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CEE countries: recovery after crisis

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Kiev September 2010

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Recovery in CEE

- **Economic recovery under way but still not supported by credit growth.**

  Most CEE countries have left recession and will record modest positive growth rates this year.

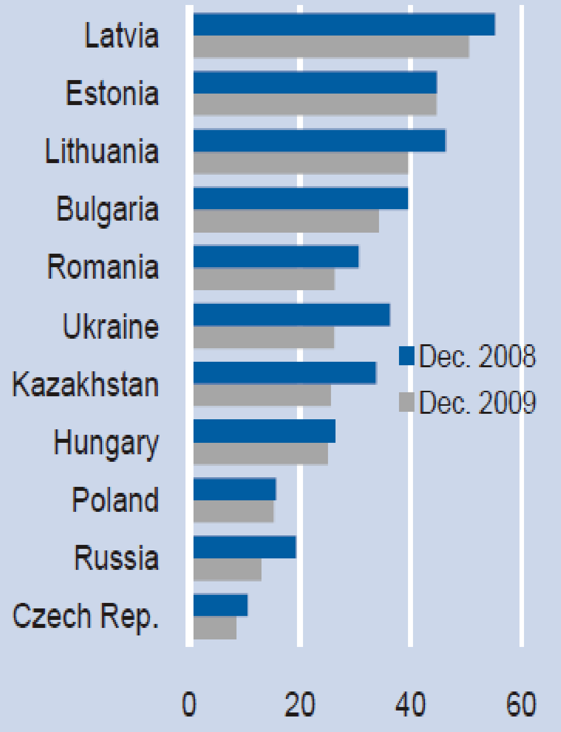
  The availability of (external) funding and the evolution of NPLs (and subsequent risks to profitability and capital) will be important determinants for credit growth over the next few months.

- **Gradual external deleveraging ongoing.**

  External asset-to-liability ratios have inched down across the board and are expected to continue to do so.

Ongoing deleveraging

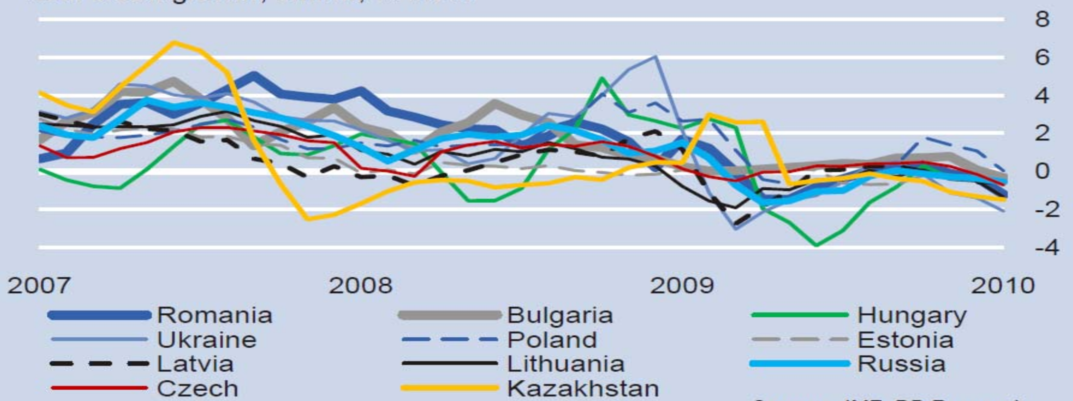
Banks' external liabilities as % of total assets in LC



Sources: IFS, Central Banks, DB Research

No credit impulse in CEE countries

Real credit growth, 3mma, % mom



Sources: IMF, DB Research

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Recovery in CEE

• **NPLs are close to peak levels, no significant risks from further provisioning needs**.

In tandem with weak economic performance and rising unemployment NPLs are continuing to trend up in almost all CEE countries.

With the exception of Ukraine, Lithuania and Russia, provisioning levels stand at comfortable levels. Overall, we expect our NPL peak level forecasts to be reached within the next few months.

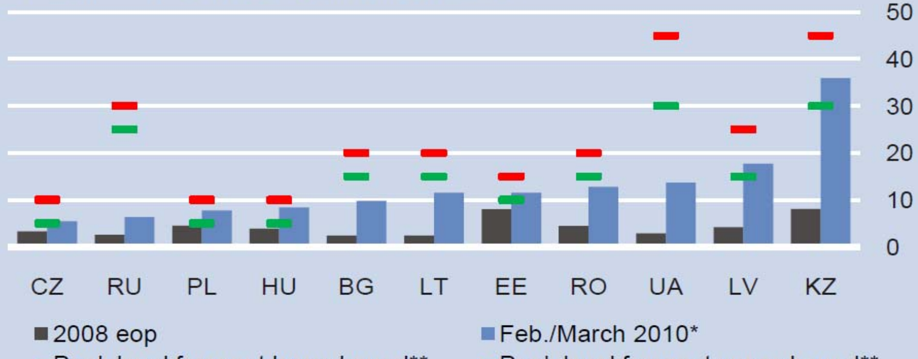
• **No significant risks to profitability and capital from further provisioning needs**

Adequate provisioning helps banks to avoid negative surprises in terms of profitability or capital needs.

Provisioning levels have declined since last year in almost all countries but still stand at relatively comfortable levels.

NPL peak levels to be reached soon

NPLs in % of total loans (national definitions)

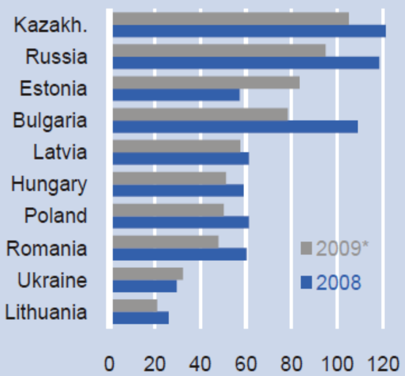


*PL, HU and UA data from Dec. **Forecasts DBR Credit Monitor Eastern Europe, 20. August 2009

Sources: National central banks and regulators, DB Research

Relatively sound provisioning levels

Bank provisions to NPLs, %

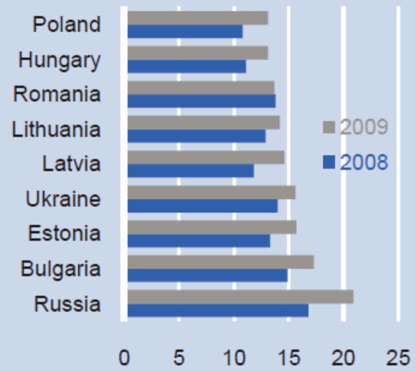


*As of Sept./Oct or Dec.

Sources: IMF, nat. statistics, DB Research

Capital adequacy ratios increased

Bank reg. capital to risk-weighted assets



Sources: IMF, DB Research

Recovery in CEE

- **Assessing contagion risks from Greek debt crisis**

After S&P's downgrade of Greece to sub-investment grade on April 28 and resulting negative financial market reactions, the question of possible contagion channels to CEE has resurfaced.

In our contagion matrix we present the three main contagion channels, i.e. contagion via reduced bank lending from Greek parent banks, contagion via reduced exports to Greece and contagion via foreign investors selling their portfolio equity and debt holdings. We grouped the CEE countries into three categories according to the relative contagion risk they face.

	Banking sector	Real economy	Capital outflows
	Greek foreign claims, in % of local GDP, Dec. 2009	Exports to Greece in % of total exports, Oct. 2009	Portfolio investment (equity + debt), in % of local GDP, 2008 eop
High (15-25%)	Bulgaria, Macedonia, Serbia		Hungary
Medium (5-15%)	Albania, Romania	Albania, Bulgaria, Macedonia	Bulgaria, Croatia, Czech Republic, Estonia, Lithuania, Poland, Slovakia
Low (<5%)	Croatia, Czech Republic, Estonia, Hungary, Kazakhstan, Latvia, Lithuania, Poland, Russia, Slovakia, Ukraine	Croatia, Czech Republic, Estonia, Hungary, Kazakhstan, Latvia, Lithuania, Poland, Romania, Russia, Serbia, Slovakia, Ukraine	Albania, Kazakhstan, Latvia, Macedonia, Romania, Russia, Serbia, Ukraine

Emerging Markets: Q2 Overview & Outlook

• **Favourable EM momentum, some headwinds from DM credit**

Emerging markets fundamentals continued to evolve favourably in 1Q10. Practically all countries have now left the crisis-induced recessions behind.

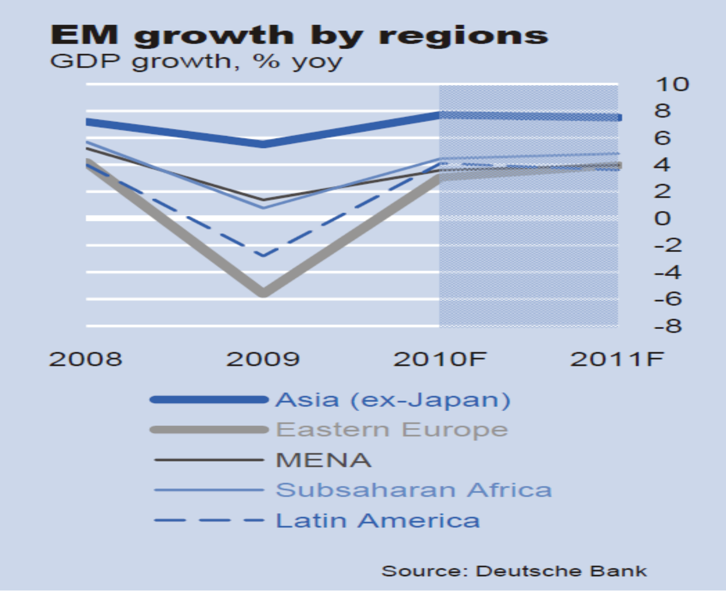
Better-than-expected GDP growth in the US (forecast at almost 4% in 2010) and Japan (2.8%) as well as a vigorous resumption of world trade will be supportive of EM growth in the months ahead, especially in Asia and Latin America.

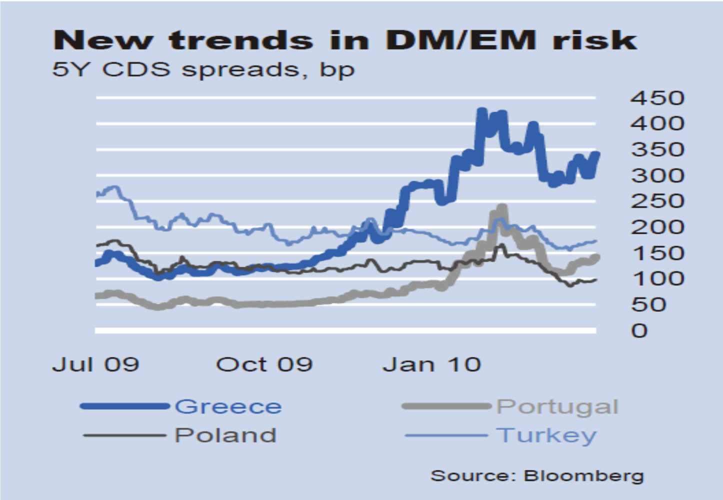
The Euro area is forecast to grow only a bit above 1%.

• **Sovereign credit trends: EM/DM divide blurring**

A key theme in recent months has been the issue of mounting sovereign risk and the narrowing sovereign risk gap between DMs and EMs, predicated on unsustainable fiscal trends in DMs.

A key prediction is that government debt in DMs will continue to rise over the next 10 years from already high levels today, while public debt in EMs will decline slightly from low-to-moderate levels today.





Emerging Markets: Q2 Overview & Outlook

- **Capital inflows to EMs remain (too) robust**

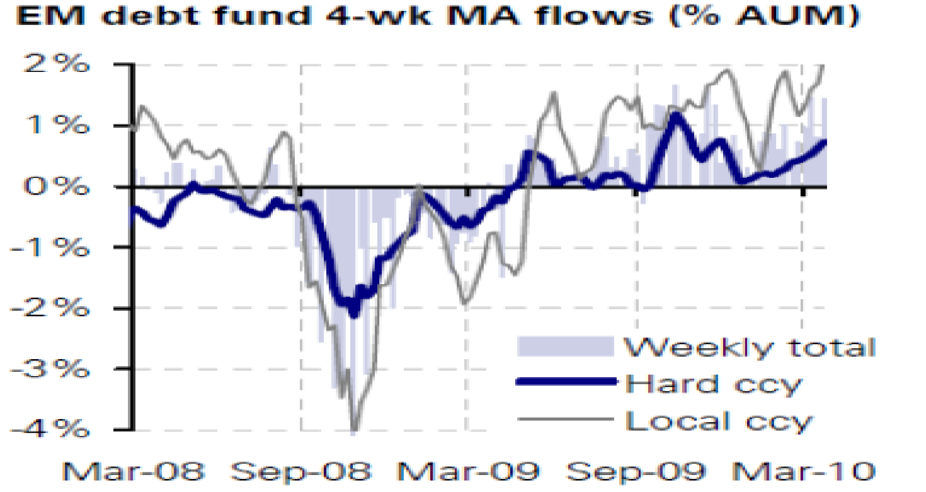
Inflows into EM funds have grown substantially in recent months. We are likely to see more countries trying to take some sort of precautionary measures in the face of large inflows. Consider that, recent inflows mean a recovery of only one third of the outflows that took place during the global crisis.

- **EM hotspots: Whatever happened to Latvia?**

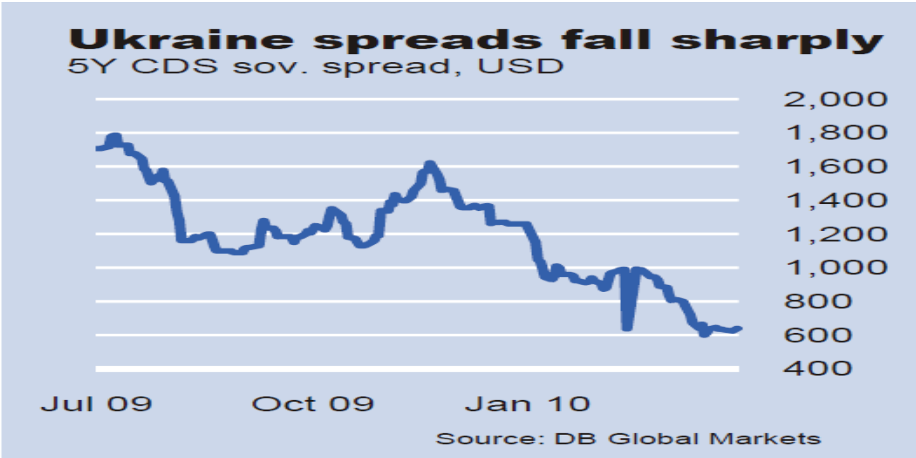
During 2009 the Baltic countries and Ukraine were at the top of country risk lists. While the situation in those countries remains fragile (and significant differences exist among them), a window of stability in market perception seems to have opened.

The next 3-6 months will be crucial to assess where economic and political improvements can be considered sustainable there.

Sustained inflows into EM debt funds



Source: DB Global Markets Research



Summary& Outlook

Multiple speed recovery in 2010 –country & banking sector differentiation to remain in place in CEE

Structurally driven contraction/stagnation in the real economy and the banking sector will continue in some CEE countries

Increasing differentiation between self-funding markets & market segments vs. externally financed markets & market segments

Public debt challenge in the EU-15 & EMU may have a significant impact on CEE and CEE financial markets

Low debt public debt levels in CEE (relative to EU-15, not EMs!) should be preserved as comparative advantage