UniCredit Group

CEE Banking Outlook

“Risk appetite crucial to win the upside”

November 2009

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The ongoing economic, financial and banking crises are clearly modifying the shape, structure and functioning of the global banking sector – higher capital ratios, deleveraging, de-risking, efficiency and cost cutting, together with a return to traditional commercial banking operations are the new mantra. The crisis had its centre in the core markets, but rapidly spread to the entire financial industry, Central and Eastern Europe (CEE) banks included. CEE banks had virtually no direct exposure to the sub-prime crisis, but the crisis has revealed imbalances, related to high dependency on foreign funding and the effects of a widespread credit boom of the past years. As a new global banking order is being rebuilt, CEE banking is also changing as a result.

Full recovery from the crisis needs time. Economic growth is expected in most of the countries for 2010, with SEE and the Baltics turning to positive figures in 2011 and economic activities remaining below the long-term potential overall. A full rebound of banking business is most likely starting from 2011. Banking penetration continues but will be more balanced. Product offering has to cope with low consumption and a weak investment environment. More diversification, away from retail lending only strategies, toward a more balanced mix is needed. Profitability will have to account for a structurally higher cost of risk, but will benefit from a leaner cost structure. In such a framework, 2009 and 2010 are likely to be the key years for reshaping positioning and strategies for the CEE banks.

Despite the crisis, the region's long term potential is confirmed – both in terms of economic and banking growth. This means the game is worth it, for both market players and potential new entrants. With new strategies currently being designed and new windows of opportunities gradually opening, those players who can afford enough risk appetite for the region now are those likely to enjoy the upside and confirm as tomorrow's leaders.

The Economic Framework

The international crisis transmission to CEE banks – different channels

The financial, banking and economic crisis had its impact on the core markets but rapidly affected all countries, including those in CEE. The impact of the crisis has been stronger in those countries where macroeconomic and banking sector imbalances were more evident. Central and East European countries have been more resilient, while Turkey has also surprised on the positive side. Kazakhstan, Ukraine and the Baltics, as well as some of the South East European countries and Hungary have suffered the most. Russia has suffered from a combination of international and domestic factors, with the decline in world oil prices playing a significant role.

The first contagion channel passed through macroeconomic factors. Given the dependency of the local economies on external funding, mainly in the form of international private debt and foreign direct investment, growing risk aversion and drying-up of capital inflows meant a serious constraint on growth. Lower international demand has also strongly impacted local export performance, leading to sizeable declines in GDP growth. The combination of poor economic performance and much lower capital inflows generated concerns for macroeconomic stability, leading to a generalised crisis of confidence, even much behind fundamentals.

The second contagion channel passed through the international banking sector crisis of confidence. In a first step, concerns for global banking sector stability had an impact on client's confidence, but a prompt increase in the threshold of deposit guarantees by the local deposit insurance schemes have reassured depositors, preventing bank runs. In a second phase, sustainability of external funding has been the issue. CEE banking sectors have traditionally been dependent on foreign funding, with the stock of external liabilities accounting for more than 20 % of total banking liabilities. Banks (in Russia, Kazakhstan and to a lesser extent Ukraine) have been financing their lending growth through access to international markets or through funding from their parent companies (in all the other CEE countries). Only Turkey, the Czech Republic and Slovakia and to a lesser extent Poland have been less dependent on foreign funding. The international liquidity crisis has been reflected in a drying up of international interbank and debt markets and in a much higher cost of external funding. A global regional shock has, however, been avoided. With most of the CEE banks belonging to international banking groups, the CEE banking industry was partly protected from the crunch, as parent banks were acting as lender of last resort for their own subsidiaries. Lately, however, as international banks have been forced to deleverage and rebalance their global position, funding has become a key structural constraint, through reduced availability and higher cost.

Table 1. **Contagion and protecting factors during the crisis**[1]

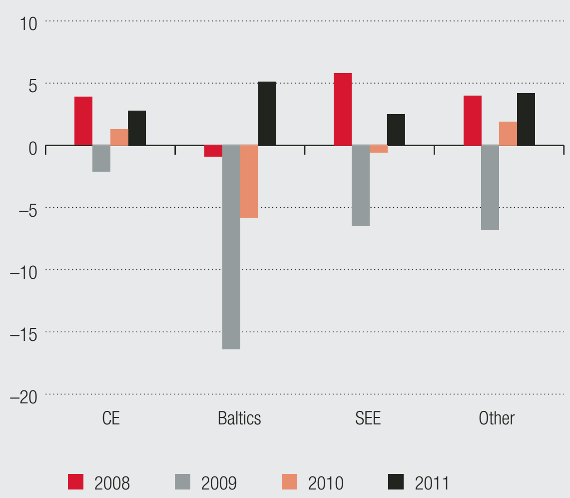
	GDP growth 2009 in %	CA/GDP 2008 in %	5Y CDS (USD) at peak	Delta CDS since onset of crisis	Loans/ deposits ratio (2008)	Foreign ownership[2] in %
Central Europe	**–2.1**	**–5.5**	**385 bp**	**369 bp**	**103**	**78**
Poland	1.4	–5.5	386 bp	372 bp	107	67
Hungary	–6.1	–8.4	597 bp	566 bp	141	89
Czech R.	–4.2	–3.1	303 bp	296 bp	76	97
Slovakia	–5.4	–6.5	216 bp	202 bp	78	96
Slovenia	–8.0	–6.2	–	–	155	30
Baltics	**–16.4**	**–11.7**	**874 bp**	**866 bp**	**213**	**79**
Estonia	–15.3	–9.4	700 bp	694 bp	199	97
Latvia	–16.3	–13.0	1050 bp	1040 bp	247	61
Lithuania	–17.0	–11.9	835 bp	828 bp	196	88
SEE	**–6.5**	**–13.3**	**692 bp**	**644 bp**	**124**	**87**
Bulgaria	–6.3	–25.3	667 bp	640 bp	123	84
Romania	–7.5	–12.3	748 bp	717 bp	126	88
Croatia	–6.2	–9.3	579 bp	551 bp	120	91
Bosnia	–3.0	–14.9	–	–	122	91
Serbia	–4.8	–13.9	650 bp	486 bp	125	75
Other	**–6.8**	**1.9**	**927 bp**	**798 bp**	**118**	**20**
Turkey	–5.2	–5.7	518 bp	305 bp	82	31
Ukraine	–13.5	–6.9	3718 bp	3496 bp	204	52
Russia	–7.4	6.0	768 bp	681 bp	128	11
Kazakhstan	–1.6	5.3	1385 bp	1300 bp	176	15

Note: 1) Sub-regional CDS spreads weighted by nominal GDP; delta CDS calculated comparing quotations on 5/3/2009 and 15/8/2007; 2) Share of banking system assets under foreign ownership in 2008
Source: UniCredit Group CEE Strategic Analysis, UniCredit Research

International commitment has been crucial

International commitment toward the CEE region has been crucial for managing the crisis. The support packages implemented by the IMF and EU in a range of CEE countries helped to deflate the partly exaggerated market concern about the fundamental viability of the region's economies and banking sectors. A total of USD 60 bn has been deployed in Serbia, Bosnia, Hungary, Latvia, Ukraine and Romania under the stand-by agreement program, while Poland benefited from a new short-term credit line from the IMF of up to USD 20.5 bn Euro. The EU made available its Balance of Payment assistance for EUR 6.5 bn for Hungary, EUR 3.1 bn for Latvia and EUR 5.0 bn for Romania. International financial institutions such as the EBRD, the EIB and the World Bank have been increasing their financial support to the region, providing more money and more flexible instruments for action. Single countries extended extra support, as in the case of the Nordic countries towards Latvia. The commitment to the region of strategic investors in the banking sector has also been key. The IMF has been securing international banks' firm commitment to single markets (as part of the IMF support packages to the countries) by getting them to sign a bilateral agreement with the local central banks to maintain their exposure and eventually recapitalize their subsidiaries over the next years if required. The size and firmness of such a global commitment has helped reverse the negative mood toward CEE, which has been a crucial step in avoiding a full fledged regional crisis in late winter 2008/early spring 2009.

Chart 1. **Real GDP (yoy % growth)**[1]



Note: 1) CE: Czech R., Hungary, Poland, Slovakia, Slovenia; SEE: Bosnia, Bulgaria, Croatia, Romania, Serbia; Other: Kazakhstan, Russia, Turkey, Ukraine
Source: UniCredit Research

Benefiting from the global macroeconomic turnaround, but rebalancing still necessary

The emergence of signs of recovery in the US and Western Europe has lead to a substantial improvement in market confidence and both factors are definitely behind the recovery in CEE.

The economic growth model for CEE has to be rebalanced, however. In the last 20 years strong economic growth has been fuelled by buoyant consumption demand and investment growth. Households were betting on income convergence, thus anticipating consumption. Investment was strong, both related to building new production infrastructure and real estate. The crisis has led to an unwinding of the huge external imbalances generated by those pressures and to a return to fundamentals. The recovery we are starting to see today in the region is production-based. Production is gradually improving, supported by some export demand and some positive stimulus from the inventory cycle. Investment activities will however remain subdued, with the only exception some potential from infrastructural projects and EU funds absorption. Unemployment will remain high, meaning dampened consumption.

The good news is that we will see positive growth in 2010 in most of the countries of the region. Growth will, however, remain below the long-term potential and strong regional differentiation is confirmed. Central European countries such as Poland and the Czech Republic or Slovakia show better recovery prospects. Turkey, which was only marginally affected by the global liquidity crisis, will rebound quickly, while Russia will profit from the oil and raw materials price recovery, rather than from a strong fiscal stimulus. South Eastern European countries and the Baltics will remain in recession in 2010, in need of some further rebalancing. Ukraine and Kazakhstan, as well as Russia, will record positive growth, but need time to fully readjust and exploit their potential.

Risks remain – the road ahead is bumpy

While signals are now all generally being read on the positive side, uncertainty remains about the sustainability of world economic recovery. The possibility of a W-shape pattern is often mentioned, which would cast a shadow over CEE growth as well. Such uncertainty opens the option of reversals in the path for market risk aversion, if not in fundamentals. Volatility is expected to dominate the stage for some time, with possible new shocks linked to a sudden change in the market mood and a drop in confidence.

Specific risk aversion towards CEE might restart in case of clear negative news on the region. Markets today tend to price-in a strong risk of devaluation for the currency in Latvia, which, if happening, will most probably be the result of a political decision, given the strong involvement of the IMF and the EU to support the re-adjustment phase in the country. The relevance of contagion channels to other countries would then be tested. In such a situation, it will be extremely important that markets learn how to discriminate among countries.

Banking Framework

"Liquidity-crisis mood" subsides but credit quality is the new challenge

Even if rebounds and additional shocks at the world level cannot be completely ruled out, global markets are currently out of a 'liquidity-crisis mood'. This is also true in CEE and, particularly for those banks with foreign ownership, liquidity is not an issue. However, availability of long-term funding and cost of borrowing remain a constraint for CEE banking sector growth, with all players searching for the right strategy to rebalance the regional banking sector growth model.

The regional banking business remains very much dependant on foreign capital with external liabilities for the CEE banking sector having reached EUR 450 bn at the end of last year (almost 30 % due to Russia), which represents some 21 % of total liabilities of CEE banks. The dependence on foreign capital is particularly high in the Baltic states, in South-East European countries and in the CIS. Despite signs of abating since the peak recorded in March 2009, the funding cost for CEE countries remains high. Credit spreads, which peaked at almost 800 bps on average in mid-March 2009 reached around 290 bps in August, still almost one-and-a-half times the level recorded at the end of August one year ago.

Banks are trying to diversify their funding base. Refinancing by way of traditional deposits gathering came particularly to the fore starting from Q3 2008. However, while single banks were trying to steal deposits from the competitors, deposits came under pressure. Corporate deposits are actually recording negative growth all over the region, when the trend is corrected for the FX devaluation effect in 2009. Retail deposits' growth remains sluggish, due to rising unemployment, lower wage growth and in general more stretched financial position of the households sector, despite the increasing propensity to save. The strong fight for deposits cannot be considered a long-lasting strategy however, given the region's growth model, which is based (in the context of a catching up process) on a national savings gap. CEE banks will have to rebalance their business, with lending growth more tied to deposit growth, but access to external funding will remain a key competitive advantage for domestic players.

While trying to rebalance the business mix leveraging on deposit collection strategies, the economic crisis is also pushing banks out of the lending market. Low demand for credit on the one hand and rising concern for credit quality on the other, are behind such credit crunch, rather than liquidity concerns.

Already in the first half of this year, average regional growth in loan volumes remained in negative territory, down by roughly –2 % ytd as compared to only a marginal increase on the deposit side (+1 %). When adjusted for the movements in exchange rates, the ongoing moderation in banking activity appears even stronger, with total loans down by –4 % since the beginning of the year. The clear drawback is that generally credit crunch episodes later have second-round effects on the economy.

The ongoing slowdown in lending activity has been particularly evident in the households segment, following a decade of sustained increase in

Chart 2.1. **CEE Banks liabilities (% of total, June 2009)**[1]

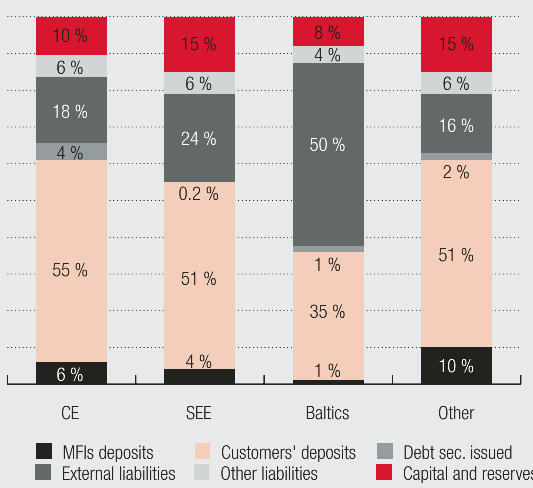
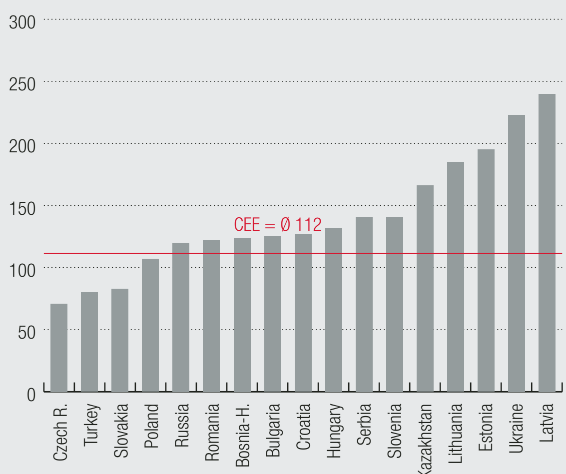
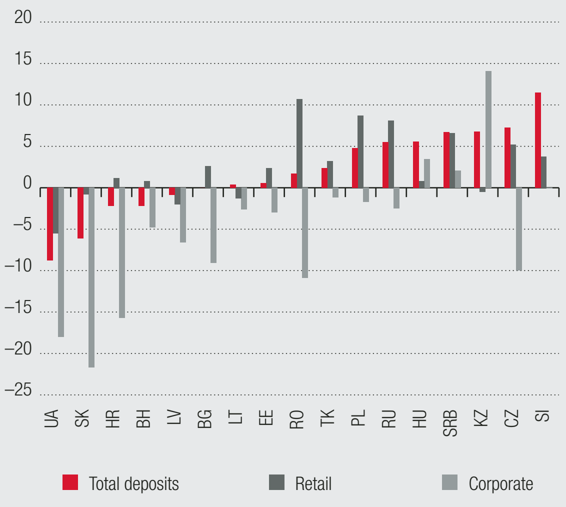


Chart 2.2. **Loans/deposits ratio (%, June 2009)**[2]



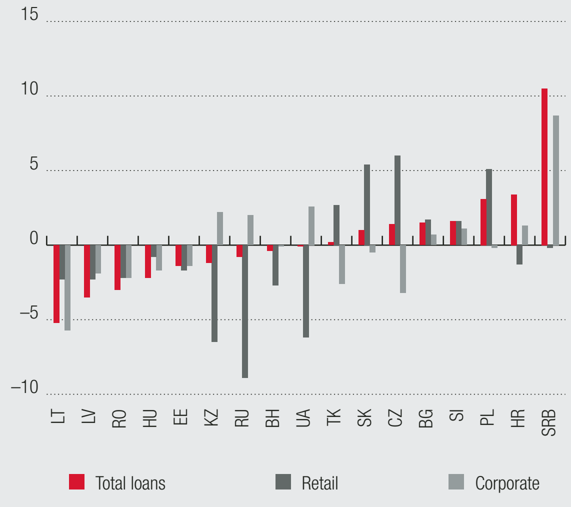
Note: 1) CE: Czech R., Hungary, Poland, Slovakia, Slovenia; SEE: Bosnia, Bulgaria, Croatia, Romania, Serbia; Other: Kazakhstan, Russia, Ukraine, Turkey; among 'Other' countries, share of external liabilities is the highest in Ukraine and Kazakhstan (27 % and 33 % out of total liabilities, respectively); 2) Loans and deposits to/from non-residents not included
Source: UniCredit Group CEE Strategic Analysis

Chart 3. **Bank deposits (YTD % growth adjusted for FX movements, June 2009)**



Source: UniCredit Group CEE Strategic Analysis

Chart 4. **Bank lending (YTD % growth adjusted for FX movements, June 2009)**

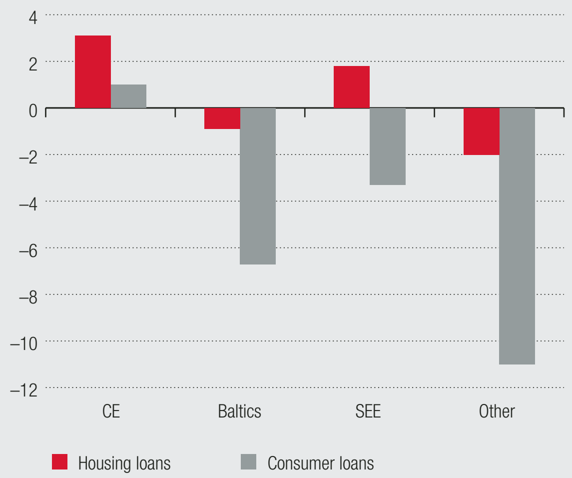


Source: UniCredit Group CEE Strategic Analysis

overall indebtedness levels. Uncertainty over income and employment prospects coupled with tightening of credit standards has been responsible for visible adjustments in household sector behavior, resulting in weakening dynamic of consumption expenditure and borrowing. Consumer sentiment deteriorated substantially since Q3 last year and reached particularly low levels in Hungary, the Baltics and some other SEE markets. Consumer credit has reacted first with visible drops, while mortgage lending remained more stable, due to longer maturities of mortgages and to some ongoing renegotiation activities.

Lending activity on the corporate sector has also remained subdued. The corporate sector has been under pressure during the last year: a) investments are significantly more sensitive than household consumption to the economic cycle, and they are noticeably declining this year (–15 % on average in CEE); b) export flows are experiencing a consistent contraction at the global level and in CEE as well (around EUR 55 bn less in 2009 with respect to 2008 in CEE), with the more open economies, such as Central European countries, particularly sensitive; c) foreign direct investments (FDI) received by CEE countries – one of the most important growths driver during the last years – are almost halving this year and they will resume only slowly (despite further off-shoring of Western manufacturing activity toward the East, which

Chart 5. **Lending to households (YTD % growth unadjusted for FX movements, June 2009)[1]**



Note: 1) CE: Czech R., Hungary, Poland, Slovakia; SEE: Bulgaria, Croatia, Romania; Other: Russia, Ukraine, Turkey
Source: UniCredit Group CEE Strategic Analysis

Table 2. **Corporate loans, FDI and trade flows**

CEE 17	The past avg 2006–'08	The present 2009	The future avg 2010–'11
Trade flows (export + import), EUR bn	1,939	1,622	1,842
FDI, EUR bn	108	59	79
Corporate loans, EUR bn	579	644	759
Corporate deposits, EUR bn	333	349	404
Loans/deposits ratio (corporate, %)	174 %	185 %	188 %

Source: UniCredit Group CEE Strategic Analysis

Table 3. Non-performing loans (in % of gross loans)[1]

	Q2 2008	Q3 2008	Q4 2008	Q1 2009	Q2 2009	YTD
Central Europe						
Poland	4.5	4.1	4.2	5.0	6.0	176 bp
Hungary	3.8	4.1	4.5	5.2	6.5	196 bp
Czech R.	2.7	3.0	3.3	3.7	4.3	103 bp
Slovakia	2.9	2.9	3.2	3.5	4.2	103 bp
Slovenia	–	–	2.9	–	–	–
Baltics	1.5	1.8	2.4	4.0	6.2	379 bp
SEE						
Bulgaria	2.7	2.8	3.2	3.2	4.4	114 bp
Romania	4.6	5.1	6.3	9.1	11.3	497 bp
Croatia	4.8	4.8	4.8	5.1	–	–
Other						
Turkey	3.0	3.0	3.5	4.1	4.6	113 bp
Ukraine	–	–	17.4	–	29.9	1,250 bp
Russia	9.0	8.9	12.7	13.9	16.0	330 bp
Kazakhstan	7.4	7.5	10.8	16.2	26.1	1,533 bp

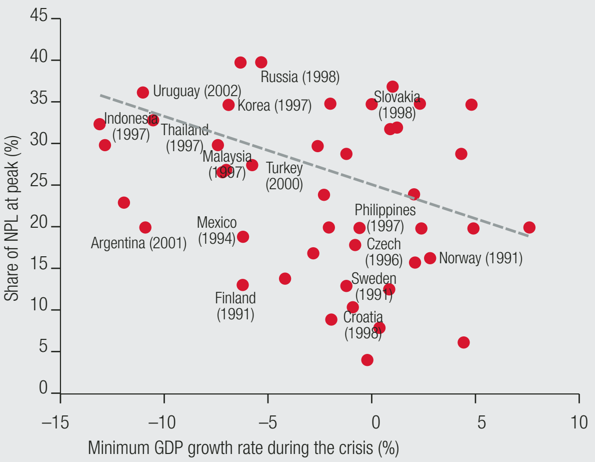
Note: 1) Including loans classified under substandard, doubtful and loss categories; data for Romania includes only doubtful and loss; including off-balance items for Ukraine, while excluding in Croatia
Source: UniCredit Group CEE Strategic Analysis

has been visible as Western companies are accelerating the restructuring of their activity during the crisis).

Interesting to note, the two countries with the strongest growth in lending on a YTD basis, namely Croatia and Serbia, experienced some state related stimulus to lending, in the form of new infrastructural projects or new state guaranteed lending being activated.

The above-mentioned deterioration in the economic outlook has already resulted in a substantial increase in the share of distressed banking assets throughout the region, for both the retail and corporate sector. NPLs for the entire banking sector have been increasing rapidly starting from the second half of 2008 particularly in CIS, the Baltics and some SEE countries, while remaining more limited in Central Europe and Turkey. Poland and Hungary have experienced the strongest relative rise in overall NPLs among the CE-5, mainly hit by credit quality deterioration in the corporate portfolio. Kazakhstan was affected by the crisis as early as August 2007, but NPLs recorded the steepest increase only since Q1 this year on the back of the failure of two leading banks, BTA and Alliance. A substantial increase in the share of distressed assets was also recorded in Ukraine and Romania, particularly due to mounting problems in the corporate and households' sectors – also on the heels of some impact of currency depreciation on unhedged customers (more evident in the case of Ukraine).

Chart 6. Non-performing loans and economic performance during past crisis



Source: IMF (2008), 'Systemic Banking Crises: A New Database'

The experience of the past crisis reveals that NPL ratios usually tend to lag the business cycle by at least two quarters. IMF data based on past episodes of credit booms which were followed by banking sector stress show that the magnitude of economic adjustments is used to explain the sharp rise of non-performing loans during a crisis period, also providing rough guidance as to how far NPLs might rise.

Taking into consideration specific vulnerability factors, such as loan concentration in the most affected sectors (i.e. real estate), relevance of FX exposure among unhedged retail customers, and the depth of the mortgage market relative to consumer financing, a stress test analysis has been performed at the beginning of this year for the different countries/customer segments[1]. Banking sector portfolios have been stressed, based on the respective level of country/segment vulnerability. The stress test results in country-specific increases in NPLs ratios by the end of the current phase of credit retrenchment, which are presented in the table 4. When comparing those results with our most recent projections on NPLs at the peak, it emerges that anticipated credit deterioration remains generally below our stress test with the exception of the Baltics and Kazakhstan, where the severity of the downturn on the one side and failure of leading domestic banks (not predictable at the time when the stress test was performed) on the other are clearly resulting in a stronger increase in non-performing loans.

1) The stress test has been performed using data as of end of 2008

Table 4. **Non-performing loans and stress testing**[1]

	NPL ratio in 2008 (A)	Estimate NPL ratio at peak (B)	(B)/(A)	Estimated increase in NLP ratio vs 2008 (Stress Test)
Central Europe				
Poland	4.2	8.4	x 2.0	x 2.5
Hungary	4.5	8.8	x 2.0	x 2.9
Czech R.	3.3	7.3	x 2.2	x 2.6
Slovakia	3.2	6.0	x 1.9	x 2.6
Slovenia	2.9	6.0	x 2.1	x 2.5
Baltics				
Estonia	1.9	9.6	x 5.0	x 4.3
Latvia	3.6	22.0	x 6.1	x 4.3
Lithuania	4.6	20.7	x 4.5	x 4.3
SEE				
Bulgaria	3.2	10.0	x 3.1	x 3.8
Romania	6.3	17.5	x 2.8	x 2.9
Croatia	3.2	10.0	x 3.1	x 3.1
Bosnia	3.0	5.8	x 1.9	x 3.7
Serbia	10.2	16.9	x 1.7	x 3.3
Other				
Turkey	3.5	5.5	x 1.6	x 3.7
Ukraine	17.4	35.0	x 2.0	x 2.2
Russia	12.7	25.0	x 2.0	x 2.2
Kazakhstan	10.8	38.8	x 3.6	x 2.2

1) In percentage of gross loans; in Ukraine, data on non-performing loans differ from the official CB reporting as they include also off-balance sheet items; data for Croatia include off-balance sheet items; stress test has been performed assuming additional collateral haircut (30 % in CIS and 10 % in the rest of CEE countries);

Source: UniCredit Group CEE Strategic Analysis

2009–2010: the road ahead – rebalancing the banking model

Once out of the crisis, we can expect volumes growth to continue, but at a more moderate pace. Lending growth will remain tied to deposit generation capacity. Yet the regional banking sector will still need some external funding and having access to stable source of funds will remain a key competitive advantage for single players.

Lending growth will restart from the corporate side. We forecast 8.8 % growth in 2010 in corporate lending for the region, mostly led by Russia, Turkey, Kazakhstan, Romania and the Czech Republic, with the other countries showing some acceleration but still a relatively sluggish trend. With subdued investment activities on the corporate side (except for some infrastructural projects), corporate lending growth will mostly be related to export financing or funding of working capital. Debt restructuring and consolidation and extraordinary activities might emerge as highly value added services banks can provide to their corporate clients.

Retail lending will remain more constrained in the short term. We forecast 8.3 % growth at the regional level in 2010, with some significant dynamic only in the Czech Republic, Slovakia and in Turkey and a relatively sluggish performance in all the other countries.

The households sector is currently facing the crisis, with worsening economic prospects forcing a retrenchment in consumer spending and credit demand. The ongoing decline in real estate prices and still tight lending conditions will keep the attractiveness of mortgages subdued in the short-term, while the long-term potential remains intact.

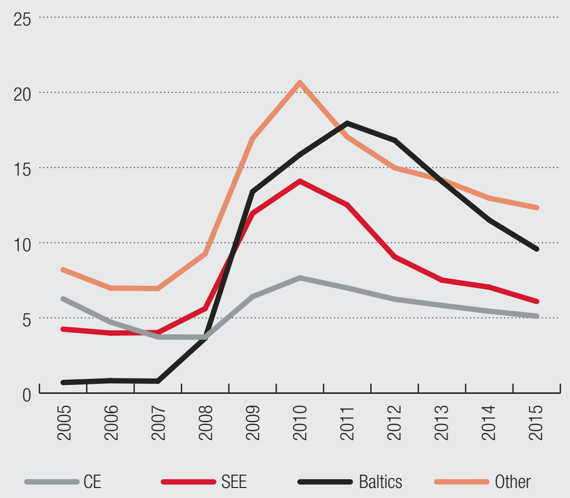
Deposit growth will show more moderate acceleration relative to 2009, averaging 8.6 % at the regional level next year, mostly on the back of some easing of liquidity problems in the corporate sector and a still resilient dynamic in retail deposits.

After some correction in 2009 and the first part of 2010, we expect the loans deposits ratio to gradually increase over time. Rebalancing will continue and is already more pronounced in those countries which had a stronger gap in terms of domestic funding, while is less pressing and might even be counterproductive in the other countries. After a drop from 116 % in 2008 to 109 % next year, we forecast an increase to around 112 % by 2015.

With stabilising needs for external funding, cost of funding for the banking sector has to gradually converge. Convergence will be only gradual however, as on the one hand most of the parent banks have partially subsidized their subsidiaries in 2009 in terms of cost of funding, on the other, the persistence of volatility might lead to a quick reversal in market risk aversion and thus in funding costs for local banks. Access to external funding at reasonable prices will remain a key competitive advantage for players in the market. Increasing access to International Financial Institutions (IFI) funding might also represent an opportunity.

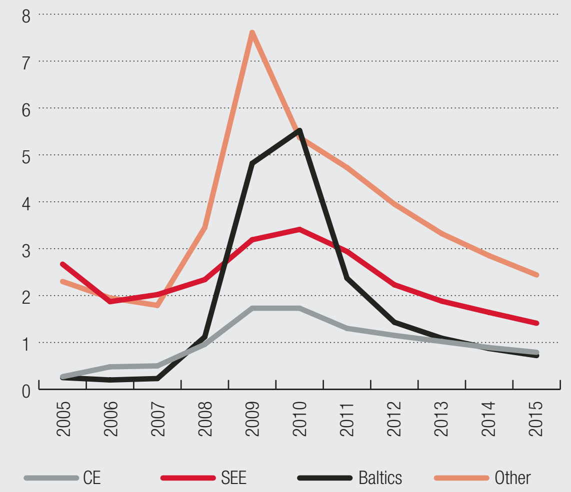
The ongoing correction in economic activity is clearly having an impact on the pace of revenue generation. Net interest income growth throughout the region is being constrained by lower volume dynamic and pres-

Chart 7. **Non-performing loans (in % of gross loans)[1,2]**



1) Including substandard, doubtful and loss categories; in Ukraine, data refer to problem credits (overdue and doubtful); in Kazakhstan, data refer to doubtful loans under category 2,4,5 and bad loans in Romania, data include only doubtful and loss; 2) CE: Poland, Czech R., Hungary, Slovakia, Slovenia; SEE: Croatia, Bosnia, Serbia, Bulgaria, Romania; Other: Turkey, Russia, Ukraine, Kazakhstan
Source: UniCredit Group CEE Strategic Analysis

Chart 8. **Cost of Risk (general and specific provisions over average loans)[1], in %**



Note: 1) CE: Czech R., Hungary, Poland, Slovakia, Slovenia; SEE: Bosnia, Bulgaria, Croatia, Romania, Serbia; Other: Kazakhstan, Russia, Ukraine, Turkey
Source: UniCredit Group CEE Strategic Analysis

sure on margins due to the deposits war. At the same time, the still widespread climate of risk aversion and volatile performance of financial markets – which contribute to lessening the attractiveness of alternative investments – in addition to a fading contribution from trading results – are impacting the dynamic of non-interest income. As a result, revenue generation will remain subdued in 2009 and 2010 compared to recent years, with full recovery most probably delayed to 2011.

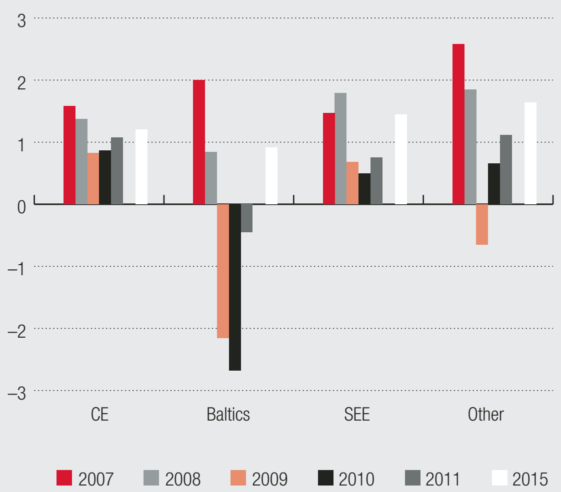
In times of uncertainty, not only with regard to the future development of risky assets but also in terms of the earnings outlook, cost saving programs have clearly captured the spotlight as operating expenses appear to be the only really manageable P&L component. Branch expansion efforts have been halted by almost all banking groups operating in the region with some bubbles in the last years, also in terms of salary costs, now expected to be rebalanced. Previously unthinkable efficiency programs have been put in place, which means the local banking sector now features slim and flexible cost structures. Yet, those players who want to be able to experience the region's upside, need to restart some investment activities as soon as market conditions allow.

Credit quality will remain the key challenge, now that the liquidity crisis is over. Non-performing loans have been rising rapidly and a peak is expected only in 2010[2] (with a one year lag versus economic recovery). Following the rapid surge observed since Q4 2008 on the back of banks' attempt to adjust the level of coverage toward higher levels, cost of risk is also expected to stay high in 2009 and 2010. While banks should monitor credit risk it is equally important to avoid a protracted credit crunch. Selecting the good opportunities for growth is important and will pave the way to future growth.

2) In Kazakhstan and the Baltics, the peak is shifted to mid/end 2011

Overall, regional banking profitability is likely to stay subdued in the next two years mainly due to the impact of higher provisioning against bad loans, with a loss most probable in 2009 and 2010 in countries such as the Baltic States, Russia, Ukraine and Kazakhstan. It is extremely important to note however that in the current environment the performance of different kinds of banks in the same market can differ widely, as profitability very much depends upon the quality of an individual bank's portfolio and cost of risk.

Chart 9. **Return on Assets (%)[1]**



Note: 1) CE: Czech R., Hungary, Poland, Slovakia, Slovenia; SEE: Bosnia, Bulgaria, Croatia, Romania, Serbia; Other: Kazakhstan, Russia, Ukraine, Turkey
Source: UniCredit Group CEE Strategic Analysis

Table 5. **Evolution in CEE banks' capital ratios**[1]

	Equity over total assets					Re-capitalisation (ReCap)/Re-invested Profits (ReProf)
	2007	2008	2009	2010	2011	
CE	10.2	9.5	10.6	11.1	11.4	Selective ReCap + partial ReProf
SEE	13.7	14.3	15.2	15.1	14.6	Selective ReCap + partial ReProf
Baltics	7.8	7.9	8.8	7.6	8.2	ReCap
Other	13.9	13.9	14.2	15.3	15.9	ReCap + partial ReProf

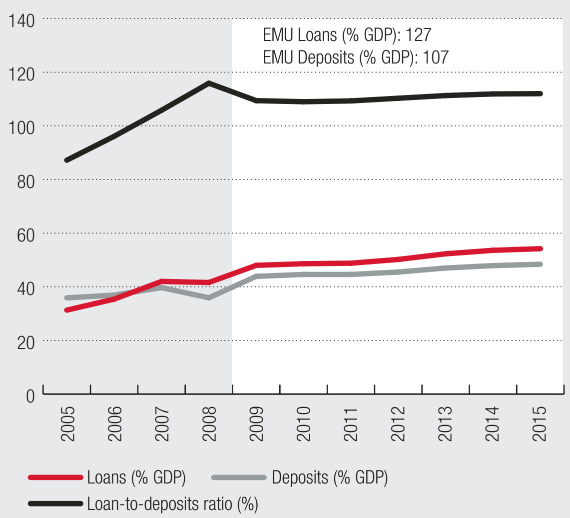
Note: 1) CE: Czech R., Hungary, Poland, Slovakia, Slovenia; SEE: Bosnia, Bulgaria, Croatia, Romania, Serbia; Other: Kazakhstan, Russia, Ukraine, Turkey
Source: UniCredit Group CEE Strategic Analysis

Following a first wave of recapitalisations which took place particularly in Russia, Ukraine and Kazakhstan targeting large state-owned and nationalised banks, further capital injections remain likely in the rest of CEE region, although mainly on a selective basis. Limited dividend payout is the most likely scenario across the entire region at least until 2010.

BOX 1. Untouched long-term prospects for CEE banking

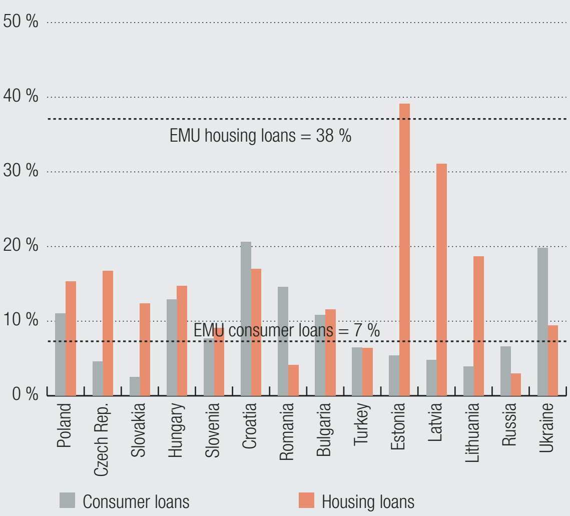
The long-term potential of the CEE banking industry remains untouched as economic convergence of the region will continue and the gap in terms of banking penetration still holds. Some rebalancing in the model is needed, both in terms of economic growth and the banking business, but the potential remains clear. On the macroeconomic side, the consumption and investment boom have now been rebalanced, but the region will continue to benefit from its competitiveness and as the production arm of old Europe. This advantage might stimulate a more balanced rebound of domestic demand, reaccelerating the growth path. To secure this result, countries in the region have to continue to leverage on growing competitiveness. Infrastructural reforms are relevant, as well as the absorption of EU Funds. On the financial side as well, penetration will continue both on the assets and on the liabilities side, albeit at a more moderate pace and strictly linked to availability of funding at the domestic and external level. The gap in financial penetration continues to be clear on the retail side however. True, the households sector is currently facing the crisis. Worsening economic prospects are forcing a retrenchment in consumer spending and thus consumer credit, while high unemployment, together with a rapidely correcting real estate market preclude a quick recovery of the mortgage market. But mortgage market penetration stood at only 8% of regional GDP at the end of 2008, versus a 38% ratio in the Euro area, an indication that market potential is still there, particularly if one considers that in CEE still some gap in terms of supply in the residential real estate market exists. Potential is less clear on the consumer credit market, where the gap vs the Euro is less visible. On the corporate side, significant room for substituting to corporate self-financing remains. Further off-shoring of Western manufacturing activities eastwards might clearly reinforce such trend, with CEE expected to strenghten its role as the manufacturing arm of Europe.

Chart 10. **Banking penetration to moderate but continuing (CEE loans and deposits, ratio and % on GDP)**[1]



Note: 1) The average for EMU countries refers to end of 2008
Source: UniCredit Group CEE Strategic Analysis

Chart 11. **Housing and consumer loans (% of GDP, 2008)**



Source: UniCredit Group CEE Strategic Analysis

Changing Competitive Framework

Table 6. Ranking of international players in CEE

Data as of 2008	Total Assets (EUR bn)[1]	Net Profit (EUR mn)[2]	Number of branches	Countries of presence[3]	CEE, % share in Group Assets	Market Capitalisation, EUR mn[4]
UniCredit	121.6	2,577	4,005	19	12	44,977
Raiffeisen	85.4	1,078	3,231	16	54	7,141
Erste	79.3	1,569	2,099	7	39	9,729
KBC	71.6	309	1,940	12	20	12,355
Société Générale[5]	65.9	1,201	2,609	16	6	35,947
Intesa San Paolo	42.5	186	1,781	11	7	40,167
OTP	35.2	958	1,573	9	100	6,050

Note: 1) 100 % of total assets, and profit after tax (before minority interests) for controlled companies (stake > 50 %) and pro rata for non-controlled companies (stake < 50 %); 2) After tax, before minority interest.
3) Including direct and indirect presence in 25 CEE countries, excluding representative officese; 4) data as of October 21st 2009; 5) Société Générale including ProFin Bank in Ukraine
Source: Bloomberg, UniCredit Group CEE Strategic Analysis

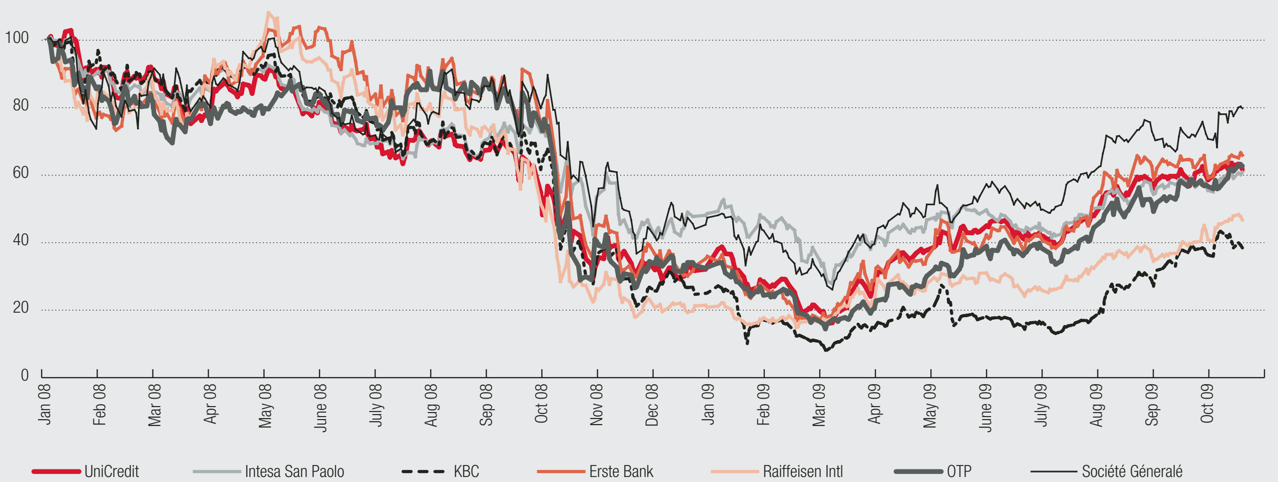
The winners are those players with enough risk appetite

The list of international players active in CEE has remained fairly stable over time. All are strategic investors in the region, highly committed t o the market, with a widespread presence. Among those players, UniCredit, Intesa, Société Générale and KBC emerge as highly diversified on a regional perspective, with assets in CEE accounting for less than 20 % of total Group assets. RZB, Erste and OTP appear to be much more dependent on the region, with a considerable share of their assets and almost all their profit stemming from the region.

All players have been impacted by the crisis in terms of market capitalisation, stock prices and cost of funding, as expressed by the CDS. The credit spreads banks have to pay on their borrowings have been moving steadily wider since the onset of the financial crisis, peaking in mid-March this year. In the first phase of the crisis, the widening of credit spreads for international banks has probably reflected the uncertainty surrounding the length of the global meltdown and fears of contagion from the US financial sector. Risk aversion towards the financial sector and toward banks in general has been the driver of such a deterioration. In the second phase of the crisis instead, as risk aversion of the market toward CEE in particular began, geographical presence has become the main driver in terms of cost of funding for the international players active in the region. Starting from March 2009, however, following strong international intervention to support the region, improving international conditions and market sentiment, both cost of risk for CEE countries and for the banks acting in CEE have started to decline and converge.

As part of the global effort to support the banking system through the crisis, most of the European governments have been offering support

Chart 12. Market Capitalisation[1]



1) Data are normalised as of January 2008 = 100
Source: Bloomberg, UniCredit Group CEE Strategic Analysis

schemes for their local banks, to help increase capital ratios and to restore confidence in the interbank market. Most of the major international banking players in CEE have been applying for government aid in a first phase: Erste and Raiffeisen in Austria, KBC in Belgium, Société Générale in France and National Bank of Greece, Piraeus and Eurobank EFG in Greece. All of these players adhered to government measures aimed at strengthening capital ratios. KBC also acquired a guarantee from the Belgian state to back its structured credit portfolio, while OTP obtained a loan facility from the Hungarian state (the source of which is the IMF Loan Programme) aimed at providing funding to local corporate clients. Following a different strategic approach, and taking advantage of the new window of opportunity offered by improved market conditions and reduced market risk aversion in the recent months, UniCredit Group and Intesa, decided for alternative measures to increase their capital base. UniCredit is currently planning a capital increase, while Intesa is considering disposal of some of its assets in addition to the recently announced launch of tier 1 hybrid instrument issue. Other

Chart 13. Evolution of sovereign CDS spread compared to average of CEE major players[1]

Note: 1) Average 5Y CDS spread for banks including UniCredit Group, Société Générale, Intesa, Erste and Commerzbank, Source: Bloomberg, UniCredit Group CEE Strategic Analysis

Table 7. CEE Banking Group applying for government aid

Country	Government aid plan	CEE Banking Group applying for government aid
Austria	**Recapitalisation** of credit institutions and insurance companies – **EUR 15 bn**	**Erste Group** agreed to issue participation and hybrid capital up to EUR 2.7 bn. Republic of Austria has subscribed **EUR 1.22 bn** of participation capital while EUR 540 mn has been placed with institutional investors
		Raiffeisen Group issued **EUR 1.75 bn** participation capital to the Republic of Austria (part of an issue totalling EUR 2.5 bn, EUR 750 mn of which subscribed by RZB shareholders (EUR 500 mn of which placed with new investors in public offering)
	Interbank Guarantee – clearing house, able to issue guaranteed bonds to stimulate interbank market – **EUR 75 bn**	**Erste Group** agreed to issue up to EUR 6 bn of government guaranteed bonds. **EUR 4 bn** already issued
		Raiffeisen Group issued **EUR 4.25 bn** of government guaranteed bonds, out of EUR 10 bn agreed
Belgium	**Bailout program** for distressed banks	**KBC** issued non-voting equity securities to both the Belgian Federal State and the Flemish Regional Government of Belgium, totalling **EUR 7 bn** (EUR 3.5 bn each respectively)
	Interbank Loan Guarantee and **Assets Guarantee**	**KBC** agreed to the purchase of CDO-linked guarantee from the Belgian Federal State in the amount of **ca EUR 20 bn**
France	**Recapitalisation** of banks – **EUR 40 bn** (of which EUR 10.5 bn available in 2008 for Top 6 banks)	**SocGen** issued **EUR 1.7 bn** of deeply subordinated notes plus **EUR 1.7 bn** of non-voting preference shares to the French government
	Interbank Guarantee – guarantees on bank papers – **EUR 320 bn**	**SocGen placed EUR 14.05 bn** of government guaranteed bonds, out of EUR 14.75 bn possible
Hungary	**Capital injection** – Capital Base Enhancement Fund – **HUF 300 bn (ca EUR 1.1 bn)**	–
	Interbank Guarantee – Refinancing Guarantee Fund – **HUF 300 bn (ca EUR 1.1 bn)**	–
	Ad hoc lending facilities to 4 local banks (OTP, FHB, MFB, Eximbank) for a total amount of ca **EUR 2.5 bn**	**OTP Bank** received **HUF 400 bn** (ca **EUR 1.4 bn**) loan from the Hungarian government
Greece	**Capital injection – EUR 5 bn**	**NBG** issued **EUR 350 mn** preference shares to the Greek state
		Eurobank EFG issued **EUR 950 mn** preference shares to the Greek state
		Piraeus issued **EUR 370 mn** preference shares to the Greek state
	Liquidity injection through the issuance of special bonds – **EUR 8 bn**	**Eurobank EFG** received **EUR 1 bn** of liquidity injection through special government bonds, out of EUR 1.4 bn agreed
		Piraeus received **EUR 865 mn** of liquidity injection through special government bonds
	State guarantee for new medium to long-term bank loans – **EUR 15 bn**	**NBG** agreed to issue **EUR 1 bn** of government guaranteed bonds
		Eurobank EFG issued **EUR 500 mn** of government guaranteed bonds, out of EUR 3.2 bn agreed

Source: UniCredit Group CEE Strategic Analysis

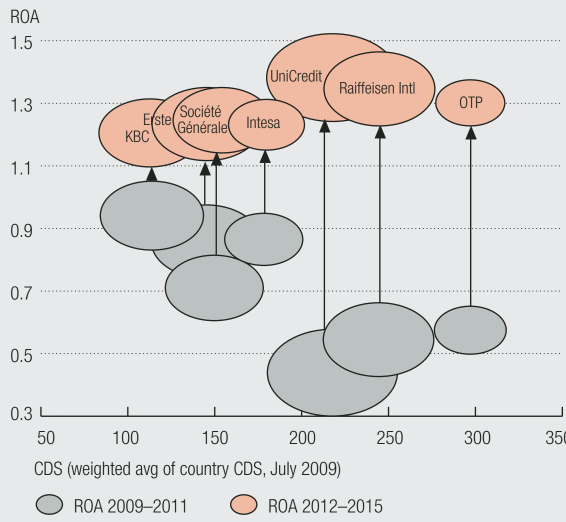
international banks might actually take advantage of the positive mood in the financial market and issue shares to repay the government support. Société Générale, for example, at the beginning of October announced a capital increase of EUR 4.8 bn through shareholders' preferential subscription rights aimed at repaying both the deeply subordinated notes and the preference shares subscribed by the French government (for a total amount of EUR 3.4 bn), as well as at improving the group's solvency ratios.

Looking ahead those top banking players committed to the CEE, can reinforce their position in the region, leveraging on their existing network, their strengthened capital position and better access to international funding, provided that the risk appetite is adequate (see table 8).

Important changes in the competitive landscape might take place in some countries. The crisis is leading to a resurgence of state power in the local banking sector – this is generally the case in Russia, Kazakhstan and Ukraine (also the takeover of Parex Group by the Latvian state is an example of such a tendency). Likewise, a new wave of M&A might also restart in the near future with banks more resilient to the crisis possibly interested in reinforcing their position in single countries, while unfocused or smaller players might likely be pressured to exit the market (this could occur in Poland, Turkey or in some countries in SEE).

Overall, we expect in the medium term the winners to be either new entrants or international players already active in the region, who enjoy an adequate risk appetite and can leverage on diversification and a strong funding position.

Chart 14. **Profit potential of top players**[1, 2]



Notes: 1) ROA and CDS for each player have been calculated as weighted average of each country of presence (CEE17 perimeter, weighted for total assets of the player in each market)
2) The dimension of the balls is total controlled assets in CEE (2008)
Source: UniCredit Group CEE Strategic Analysis

Table 8. **CEE International players – Key strategic drivers**

	Assets in CEE in % of group assets	Group T1 Ratio[1] in %	CEE Loans[2]/ Deposits in %	CEE GAP[3] (CEE Loans – CEE Deposits) in % of Group assets	Group CDS (current) bps	CEE Cost of Risk bps
UniCredit	12	8.5	118	1.5	81	≈ 200
Raiffeisen	54	8.9	127	10.1	248	> 300
Erste	39	8.1	95	3.8	128	≈ 200
KBC	20	10.8	98	1.4	157	n.a.
SoGen	6	9.9	96	0.5	84	n.a.
IntesaSP	7	8.1	118	1.1	47	≈ 200[4]
OTP	100	12.0	129	14.2	–	> 300

Note: T1 ratio is pro-forma Jun. 2009; CDS as of Oct. 2009, Cost of Risk as of Jun. 2009, other data as of Dec. 2008; data are riclassified to be comparable among banks and do not match with official reported data
1) It includes private and public T1 injections announded till mid October 2009; 2) Net Loans; 3) CEE gap = sum of various (loans-deposits) only if loans > deposits. Loans are net loans; 4) calculated for "International Subsidiary Banks", which include also Bank of Alexandria in Egypt
Source: UniCredit Group CEE Strategic Analysis

Chart 15. Top 10 banks by total assets (rank as of Dec 2008)

	# 1	# 2	# 3	# 4	# 5	# 6	# 7	# 8	# 9	# 10
Poland	PKO BP (state)	Pekao (UCG)	BRE (Commerzbank)	ING BSK (ING)	BZ WBK (AIB)	Millenium (BancoComPort)	Citibank (Citi)	Kredyt Bank (KBC)	BGK (state)	Raiffeisen (RZB)
Czech R.	Ceska Sporitelna (ERSTE)	CSOB (KBC)	Komercni Banka (SocGen)	UniCredit (UCG)	Raiffeisen (RZB)	ING Bank (ING)	Citibank (Citi)	GE Money (GE Capital)	Commerzbank (Commerzbank)	Volksbank (Volksbank Intl)
Slovakia	Slov Sporitelna (ERSTE)	VUB (IntesaSP)	Tatra (RZB)	CSOB (KBC)	UniCredit (UCG)	Dexia (Dexia)	Prva Stavebna (Bausparkassen)	ING (ING)	OTP (OTP)	Volksbank (Volksbank Intl)
Hungary	OTP Majority foreign capital	K&H (KBC)	CIB (IntesaSP)	MKB (BayernLB)	Raiffeisen (RZB)	ERSTE (ERSTE)	UniCredit (UCG)	Budapest Bank (GE Capital)	FHB (No majority)	Citibank (Citi)
Slovenia	NLB (state)/(KBC)	NKBM (state)	Abanka Vipa Local private	UniCredit (UCG)	SKB (SocGen)	Banka Koper (IntesaSP)	Banka Celje (NLB 41%)	Hypo Alpe (BayernLB)	SID banka d.d. (state)	Gorenjska (Local private)
Croatia	Zagrebacka Banka (UCG)	Privredna (IntesaSP)	ERSTE (ERSTE)	Raiffeisen (RZB)	Hypo Alpe (BayernLB)	SocGen (SocGen)	Hrvatska Postanska (state)	(OTP) (OTP)	Volksbank (Volksbank Intl)	Podravska Banka (Foreign ownership)
Bulgaria	UniCredit (UCG)	DSK (OTP)	UnBulgBnk (NB of Greece)	Raiffeisen (RZB)	Eurobank EFG (Eurobank EFG)	FirstInvestBank (Private)	Piraeus (Piraeus)	SG Expressbank (SocGen)	Alpha Bank (Alpha Group)	CrpCommBnk (Local private)
Romania	Banca Comerciala (ERSTE)	Pentru Dezvoltare (SocGen)	Volksbank (Volksbank Intl)	Raiffeisen (RZB)	Alpha Bank (Alpha Group)	UniCredit (UCG)	Banca Transilvania (Local private)	Banc Post (Eurobank EFG)	CEC (state)	ING (ING)
Bosnia-H.	Raiffeisen (RZB)	UniCredit (UCG)	Hypo Alpe Mostar (BayernLB)	Hypo Alpe BL (BayernLB)	NLB Razvojna (NLB)/(KBC)	Intesa SP (IntesaSP)	Volksbank (Volksbank Intl)	NLB Tuzlanska NLB/(KBC)	Nova (foreign private)	–
Serbia	Banca Intesa (IntesaSP)	Komercijalna (state)	Raiffeisen (RZB)	Eurobank EFG (Eurobank EFG)	Hypo Alpe (BayernLB)	UniCredit (UCG)	Vojvodjanska (NB of Greece)	AIK (ATEbank Greece)	SocGen (SocGen)	ProCredit (ProCredit)
Turkey	Ziraat (state)	Is Bankasi (Is Bank fund)	Garanti (Dogus Group & GE Capital)	Akbank (Sabanci Group & Citi)	Yapi Kredi (UCG)	Vakifbank (state)	Halk Bank (state)	Finansbank (NB of Greece)	Denizbank (Dexia)	ING (ING)
Ukraine	PrivatBank (Local private)	Raiffeisen (RZB)	UniCredit (UCG)	Oschadbank (state)	Ukrsibbank (BNP Paribas)	Ukreximbank (state)	(OTP) (OTP)	Alfa (Alfa Group)	Bank Nadra (Local private)	VTB bank (VTB Group)
Russia	Sberbank (state)	VTB (state)	Gazprombank Gazprom / (state)	Rosselkhozbank (state)	Bank of Moscow (Moscow City)	Alfa-bank (Alfa Group)	UniCredit (UCG)	Raiffeisen (RZB)	Rosbank (SocGen)	Uralsib (Local private)
Kazakhstan	BTA Bank (state)	Kazkommerts Bank (Local private)	Halyk Sav(ING)s (Local private)	Alliance Bank (state)	ATF Bank (UCG)	Center Credit (Kookmin B. Korea)	NUR Bank (Local private)	Temirbank (state)	Eurasian Bank (Local private)	Kaspi Bank (Caspian Group)
Estonia	Swedbank (Swedbank)	SEB (SEB)	Sampo Pank (Danske Bank)	Nordea (Nordea)	Eesti Krediidipank (Latv Bsn. Bank)	DnB Nord (DnB Nord)	Tallinna Aripank (Local private)	Marfin Bank (Marfin Popular)	UniCredit (UCG)	Parex banka (Parex Group)
Latvia	Swedbank (Swedbank)	Parex banka (state)/EBRD	SEB (SEB)	Nordea (Nordea)	DnB Nord (DnB Nord)	Rietumu (Private)	Aizkraukles (Local private)	Mortgage Bank (state)	UniCredit (UCG)	Latvijas Krajbanka (Snoras)
Lithuania	SEB (SEB)	Hansabankas (Swedbank)	DnB Nord (DnB Nord)	Nordea (Nordea)	Danske Bank (Danske Bank)	Snoras (Local private)	Ukio (Local private)	Parex bankas (Parex Group)	Siauliu (EBRD)	UniCredit (UCG)

Large international groups (top7 in CEE) — State, state-controlled and state-related — Regional foreign players — xxxxxxxxx Other international players

Source: UniCredit Group CEE Strategic Analysis

Chart 16. Winners and losers: times of change bring strong opportunities for those able to take advantage of them

Banking environment

OPPORTUNITIES

Long term growth **potential** unchanged

Weaker **competitive pressures** in the local market, with some competitors strongly constrained by their strategies

THREATS

State influence to increase

New entrants might consider the market, taking advantage of lower prices and untapped long-term potential

CEE Players

STRENGHTS

Incumbents with:
(1) **strong presence** in the market,
(2) long term commitment and
(3) adequate risk appetite might turn out to be clear **winners**

Access to capital and funding

Diversification

WEAKNESSES

Credit quality problems eroding profitability

Incumbents might be forced to retreat as dealing with **strict risk control**

Funding constraint

BOX 2. FX lending business in CEE – an unavoidable risk?

Lending in FX is particularly relevant in the retail segment (mostly taking the form of long term loans for house purchase) with a share of 31 % of total lending at the end of last year (from roughly 26 % in 2003[1]). The relevance of FX lending is also significant in the corporate segment (38 % in 2008, from 44 % in 2003). Predominance of FX lending has been particularly relevant in Hungary, Poland, Romania, Serbia and in the countries with fixed or 'stable' exchange rate, like the Baltics, Bosnia and Croatia. In those countries, Euro and Swiss franc loans have played a dominant role. FX lending was negligible in the Czech Republic and in Slovakia, before euro introduction, mainly due to historical absolute low level of benchmark rates in the two countries and the introduction in early '90s of mortgage finance and housing scheme which made lending in LC more appealing. In Russia, Kazakhstan, Ukraine and Turkey, some USD lending has been developing, as the economies tend to be more dollarized.

Strong demand for FX lending has been determined by the lower level of interest rates applied, given the lower benchmark of EUR, CHF, JPY or USD, versus that of local currencies. On the supply side banks have been offering the product, despite publicly rising warnings of the risk of an unhedged position for the households sector (such warnings have been addressed particularly in the last years and together with central banks and regulators). To note that for banks, which rely to a large extent on FX external debt for their funding (from parent company or international capital markets), providing loans in FX is a natural choice to avoid FX mismatches. This is particularly relevant when the mortgage segment is considered, given the lack of a relevant long term LC funding base in most of the countries.

The crisis has clearly revealed the macroeconomic problems related to FX lending, starting a new wave of discussion concerning FX lending regulation. Different proposals are now on the table. On the one side the EU is proposing a draft directive which, if passed, might lead to higher capital absorption for those loans in FX towards unhedged retail clients. This higher capital absorption will address only the new business and will be applied to those loans with a loan-to-value (LTV) above 50 %. Hungarian authorities are discussing another regulatory reform, which would work upfront, limiting the LTV for mortgage loans to un-hedged clients to 75 % in the case of LC loans, 55 % in case of Euro loans and 35 % in case of other currencies.

While the macroeconomic risk of a high share of FX lending in the economy is clear, a number of things should be considered:
1) Currency matters: for highly euroised economies converging towards the euro, trying to develop an alternative market in local currency might turn out to be a huge unnecessary effort. Instruments should be found to manage the current state, waiting for euro adoption of those countries; 2) From a customer perspective, FX lending might be a rational choice: lower interest rates usually compensate for the risk in terms of FX and might per se allow quite a relevant depreciation before breakeven. In the event of a FX crisis, the natural reaction of a central bank would be rising interest rates in LC. Those clients opting for LC loans would then face an interest rate risk, comparable to the exchange rate risk connected to FX denominated/indexed loans; 3) The lack of long term LC funding for the banks is a serious constraint for the development of a long term LC lending market in the region.

1) Average for CEE countries excluding Slovakia, Slovenia, Serbia, Estonia and Kazakhstan

Loans denominated/indexed in FX (Q2 2009)[1]

	Retail loans (% of total)			Retail loans (YTD % growth)			Corporate loans	
	Total FX	o/w EUR	o/w Other	Total FX	o/w EUR	o/w Other	% of total	YTD % growth
Central Europe								
Poland	40	40	–	8	8	–	26	7
Hungary	66	4	63	0.3	107	–3	58	–0.1
Czech R.	0.1	0.1	0.01	–13	–14	4	17	–10
Slovakia	0.2	–	0.2	3	–	3	2	–17
Slovenia	17	–	17	–8	–	–8	3	–24
Baltics								
Estonia	83	83	–	–1	–1	–	89	1
Latvia	89	89	–	–1	–1	–	92	–0.3
Lithuania	67	66	1	5	6	–4	72	0.5
SEE								
Bulgaria	30	30	1	5	5	0	74	2
Romania	60	48	13	3	4	0	58	2
Croatia	69	54	15	–1	5	–17	68	14
Bosnia	89	89	–	–4	–4	–	64	0.3
Serbia	82	82	–	4	4	–	64	12
Other								
Turkey	3	–	3	–5	–	–5	48	–4
Ukraine	72	2	70	–9	–10	–9	44	–15
Russia	12	–	12	–4	–	–4	29	2
Kazakhstan	40	–	40	12	–	12	58	35

Note: 1) Other FX includes mainly loans denominated/indexed in CHF and USD; growth rates are not adjusted for FX movements

Source: UniCredit Group CEE Strategic Analysis

Central Europe
More resilient – but full recovery of banking profitability needs time

Central Europe (CE) has been relatively more resilient to the crisis than the rest of the region. Poland is the only country in Europe which managed to avoid a recession in 2009. The Czech Republic and Slovakia have seen a substantial contraction, but are now prepared for a rebound, as international demand is gradually restarting. The same is true for Slovenia, although high dependency on external funding of the local banking sector might generate stronger and faster deleveraging and a more prolonged credit crunch. All these countries will see positive growth in 2010, based on recovering production and export. Investment and consumption will remain subdued, while unemployment remains as a social and economic challenge. As opposed to other CE countries, Hungary has been severely hit by the crisis because of its high external and domestic imbalances at the time of its onset (above all the high external debt). The country secured EUR 20.0 bn in support from the IMF/EU/WB last year, which is contributing to stabilising the macroeconomic framework, by reducing the country risk.

After a strong deceleration in 2009, lending activity in CE will revive only slowly in 2010, to 7.4 % from 5.0 % yoy in the previous year. Total loans will stand at only 58.4 % of GDP, from 59.9 % in 2009. Low demand and credit quality concerns will be the main factors behind subdued lending activity. The need to deleverage is not a real issue for banks in CE. Only in Hungary and Slovenia is the gap between loans and deposits significant, meaning relative dependency of the local banking industry on external funding. In Central Europe as a whole, lending growth will be mostly driven by the recovery of corporate lending. The Czech Republic and Slovakia represent an exception, with retail lending showing some respectable growth in 2010, as both countries failed to experience the retail lending credit boom in the last years. A sensitive issue is related to FX lending, which accounts for 65 % and 33 % of total lending in Hungary and Poland, respectively.

Central Europe

	2006	2007	2008	2009	2010	2011
Real GDP (yoy % growth)	6.1	6.1	3.9	–2.1	1.3	2.8
CPI, avg	2.1	3.5	5.0	2.9	2.6	2.6
Loans (yoy % growth)	23.1	29.0	17.3	5.0	7.4	7.3
Loans (% GDP)	43.1	48.7	50.1	59.9	58.4	59.5
Mortgage loans (yoy % growth)	39.8	42.8	31.2	9.0	9.4	8.8
Mortgage loans (% GDP)	9.1	11.4	13.2	16.3	16.2	16.7
Loans denominated/indexed in FX (% total loans)	29.0	24.1	29.4	–	–	–
Deposits (yoy % growth)	14.9	17.9	8.0	5.7	5.4	5.5
Deposits (% GDP)	49.9	51.6	48.8	58.7	56.1	56.2
Loans-to-deposits ratio	86.4	94.5	102.7	102.1	104.0	105.8
External liabilities (in % total liabilities)	14.0	16.8	21.0	–	–	–
Return on assets (%)	1.6	1.6	1.4	0.8	0.9	1.1
Non-performing loans (% of gross loans)	4.7	3.7	3.7	6.4	7.7	7.0
Cost of risk (in % Ø gross loans)	48 bp	50 bp	96 bp	173 bp	173 bp	130 bp

Source: UniCredit Group CEE Strategic Analysis

Chart. 17.1 **Loans/deposits ratio (%)**

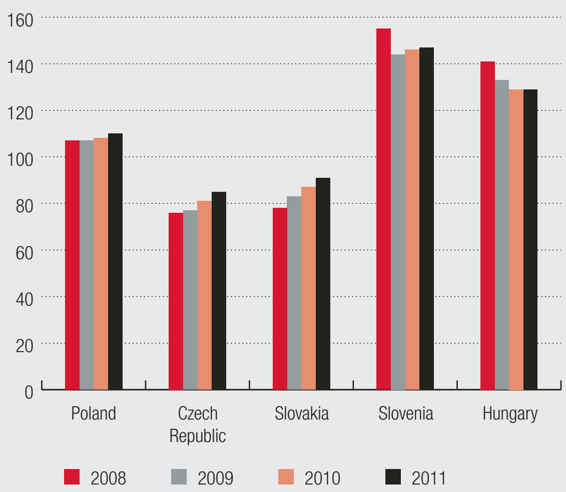
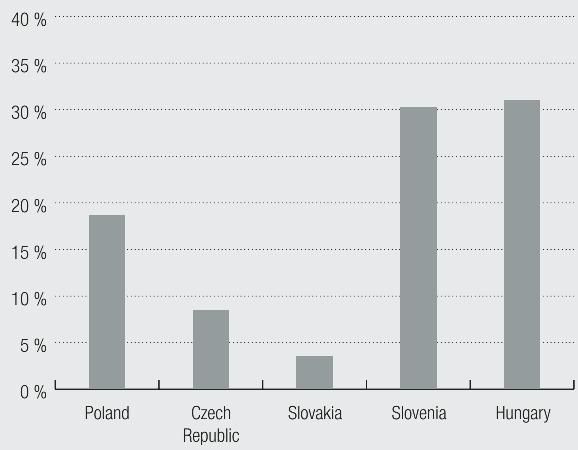


Chart. 17.2 **External liabilities/total liabilities (%) – June 2009**



Source. UniCredit Group CEE Strategic Analysis

Deposit growth will slow in 2010 still affected by modest economic recovery and fading effects from state support. Corporate deposits (after being hit by liquidity problems) will return to positive growth (to 5.7 % from –2.2 % yoy in 2009). Retail deposits will suffer from households' low saving capacity (due to dampened wage growth and high unemployment) and some pressures for diversification, as a recovery in equity markets is expected.

Credit quality remains the issue to watch. The non-performing loans ratio is expected to reach a peak in 2010 to more than double the level observed at the end of 2008. The deterioration in credit quality has so far been worse in the corporate sector than in the retail segment, with the exception of Hungary, where however, the non-performing loans' ratio for the corporate sector remains higher in absolute terms.

The cost of risk is expected to remain high in 2010, stretching profitability. All CE countries are, however, forecast to achieve profit both in 2009 and in 2010, due mainly to cost efficiency. Net revenues growth remains modest, underpinned by moderate volumes with still relatively narrow margins from on the one hand, and little room to leverage on non-interest income (fees and commission in particular) on the other.

Baltics

Collapsing economic growth, with impact on the banks

The Baltics have been seriously affected by the ongoing global credit crunch and regional recession. In the first half of 2009, economic activity was weaker than expected particularly in Lithuania, where GDP contraction deepened to -20.2 % yoy, worse than those of Estonia and Latvia, which moved into recession earlier. Despite local governments' support measures and IMF/EU financial assistance to Latvia, the deterioration in the economy has remained broad based with exports improving somewhat but remaining still deeply in the red and domestic demand weakening further. 2010 is expected to be a challenging year for all three Baltic states relative to the rest of CEE region, with the sharpest correction expected in Lithuania and still significant uncertainty regarding their economic and financial outlook. A change in Latvia's currency regime – with possible contagion on the other two Baltics – is a risk as are additional problems in the banking sector.

The very first signs of credit squeeze that emerged in the second half of 2007 particularly in Estonia and Latvia, became evident in 2008 driven by both demand and supply factors. Credit demand was shrinking largely due to the ongoing stabilisation in the real estate market and the economic downturn. At the same time, Nordic banks – which dominate the local banking system – gradually reduced their funding to the local financial institutions. Loan flow into the domestic economy declined noticeably starting from the second half of 2008 turning negative (in qoq terms) in Q1 2009. Retail credit (both for consumer and mortgage financing) and the corporate segment have all been affected. The dynamic in customer deposits has also remained weak since mid 2008 with some outflows from banks driven by residents' withdrawals in late 2008 particularly in Latvia before the nationalisation of Parex Bank. In the first half of this year, growth in retail deposits continued to weaken, although partially recovered from the financial market turbulence in October of last year, while the one in corporate remains constrained by rising liquidity problems faced by local corporations.

The gloomy macroeconomic outlook and persistent instability are expected to put clear pressures on banking volumes next year. Lending growth is anticipated to remain in negative territory in all three Baltic countries in 2010, with some slower dynamic in retail lending compared to the corporate side. Growth in deposits will stay marginally above the one in lending as the deleveraging process is anticipated to last at least until end of next year, with retail deposits proving to be more resilient as the corporate segment is still hit by pressure on profits and liquidity problems. The ongoing cooling in refinancing from parent banks and the relative high loan-to-deposits ratio (among the highest in the CEE region) will remain a key constraint for lending growth.

The sharp adjustment in economic activity is clearly having an impact on the pace of revenue generation. Pressures on banks' margins are however expected to ease somewhat next year on the back of still tight credit conditions, with fee and commission income remaining a sufficiently stable source of bank income, particularly in Latvia and Lithuania.

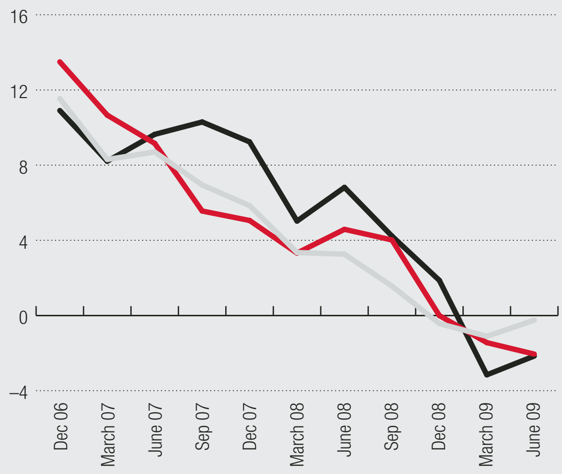
Overall, we do anticipate banks' profitability to be mainly impacted by higher provisioning. Credit quality is expected further to deteriorate looking ahead with the non-performing loans ratio most likely peaking around mid/end of 2011, with a huge upside risk in the event of a de-

Baltics

	2006	2007	2008	2009	2010	2011
Real GDP (yoy % growth)	9.8	8.6	–0.9	–16.4	–5.8	5.1
CPI, avg	4.7	7.3	12.3	3.1	–1.5	1.3
Loans (yoy % growth)	45.9	36.7	13.4	–	–	–
Loans (% GDP)	70.0	77.9	80.4	–	–	–
Mortgage loans (yoy % growth)	70.8	44.2	12.6	–	–	–
Mortgage loans (% GDP)	22.6	26.5	27.2	–	–	–
Loans denominated/indexed in FX (% total loans)	69.2	73.6	78.8	–	–	–
Deposits (yoy % growth)	30.2	18.6	3.8	–	–	–
Deposits (% GDP)	41.4	40.0	37.8	–	–	–
Loans-to-deposits ratio	169.1	194.8	212.8	–	–	–
External liabilities (in % total liabilities)	46.8	51.3	52.8	–	–	–
Return on assets (%)	1.6	2.0	0.8	–2.1	–2.7	–0.5
Non-performing loans (% of gross loans)	0.8	0.8	3.6	13.4	15.9	17.9
Cost of risk (in % Ø gross loans)	20 bp	23 bp	112 bp	482 bp	552 bp	237 bp

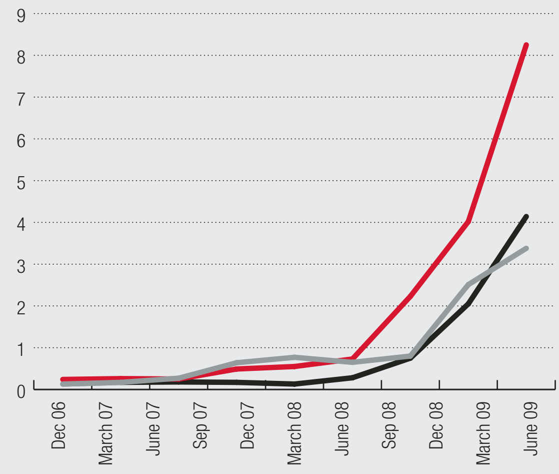
Source: UniCredit Group CEE Strategic Analysis

Chart 18. **Total loans (qoq % growth)**



Source: UniCredit Group CEE Strategic Analysis

Chart 19. **Cost of risk in the Baltics (general and specific provisions over average gross loans, %)[1]**



Note: 1) Annualised figures
Source: UniCredit Group CEE Strategic Analysis

valuation (given the relatively high share of EUR-denominated loans in banks' portfolios). In that context, the definition of loss-sharing mechanisms between foreign banks, local customers and government in the event of a devaluation remains crucial.

Under the current scenario, the probability of a loss remains high in all three countries in both 2010 and 2011 with profitability expected to return to positive territory only starting from 2012.

Under these circumstances, there is an increasing probability that capital adequacy ratios of individual banks might fall below the minimum requirements unless extra capital is raised. Overall, loan-loss absorption capacity however remains pretty strong particularly in Estonia where the capital adequacy ratio of the banking sector stood at 22 % in August of this year, more than twice the 10 % minimum requirement.

South-Eastern Europe

More adjustment in 2010, credit quality remaining the key constraint

South-Eastern Europe

	2006	2007	2008	2009	2010	2011
Real GDP (yoy % growth)	6.7	6.2	5.8	–6.5	–0.6	2.5
CPI, avg	6.7	5.0	8.6	4.9	3.5	3.6
Loans (yoy % growth)	36.5	38.2	20.3	–0.2	4.8	10.2
Loans (% GDP)	39.8	45.5	48.8	54.2	55.5	56.3
Mortgage loans (yoy % growth)	49.1	42.2	27.4	–0.3	6.9	11.3
Mortgage loans (% GDP)	6.1	7.2	8.2	9.2	9.6	9.7
Loans denominated/indexed in FX (% total loans)	57.5	58.0	61.0	–	–	–
Deposits (yoy % growth)	31.5	27.9	4.5	–0.4	5.9	11.8
Deposits (% GDP)	40.0	42.4	39.5	43.7	45.2	46.5
Loans-to-deposits ratio	99.4	107.5	123.7	124.0	122.7	121.0
External liabilities (in % total liabilities)	22.6	23.2	26.0	–	–	–
Return on assets (%)	1.5	1.5	1.8	0.7	0.5	0.8
Non-performing loans (% of gross loans)	4.0	4.0	5.6	11.9	14.1	12.5
Cost of risk (in % Ø gross loans)	187 bp	202 bp	234 bp	319 bp	341 bp	294 bp

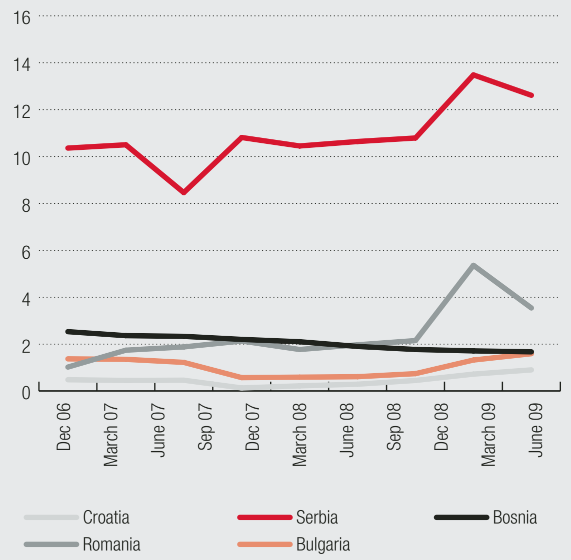
Source: UniCredit Group CEE Strategic Analysis

The economic outlook deteriorated in the SEE region at the beginning of this year as the feared transmission channel passing through lower capital inflows and the internationally induced credit squeeze took effect. Particularly in Romania, the economic adjustment is proceeding faster than previously expected with recession deepening in Q2 to 8.7 %. A sharp contraction in domestic demand – with consumption hampered by accelerating unemployment and investment by higher interest rates – and no visible improvement in exports are a common denominator in SEE in the current phase of adjustment. The anti-crisis measures implemented by local governments and IMF aid packages to Romania, Serbia and Bosnia are providing some relief in the context of a high external financing requirement, but cannot be considered a panacea. Although there are signs that SEE economies are bottoming out, the economic outlook remains quite uncertain with regional GDP growth not expected to return to positive territory before the second half of next year. The outlook for the SEE banking system remains challenging as well, with ongoing deterioration in credit quality and slackening volumes growth expected to put further pressures on banks' profitability.

A clear credit crunch has materialised in the first months of 2009 in Romania, Bulgaria and Bosnia, while some lending activity has been recorded in both Croatia and Serbia, mostly thanks to government-guaranteed schemes or infrastructural projects. Some very moderate growth is expected for the next year in Croatia, Bulgaria and Bosnia, as retail lending will continue to be hampered by low consumption demand and corporate lending by weak investment spending. In Serbia and Romania some more dynamic acceleration is possible. On the deposit side, the liquidity crunch felt by the corporate sector at the global level is also confirmed in the region. In 2009 all countries (except for Serbia) will record negative growth in corporate deposits, which will also be reconfirmed in 2010 in Croatia and Bulgaria. Retail deposit growth is subdued in Croatia. In the other countries, while the saving capacity of the households sector will remain limited, we expect some emergence of hidden funds as competition for deposits in the banking sector is high. All countries indeed feature a loans-to-deposits ratio well above 100 %, which indicates dependency on external funding. Deleveraging in 2009 will be recorded only in Romania and Bosnia, though, while the loans-to-deposits ratio will continue to increase in the other countries. Looking ahead we expect some further deleveraging, mostly due to low demand and to strong pressure for expanding the deposit base, despite increasing competition from alternative products in some countries, as capital markets rebound. It is important to note that deleveraging is not coming from lack of external funding to local institutions. With parent banks of the top local institutions having signed commitments with the local central banks (as part of the IMF support packages) to maintain on their cross-border exposure to Serbia, Romania and Bosnia, liquidity should not be an issue for the banks in those countries. Funding also does not seem to be a concern for banks in Bulgaria and Croatia.

Banks' profitability is being hit by economic recession throughout the region. Reduced banking activities and accelerated non-performing loans constrain banks' profitability. We forecast the peak in terms of non performing loans in the region between the end of 2010 and the first half of 2011, with the peak in cost of risk in 2010. We forecast a strong drop in profits in Romania to a still positive EUR 135 mn (compared to EUR 1.5 bn last year), despite strict cost control and in Bulgaria, where profits are forecasted to halve both in 2009 and 2010. In Serbia as well, profits will be halved in 2009 with respect to 2008, with some recovery, albeit slow, expected for 2010–11. The Croatian banking sector should be slightly more resilient, with profits declining by 15 % in 2009 and 5 % in 2010. In Bosnia we see the currency board remaining stable given an IMF agreement is in place, implying minimal risk to EUR-linked loans (CHF-linked loans are less than 5 % of all outstanding loans). The banking sector is well capitalised and the support of parent banks will ensure this remains the case in spite of the expected increase in non-performing loans.

Chart 20. **Cost of risk in SEE (general and specific provisions over average gross loans, %)[1]**



1) Annalised figures
Source: UniCredit Group CEE Strategic Analysis

Other CEE countries

Turkey to benefit from a solid banking sector, while state intervention has been key in the CIS to preserve banking system stability

Ukraine and Kazakhstan have been the first countries in the region experiencing a full fledged economic and banking crisis, with an interactive of national imbalances and international features. The Ukrainian economy, which will probably record one of the most significant declines in GDP at the global level, is paying the cost of high political instability, high internal and external imbalances, high dependency on energy imports and from steel exports, in a period in which all these factors have been recognized as key vulnerabilities. Kazakhstan had a severe slowdown of economic activity starting in the first part of 2008, as a consequence of the bursting of the real estate bubble and a reversal in raw material and oil prices, rather than from a drop in capital inflows and export demand. The huge support program from authorities (12.5 % of GDP) has been the mainstay for the economy, which however in the future will have to rely on resources even more than previously. In February 2009 the tenge was devalued (20 % versus dollar). The decline in economic activity was evident in Turkey and Russia as well in 2009, but some recovery might be in reach. In Russia, recovery of oil prices and significant state support are the basis for some new business opportunities in 2010. Growth will remain considerably below potential for a while, however. Turkey has been largely suffering from internal demand constraints, while the stability of the banking sector is a valuable support factor.

As a result of the above-mentioned macro trends, a credit crunch has materialised in all the countries in 2009. Strong leveraged banking sector and dependency on external funding have been a key driver for banking sector correction in Kazakhstan, Ukraine and Russia, together with rapidly mounting credit quality issues. In Turkey, the banking sector is more balanced, with the loans/deposits ratio below 100 %, meaning no issues in terms of funding and no pressure for deleveraging. Retail lending growth has been extremely weak in Russia, Ukraine and also in Kazakhstan, where some boom had been recorded in the last years, both in terms of consumer credit and real estate. On the corporate side, some more resilience has been recorded in Russia, thanks to a government stimulus program. By contrast, in Turkey retail lending outperformed corporate lending growth, as investment and trade activities have so far been the hardest hit. Deposit growth has remained relatively comfortable in Russia, Turkey and Kazakhstan (with some constraints from low corporate liquidity in Russia). The impact of the crisis and the devaluation led to a substantial drain of deposits in Ukraine, with an estimated drop of some 31 % in 2009. Overall, the loans-to-deposits ratio is set to continue to decline in Russia, Kazakhstan and Ukraine this year and next. More dynamic volumes performance and some increase in the loans-to-deposits ratio is expected, however, in Turkey in 2010.

Other CEE countries

	2006	2007	2008	2009	2010	2011
Real GDP (yoy % growth)	7.6	7.1	4.0	–6.8	1.9	4.2
CPI, avg	9.6	9.3	14.0	10.1	7.4	7.5
Loans (yoy % growth)	38.6	45.0	10.7	–10.7	10.8	22.4
Loans (% GDP)	30.3	37.4	35.7	40.3	41.7	42.1
Mortgage loans (yoy % growth)	94.4	78.1	17.5	–6.9	17.7	27.0
Mortgage loans (% GDP)	1.9	2.9	3.0	3.5	3.8	4.0
Loans denominated/indexed in FX (% Total loans)	30.3	28.6	31.9	–	–	–
Deposits (yoy % growth)	23.4	31.7	1.1	–1.5	12.2	22.2
Deposits (% GDP)	31.0	34.7	30.2	37.6	39.4	39.7
Loans-to-deposits ratio	98.0	107.9	118.1	107.2	105.8	105.9
External liabilities (in % total liabilities)	18.7	19.1	18.2	–	–	–
Return on assets (%)	2.6	2.6	1.8	–0.6	0.7	1.1
Non-performing loans (% of gross loans)	7.0	7.0	9.3	16.9	20.6	17.0
Cost of risk (in % Ø gross loans)	195 bp	179 bp	345 bp	761 bp	537 bp	473 bp

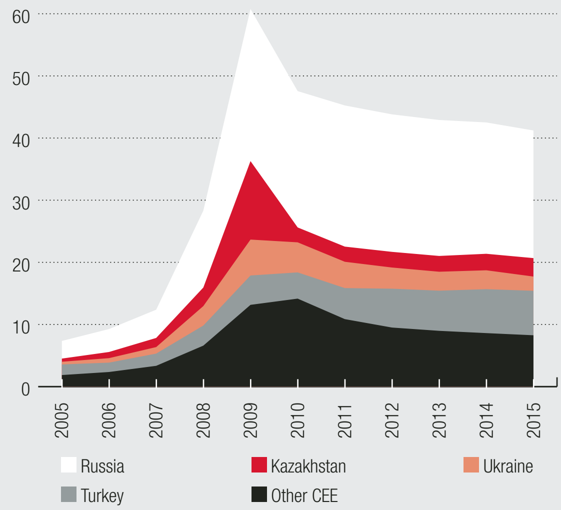
Source: UniCredit Group CEE Strategic Analysis

As concerns Russia, Ukraine and Kazakhstan, credit quality is the key issue for this year and next, shaping the system's profitability. The peak in non-performing loans is expected in 2010 in Russia and Ukraine and in 2011 in Kazakhstan, while the peak in cost of risk may have already materialised in 2009, provided most of the banks do not end up smoothing the provisioning effort over time. Based on strong provisioning and despite a complete halt in investment projects and substantial efforts in terms of efficiencies, we forecast negative profitability in the three countries in 2009 and in Ukraine and Kazakhstan also in 2010. It is important to note, as banks in the market can be very different in terms of portfolio exposure and in terms of access to liquidity, performance varies substantially among players. With particular reference to Kazakhstan, Ukraine and Russia, structural changes in the system must be noted.

In Kazakhstan, two of the major banks (BTA and Alliance, ranked first and fourth in the country in terms of assets) defaulted on their external obligations and are now under state control. Restructuring of about 40 % of their foreign liabilities is pending; the affected banks and the authorities suggest a haircut at some 80 % in net present value terms with several options (including debt for equity swaps). The bankruptcy of the formerly largest bank, BTA, can not be excluded. This is affecting the performance of the Kazakhstani banking sector, which is expected to post a loss this year and also in 2010. High provisioning is the main culprit, related to the increase in non-performing loans, to 28.3 % as of August (they could reach 37 % in 2010). Given the current crisis, Kazakhstan's banking sector will be markedly different than in the past: judging from discussion papers of the central bank and the FSA, a possible banking reform will include tightening of the regulations for capital adequacy, for foreign funding, and possibly even impose loans-to-deposits ratio (150 %, while the average stood at 156 % in August).

In Ukraine, the crisis and the drastic UAH devaluation (68 % against USD between August 2008 and September 2009) led to a first run on the banks and mounting credit quality problems (NPLs surged from 17.4 % at the end of 2008 to about 30 % at the end of June 2009, when the ratio is calculated to also account for off-balance sheet positions). With results for the sector turning negative (we forecast losses for the system both in 2009 and 2010, with return to a small positive profit in 2011), most of the foreign banks have injected capital into their subsidiaries, while the state had to recapitalise state banks and nationalise several mid-size ones.

Chart 21. **Banking system risk costs (EUR bn): CIS countries, Turkey and CEE**



Source: UniCredit Group CEE Strategic Analysis

The Russian banking sector has been significantly affected by the crisis as well, but the wide range of government anti-crisis packages are partially cushioning the negative effects. Banking profitability is worsening, with a loss forecast for 2009. However, continuing recovery of the securities market will result in a positive revaluation gain and higher non-interest income, while interest expenses will certainly decrease on easing of the domestic money market. Altogether, the Russian banking sector will return to profit as soon as 2010 (with Russia representing almost 20 % of the CEE profit pool in 2010). Moreover, we expect further capital injections in the banking sectors (around RUB 450 bn) from various sources, partially provided by the government (2010 budget) and partially from capital increases and accumulated profits.

In contrast to the above three, the Turkish banking sector proved to be very resilient to the crisis. With no liquidity issues and the deterioration in credit quality under control, profitability in 2009 is remaining strong. The peak in cost of risk will probably be reached during 2009 (CoR will be slightly lower in 2010).

Annex – Country data

Central Europe

Czech Republic

	2006	2007	2008	2009	2010	2011
Real GDP (yoy % growth)	6.8	6.1	2.7	–4.2	1.4	3.5
CPI, avg	2.5	2.8	6.3	1.1	2.2	2.1
Loans (yoy % growth)	17.4	24.5	15.3	2.9	8.9	11.3
Loans (% GDP)	42.0	47.7	52.6	54.8	58.1	61.3
Mortgage loans (yoy % growth)	32.6	37.6	20.1	9.8	10.7	13.1
Mortgage loans (% GDP)	11.5	14.5	16.7	18.5	19.9	21.4
Loans denominated/indexed in FX (% total loans)	10.4	9.1	9.5	–	–	–
Deposits (yoy % growth)	8.8	15.2	8.4	1.2	3.2	6.1
Deposits (% GDP)	63.8	67.0	69.6	71.3	71.6	72.0
Loans-to-deposits ratio	65.8	71.1	75.6	76.9	81.2	85.2
External liabilities (in % total liabilities)	7.8	9.4	10.5	–	–	–
Return on assets (%)	1.5	1.6	1.3	1.1	1.1	1.4
Non-performing loans (% of gross loans)	3.7	2.8	3.3	5.9	7.3	6.9
Cost of risk (in % Ø gross loans)	31 bp	50 bp	86 bp	172 bp	175 bp	109 bp

Hungary

	2006	2007	2008	2009	2010	2011
Real GDP (yoy % growth)	4.0	1.2	0.6	–6.1	–0.6	2.4
CPI, avg	3.9	8.0	6.1	4.2	3.1	1.9
Loans (yoy % growth)	18.8	13.5	18.5	–0.2	0.9	6.4
Loans (% GDP)	57.5	60.9	69.0	71.7	71.2	72.3
Mortgage loans (yoy % growth)	19.3	17.2	25.4	2.0	1.7	7.2
Mortgage loans (% GDP)	11.8	12.9	15.4	16.4	16.4	16.8
Loans denominated/indexed in FX (% total loans)	47.4	56.4	64.6	–	–	–
Deposits (yoy % growth)	13.8	9.3	10.8	5.9	4.1	6.3
Deposits (% GDP)	45.2	46.1	48.9	53.9	55.2	56.0
Loans-to-deposits ratio	127.2	132.0	141.1	133.0	128.9	129.0
External liabilities (in % total liabilities)	25.9	27.5	32.9	–	–	–
Return on assets (%)	1.6	1.4	0.8	0.8	0.8	0.9
Non-performing loans (% of gross loans)	3.6	3.7	4.5	8.3	8.8	8.1
Cost of risk (in % Ø gross loans)	61 bp	73 bp	85 bp	202 bp	189 bp	157 bp

Poland

	2006	2007	2008	2009	2010	2011
Real GDP (yoy % growth)	6.2	6.8	4.9	1.4	1.8	2.6
CPI, avg	1.0	2.5	4.2	3.7	2.8	2.8
Loans (yoy % growth)	22.4	29.4	36.7	6.4	4.8	6.0
Loans (% GDP)	34.2	39.9	50.5	51.6	52.0	52.3
Mortgage loans (yoy % growth)	54.3	50.7	64.9	7.1	6.2	6.8
Mortgage loans (% GDP)	7.4	10.0	15.3	15.7	16.0	16.2
Loans denominated/indexed in FX (% total loans)	26.4	23.8	33.0	–	–	–
Deposits (yoy % growth)	14.0	14.4	20.5	6.5	3.6	4.6
Deposits (% GDP)	41.0	42.3	47.1	48.2	48.0	47.7
Loans-to-deposits ratio	83.4	94.4	107.0	106.9	108.2	109.6
External liabilities (in % total liabilities)	8.7	12.2	19.3	–	–	–
Return on assets (%)	1.8	2.0	1.6	0.9	0.8	1.1
Non-performing loans (% of gross loans)	6.8	4.9	4.2	6.6	8.4	7.5
Cost of risk (in % Ø gross loans)	48 bp	41 bp	94 bp	189 bp	187 bp	149 bp

Slovakia

	2006	2007	2008	2009	2010	2011
Real GDP (yoy % growth)	8.5	10.4	6.4	–5.4	2.1	3.5
CPI, avg	4.5	2.8	4.6	1.7	1.7	3.5
Loans (yoy % growth)	20.0	23.9	15.3	1.3	8.4	11.3
Loans (% GDP)	40.3	44.7	47.1	50.6	52.8	55.4
Mortgage loans (yoy % growth)	20.9	22.9	20.5	8.7	12.1	12.6
Mortgage loans (% GDP)	7.1	7.8	8.6	9.9	10.7	11.4
Loans denominated/indexed in FX (% total loans)	1.2	1.3	1.2	–	–	–
Deposits (yoy % growth)	12.2	13.7	15.4	–4.6	3.3	6.8
Deposits (% GDP)	56.0	57.0	60.1	60.9	60.6	61.0
Loans-to-deposits ratio	71.9	78.4	78.3	83.1	87.2	90.9
External liabilities (in % total liabilities)	12.6	17.3	18.4	–	–	–
Return on assets (%)	1.5	1.2	1.1	0.7	1.0	1.1
Non-performing loans (% of gross loans)	3.3	2.5	3.2	5.6	6.0	5.5
Cost of risk (in % Ø gross loans)	43 bp	27 bp	99 bp	153 bp	100 bp	67 bp

Slovenia

	2006	2007	2008	2009	2010	2011
Real GDP (yoy % growth)	5.9	6.8	3.5	–8.0	0.5	1.4
CPI, avg	2.5	3.6	5.7	1.0	2.5	2.5
Loans (yoy % growth)	25.2	32.3	18.1	3.3	3.7	5.8
Loans (% GDP)	65.1	77.4	85.0	94.1	95.3	97.1
Mortgage loans (yoy % growth)	43.0	36.4	27.2	9.0	10.5	12.0
Mortgage loans (% GDP)	6.3	7.7	9.2	10.7	11.5	12.4
Loans denominated/indexed in FX (% total loans)	63.1	7.2	7.5	–	–	–
Deposits (yoy % growth)	9.5	8.4	7.5	11.5	2.2	5.0
Deposits (% GDP)	56.3	54.9	54.8	65.5	65.4	66.1
Loans-to-deposits ratio	115.6	141.1	155.0	143.6	145.7	146.9
External liabilities (in % total liabilities)	31.7	37.3	36.5	–	–	–
Return on assets (%)	1.1	1.2	0.7	0.4	0.4	0.6
Non-performing loans (% of gross loans)	4.1	3.1	2.9	5.5	6.0	5.8
Cost of risk (in % Ø gross loans)	68 bp	68 bp	83 bp	128 bp	124 bp	94 bp

Baltics

Estonia

	2006	2007	2008	2009	2010	2011
Real GDP (yoy % growth)	10.4	6.3	–3.5	–15.3	–3.8	5.1
CPI, avg	4.4	6.6	10.4	–0.1	–1.4	1.7
Loans (yoy % growth)	41.6	33.3	7.9	–	–	–
Loans (% GDP)	84.3	94.2	98.8	–	–	–
Mortgage loans (yoy % growth)	63.4	31.5	10.4	–	–	–
Mortgage loans (% GDP)	32.6	36.0	38.6	–	–	–
Loans denominated/indexed in FX (% total loans)	78.1	79.2	85.2	–	–	–
Deposits (yoy % growth)	28.0	13.8	6.0	–	–	–
Deposits (% GDP)	50.4	48.1	49.6	–	–	–
Loans-to-deposits ratio	167.1	195.7	199.3	–	–	–
External liabilities (in % total liabilities)	47.4	52.9	54.1	–	–	–
Return on assets (%)	1.6	2.4	1.2	–1.3	–1.1	–0.4
Non-performing loans (% of gross loans)	0.2	0.5	1.9	6.5	8.0	9.6
Cost of risk (in % Ø gross loans)	15 bp	28 bp	81 bp	310 bp	289 bp	166 bp

Latvia

	2006	2007	2008	2009	2010	2011
Real GDP (yoy % growth)	12.2	10.0	–4.6	–16.3	–5.4	6.0
CPI, avg	6.5	10.1	15.5	3.4	–2.7	1.5
Loans (yoy % growth)	57.3	34.0	12.4	–	–	–
Loans (% GDP)	87.7	88.8	90.8	–	–	–
Mortgage loans (yoy % growth)	86.4	44.5	7.3	–	–	–
Mortgage loans (% GDP)	29.2	31.9	31.1	–	–	–
Loans denominated/indexed in FX (% total loans)	76.9	86.3	88.4	–	–	–
Deposits (yoy % growth)	43.1	17.2	8.7	–	–	–
Deposits (% GDP)	42.0	37.2	36.8	–	–	–
Loans-to-deposits ratio	208.7	238.6	246.6	–	–	–
External liabilities (in % total liabilities)	54.7	59.2	57.5	–	–	–
Return on assets (%)	1.9	2.0	0.4	–3.4	–3.7	–0.4
Non-performing loans (% of gross loans)	1.0	0.7	3.6	16.2	19.8	22.0
Cost of risk (in % Ø gross loans)	18 bp	25 bp	225 bp	723 bp	818 bp	265 bp

Lithuania

	2006	2007	2008	2009	2010	2011
Real GDP (yoy % growth)	7.8	8.9	3.0	–17.0	–7.0	4.4
CPI, avg	3.7	5.7	11.0	4.4	–0.7	1.1
Loans (yoy % growth)	38.1	42.9	19.1	–	–	–
Loans (% GDP)	50.5	60.8	63.8	–	–	–
Mortgage loans (yoy % growth)	60.2	61.8	24.9	–	–	–
Mortgage loans (% GDP)	12.5	17.1	18.8	–	–	–
Loans denominated/indexed in FX (% total loans)	52.1	54.8	64.0	–	–	–
Deposits (yoy % growth)	23.2	23.4	–1.3	–	–	–
Deposits (% GDP)	36.1	37.5	32.6	–	–	–
Loans-to-deposits ratio	139.9	162.2	195.7	–	–	–
External liabilities (in % total liabilities)	35.9	39.7	45.9	–	–	–
Return on assets (%)	1.3	1.7	1.1	–1.5	–1.5	–0.6
Non-performing loans (% of gross loans)	1.0	1.0	4.6	16.1	18.4	20.7
Cost of risk (in % Ø gross loans)	28 bp	17 bp	20 bp	370 bp	390 bp	268 bp

South-Eastern Europe

Bosnia

	2006	2007	2008	2009	2010	2011
Real GDP (yoy % growth)	6.7	6.8	5.4	–3.0	–1.0	0.8
CPI, avg	6.1	1.5	7.4	0.2	2.6	2.2
Loans (yoy % growth)	23.2	28.4	22.1	–1.6	1.6	5.5
Loans (% GDP)	48.5	54.7	58.8	59.6	59.6	61.0
Mortgage loans (yoy % growth)	–	–	–	–	–	–
Mortgage loans (% GDP)	–	–	–	–	–	–
Loans denominated/indexed in FX (% total loans)	76.4	77.2	74.4	–	–	–
Deposits (yoy % growth)	27.9	37.5	–1.4	1.6	2.6	5.8
Deposits (% GDP)	45.9	55.5	48.2	50.4	50.8	52.2
Loans-to-deposits ratio	105.6	98.7	122.1	118.3	117.2	116.8
External liabilities (in % total liabilities)	27.4	26.2	30.0	–	–	–
Return on assets (%)	0.8	0.8	0.5	0.1	–0.2	0.3
Non-performing loans (% of gross loans)	3.3	2.5	3.0	5.5	5.8	4.9
Cost of risk (in % Ø gross loans)	246 bp	237 bp	180 bp	243 bp	323 bp	277 bp

Bulgaria

	2006	2007	2008	2009	2010	2011
Real GDP (yoy % growth)	6.3	6.2	6.0	–6.3	–2.5	2.0
CPI, avg	7.3	8.4	12.4	2.6	–0.6	1.5
Loans (yoy % growth)	24.3	63.6	32.9	0.7	3.3	7.6
Loans (% GDP)	45.9	65.6	73.8	77.2	82.3	85.5
Mortgage loans (yoy % growth)	81.9	71.8	38.6	4.3	7.5	11.8
Mortgage loans (% GDP)	7.4	11.2	13.1	14.2	15.8	17.0
Loans denominated/indexed in FX (% total loans)	45.0	50.0	56.7	–	–	–
Deposits (yoy % growth)	33.8	35.0	8.8	1.0	3.9	8.7
Deposits (% GDP)	55.2	65.1	59.9	62.8	67.4	70.7
Loans-to-deposits ratio	83.2	100.8	123.2	122.8	122.1	120.9
External liabilities (in % total liabilities)	15.2	19.8	25.7	–	–	–
Return on assets (%)	2.2	2.1	2.2	1.1	0.5	1.2
Non-performing loans (% of gross loans)	3.0	2.5	3.2	5.7	10.0	9.6
Cost of risk (in % Ø gross loans)	56 bp	120 bp	75 bp	219 bp	298 bp	199 bp

Croatia

	2006	2007	2008	2009	2010	2011
Real GDP (yoy % growth)	4.7	5.5	2.4	–6.2	–1.5	1.2
CPI, avg	3.2	2.9	6.1	3.0	3.3	3.1
Loans (yoy % growth)	22.5	13.4	14.6	3.9	3.7	4.8
Loans (% GDP)	66.3	68.5	72.1	77.4	78.8	79.1
Mortgage loans (yoy % growth)	33.3	22.9	15.7	2.5	2.8	5.0
Mortgage loans (% GDP)	14.3	16.0	17.0	18.0	18.2	18.4
Loans denominated/indexed in FX (% total loans)	71.8	62.3	65.8	–	–	–
Deposits (yoy % growth)	16.7	16.5	6.3	–3.1	1.3	4.7
Deposits (% GDP)	57.8	61.3	59.8	59.9	59.6	59.8
Loans-to-deposits ratio	114.7	111.7	120.4	129.1	132.1	132.2
External liabilities (in % total liabilities)	25.4	19.4	20.8	–	–	–
Return on assets (%)	1.4	1.5	1.6	1.3	1.3	1.4
Non-performing loans (% of gross loans)	3.2	3.1	3.2	8.0	10.0	10.0
Cost of risk (in % Ø gross loans)	39 bp	48 bp	48 bp	112 bp	126 bp	113 bp

Romania

	2006	2007	2008	2009	2010	2011
Real GDP (yoy % growth)	7.9	6.2	7.1	–7.5	0.4	3.5
CPI, avg	6.6	4.8	7.9	5.7	3.9	3.8
Loans (yoy % growth)	54.7	60.8	34.6	1.3	5.0	9.9
Loans (% GDP)	27.4	36.8	40.5	41.5	41.4	42.2
Mortgage loans (yoy % growth)	55.9	71.8	57.2	1.0	9.9	11.9
Mortgage loans (% GDP)	2.4	3.5	4.5	4.6	4.8	5.0
Loans denominated/indexed in FX (% total loans)	46.3	53.0	56.0	–	–	–
Deposits (yoy % growth)	28.1	33.9	18.7	6.4	8.0	12.4
Deposits (% GDP)	29.5	33.0	32.1	34.5	35.4	36.9
Loans-to-deposits ratio	92.7	111.3	126.2	120.2	116.8	114.2
External liabilities (in % total liabilities)	22.5	28.2	30.6	–	–	–
Return on assets (%)	1.5	1.2	1.7	0.2	0.1	0.3
Non-performing loans (% of gross loans)	2.7	3.9	6.3	16.0	17.5	14.0
Cost of risk (in % Ø gross loans)	123 bp	180 bp	219 bp	354 bp	366 bp	323 bp

Serbia

	2006	2007	2008	2009	2010	2011
Real GDP (yoy % growth)	5.6	7.1	5.4	–4.8	–0.7	1.3
CPI, avg	12.7	6.5	11.7	8.6	7.0	6.1
Loans (yoy % growth)	15.0	36.4	34.8	18.9	8.0	8.9
Loans (% GDP)	30.9	35.4	40.7	46.6	47.4	48.0
Mortgage loans (yoy % growth)	–	–	–	–	–	–
Mortgage loans (% GDP)	–	–	–	–	–	–
Loans denominated/indexed in FX (% total loans)	–	–	70.0	–	–	–
Deposits (yoy % growth)	40.6	46.3	7.7	13.2	11.3	10.0
Deposits (% GDP)	28.9	35.4	32.5	35.5	37.1	38.0
Loans-to-deposits ratio	107.2	99.9	125.1	131.4	127.5	126.2
External liabilities (in % total liabilities)	24.2	17.9	18.2	–	–	–
Return on assets (%)	1.3	1.4	1.8	0.8	0.9	0.9
Non-performing loans (% of gross loans)	4.1	3.8	10.2	16.8	16.9	14.9
Cost of risk (in % Ø gross loans)	1081 bp	844 bp	1059 bp	983 bp	874 bp	799 bp

Other CEE countries

Kazakhstan

	2006	2007	2008	2009	2010	2011
Real GDP (yoy % growth)	10.7	8.9	3.3	–1.6	2.5	5.0
CPI, avg	8.6	10.8	17.2	7.5	7.3	7.0
Loans (yoy % growth)	85.6	50.5	5.5	–14.0	12.6	17.3
Loans (% GDP)	49.6	59.8	50.6	46.5	46.1	46.9
Mortgage loans (yoy % growth)	–	–	–	–	–	–
Mortgage loans (% GDP)	–	–	–	–	–	–
Loans denominated/indexed in FX (% total loans)	48.4	42.7	44.2	–	–	–
Deposits (yoy % growth)	87.1	24.9	19.9	19.7	14.6	14.4
Deposits (% GDP)	30.0	30.0	28.8	36.9	37.2	36.9
Loans-to-deposits ratio	165.5	199.4	175.6	126.1	124.0	127.0
External liabilities (in % total liabilities)	46.0	46.0	37.1	–	–	–
Return on assets (%)	1.5	2.2	0.3	–19.8	–1.7	0.4
Non-performing loans (% of gross loans)	2.6	6.6	10.8	21.8	36.8	38.8
Cost of risk (in % Ø gross loans)	402 bp	389 bp	674 bp	3513 bp	738 bp	614 bp

Russia

	2006	2007	2008	2009	2010	2011
Real GDP (yoy % growth)	7.7	8.1	5.6	–7.4	1.3	4.1
CPI, avg	9.7	9.0	14.1	11.8	7.9	8.4
Loans (yoy % growth)	46.5	51.9	34.3	1.0	7.1	12.0
Loans (% GDP)	29.6	36.5	39.1	40.2	37.9	37.2
Mortgage loans (yoy % growth)	182.4	113.8	59.4	–0.1	12.8	16.8
Mortgage loans (% GDP)	1.4	2.5	3.2	3.2	3.2	3.3
Loans denominated/indexed in FX (% total loans)	24.5	22.7	24.7	–	–	–
Deposits (yoy % growth)	41.4	41.5	20.2	11.5	10.2	12.6
Deposits (% GDP)	27.8	31.9	30.6	34.7	33.7	33.2
Loans-to-deposits ratio	106.7	114.6	128.0	115.9	112.6	112.0
External liabilities (in % total liabilities)	19.5	20.4	17.9	–	–	–
Return on assets (%)	2.6	2.5	1.5	–0.3	0.4	0.7
Non-performing loans (% of gross loans)	10.0	9.5	12.7	21.0	25.0	21.0
Cost of risk (in % Ø gross loans)	188 bp	159 bp	318 bp	694 bp	618 bp	557 bp

Turkey

	2006	2007	2008	2009	2010	2011
Real GDP (yoy % growth)	6.9	4.6	0.9	–5.2	3.2	4.5
CPI, avg	9.6	8.8	10.5	6.0	5.4	5.1
Loans (yoy % growth)	40.4	26.4	29.6	4.7	12.1	18.8
Loans (% GDP)	28.3	32.2	37.1	38.6	39.8	43.0
Mortgage loans (yoy % growth)	79.3	39.1	21.5	10.0	19.0	20.0
Mortgage loans (% GDP)	3.0	3.8	4.1	4.5	4.9	5.3
Loans denominated/indexed in FX (% total loans)	31.5	30.1	34.8	–	–	–
Deposits (yoy % growth)	22.1	14.6	26.9	11.9	9.1	14.8
Deposits (% GDP)	39.1	40.3	45.4	50.6	50.7	53.0
Loans-to-deposits ratio	72.4	79.9	81.6	76.4	78.4	81.1
External liabilities (in % total liabilities)	12.0	10.2	11.7	–	–	–
Return on assets (%)	2.9	3.1	2.2	2.6	2.2	2.2
Non-performing loans (% of gross loans)	3.6	3.5	3.5	5.7	5.5	5.2
Cost of risk (in % Ø gross loans)	148 bp	144 bp	198 bp	290 bp	258 bp	240 bp

Ukraine

	2006	2007	2008	2009	2010	2011
Real GDP (yoy % growth)	7.1	7.6	2.1	–13.5	1.7	3.3
CPI, avg	9.1	12.8	25.2	16.3	11.4	9.6
Loans (yoy % growth)	71.0	74.1	72.0	–3.1	–0.2	6.2
Loans (% GDP)	45.6	59.9	77.2	76.6	65.5	58.6
Mortgage loans (yoy % growth)	195.9	127.2	92.2	–	–	–
Mortgage loans (% GDP)	3.8	6.5	9.4	–	–	–
Loans denominated/indexed in FX (% total loans)	49.5	49.9	59.1	–	–	–
Deposits (yoy % growth)	38.0	52.7	26.7	–16.4	3.2	9.3
Deposits (% GDP)	34.6	39.8	37.8	32.4	28.6	26.4
Loans-to-deposits ratio	131.9	150.4	204.0	236.6	228.6	222.2
External liabilities (in % total liabilities)	18.3	23.3	29.2	–	–	–
Return on assets (%)	1.6	1.4	1.1	–2.9	–1.8	0.2
Non-performing loans (% of gross loans)	1.7	1.3	2.3	15.0	25.0	15.0
Cost of risk (in % Ø gross loans)	236 bp	216 bp	416 bp	909 bp	797 bp	588 bp

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