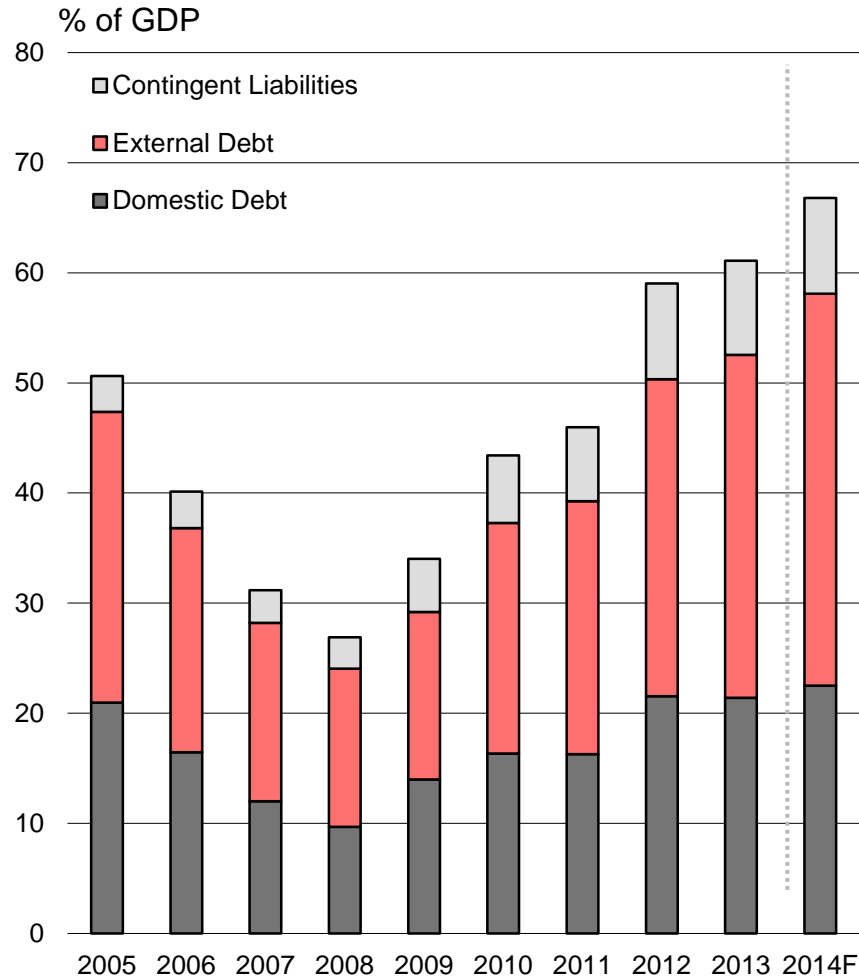
... but weak private consumption continues to drag domestic demand



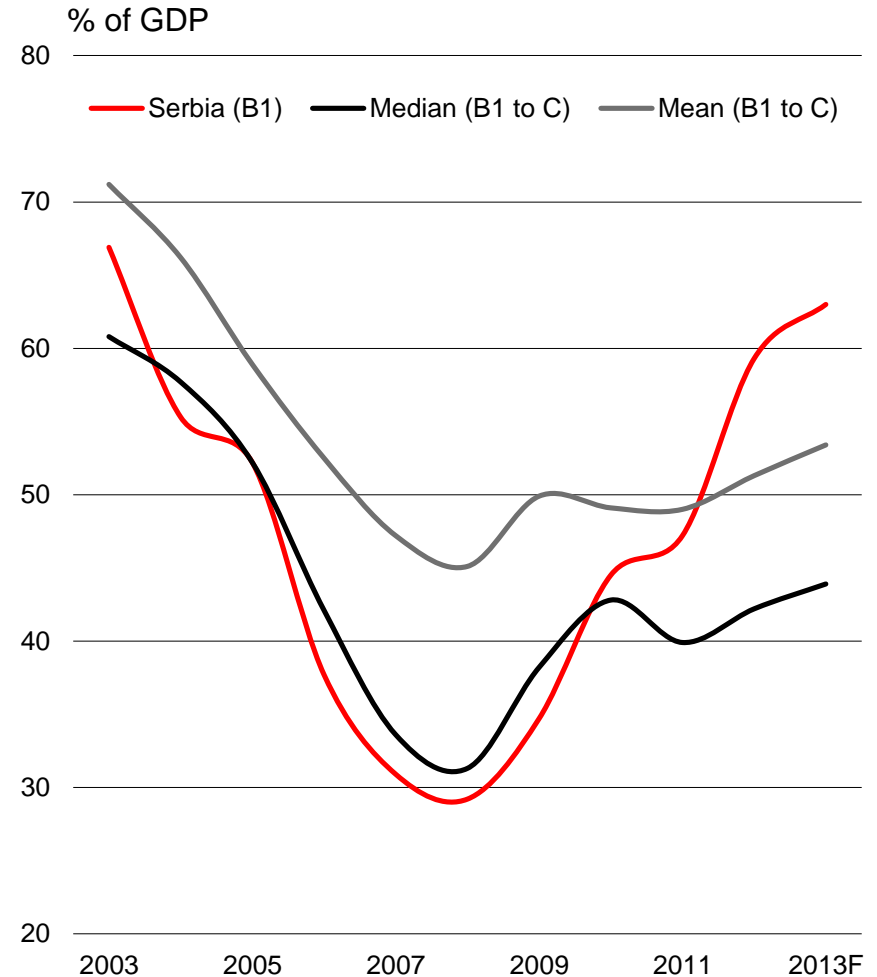
Sources: NBS, MinFln, UniCredit Research

Serbia: A tougher stance on fiscal consolidation is needed

The sovereign has heavily increased its reliance on foreign funding



Public debt dynamics compare poorly to B-rated peers

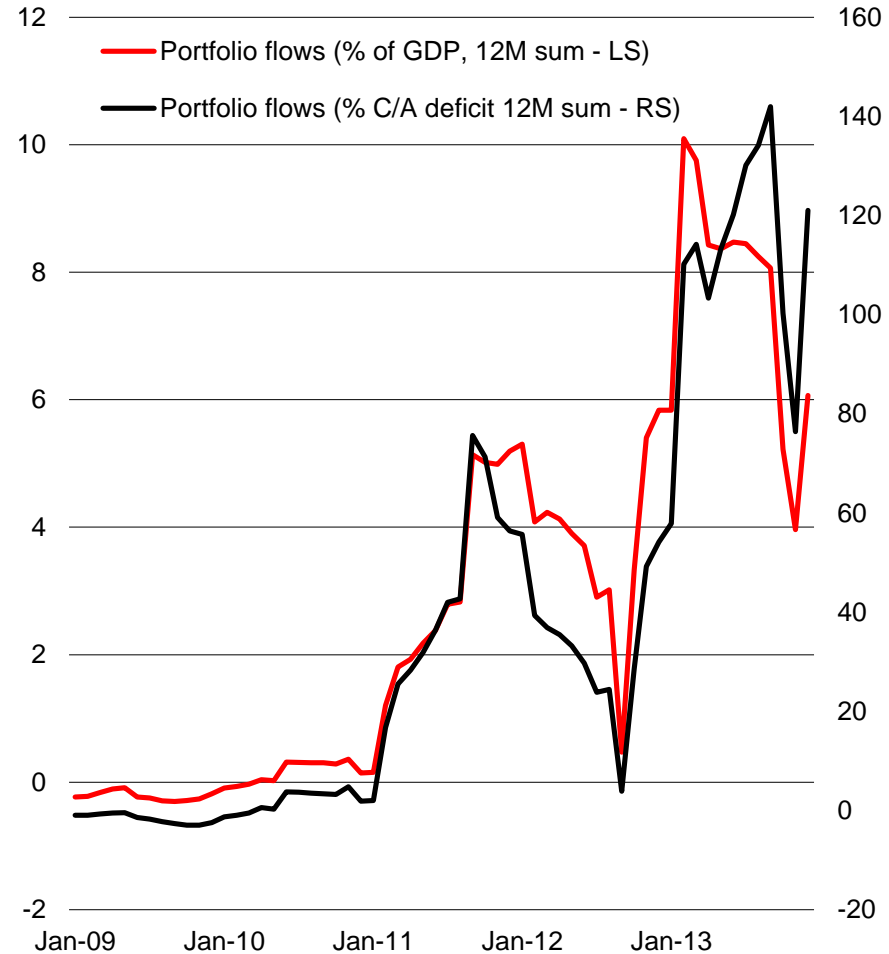
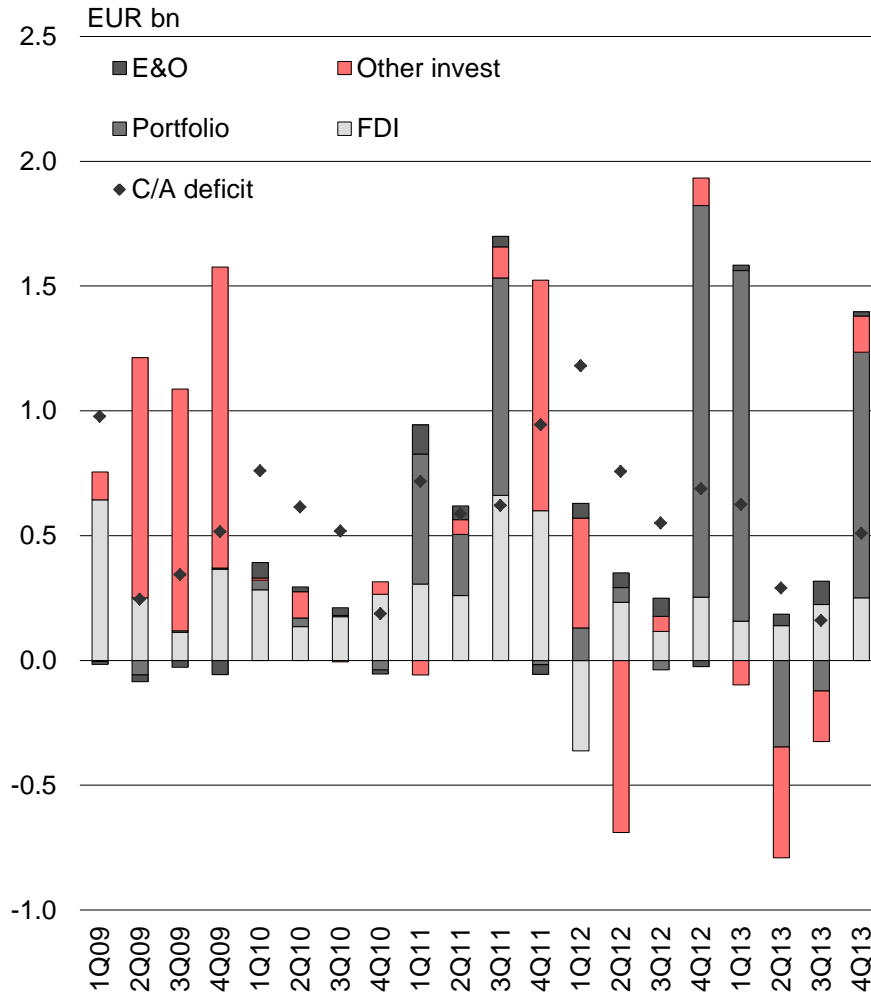


Sources: NBS, MinFin, Moody's Investors Service, UniCredit Research

Serbia: Accelerating capital outflows are a risk to Serbia

C/A funding remains too dependant on portfolio capital...

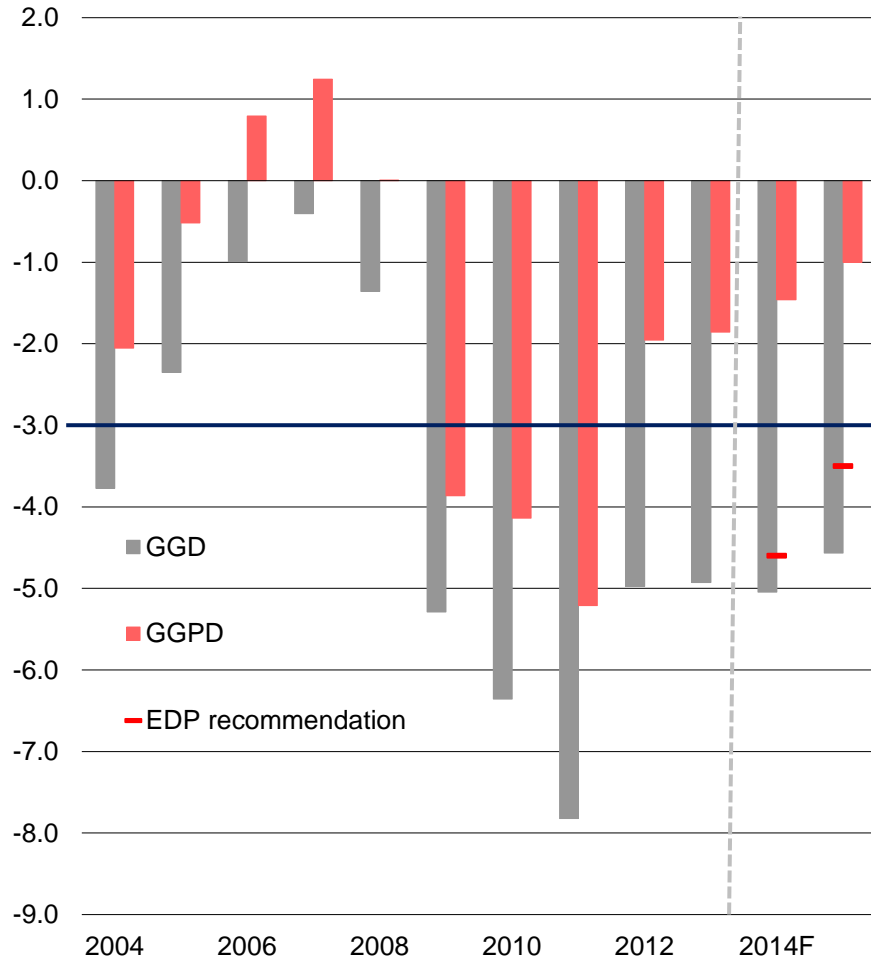
...which remains highly volatile



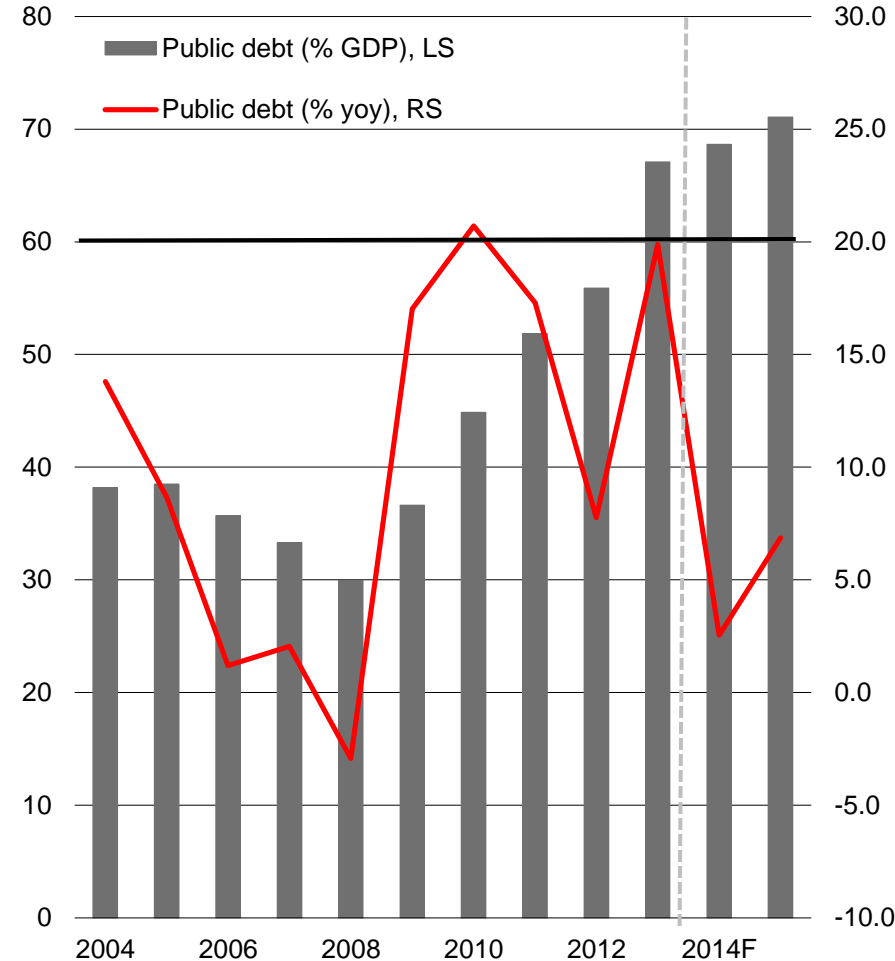
Sources: NBS, MinFln, UniCredit Research

Croatia: Fiscal imbalances – activated Excessive Deficit Procedure creating a framework for reforms

Fiscal gap opened with recession as a drag for economic recovery...



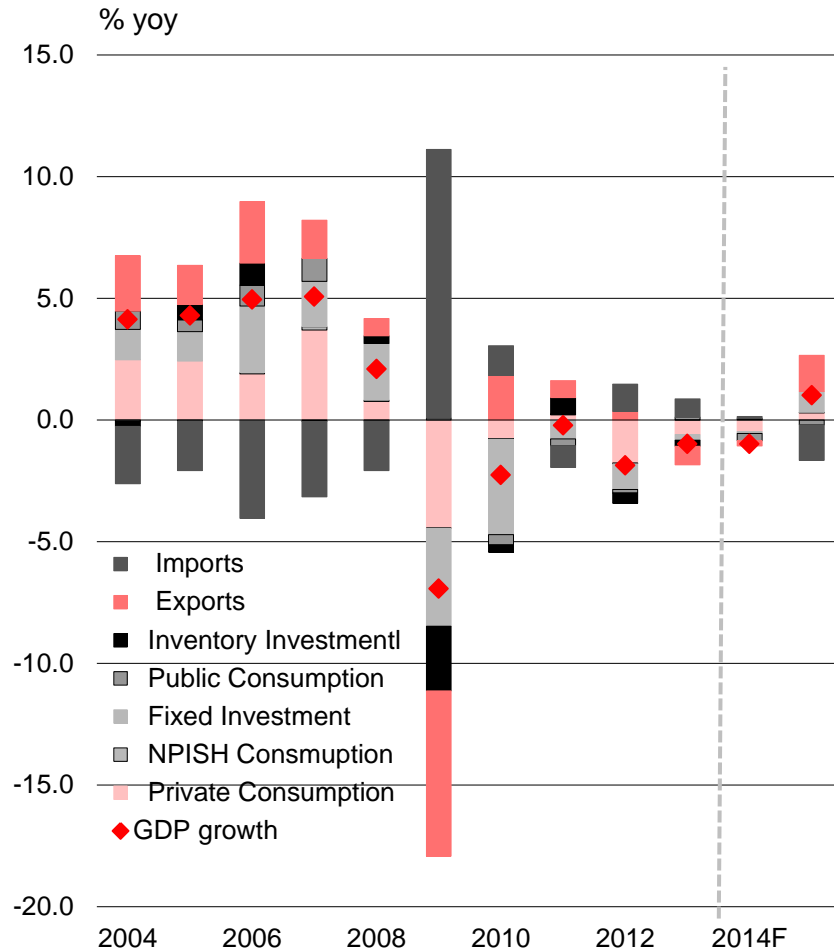
... with public sector creating large demand for financing.



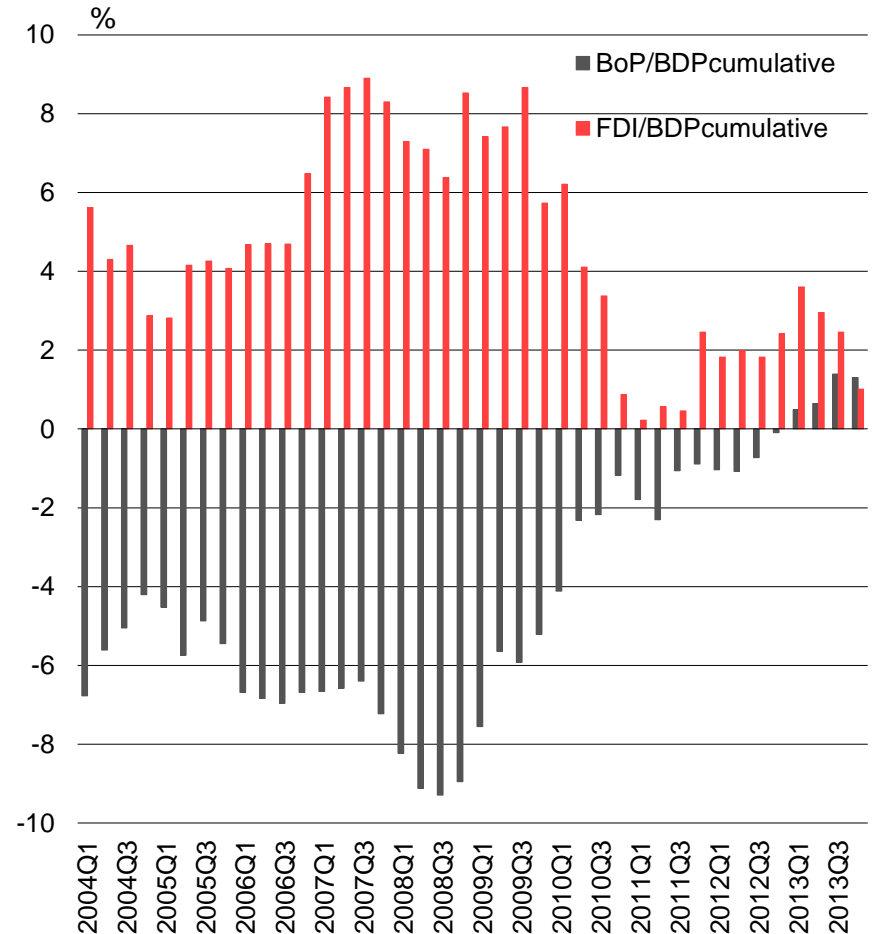
Sources: IMF, MinFln, Eurostat, UniCredit Research

Croatia: Growth outlook remains gloomy, restoring investment climate becomes a challenge

Recession extended to sixth year helped external adjustments...



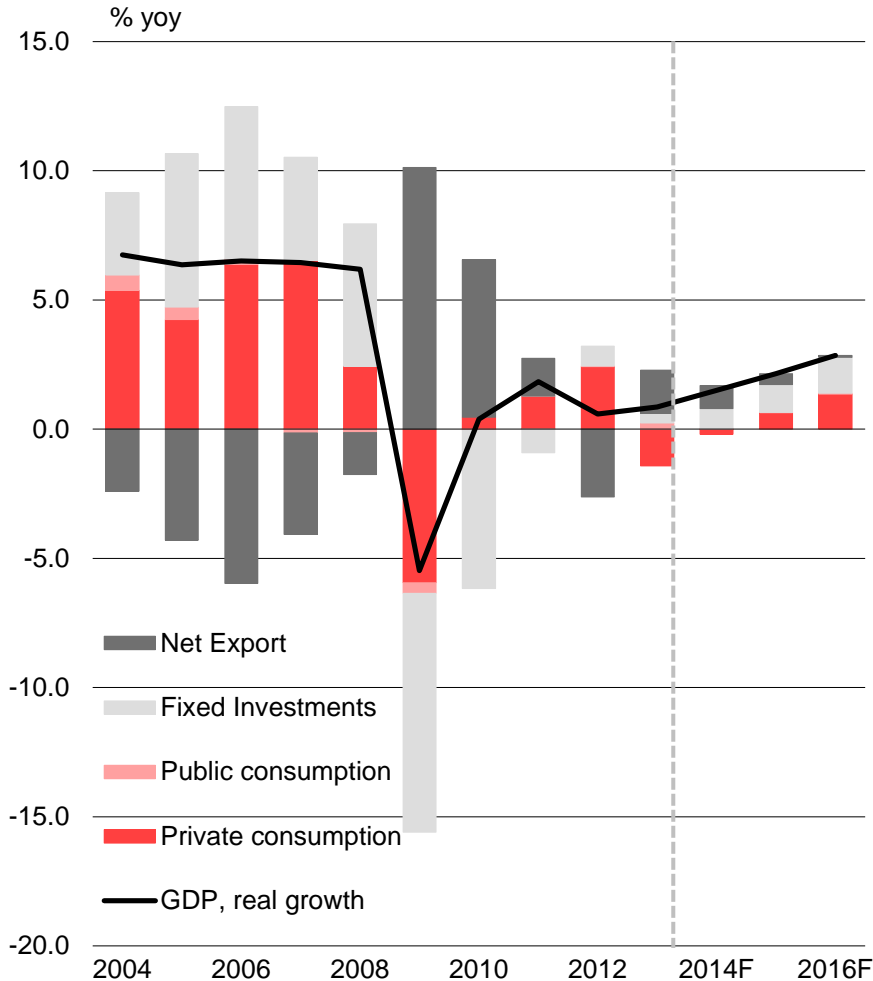
...but, without reform incentives, attracting FDI remains difficult, while EU funds absorption is weak.



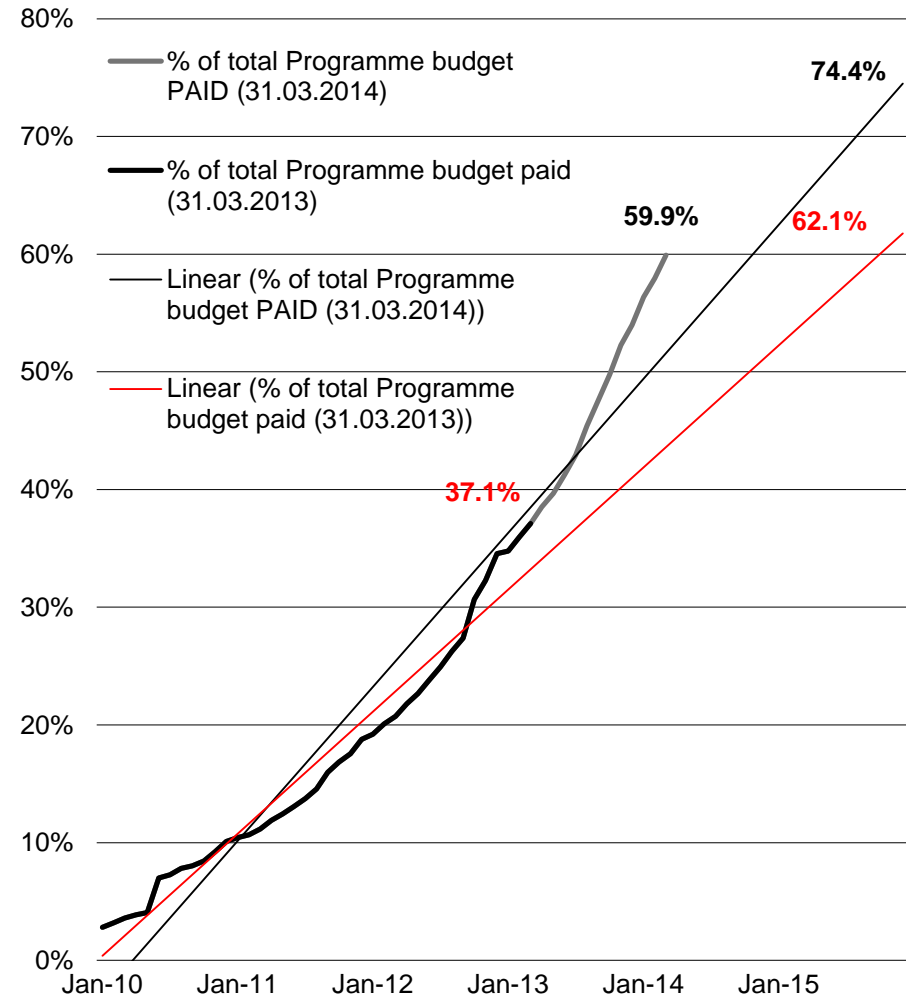
Sources: IMF, MinFln, Eurostat, UniCredit Research

Bulgaria: So far GDP growth has been over reliant on export and improving EU funds absorption

But domestic demand recovery has been weak and uneven...



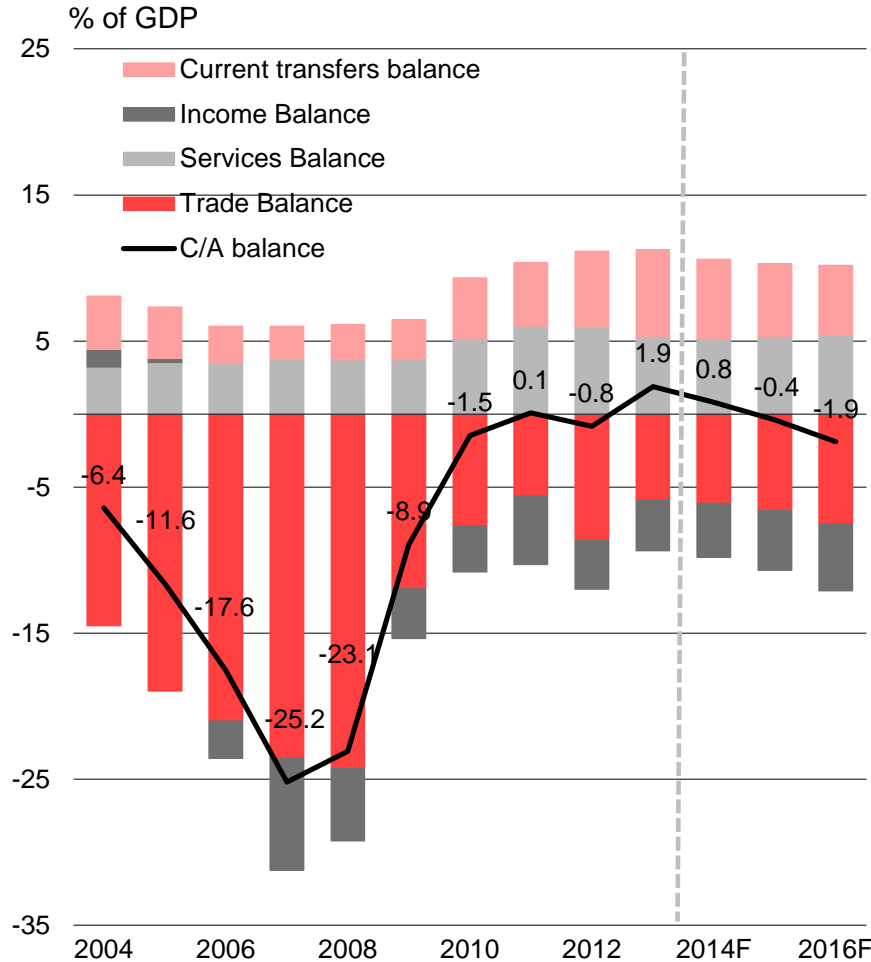
EU funds absorption has seen tangible improvement over the last several years



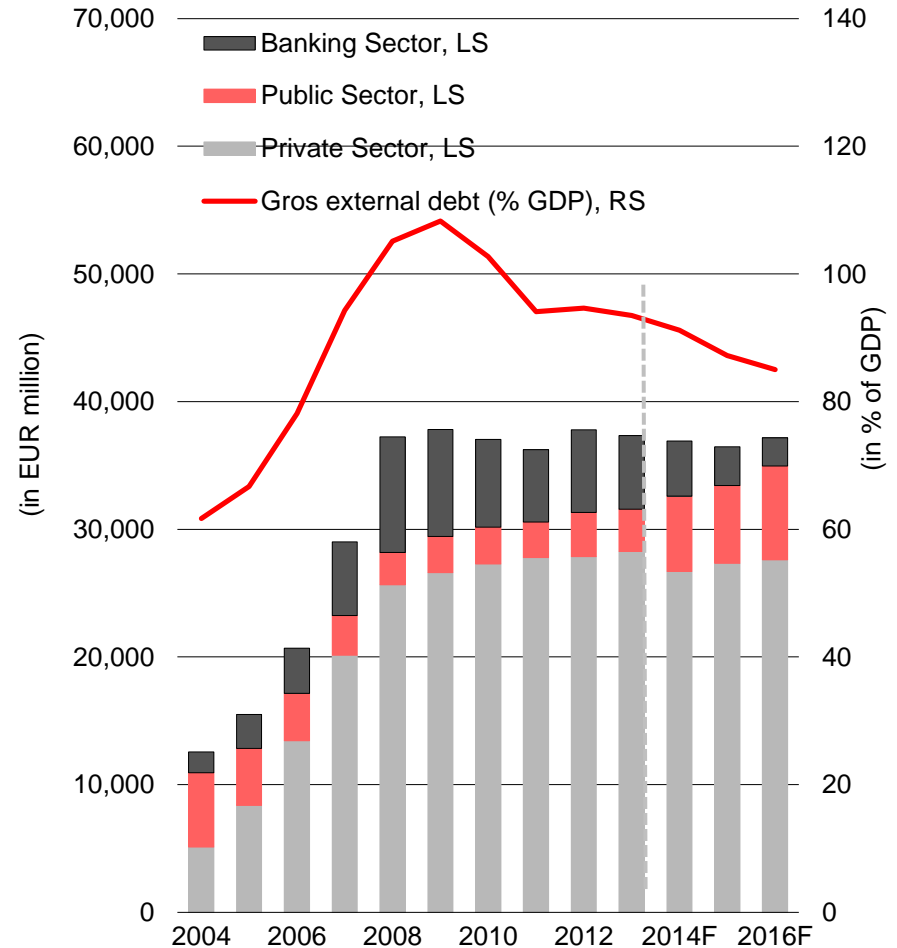
Sources: Eurostat, NSI, UniCredit Research

Bulgaria: External position has seen marked improvement

Large current account imbalances have been successfully addressed...



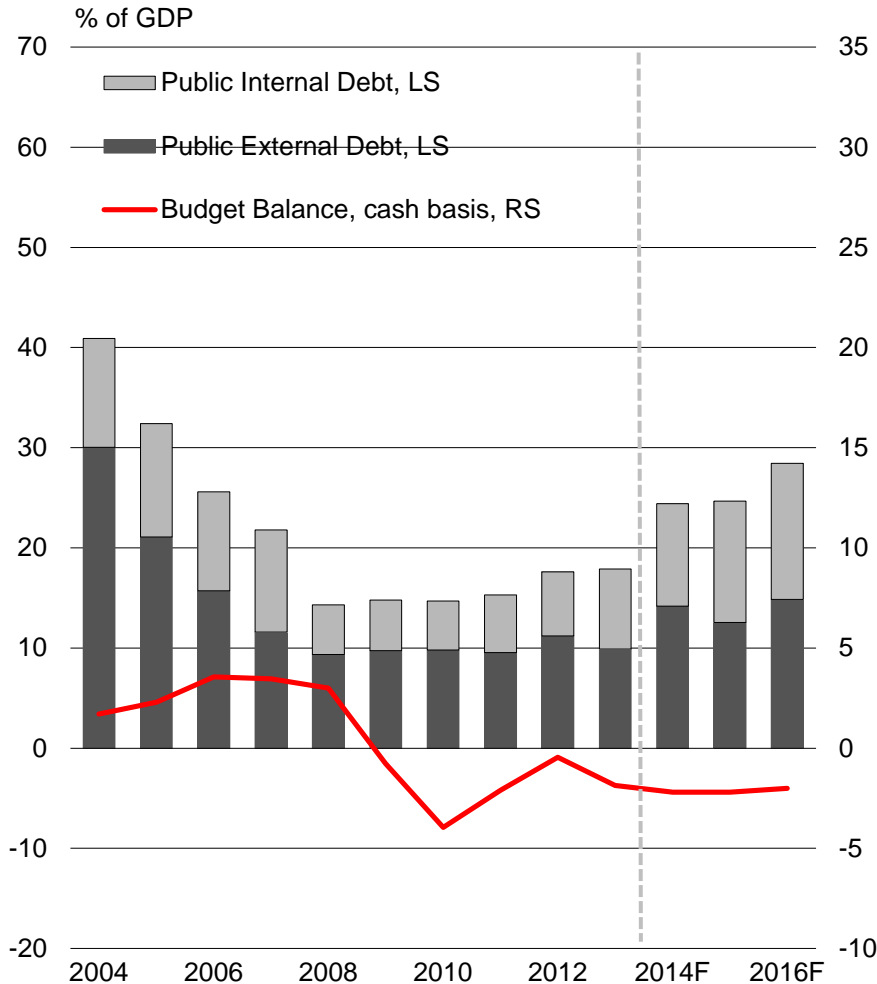
...but high foreign debt in the private corporate sector suggests deleveraging is not over



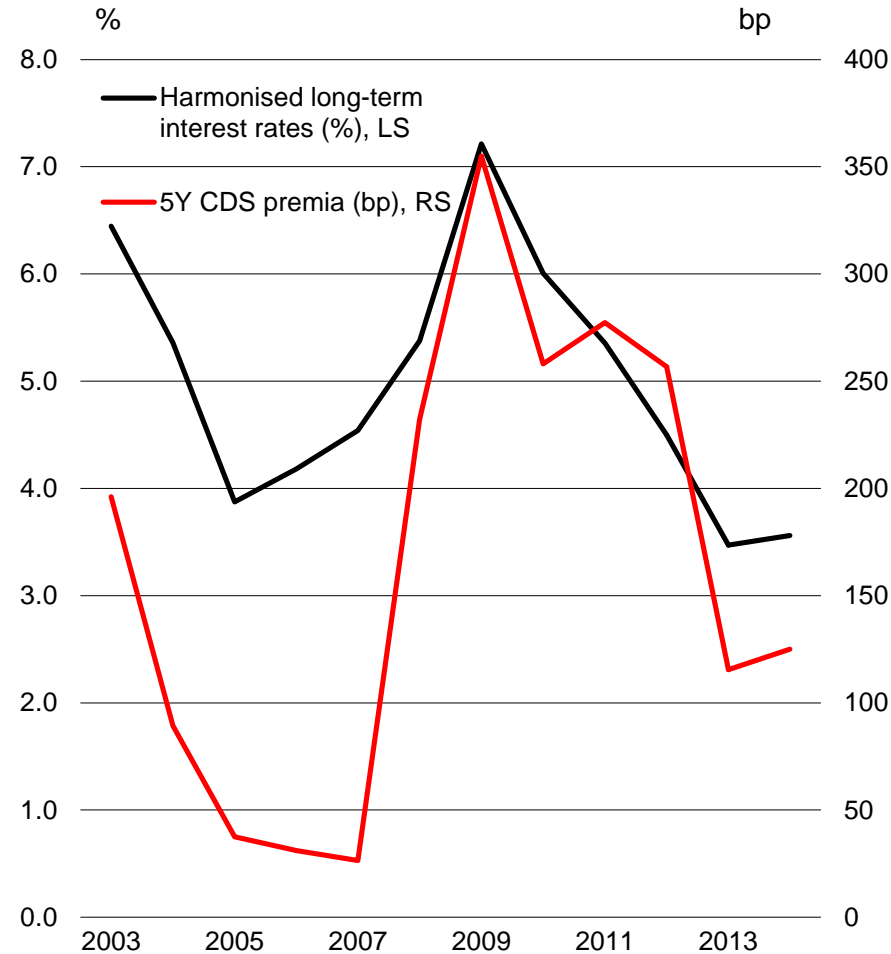
Sources: Eurostat, NSI, UniCredit Research

Bulgaria: Solid fiscal fundamentals have been a key source of strength

Low public debt justifies a temporarily increase in public sector investments



The financing cost for the government has stabilized at supportive levels



Sources: Eurostat, NSI, UniCredit Research

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