UniCredit

CEE

Quarterly

Economics & FI/FX Research
Credit Research
Equity Research
Cross Asset Research

1Q 2010

"Your Leading Banking Partner in Central and Eastern Europe"

Contents

4 **Emerging Europe: Variety is the spice of life**

EU members

12 Bulgaria
14 Czech Republic
16 Estonia
18 Hungary
20 Latvia
22 Lithuania
24 Poland
26 Romania
28 Slovakia
30 Slovenia

EU candidates and other countries

32 Bosnia & Herzegovina
34 Croatia
36 Kazakhstan
38 Russia
40 Serbia
42 Turkey
44 Ukraine

Published 12 January 2010

Imprint:
UniCredit Bank AG
UniCredit Research
Arabellastrasse 12
D-81925 Munich

Supplier identification:
www.research.unicreditgroup.eu

V.i.S.d.P.:
Marco Annunziata,
Chief Economist (UniCredit Group)
Global Head of Economics,
Fixed Income & FX Research
120 London Wall
London
EC2Y 5ET

For publication requests in Austria and CEE please refer to:

Bank Austria Identity & Communications Department
pub@unicreditgroup.at
+43 5 05 05 52826

Marco Annunziata, Chief Economist, UniCredit Group,
Global Head of Economics, Fixed Income & FX Research (UniCredit Bank)
+44 207 826 1770, marco.annunziata@unicreditgroup.eu

Cevdet Akcay, Ph.D., Chief Economist, Turkey (Yapi Kredi)
+90 212 319 8430, cevdet.akcay@yapikredi.com.tr

Matteo Ferrazzi, Economist, EEMEA (UniCredit Bank)
+39 02 8862 8600, matteo.ferrazzi@unicreditgroup.eu

Dmitry Gourov, Economist, EEMEA (CAIB)
+43 5 05 05 82364, dmitry.gourov@caib.unicreditgroup.eu

Hans Holzhacker, Chief Economist, Kazakhstan (ATF Bank)
+7 727 244 1463, h.holzhacker@atfbank.kz

Anna Kopetz, Economist, Baltics (CAIB)
+43 5 05 05 82364, anna.kopetz@caib.unicreditgroup.eu

Marcin Mrowiec, Chief Economist, Poland (Bank Pekao)
+ 48 22 524 5914, marcin.mrowiec@pekao.com.pl

Vladimir Osakovsky, Ph.D., Head of Strategy and Research, Russia (UniCredit Bank)
+7 495 258 7258 ext. 7558, vladimir.osakovskiy@unicreditgroup.ru

Rozália Pál, Ph.D., Macro and Strategic Analysis Coordinator, Romania (UniCredit Tiriac Bank)
+40 21 203 2376, rozalia.pal@unicredit.ro

Kristofor Pavlov, Chief Economist, Bulgaria (UniCredit Bulbank)
+ 359 2 9269 390, kristofor.pavlov@unicreditgroup.bg

Goran Šaravanja, Chief Economist, Croatia (Zagrebačka banka)
+ 385 1 6006 678, goran.saravanja@unicreditgroup.zaba.hr

Pavel Sobisek, Chief Economist, Czech Republic (UniCredit Bank)
+420 2 211 12504, pavel.sobisek@unicreditgroup.cz

Gyula Toth, Economist/Strategist, EEMEA (CAIB)
+43 5 05 05 82362, gyula.toth@caib.unicreditgroup.eu

Jan Toth, Chief Economist, Slovakia (UniCredit Bank)
+421 2 4950 2267, jan.toth@unicreditgroup.sk

Emerging Europe: Variety is the spice of life

- **On the back of the healthier rebound in global growth and improved outlook for some of the EME countries we raised our broad CEE-17 2010 growth forecast to 2.3% (from 1.4%).** The upgrade comes mostly from our revision to the bigger countries (Turkey & Russia) whilst some smaller countries will still experience recession in 2010. In short differentiation will likely remain high in 2010.

- **We believe the global economic recovery is now solidly underway, and is sustain-able – but its initial pace is not.** We are particularly cautious on the Eurozone, for which we forecast below-consensus growth of under 1% in 2010. Individual economies will fare very differently in the recovery with Germany probably outperforming (around 2%). Against this background, we expect that US and Eurozone policymakers will take a cautious approach to their exit strategies.

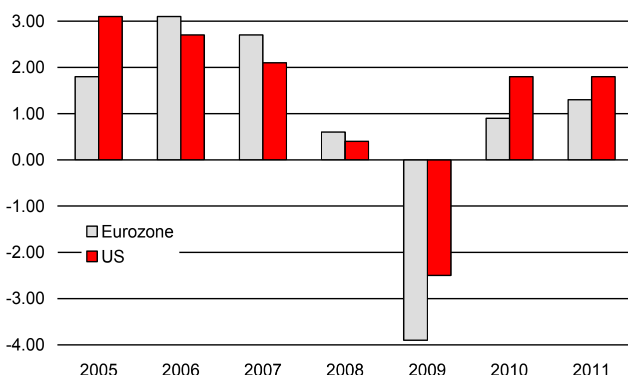
- **CEE recovery is underway but growth differentiation will remain relatively strong in 2010** as countries have different abilities to support their export growth via weaker exchange rates and domestic demands will remain weak. Inflation will remain off the agenda in CEE but in the case of Turkey stronger growth will warrant rate hikes starting in Q3. Fiscal situation has deteriorated but still looks better than in many of the Western European countries (public sector debt is below 60% in all countries apart from Hungary).

- **Key macro forecast highlights**: **1.** Although Poland is outperforming at the moment we still believe that this reflects the late cycle nature of its economy, and expect this to turn into a moderate underperformance in 2011. This is the key reason behind our dovish NBP rate forecast (only 25bp hike). **2.** We upgraded our 2010 Turkish GDP growth to 4.5% and now expect the CBT to be first central bank to hike rates in 2010. **3.** We keep our Russian GDP forecast (2.7%) slightly below consensus due to weak domestic demand, **4.** We expect Hungary, the Baltic Countries, Bulgaria, and Romania to underperform.

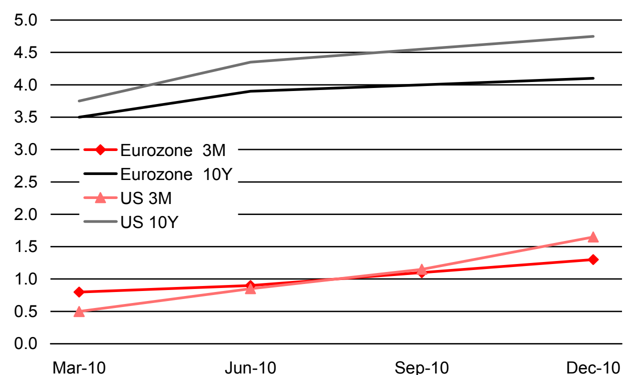
- **FI/FX market outlook**: We continue to see scope for underperformance of CEE FX vs. other asset classes, though we see value in selected relative value trades. We prefer TRY (due to monetary policy direction) and PLN (due to fundamental support). In the rates space we'd keep moderately long duration in Hungary and reduce Turkey. We believe that CEE credit could continue to outperform EMU periphery.

EU-US GROWTH DIFFERENCE WILL LIKELY WIDEN USD-EUR RATE SPREADS IN 2010

UniCredit Eurozone and US GDP forecasts



Expected yield curve movements in the Eurozone and the US



Source: UniCredit Research

Global recovery is now solidly underway, but will lose momentum during 2010

The global economic recovery is now solidly underway, and is sustainable – but its initial pace is not, and we expect some loss of momentum during 2010

2010 is starting off on a promising note – a sharp contrast to a year ago. We believe a healthy measure of optimism is warranted, as we expect a gradual consolidation of the global economic recovery and a progressive further normalization in financial markets. We also believe, however, that 2010 will be fraught with challenges for both policymakers and investors. The recovery in asset prices from the apocalyptic valuations of a year ago has largely run its course, pricing in a lot of the recovery in output: successful investment strategies will, therefore, hinge crucially on extracting alpha from individual countries' and companies' fundamentals, and relative value plays will need to take a greater role. Meanwhile, over the course of the year policymakers will have to wean the global economy off the powerful monetary and fiscal stimulus: getting the timing and speed of the exit strategy exactly right will be key to steering the global economy between the Scylla of a double-dip recession and the Charybdis of renewed imbalances and instability.

We believe the global economic recovery is now solidly underway, and is sustainable – but its initial pace is not, and we expect some loss of momentum during 2010. Within the industrial world, we are more positive on the US, where we expect growth of just under 2% in 2010 after a 2.5% contraction in 2009. Risks to our US growth outlook are probably skewed to the upside, especially for the first part of the year. There is still a significant amount of fiscal stimulus in the pipeline, the inventory rebound has just begun, and, most importantly, recent data suggest we might see a positive surprise on the labor market front. As US corporates have been extremely aggressive in slashing employment during the crisis, US productivity has risen to record levels which are now generally seen as unsustainable. As high productivity does not seem to be due to excessive capital stock levels, this suggests that companies will soon need to start hiring again. The rise in US unemployment has been extremely fast by historical standards; if its decline also turns out to be quicker than expected, it could provide the support to household consumption that is needed to give the recovery a second wind.

We are less optimistic on the Eurozone; individual countries will fare very differently

Eurozone will underperform the US but individual countries will fare very differently in the recovery

We are much less optimistic on the Eurozone, for which we forecast below-consensus growth of under 1% this year after a nearly 4% contraction in 2009. Private domestic consumption remains the Eurozone's Achilles' heel, and in this recovery we fear it will be constrained by a sluggish labor market performance. A number of European countries have relied on a variety of schemes to limit the rise in unemployment, mainly via shifting workers to part time or to a short working week, partly funded with budgetary support. These schemes have likely helped to support consumption during the worst of the crisis. The other side of the coin, however, is that as demand gradually picks up, companies have much less need to hire additional workers, so that the recovery in the European labor market is likely to be slower than in the US.

It is essential to note, however, that individual Eurozone economies will fare very differently in the recovery. Some of the "peripheral countries" will struggle to emerge from the recession, and will hence feel even more acutely the burden of increased fiscal imbalances. Greece is the clearest example: growth is projected to remain in negative territory this year (albeit, admittedly, after a particularly benign recession in 2009), and the sharp widening in the budget deficit has alarmed both investors and the rating agencies. Spain will also remain in recession, and for Italy we project a mere 0.5% increase in real GDP. At the other extreme, Germany's export-oriented model has been vindicated, at least for the time being, and we forecast an above-potential rebound to 2% this year. Therefore, while the CEE region as a whole will suffer somewhat from its close association with a sluggish Eurozone, those economies which are more strongly tied to the German economic cycle should fare better.

Cautious approach to exit strategies

Against this background, we expect that US and Eurozone policymakers will take a cautious approach to their exit strategies. Fed Chairman Bernanke and Fed Governor Kohn sent a very clear message in the speeches they delivered at the American Economic Association in early January: substantial slack in the economy still suggests that the Fed funds rate should remain low "for a considerable period", as the latest FOMC statements have repeated. Moreover, both Bernanke and Kohn cautioned that monetary policy is too blunt a tool to use against asset price bubbles, and that especially in the current circumstances the attendant risks to growth would be excessive – this seems to indicate that the Fed is unlikely to get excited at a possible market rally in the first part of the year. The Fed will now start draining liquidity from the market in a gradual and gentle way, and we do not expect rate hikes before the second half of the year. The ECB, we believe, will wait even longer before raising the policy rate, which we forecast will remain on hold for the whole year; however, by April the ECB should accelerate the withdrawal of liquidity with the aim of raising short-term interest rates (currently at around 0.35%) towards the policy Refi rate. This tightening "under the radar" should allow the ECB to start normalizing liquidity conditions without headline-grabbing rate hikes that could attract unwanted political attention and boost the EUR to even stronger levels.

As Fed and ECB monetary tightening gets underway, we expect a marked flattening of yield curves on both sides of the Atlantic. The increase in long-term yields should be relatively moderate – we see 10Y USTs at 4.75% by year-end – but the bearish outlook for USTs and Bunds is another important consideration to factor into emerging markets (EM) investment strategies for the year. The stronger US outlook should also push EURUSD down in the latter part of the year – note that this would be consistent with healthy levels of risk appetite, as growth and rates differentials would become the main driving force of the EURUSD cross.

Our growth forecasts for the US and the Eurozone do not suggest a powerful V-shaped recovery, and our outlook for Japan and the UK is similarly prudent. The headwinds facing the recovery of advanced economies are well-known: fiscal stimulus and the inventory cycle will eventually fade, high unemployment dims the consumption outlook and record low levels of capacity utilization bode ill for investment; meanwhile, the risk that credit supply might slow the recovery further remains. Even allowing for the upside risks we have mentioned for the US, this is hardly a very bullish outlook. What gives us confidence in the sustainability of the global recovery, therefore, is the strength of emerging markets: EM have weathered the crisis well thanks to sounder macroeconomic fundamentals and robust and largely untainted financial sectors. Indeed, the recovery has started from EM, notably in Asia, and Asia ex-Japan is still expected to lead the charge in 2010, followed by Latin America.

The resilience of emerging markets also implies that commodity prices are likely to remain well-supported across the board: energy, industrial metals and agricultural commodities. We are forecasting Brent oil prices to move in an USD 80-90 per barrel range over the course of the year. Good news for commodity exporters of course, but it also means that headline inflation will tend to move upwards in both developed and emerging economies, as base effects turn unfavorable. In industrial economies this is just welcome reassurance that the specter of deflation has been avoided: as large output gaps will push core inflation down for most of the year, the rebound in headline inflation will be moderate and should have little if any impact on inflation expectations and on central banks' policy. In some EM, however, we will see more robust inflation pressures, as **1.** growth is stronger, and **2.** food prices in particular carry a greater weight in the CPI basket. In some of the fastest growing EM this will likely lead to the start of a monetary policy tightening cycle, and/or to greater tolerance for exchange rate appreciation. China seems likely to allow some moderate strengthening of the renminbi, after a long period of enforced stability against the USD, and some other emerging Asian currencies are also likely to appreciate over the course of the year.

CEE recovery is underway but growth differentiation will remain relatively strong in 2010

CEE recovery is underway but return to pre crisis growth is unlikely

By the end of 2009 the recovery was already underway CEE-wide: PMI indicators are improving across the board boosted initially by an inventory rebound, and overall we expect the qoq GDP dynamic to pick up throughout the region until 2Q10. Fixed investment and private consumption are still relatively weak, however, and are expected to remain so in 2010. In most of the CEE, therefore, the recovery is likely to resemble more closely that of the Eurozone rather than that of Asia ex-Japan – although we expect Turkey to show a more dynamic rebound. Looking beyond 2011, **we project GDP growth to still remain below the pre crisis level across the whole CEE-17 region**. This reflects both the less dynamic global growth environment, but also the fact that the credit boost of the pre-crisis years is unlikely to be repeated. Overall we forecast the CEE-17 region to grow around 4% annually after 2011 which is close to our estimated potential growth numbers. We believe that less developed countries (in terms of GDP per capita) will likely experience faster growth than average.

UNICREDIT GDP FORECAST CHANGES AND COMPARISON VS. CONSENSUS

	UniCredit Sep 2009 Forecast		UniCredit Jan 2010 Forecast		Focus Economics	
GDP	2010	2011	2010	2011	2010	2011
Bulgaria	-2.5	2.0	-1.5	1.7	-0.6	2.7
Croatia	-1.5	1.2	-1.0	1.3	0.1	2.4
Czech Rep.	1.4	3.5	1.6	2.4	1.6	3.0
Estonia	-3.8	5.1	-3.9	4.8	-1.1	2.8
Hungary	-0.6	2.4	-0.3	2.7	0.1	2.9
Latvia	-5.4	6.0	-4.0	6.1	-3.3	2.5
Lithuania	-7.0	4.4	-5.5	4.7	-2.9	2.4
Poland	1.8	2.6	2.3	2.7	2.3	3.5
Romania	0.4	3.5	0.4	3.5	0.7	3.0
Russia	1.3	4.1	2.7	5.2	3.4	3.7
Turkey	3.2	4.5	4.5	4.5	3.4	4.2
Ukraine	1.7	3.3	2.0	4.0	2.3	4.1

Source: Focus Economics, UniCredit Research

Focus should shift on export competitiveness

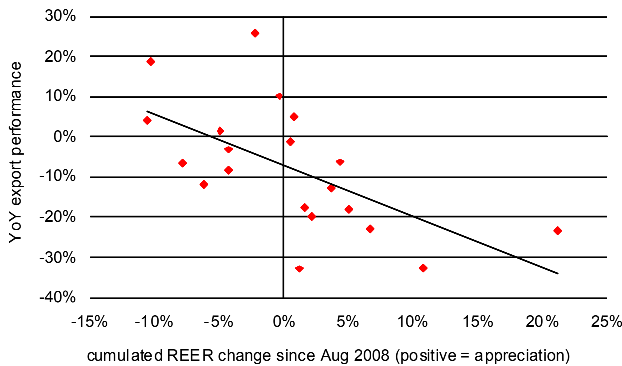
Beyond the inventory rebound export seems to be a more sustainable driver of growth for both the short and the medium term. In a relatively low-growth environment, export competitiveness will be tested already in 2010, and given the importance of export in “future” growth we believe CEE central banks will be on balance less tolerant toward palpably firmer currencies. Indeed even during the full-blown crisis period countries with weaker REER managed better export performance (chart 3). Concerns about excessive FX strength are also evident in recent talk of potential capital controls by policymakers in the CIS countries. For EU members we do not expect actual capital controls but excessive FX appreciation might lead to deeper rate cuts and potentially direct interventions.

Growth differentiation will remain relatively strong in 2010 but decline in 2011: as we stressed already in our previous quarterly publication, growth differentiation is increasing and evidenced in the diverging pick up in PMI indices, and in actual GDP growth data. We believe that the main drivers of this differentiation are the level of previous overheating, the health of the local banking sector and the flexibility of the local policy response to the crisis. In this context we still favour Turkey (we increased our 2010 GDP forecast to 4.5% from 3.2%) and Poland (2.3% from 1.8%) but expect the Baltics, Bulgaria, Hungary and Romania to remain well below average GDP growth in 2010. Compared to the consensus view we are above in Turkey, in line with Poland and the Czech Republic, slightly below Russia and below with the Baltics, Bulgaria, Hungary and Romania (table 1). The key rationales behind our generally cautious view (ex-Turkey): **1.** we are below consensus with our EMU growth outlook (0.9%),

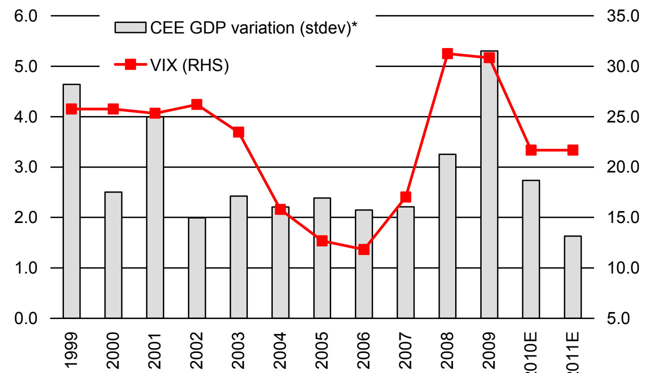
2. we still see poor outlook for investments and household demand particularly in the more leveraged economies. Looking beyond 2010 we however expect GDP growth differentiation to gradually decline on the back of corrected imbalances in the more leveraged economies and also due to lower global volatility (chart 4).

DIVERGING ABILITY TO WEAKEN FX WILL LIKELY KEEP GDP DIFERENTIATION HIGH IN 2010

Weaker real exchange helped export performance during the crisis



Declining volatility might push CEE growth variation lower in 2011



*Variation is measured as standard deviation in the CEE-17 universe this publication covers.

Source: BIS, UniCredit Research

Central bank CPI target vs. UCG forecast for 2010 (%)

	CB target*	UCG forecast
CZK	2.00	2.70
HUF	3.00	1.80
PLN	2.50	2.30
RON	3.50	4.20
RUB	7.00	7.96
TRY	6.50	6.20

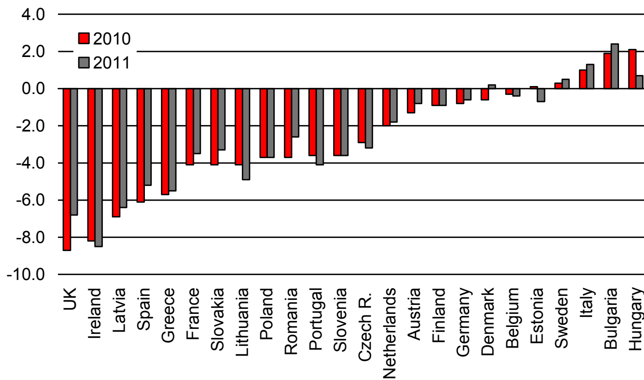
*central target

Inflation will remain off the agenda in CEE but in the case of Turkey stronger growth and likely cyclical acceleration of inflation will warrant somewhat stronger rate hikes. Firmer currencies (due to better current accounts), deeply negative output gaps and generally soft domestic demand will keep core inflation under control whilst headline inflation will be adversely affected by unfavorable base effects in commodity prices. Given our relatively bullish GDP view for Turkey and adverse base effects we expect inflation to tick higher from the current levels but given we expect the CBT to hike rates in 2H10 we do not believe that inflation expectations would significantly increase from current levels. Apart from Turkey, we also expect Poland and the Czech Republic to hike rates in 2010 but only in 4Q and relatively not by much (50bp and 25bp respectively). **On balance we expect all CEE central banks to meet their inflation targets in 2010** (taking into the account the tolerance bands) which is the main reason behind our relatively dovish central bank outlook.

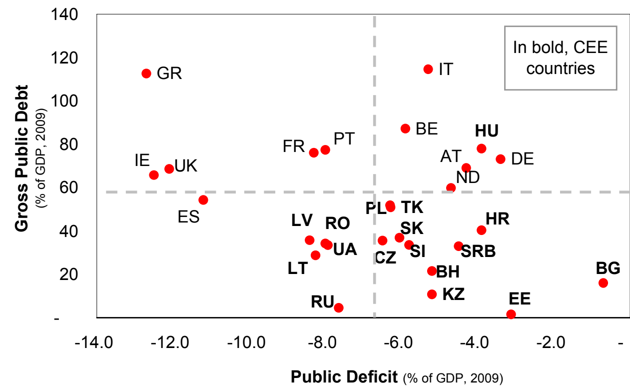
Fiscal situation has deteriorated but still looks better than in many of the Western European countries; there are wide differences in the CEE region: following the sharp deterioration of fiscal balances in 2009 (regional average deficit increasing to 6.7%/GDP from 0.46%/GDP surplus) we expect some consolidation in 2010 mostly in Turkey and Russia. Although budget deficits indeed widened we believe that the generally low level of public sector debt (apart from Hungary) makes CEE public finances more manageable. On a cyclical adjusted basis Hungary and Bulgaria will show the biggest primary surpluses in the EU as a whole (according to the autumn EC forecast). Wider budget deficits imply that local currency gross and net t-bond issuance will increase in 2010 but not too significantly compared to WE countries. The biggest percentage increase will be recorded in Poland but here much will depend on the privatization flows. **Eurozone membership became possible from an inflation perspective but fiscal policy needs to be tightened which makes the membership decision probably more political**. The large-scale CEE election cycle in 2010 – elections in seven CEE countries, at least, will be held during the year – is not supportive for a significant fiscal tightening (see our separate publication).

FISCAL BACKDROP IS DIVERGING SIGNIFICANTLY

Cyclical adjusted primary balance (% of GDP)



Fiscal metrics look better in CEE than in many WE countries



Source: European Commission, UniCredit Research estimates

CEE FI/FX market outlook

FX portfolio allocation recommendations

CZK	U/W
HUF	U/W
PLN	Mod O/W
RUB	M/W
TRY	Mod O/W

M/W: market weight,
U/W: underweight,
O/W: overweight

FX: in line with the view we expressed in our previous CEE Quarterly, FX markets continued to underperform other asset classes in the fourth quarter. We still believe that the main reason for CEE FX underperformance lies in the less tolerant central bank behavior toward strong currencies. This was evidenced in various comments about excessive FX appreciation, FX interventions in CIS countries and further rate cuts (CBR cut by 125bp in 4Q, NBH by 75bp, CNB by 25bp and the CBT by 75bp). Against the still relatively weak domestic economic backdrop (our macro forecast assumes household demand slowing further in 2010 in many of the CEE-17 countries) we believe the “central bank resistance” topic will remain valid in the coming quarter as well. Accordingly, we continue to see scope for ongoing underperformance of CEE FX vs. other asset classes in 1Q10, though we see value in selected relative value trades.

1. **Relative monetary policy outlook:** given that we expect the Turkish economy to significantly outperform the rest of the CEE region (4.5% GDP growth vs. 2.3%) the CBT will likely be the first central bank in the region to hike its interest rates in 2010 (125bp cumulative). Apart from Turkey, we expect only a small hike from Poland and the Czech Republic in 4Q whilst Hungary, Romania and Russia will likely continue reducing their rates. Higher Turkish rates and already relatively low implied FX volatility will likely push the carry/vola ratio on the TRY to the highest in the region (chart 7). In our view this plus a relatively balanced current account will likely see the TRY outperforming (particularly after the underperformance in 2009). Although fiscal policy (a near 100% local debt roll-over) is a risk we think the recent divergence between rates and FX can be sustained. Accordingly we increased our TRY allocation to Overweight from Market weight.

2. **Diverging fundamental support**: on a fundamental basis we still see value in PLN given its relatively better growth prospects, continuing deep undervaluation in REER terms and the likely further improvement in the current account balance (due to the undervalued currency). On a simple fundamental ranking basis the above factors put PLN in a relatively strong position in the region. On the other side of the scale we think Poland’s closer peer countries (Czech Republic, Hungary and Romania) will all underperform its economic growth. From this perspective we think that long PLN trades still make sense and accordingly we remain long PLN/HUF and would also keep PLN moderately Overweight in real money portfolios. As the year progresses we believe that EUR/PLN could well move to overshoot territory below 3.85 (due to the expected privatization inflows) which might put the NBP into a difficult position (in 1Q the yoy FX impact will be the strongest) which might put significant downside pressure on CPI.

Central bank rate forecast versus market pricing (bp)

	Yield curve pricing	UCG forecast
CZK	+100	+50
HUF	+10	-75
PLN	+90	+25
RON	-	-100
RUB	+40*	-100
TRY	+150**	+125

* over 6M, ** over 9M

Local currency duration recommendations

CZK	Neutral
HUF	Mod long
PLN	Neutral
RUB	Neutral
TRY	Short

UCG credit rating outlook

CZK	Positive
HUF	Stabilizing
PLN	Positive
RUB	Neutral
TRY	Positive
UAH	Negative

Rates: as we mentioned above we believe that central bank interest rate decisions will be driven by potential upside pressure on the currencies and likely further downside pressure on inflation (apart from Turkey). On balance this still creates a dovish backdrop for CEE central banks and accordingly apart from Turkey we do not expect any of the policymakers to enter into a stronger tightening cycle. As a reminder our G10 colleagues expect the ECB to keep its rates on hold during the whole year. Against this backdrop we disagree with the 12M rate outlook pricing on the PLN and CZK yield curves (around 80bp and 100bp respectively) and would continue to receive rates on the short end (vs. the EUR). Elsewhere on the short ends **1.** we do not see enough juice left in Russia (after taking 400bp profit on short end receivers), **2.** add HUF short end receivers following the December sell-off.

Looking at the long ends we believe that **1.** local supply pressure and **2.** upside pressure on G3 yields will keep CEE yield curves relatively steep. According to our estimations currently all yield curves but the CZK are too steep vs. their own short end which suggests that the curves are generally pricing some fiscal & supply related risk premium. A heavy election cycle in 2010 is not helping fiscal consolidation and on balance we do not expect significant tightening in any of the CEE countries. Overall albeit recognizing some risk premium we remain wary of holding long duration positions in the local currency bond markets and reduce our TURKGB duration to short from neutral and keep POLGB and CZGB neutral. We remain long duration only in Hungary where the year end sell off created an attractive entry point whilst fiscal newsflow is going in the right direction for now. As the year progresses and governments announce new ERM2 targets (or someone joins in a surprise move) we would look to increase duration allocation again in Poland and Hungary where the 5y5y forwards versus EUR are sufficiently high and these spreads could benefit for improving EMU convergence newsflow.

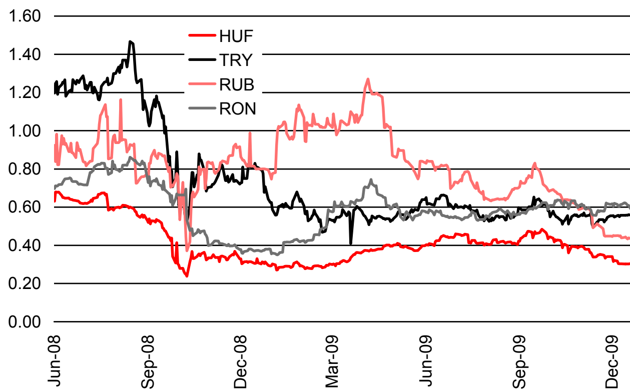
Sovereign Credit: amid the recent credit worries (Dubai, Greece) we noticed increasing investor worries around CEE sovereign credit valuations. As the spread between CEE and Greek 5y CDS tightened to negative territory in 4Q and currently all countries apart from the Baltics and Ukraine are trading inside Greek CDS we think it is valid to ask whether CEE might become poisoned. We believe however that CEE credit markets could remain relatively “protected” and recent outperformance (against a broader EMU periphery group) could continue in Q1: **1.** the actual fiscal position of CEE countries is more solid than the Greek one: the fiscal deficits of CEE countries in 2009 will remain far from Greek levels and debt levels are sensibly lower. Although EMU members probably enjoy an “implicit” guarantee we believe this is to some extent also true for the EU member CEE countries (the Commission was involved in all EU member bail out programs and in some cases was probably tougher on fiscal policies than the IMF). **2.** As opposed to Greece, the CEE economies had the possibility to loosen their monetary policy via the exchange rate channel (to a certain extent). Weaker currencies help them to correct the current account balances and also to avoid deflation. Mapping inflation vs. CDS at a global level shows a polynomial relationship (chart 5), namely credit markets like low inflation but they do not like deflation (due to negative implications on fiscal metrics).

CEE PUBLIC FINANCES LOOK BETTER THAN IN EMU PERIPHERY COUNTRIES

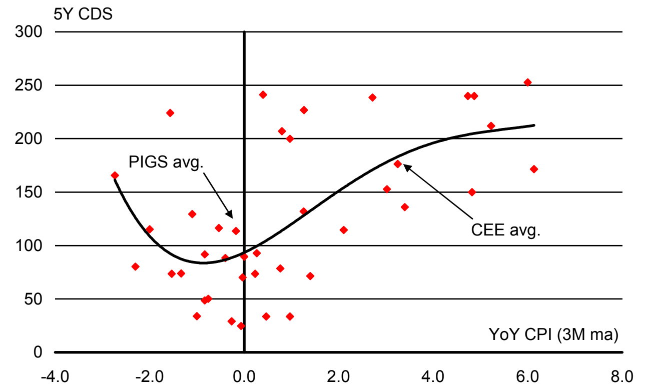
2009, % of GDP	Current account	General Govt Balance	General Govt Debt	Moody’s Rating	S&P Rating
Spain	-5.4	-12.2	54.3	Aaa	AA+
Portugal	-10.2	-8.0	77.0	Aa2	A+
Italy	-2.4	-5.3	114.6	Aa2	A+
Greece	**-8.8**	**-12.7**	**112.6**	**A2**	**BBB+**
Czech	-0.9	-6.5	35.6	A1	A
Poland	-1.3	-6.3	51.9	A2	A-
Hungary	-0.2	-3.9	78.0	Baa1	BBB-
Romania	-5.4	-8.0	34.3	Baa3	BB+

Source: European Commission, UniCredit Research

3M carry/volatility ratio: RON & TRY look more attractive



CPI Inflation (3M moving average) versus CDS around the world*



*Countries with CDS above 500bp are excluded.

Source: UniCredit Research

Authors:

Marco Annunziata, Ph.D., Chief Economist (UniCredit Group)
+44 207 826 1770, marco.annunziata@unicreditgroup.eu

Gyula Toth, EEMEA Economist/Strategist (CAIB)
+43 5 05 05 82362, gyula.toth@caib.unicreditgroup.eu

Bulgaria

Outlook

The rebalancing of the Bulgarian economy is not over and we expect GDP to slide further in 2010. There are, however, some sources of comfort which make us less pessimistic than we were a couple of months ago (we also revised upward our GDP projection), namely the faster-than-expected adjustment in the current account and the fiscal position, which remains solid. However, our growth forecast remains a notch more bearish than consensus.

Author: Kristofor Pavlov, Chief Economist (UniCredit Bulbank)
+ 359 2 9269 390, kristofor.pavlov@unicreditgroup.bg

	Moody's	S&P	Fitch
Long-term foreign currency credit rating	**Baa3 stable**	**BBB stable**	**BBB- negative**

MACROECONOMIC DATA AND FORECASTS

	2007	2008	2009E	2010F	2011F
GDP (EUR bn)	28.9	34.1	33.3	32.9	33.7
Population (mn)	7.6	7.6	7.6	7.5	7.5
GDP per capita (EUR)	3782	4485	4394	4359	4484
GDP (constant prices yoy %)	6.2	6.0	-5.2	-1.5	1.7
Private Consumption, real, yoy (%)	5.1	4.5	-5.3	-4.1	-0.7
Fixed Investment, real, yoy (%)	21.7	20.4	-25.4	-14.0	-3.5
Public Consumption, real, yoy (%)	3.4	-1.4	-0.9	-0.1	2.0
Exports, real, yoy (%)	5.2	2.9	-11.8	-0.3	3.4
Imports, real, yoy (%)	9.9	4.9	-22.5	-8.2	-1.3
CPI (average, yoy %)	8.4	12.4	2.8	0.3	0.8
LEONIA, eop (%)	4.56	4.07	0.23	0.80	2.35
Monthly wage, nominal (EUR)	220	268	288	274	268
Unemployment rate (%)	6.9	6.3	9.3	12.8	12.6
Budget balance/GDP (%)	3.5	3.0	-0.7	-1.7	-1.7
Current account balance (EUR bn)	-7.3	-8.7	-3.2	-2.1	-2.4
Current account balance/GDP (%)	-25.2	-25.4	-9.6	-6.4	-7.1
Net FDI (EUR bn)	8.4	6.1	3.2	2.6	2.3
FDI % GDP	29.0	17.8	9.5	7.9	6.9
Gross foreign debt (EUR bn)	29.0	37.0	36.8	37.8	39.0
Gross foreign debt (% of GDP)	100.3	108.4	110.7	115.0	115.9
FX reserves (EUR bn)	11.9	12.7	12.9	13.5	15.1
(Cur.Acc-FDI)/GDP (%)	3.8	-7.6	-0.1	1.5	-0.2
FX reserves/Gross foreign debt (%)	41.2	34.4	35.1	35.7	38.8
Exchange rate to USD eop	1.34	1.40	1.37	1.32	1.39
Exchange rate to EUR eop	1.96	1.96	1.96	1.96	1.96
Exchange rate to USD AVG	1.43	1.33	1.40	1.28	1.36
Exchange rate to EUR AVG	1.96	1.96	1.96	1.96	1.96

Source: UniCredit Research

STRENGTHS

- Reestablished fiscal discipline
- Commitment to push healthcare and education reforms
- Untapped potential to stimulate growth by better EU aid use

WEAKNESSES

- Large private sector external debt
- Limited room for fiscal and monetary policy stimulus
- Still unsustainable foreign funding needs

Unwinding of remaining imbalances will weigh on 2010 growth

Recession which started in industry spreads to rest of the economy

While the Euro zone may now be starting to expand again, there are still no clear signs that Bulgaria has begun to emerge from recession. GDP contraction reached 5.4% yoy in 3Q: the annual rate of decline of industry has eased, but services output fell for the first time since the downturn began. Faced with growing spare capacity there was little incentive for companies to invest in new plant and machinery, and gross fixed capital formation plunged by 36.5% yoy. The recent pick-up in business confidence has been more modest than elsewhere in the CEE region and still looks consistent with weak economic activity. There are little grounds to be optimistic about the short-term prospects for household spending either. The recent worsening in consumer confidence suggests that households are becoming less willing to spend. Bulgarian consumers will be under pressure from being relatively more indebted than some of their counterparts elsewhere in the region. Job losses are set to peak in 2010 when downsizing of the bloated public sector is due. Importantly, high joblessness is likely to prove relatively persistent as setting the economy on the path of sustainable growth will require changing the existing growth patterns. This implies a reallocation of production resources from overheated domestic demand oriented sectors towards export-driven industries. However, while the list of sectors freeing up capital and labor is clear, the list of those which should pick-up and become the new engines of growth has not taken shape yet, indicating that the evolution of the economy's growth pattern is still in its early stages.

Changing the growth pattern of the economy is the challenge

Some positive signals: foreign funding needs declined significantly…

However, there are several sources of comfort which make us less pessimistic than we were a couple of months ago. First, the current account adjustment is proceeding faster than expected, which helped to slash the country's external funding needs. Though falling by slightly more than a half, FDI still continued to cover the CA deficit in full. Renewed spending restraints helped to reestablish fiscal discipline, following a dangerous slip in discretionary spending by the previous Socialist-led government ahead of July's general elections. Thus, the budget ended 2009 with an estimated deficit of just of 0.8% of GDP (based on national methodology), the lowest in the EU. We believe that cyclical factors will push the budget deficit further in 2010; nevertheless, we do not expect a dangerous weakening of the fiscal position as measures to boost tax compliance and optimize discretionary spending have started to yield the desired results. Moreover, there is still some room for further discretionary fiscal easing in 2010 without risk of breaching the 3% deficit euro adoption criterion. Progress in fighting corruption helped to unfreeze a large part of EU aid, while reinvigoration of structural reforms paved the way for S&P in December 2009 to revise upward its outlook on the country's credit rating from negative to stable.

… and Bulgaria has the most solid fiscal position among all EU member states

Progress in reforms helped

Unwinding of remaining imbalances will require painful adjustment process to continue

Against this backdrop, and thanks to the more pronounced signs of recovery in the Euro zone, we revised upward our GDP growth projection for the whole of 2009 to -5.2% (from -6.3%) and for 2010 to -1.5% (from -2.5%). Nevertheless, our growth forecast remains a notch more bearish than consensus. We believe that the rebalancing of the Bulgarian economy is not over and GDP should slide further in 2010. In 2011, activity will gradually pick up as unemployment is expected to level off, which together with the stabilization of housing prices and the normalization of credit flows should prop up the recovery dynamics.

We don't see a stretched Bulgarian REER as a risk for the recovery process

The Bulgarian Real Effective Exchange Rate (REER) still looks somewhat overvalued versus SEE and CEE free floating currencies, but the level of divergence significantly declined recently in response to the ongoing currency appreciation in many emerging markets. As the recovery process becomes more entrenched we expect to see more appreciation down the road for many emerging markets which should eventually erase the existing cost advantage. This is crucial because Bulgaria's export business is specialized in the manufacturing of lower-value-added products which tend to be particularly price sensitive. The upshot is that at the moment we do not see a stretched Bulgarian REER as a risk for the country's export recovery.

Czech Republic

Outlook – Although 3Q GDP improved on a qoq basis we think that the recovery is still far from smooth as household demand and investment will remain weak, with 2010 GDP set to grow by only 1.6%. Doubts around the sustainable recovery are also reflected by the latest 25bp rate cut. We expect rates to be left on hold until 4Q10. Given our relatively bearish growth outlook we do not expect CZK to appreciate in 2010 and see EUR/CZK at 26.00.

Authors: Pavel Sobisek, Chief Economist (UniCredit Bank)
+420 2 211 12504, pavel.sobisek@unicreditgroup.cz

Patrik Rozumbersky, Economist (UniCredit Bank)
+420 2 211 12506, patrik.rozumbersky@unicreditgroup.cz

	Moody's	S&P	Fitch
Long-term foreign currency credit rating	**A1 stable**	**A stable**	**A+ stable**

MACROECONOMIC DATA AND FORECASTS

	2007	2008	2009E	2010F	2011F
GDP (EUR bn)	127.3	147.9	138.0	144.8	154.2
Population (mn)	10.3	10.4	10.5	10.5	10.6
GDP per capita (EUR)	12336	14181	13151	13734	14544
GDP (constant prices yoy %)	6.1	2.5	-3.9	1.6	2.4
Private Consumption, real, yoy (%)	4.9	3.6	1.2	-1.0	2.0
Fixed Investment, real, yoy (%)	10.8	-1.5	-8.7	-3.5	4.0
Public Consumption, real, yoy (%)	0.7	1.0	4.4	-0.5	0.0
Exports, real, yoy (%)	15.0	6.0	-10.5	7.9	8.4
Imports, real, yoy (%)	14.3	4.7	-11.8	8.1	8.6
CPI (average, yoy %)	2.8	6.3	1.0	2.2	2.4
Central bank reference rate	3.50	2.25	1.00	1.50	3.00
Monthly wage, nominal (EUR)	755	910	887	924	983
Unemployment rate (%)	6.6	5.5	8.1	9.5	9.5
Budget balance/GDP (%)	-0.7	-2.1	-6.5	-5.7	-5.0
Current account balance (EUR bn)	-4.1	-4.6	-1.3	-0.2	-1.5
Current account balance/GDP (%)	-3.2	-3.1	-0.9	-0.1	-1.0
Net FDI (EUR bn)	7.6	7.3	3.0	3.5	4.7
FDI % GDP	6.0	5.0	2.2	2.4	3.1
Gross foreign debt (EUR bn)	51.6	57.8	64.2	67.3	74.0
Gross foreign debt (% of GDP)	38.9	42.2	45.7	46.5	47.1
FX reserves (EUR bn)	23.7	26.6	28.0	29.0	29.0
(Cur.Acc-FDI)/GDP (%)	2.8	1.9	1.3	2.3	2.1
FX reserves/Gross foreign debt (%)	45.9	46.0	43.6	43.1	39.2
Exchange rate to USD eop	18.20	19.22	18.46	17.57	17.73
Exchange rate to EUR eop	26.55	26.85	26.44	26.00	25.00
Exchange rate to USD AVG	20.25	16.97	18.95	17.14	17.71
Exchange rate to EUR AVG	27.76	24.96	26.44	26.22	25.50

Source: UniCredit Research

STRENGTHS

- External financing at comfortable levels
- Flexible monetary policy
- Low vulnerability of financial sector

WEAKNESSES

- Sharply weakening FDI inflow
- Private consumption set to slow
- Interim government lacking political mandate

The recovery continues but no reason for enthusiasm

Net exports and inventories have so far disappointed in pulling the economy out of recession

The economic recovery gained momentum in 3Q09, with GDP growth picking up to 0.8% qoq from 0.2% qoq in 2Q and the contraction on yoy basis easing to -4.1% from 2Q's -4.7%. The demand structure of 3Q GDP revealed that domestic consumption maintained its solid yoy growth on the previous quarter as the slowdown in household spending was offset by accelerating government expenditures. On the other hand, fixed capital formation deepened its yoy decline while the rate of inventory reduction moderated only slightly from its record drop in 2Q. Finally, the contribution of net exports to GDP growth was broadly neutral as the entire increase in the foreign trade surplus was eaten up by the improving terms of trade and deteriorating balance of services. Similar to the economic activity, inflation has also bottomed out. In fact, prices remained in deflation territory for a single month only, rebounding to +0.5% yoy in November from October's -0.2% yoy. With demand pressures remaining pretty muted, the rise was driven by an upturn in food and fuel prices. The external position of the economy, as outlined by recent BoP data, has been confirmed as stable. The C/A deficit is set to fall below 1% of GDP in 2009 from 3.1% in 2008 pulled down by a sharp improvement in foreign trade and a weakening dividend outflow. However, a negative trend has become evident in FDI, with net inflow YTD shrinking to almost zero.

Economic recovery in 2010 seen to be modest with crisis in household segment yet to peak

Since manufacturers have failed to win back foreign orders lost in the crisis and labor market problems are yet to peak, further recovery is set to be far from smooth. We expect a favorable base effect to provide a major boost to 4Q GDP (seen at -2.0% yoy), while the underlying picture is unlikely to change much from 3Q. Inventory re-building accompanied by reviving foreign demand is believed to drive the rebound in 2010. The depth of reduction in inventories in 2009 gives hope for the similarly robust opposite impact on growth in 2010. Net exports should also add to GDP expansion but to a much lesser extent. All the other components are envisaged to subtract from growth. We expect fixed capital formation to continue contracting as the excess of capacity persisting through 2010 will hardly motivate companies for any new investments. Moreover, household spending which has held up surprisingly well so far will hardly maintain its positive growth as slower wage rise and the peaking unemployment are set to drag down household disposable income. We expect GDP growth to pick up to 1.6% in 2010 from -3.9% in 2009.

2010 state budget was approved in the final vote but extra spending was pushed through by the left

In line with the government's austerity package, the 2010 state budget was proposed with a deficit of CZK 163bn which would cut the public sector gap to 5.3% of GDP from around 6.5% forecast for 2009. However, during the final vote on the budget, leftist parties managed to push through additional spending – on public sector wages, social spending and farm subsidies – worth about CZK 12bn which are estimated to raise the public sector deficit by 0.4 percentage points. Unfortunately, this has sent a worrying signal in terms of the speed of necessary fiscal consolidation since the interim government may find it pointless to propose any further spending reforms before the elections in May 2010. Positively, FinMin Janota who decided to stay in office after the state budget vote promised to continue with his reform program.

Given the absence of demand inflationary pressures the CNB will be in no hurry to start raising interest rates

Following the 25bp rate cut in December we do not expect the CNB to extend its monetary policy stimulus any further. On the other hand, as the economic recovery still looks pretty fragile we do not see the CNB switching to a tightening bias any time soon. Hence, we bet on a longer period of flat rates, with the first hike coming no earlier than in 4Q10.

Fundamental factors seem to be playing a minimal role in determining EUR/CZK moves

EUR/CZK has traded in a range between 25.5 and 26.5 in the last two months with investor sentiment rather than fundamental factors still driving the moves. Lacking any clear direction, we expect EUR/CZK to continue hovering around 26.0 throughout the whole of 2010. We forecast a similar productivity growth in the Czech Republic to that envisaged for the euro zone, thus seeing no fundamental reason for CZK to resume appreciating. However, an increase in risk appetite triggering carry trades and the election factor could raise volatility.

Estonia

Outlook

The pace of economic contraction eased somewhat in 3Q, but the overall picture remains quite gloomy. We therefore stick to our view of a sharp decline in economic activity (in fact sharper than the one forecast by Estonia's officials), which means that we still see a big question mark about Estonia's introduction of the euro in 2011. Final clarity on this question will probably only be available at the end of 1H10.

Author: Anna Kopetz, Economist (CAIB)
+43 5 05 05 82364, anna.kopetz@caib.unicreditgroup.eu

	Moody's	S&P	Fitch
Long-term foreign currency credit rating	**WR negative**	**A- negative**	**BBB+ negative**

MACROECONOMIC DATA AND FORECASTS

	2007	2008	2009E	2010F	2011F
GDP (EUR bn)	15.6	16.1	13.0	11.7	10.6
Population (mn)	1.3	1.3	1.3	1.3	1.3
GDP per capita (EUR)	11644	12001	9754	8780	7968
GDP (constant prices yoy %)	6.3	-3.5	-15.5	-3.9	4.8
Private Consumption, real, yoy (%)	7.9	-4.6	-18.0	-5.4	2.3
Fixed Investment, real, yoy (%)	4.8	-11.5	-30.7	-3.2	1.2
Public Consumption, real, yoy (%)	3.9	4.1	-3.1	-3.8	-1.4
Exports, real, yoy (%)	0	-0.7	-11.9	-1.8	4.3
Imports, real, yoy (%)	4.2	-8.7	-25.0	-2.6	0.5
CPI (average, yoy %)	6.6	10.4	-0.1	-1.4	1.7
Monthly wage, nominal (EUR)	725	819	776	709	584
Unemployment rate (%)	4.7	5.5	13.7	15.5	15.1
Budget balance/GDP (%)	2.7	-2.9	-3.1	-3.1	-3.0
Current account balance (EUR bn)	-2.8	-1.5	0.2	0.2	0.4
Current account balance/GDP (%)	-18.1	-9.4	1.6	2.1	3.7
Net FDI (EUR bn)	0.8	0.6	0.0	0.2	0.2
FDI % GDP	5.3	3.7	0.1	1.4	1.9
Gross foreign debt (EUR bn)	17.2	19.1	16.5	15.8	14.1
Gross foreign debt (% of GDP)	112.4	118.5	126.4	135.2	133.2
FX reserves (EUR bn)	2.2	2.8	2.3	2.0	2.2
(Cur.Acc-FDI)/GDP (%)	-12.5	-5.7	1.8	3.5	5.6
FX reserves/Gross foreign debt (%)	13.0	14.7	14.0	12.6	15.6

Source: UniCredit Research

STRENGTHS

- Political determination to introduce the EUR as soon as possible
- Rapidly unwinding external imbalances

WEAKNESSES

- Difficulties to meet the 3% budget deficit criterion
- High FX leverage in domestic private sector

Euro – a very close call

Some easing in the pace of economic contraction registered in 3Q

3Q09 was the first quarter to see some modest easing in the pace of economic contraction: after a decline of 16.1% yoy in 2Q09, the 3Q data came in at a slightly better -15.6% yoy (which was, however, still worse than the flash estimate figures). For the whole year 2009 we expect a GDP figure of -15.5% yoy, almost unchanged from last quarter's forecast. The development of economic activity in 3Q definitely gives no reason for being overly optimistic: Private consumption was barely changed at -19.6% yoy (from -20.3% in 2Q); exports inched slightly lower to -12.6% yoy (from 2Q's good -11.1% yoy); imports came in at -25.5% yoy (after -30.9% yoy in 2Q). Fixed investment improved somewhat from the very depressed 2Q data (2Q at -38.8% yoy, 3Q at -34.6% yoy).

Increase in consumer confidence

The improvement in consumer confidence is interesting and worth noting. The composite Economic Sentiment Indicator figure improved steadily since reaching its trough in March 2009 and stands now at levels last seen the previous summer (when the decrease in economic activity was still quite moderate at -1% yoy).

The stronger than expected fall in imports led to a revision of our C/A forecast – we expect the C/A surplus in 2009 to reach 1.6% of GDP. For 2010 we pencil in an increase in the C/A to 2.1% of GDP.

Deflation to continue

Since May 2009 Estonia has been seeing negative headline inflation rates; we expect this trend to continue well into the year and pencil in a 2010 average figure of -1.4%. November's CPI release of -2.1% yoy prompted members of Estonia's Central Bank to declare that it could already be assumed that Estonia has met the inflation criterion for euro-adoption. The bigger hurdle for the introduction of the euro in 2011 – which is the target date of the government – is however if the budget deficit can be refrained from exceeding 3% of GDP in 2010.

The government sticks to its euro-introduction plan in 2011

The question about whether Estonia will manage to achieve a 3% of GDP deficit in 2009 is still unclear and – given the fact that it might be decisive for Estonia's euro-adoption plan in 2011 – very much disputed. The problem is, however, that there is not only a lot of uncertainty about the final outcome of the 2009 budget figures (recent figures looked quite promising) but also for the 2009 nominal GDP. Even the recent figures can only serve as a guideline, since the probability that they will be revised by a non-negligible amount is quite high. Nevertheless, the IMF was positive at the end of October ("Euro-adoption appears within reach"), as was the World Bank in November. Our view is that the decision on the 2011 euro-adoption in Estonia will be a very close call. Our general feeling, however, remains that the sharp fall in economic activity (our GDP forecast is more pessimistic than the forecast used by Estonia's policy makers) and the rise in the unemployment rate means that Estonia is unlikely to introduce the euro in 2011. June 2010 should bring more clarity on this point when the calculations with the final figures are done and – according to recent comments by Commissioner Almunia – a possible invitation to join the Euro-Area could also be expected in this period. Considerable effort has been made to design a tight budget for 2010, which was approved by parliament in the third reading at the beginning of December. The 2010 budget aims for a deficit of 2.8% to GDP.

Sovereign credit rating outlook

Recent comments by the ratings agencies suggest that the developments on the fiscal front are very important for the ratings – Estonia meeting the euro-adoption criteria could very likely be a trigger for an upward movement in the ratings. Fitch, however, sees Estonia introducing the euro only in 2012, while Moody's and S&P think 2011 a possible date.

Hungary

Outlook

Disappointing 3Q GDP (vs. the region) underlined the fact that Hungary entered this crisis from an overleveraged position (private and public) and that debt reduction has an ongoing negative effect on growth. Accordingly, despite some improvement in the global outlook we still forecast GDP contraction in 2010 (below market consensus). On the positive side we do not think that fiscal policy will be meaningfully softened after the April elections which will likely be won by the current opposition party (Fidesz). Due to dovish monetary policy and concerns about regional economic performance we do not believe EUR/HUF will move significantly lower from current levels in 1H10.

Author: Gyula Toth, Economist/Strategist (CAIB)
+43 5 05 05 82362, gyula.toth@caib.unicreditgroup.eu

	Moody's	S&P	Fitch
Long-term foreign currency credit rating	**BAA1 negative**	**BBB- stable**	**BBB negative**

MACROECONOMIC DATA AND FORECASTS

	2007	2008	2009E	2010F	2011F
GDP (EUR bn)	101.1	105.5	91.1	99.1	105.7
Population (mn)	10.1	10.1	10.0	10.0	10.0
GDP per capita (EUR)	10044	10495	9072	9892	10558
GDP (constant prices yoy %)	0.9	0.7	-6.5	-0.3	2.7
Private Consumption, real, yoy (%)	-1.6	-0.7	-7.7	-5.0	1.7
Fixed Investment, real, yoy (%)	1.6	0.4	-7.5	4.7	9.0
Public Consumption, real, yoy (%)	-4.3	-0.3	-1.1	-3.3	1.7
Exports, real, yoy (%)	16.2	5.5	-10.5	4.4	7.0
Imports, real, yoy (%)	13.3	5.7	-17.1	5.4	8.6
CPI (average, yoy %)	8.0	6.1	4.2	3.8	1.9
Central bank reference rate	7.50	10.00	6.25	5.50	5.50
Monthly wage, nominal (EUR)	736	799	703	744	788
Unemployment rate (%)	7.3	7.8	9.9	10.5	9.5
Budget balance/GDP (%)	-4.9	-3.4	-3.9	-5.0	-4.0
Current account balance (EUR bn)	-6.9	-7.6	-0.2	-0.3	0.0
Current account balance/GDP (%)	-6.8	-7.2	-0.2	-0.3	-1.9
Net FDI (EUR bn)	4.5	3.1	1.9	3.8	4.0
FDI % GDP	4.4	3.0	2.0	3.8	3.8
Gross foreign debt (EUR bn)	99.5	121.8	122.9	122.7	117.7
Gross foreign debt (% of GDP)	98.4	115.4	131.5	121.0	109.3
FX reserves (EUR bn)	16.4	24.0	32.0	29.0	28.0
(Cur.Acc-FDI)/GDP (%)	-2.4	-4.2	1.8	3.5	3.8
FX reserves/Gross foreign debt (%)	16.5	19.7	26.0	23.6	23.8
Exchange rate to USD eop	173.32	190.12	188.81	179.05	187.94
Exchange rate to EUR eop	252.86	265.62	270.39	265.00	265.00
Exchange rate to USD AVG	183.38	171.07	200.90	176.47	184.03
Exchange rate to EUR AVG	251.39	251.68	280.22	270.00	265.00

Source: UniCredit Research

STRENGTHS

- Significant IMF and EU balance of payments support
- Strong influence on fiscal policy by IMF/EU
- Low budget deficit in the region

WEAKNESSES

- High public sector debt levels (above 80% in 2009)
- Still wide external financing gap
- High FX leverage in domestic private sector

Lagging the region but inventory cycle will help

Hungarian GDP failed to recover in line with the region

Although 3Q GDP was broadly in line with our forecast (at -7.2% yoy) we believe it was still a significant disappointment against the relatively sharp improvement observed across the CEE region. For instance on a qoq basis the Hungarian GDP number (-1.8% qoq) was the lowest indicating that the "turnaround" was far less powerful than elsewhere. That said, we still believe that the significant ongoing inventory reduction (we estimate yoy inventory reduction totalled 29.6% in 1Q-3Q) will eventually jumpstart the economy as companies begin to rebuild their inventories responding to better demand from outside. Apart from the somewhat lagging inventory cycle, we believe that the key culprit of the underperformance was household demand (down 8.8% yoy in 3Q vs. positive numbers in other CEE countries); high frequency indicators suggest that it did not improve at all in the last quarter of 2009. Looking further ahead we maintain our bearish stance on household demand given **1.** lending is still contracting, as banks continue to shrink loan to deposit ratios (from about 140%), **2.** wage growth remains depressed and **3.** unemployment is still ticking higher. In terms of other elements of domestic growth we expect investment to increase in 2010 but mostly due to a couple of large investment projects (Daimler-Chrysler is set to invest some 1%/GDP, Hankook about 0.2%/GDP in the coming years but this will partly boost imports as well) while broader industries are still facing significant excess capacity. We do not expect any meaningful government consumption either. Overall, we see qoq GDP dynamics slowly improve in 1Q-2Q10 while the yoy GDP will likely to hover in negative territory throughout the whole year at -0.3% yoy. With this forecast we believe we are about 1pct below the current market consensus.

Inflation will likely undershoot the NBH target leaving "theoretical" room for further monetary easing

Inflation has completely moved off the policymakers' radar screen as recent numbers always surprised on the downside and the outlook is extremely dovish. Due to the above growth outlook and supportive base effect in 3Q10 we expect CPI to move below the NBH target of 3% and forecast the 2010 year end number at around 2.0% yoy. Accordingly from a very simple Taylor rule perspective (combination of output gap and difference from CPI target) there is still a lot of downside scope for interest rates.

The new government will likely modify the 2010 budget but we think this will happen with an approval from the IMF/EU

The currently approved budget law targets a 3.8%/GDP deficit in 2010 in line with the agreement between the government and IMF/EU. Given we estimate that the fiscal consolidation is about 50/50 split between sustainable measures and temporary measures we see some upside risk independently from the elections and despite very high level of reserserves. But more importantly Hungary will hold parliamentary elections in April 2010 and based on their comments the new government (most probably a Fidesz government) will try to modify the budget. We however do not believe that the new deficit will be as high as Fidesz is talking about (7.0%-7.5%/GDP) given the international agencies would not tolerate such numbers. The main factors behind the higher deficit according to Fidesz are consolidation of state owned company debt, overestimated tax revenues and somewhat higher spending. Overall we expect a Fidesz government to ease fiscal policy a little (5%/GDP) but we think this will occur in an agreement with the IMF/EU and as such the program will remain in place.

NBH will continue to cut rates in Jan-Feb and moves on hold due to fiscal related noise

Although the inflation and growth outlook would allow lower rates (see above) we think the NBH will remain cautious given it does not want to steer EUR/HUF above the upper "threshold" level which we believe is around 310. Coming closer to the elections we hence think that the NBH will implement only two 25bp cuts in January and February and then move to wait and see mode particularly given the potential fiscal related noise around and after the elections. On the downside we believe that the NBH does not want to see EUR/HUF below 265 as it would negatively affect export competitiveness. We would expect more rate cuts if the cross moves below this level. Overall we believe EUR/HUF will likely trade in this relatively wide range in 1Q-2Q probably around 280 and would expect a return to a longer term appreciation path only in the second half and we target 265 by the end of 2010.

Latvia

Outlook

The passing of the 2010 budget in early December eased some pressure on the lat and doubts about the near-term sustainability of the peg; nevertheless, we still think that 2010 is going to be a very challenging year with our growth forecast set for a further 4% contraction, while the fact that parliamentary elections are scheduled for October 2010 does not help either.

Author: Anna Kopetz, Economist (CAIB)
+43 5 05 05 82364, anna.kopetz@caib.unicreditgroup.eu

	Moody's	S&P	Fitch
Long-term foreign currency credit rating	**Baa3 negative**	**BB negative**	**BB+ negative**

MACROECONOMIC DATA AND FORECASTS

	2007	2008	2009E	2010F	2011F
GDP (EUR bn)	21.0	23.1	19.5	16.5	14.7
Population (mn)	2.3	2.3	2.3	2.3	2.2
GDP per capita (EUR)	9218	10177	8669	7333	6569
GDP (constant prices yoy %)	10.0	-4.6	-17.0	-4.0	6.1
Private Consumption, real, yoy (%)	14.8	-10.6	-23.4	-8.5	1.8
Fixed Investment, real, yoy (%)	7.5	-12.7	-29.5	-6.6	2.7
Public Consumption, real, yoy (%)	3.7	1.5	-11.4	-9.6	-3.1
Exports, real, yoy (%)	10.0	-1.3	-17.0	0.7	10.5
Imports, real, yoy (%)	14.7	-13.6	-34.2	-3.8	0.2
CPI (average, yoy %)	10.1	15.5	3.7	-2.9	1.5
Central bank reference rate	6.00	6.00	3.50	4.50	3.00
Monthly wage, nominal (EUR)	565	682	648	530	449
Unemployment rate (%)	6.0	7.5	17.1	21.8	18.2
Budget balance/GDP (%)	-0.4	-4.0	-8.4	-8.5	-6.7
Current account balance (EUR bn)	-4.6	-3.0	1.3	1.3	1.0
Current account balance/GDP (%)	-23.8	-13.0	6.4	8.1	6.9
Net FDI (EUR bn)	1.4	0.7	0.2	0.3	0.4
FDI % GDP	6.8	3.0	1.2	2.0	2.6
Gross foreign debt (EUR bn)	28.4	29.8	28.6	26.1	20.1
Gross foreign debt (% of GDP)	135.1	128.8	146.3	158.3	136.3
FX reserves (EUR bn)	3.8	3.5	4.5	2.3	2.5
(Cur.Acc-FDI)/GDP (%)	-14.9	-10.0	7.6	10.1	9.5
FX reserves/Gross foreign debt (%)	13.4	11.8	15.7	8.8	12.4

Source: UniCredit Research

STRENGTHS

- Significant IMF and EU balance of payments support
- Improving external environment

WEAKNESSES

- Political instability
- Doubts about sustainability of the currency regime
- High FX leverage in domestic private sector

Economic activity to continue to decelerate

The pace of decline in economic activity accelerated over the year

The decline in economic activity gained further momentum in 3Q, falling by 19.0% yoy (after a 18.7% yoy fall in 2Q). Private final consumption moved 27.4% yoy lower (after -24.7% seen in 2Q) and fixed investment registered -39.4% yoy (from -38.1% yoy in 2Q). Exports and imports slowed their decline and posted figures of -14.7% and -35.4% yoy, respectively (from -17.9% yoy and -39.3% yoy). In real terms, the 3Q09 GDP data is the lowest 3Q figure since 2005. Given the worse-than-expected data, we revised our GDP forecast down to around -17.0% yoy for the full year 2009. It should be noted that the statistical noise part in the data is quite large, which means that we feel more comfortable indicating that we expect the full-year 2009 GDP to come in between -17.0% and -18.0% yoy.

C/A improving quickly

Over the past months, the C/A continued to improve – the rolling C/A to GDP ratio (4Q08-3Q09) now stands at 3.5% – significantly up from the -2.2% seen last quarter. We expect this ratio to continue improving over the remainder of 2009 and pencil in a full year C/A to GDP ratio of 6.4%. The unwinding of the huge C/A deficit has been extraordinarily fast: only two years ago the C/A to GDP ratio stood at -23.8%.

Deflation in place since October

October 2009 was the first month to register a negative inflation rate – the headline figure came in at -0.9% yoy and has further declined since. We think that this is something the Latvian population will need to get used to; we expect deflation to be a feature throughout most of 2010. Obviously, this is not going to help the already depressed private consumption figures. Another reason (which is however perfectly in line with the "real devaluation strategy" implemented by decision makers) for a dire outlook on private consumption is the fact that wages continued to decline over 3Q: public wages declined by 20.3% yoy in September, private sector wages were down as well, but by "only" 5% yoy. It should be noted, however, that the Economic Sentiment Indicator showed some rebound over the last 6 months, driven by a steady improvement in the Retail Trade Confidence component (which came in at -19 in November 2009 up from -35 in February 2009, so admittedly at still very depressed levels).

Much discussed 2010 budget approved

The beginning of December saw the much awaited passing of the 2010 budget by parliament. The Saeima approved budget cuts worth LVL 500mn, as negotiated with the International lenders. The measures to decrease the gap in public finances comprise (among others) a rise in personal income tax, cuts in social expenditures and the introduction of a real estate tax. It is, however, quite likely that the 2010 budget will see further amendments over the course of 2010, since some of the assumptions seem to be overly optimistic. Nevertheless, the fact that the budget was approved was certainly a big positive. The remaining question now is, whether the government will manage to survive until the parliamentary elections in October. Rumors had it that different forces would try to topple the government after the passing of the budget deficit, but so far, no such attempts have been made.

Sustainability of the peg still questionable

The passing of the 2010 budget deficit certainly eased some of the doubts concerning the capability of the peg to remain in place over the medium-term. Officials underlined only recently their goal of introducing the euro as soon as possible (the official target at the moment is 2014, the CB governor Rimsevics even hopes for 2013 if the government manages to narrow the public financing gap). We don't want to get carried away, however, by this optimistic mood and still see some risks to the peg. Our main concern remains the amalgam of the need to keep a very tight rein on public finances with an already unsatisfied public that sees wages going down and unemployment going up during an election year (which naturally drives a wedge into the political cycle thereby interrupting policies that would need a stable political environment). Furthermore, it appears that the public is not too confident about the peg either: the 3-months moving average of household-deposit growth shows -31.1% yoy in October for local-currency deposits, while deposits denominated in foreign currency inched up by an average of 1.3% yoy.

Lithuania

Outlook

After the depressed economic activity figures seen in the first half of 2009, the second half showed better data, albeit deeply in the red. We expect a slow improvement in the data during 2010, but positive growth rates are only expected in 2011.

Author: Anna Kopetz, Economist (CAIB)
+43 5 05 05 82364, anna.kopetz@caib.unicreditgroup.eu

	Moody's	S&P	Fitch
Long-term foreign currency credit rating	**Baa1 negative**	**BBB negative**	**BBB negative**

MACROECONOMIC DATA AND FORECASTS

	2007	2008	2009E	2010F	2011F
GDP (EUR bn)	28.4	32.2	28.1	25.0	22.5
Population (mn)	3.4	3.4	3.4	3.3	3.3
GDP per capita (EUR)	8420	9569	8389	7467	6722
GDP (constant prices yoy %)	8.9	2.8	-16.0	-5.5	4.7
Private Consumption, real, yoy (%)	12.4	4.0	-17.7	-6.0	2.6
Fixed Investment, real, yoy (%)	20.8	-5.9	-37.4	-6.8	2.6
Public Consumption, real, yoy (%)	3.3	7.9	-2.3	-2.0	-1.9
Exports, real, yoy (%)	4.3	12.2	-18.9	-5.0	6.0
Imports, real, yoy (%)	11.6	10.5	-30.5	-4.8	1.2
CPI (average, yoy %)	5.7	11.0	4.4	-0.7	1.1
Monthly wage, nominal (EUR)	522	654	622	536	410
Unemployment rate (%)	4.3	5.8	13.5	16.6	17.3
Budget balance/GDP (%)	-1.2	-3.2	-8.3	-8.0	-5.3
Current account balance (EUR bn)	-4.1	-3.8	0.4	0.6	0.9
Current account balance/GDP (%)	-14.6	-11.9	1.4	2.2	3.8
Net FDI (EUR bn)	1.0	1.0	0.2	0.5	0.7
FDI % GDP	3.6	3.2	0.7	1.9	3.0
Gross foreign debt (EUR bn)	20.5	23.0	24.5	22.5	20.1
Gross foreign debt (% of GDP)	72.3	71.6	87.0	89.9	89.2
FX reserves (EUR bn)	5.2	4.6	5.1	3.9	4.3
(Cur.Acc-FDI)/GDP (%)	-11.0	-8.8	2.1	4.1	6.8
FX reserves/Gross foreign debt (%)	25.3	20.0	20.8	17.4	21.4

Source: UniCredit Research

STRENGTHS

- Quickly unwinding external imbalances
- Politicians' determination to reign in the public deficit

WEAKNESSES

- Sharp contraction in economic activity
- Widening fiscal deficit

Some signs of stabilization

Stronger than expected figures seen in 3Q

After the very strong fall in economic activity registered in 2Q (at -19.5% yoy), 3Q figures surprised positively at -14.2% yoy. Especially surprising were the seasonally adjusted figures: according to calculations by the local statistics office the qoq increase amounted to 6.1% in 3Q, up from -7.7% seen one quarter earlier. The stronger-than-expected headline figure came mainly on the back of improving export figures. Thus, exports decreased by 17.4% yoy in 3Q (after -23.4% seen in 2Q), while imports remained stable at -31.3% yoy (from -33.2% yoy in 2Q). The other indicators performed more or less as expected with private final consumption moving lower to -19.0% yoy (from -17.5% in 2Q) and fixed investment registering a very low -41.4% yoy (from -40.9% yoy in 2Q). The stronger-than-expected performance in exports led us to revise our forecast by 1pct. to -16.0% yoy for FY 2009. The monthly trade data underlines the picture seen in the aggregate national account figures: 3 months moving averages of seasonally adjusted exports, as well as imports, have been in positive territory (on a mom basis) since June (exports)/ July (imports) respectively.

C/A improving

The better-than-expected development in exports is also reflected in the higher than forecast C/A data. Our calculations of the rolling C/A to GDP ratio give a figure of -0.3% for 4Q08-3Q09, up from -4.0% seen last quarter. We pencil in an average figure of 1.4% for 2009.

Inflation moving lower

In general, inflation has been on a downwards path since the beginning of 2009 – the hike in VAT in place since the beginning of September resulted in a more modest feed-through than expected and therefore led to a smaller-than-anticipated increase in headline inflation. The November reading stood at 1.5% yoy, sharply down on the 9.6% yoy registered at the beginning of 2009. We expect inflation rates to turn negative in the first quarter of 2010 and see the average CPI figures at 4.4% yoy for 2009 and -0.7% yoy for 2010.

Budget approved

Reining in public finances in times of deep recessions is no easy thing – and persuading parliament to approve a tight budget is equally difficult. As far as the first point is concerned, despite the sharp cuts in public spending (e.g. 7% of all state jobs were cut in 2009), Lithuania's budget deficit is still expected to come in at a whopping above 8% to GDP in 2009. As for the second point, the situation in Lithuania at first glance should be expected to be somewhat easier – as opposed to Latvia –, since the country has so far avoided turning to the international community for financial help, which means that no international players are involved in the budget drafting process. (In order to provide the state with liquidity Lithuania managed to issue a Eurobond in June and in October.) Nevertheless, the process of adopting the 2010 budget has proved so far to be quite controversial: discussions in Lithuania centered around the "State Social Insurance Fund" (Sodra) – cuts to pensions and other benefits concerning the Sodra were only approved in a second attempt by parliament and even then only by a narrow majority (66 in favor, 63 against). At the time of writing, the 2010 budget has been approved by parliament but still not signed by President Dalia Grybauskaite.

No ratings actions expected in the near-term

Recent comments by Fitch suggest that Lithuania's current BBB is under downward pressure, mainly from the sharp deterioration in public finances, but also from "the extent of the recession, the risk of political fallout over the fiscal austerity measures, the pace of the deterioration of bank asset quality and the risk of currency devaluation in Latvia". Moody's most recent comments were more balanced, saying the rating reflected "its medium economic and high institutional strength" but also the poor fiscal outlook and the rising government. We don't expect any ratings action in the near future.

Poland

Outlook

We expect the recent relatively stellar GDP growth momentum to continue until 1Q/2Q10 when a slowdown is anticipated. This and a renewed focus on the fiscal issues will probably rub off some of the shine from PLN, we forecast EUR/PLN to move below 4.00 in 1Q but expect some moderate reversal toward the end 2010. Against this growth backdrop and our CPI forecast inside the NBP target we expect only one rate hike (25bp) in 2010.

Author: Marcin Mrowiec, Chief Economist (Bank Pekao)
+48 22 524 5914, marcin.mrowiec@pekao.com.pl

	Moody's	S&P	Fitch
Long-term foreign currency credit rating	**A2 stable**	**A- stable**	**A- stable**

MACROECONOMIC DATA AND FORECASTS

	2007	2008	2009E	2010F	2011F
GDP (EUR bn)	310.8	360.2	295.3	338.4	370.7
Population (mn)	38.1	38.1	38.1	38.1	38.1
GDP per capita (EUR)	8154	9453	7751	8885	9739
GDP (constant prices yoy %)	6.8	4.9	1.7	2.3	2.7
Private Consumption, real, yoy (%)	4.9	5.4	2.3	1.9	2.5
Fixed Investment, real, yoy (%)	17.6	8.1	-1.6	-3.3	2.0
Public Consumption, real, yoy (%)	3.7	7.6	2.5	2.3	2.4
Exports, real, yoy (%)	9.1	7.2	-2.9	7.5	9.0
Imports, real, yoy (%)	13.7	8.2	-6.4	6.7	6.5
CPI (average, yoy %)	2.5	4.2	3.5	2.3	2.6
Central bank reference rate	5.00	5.00	3.50	3.75	4.25
Monthly wage, nominal (EUR)	762	905	834	958	1030
Unemployment rate (%)	12.7	9.8	10.9	12.3	12.0
Budget balance/GDP (%)	-2.0	-3.9	-6.3	-7.0	-4.3
Current account balance (EUR bn)	-14.6	-19.6	-3.9	-8.5	-9.2
Current account balance/GDP (%)	-4.7	-5.1	-1.3	-2.4	-2.5
Net FDI (EUR bn)	16.7	11.0	7.0	10.0	10.0
FDI % GDP	5.4	3.0	2.3	2.8	2.7
Gross foreign debt (EUR bn)	159.1	172.8	192.2	198.6	214.0
Gross foreign debt (% of GDP)	48.7	56.4	57.2	58.2	58.3
FX reserves (EUR bn)	44.7	44.1	55.6	61.4	68.4
(Cur.Acc-FDI)/GDP (%)	0.7	-2.4	1.0	0.4	0.2
FX reserves/Gross foreign debt (%)	28.1	25.5	28.9	30.9	32.0
Exchange rate to USD eop	2.46	2.97	2.86	2.77	2.84
Exchange rate to EUR eop	3.60	4.15	4.10	4.10	4.00
Exchange rate to USD AVG	2.76	2.39	3.10	2.55	2.74
Exchange rate to EUR AVG	3.78	3.52	4.32	3.90	3.95

Source: UniCredit Research

STRENGTHS

- The only EU country with positive GDP growth in 2009
- Significant improvement in foreign trade balance
- Large EU funds offset decline in private sector investment

WEAKNESSES

- Strong increase of deficits and borrowing needs
- Weak outlook for labor market and private sector investments
- Lack of fiscal reforms in next 2Y due to political calendar

Poland maintains positive momentum in the near term

We slightly increased our GDP forecast for 2010 and slightly reduced our CPI forecast

In the previous issue we stated that "in the coming quarters we expect better and better data". That was substantiated by 3Q GDP data (+1.7%, after 0.8% in 1Q and 1.1% in 2Q) and will likely be substantiated by 4Q data (we look for a reading slightly exceeding 3%), and by 1Q10 GDP data (also above 3%, additionally supported with base effects from 2009). These numbers – fitting into the pattern of "better and better data", but even exceeding our previous forecasts – have prompted us to push up our GDP forecasts: for 2009 to 1.7% (from 1.4%), and for 2010 to 2.3% (from 1.8%). Apart from a strong contribution from net exports, and the stabilizing influence of an orderly decline in private consumption, currently support for the domestic economy comes from the rebound in Western Europe, as well as from sizeable EU-co-financed structural investments, which are offsetting declines in private sector investments. Regarding our CPI forecast for end-2010, we revised it down slightly (to 2.3%), and this makes us expect only one rate hike in 2H10 (vs. previous two hikes). We continue to be constructive on the zloty – we expect it to see sub-4.00 levels vs. EUR in 1Q10. At the same time, around 1Q-2Q10 we'd be looking for signs of a reversal of the zloty-strengthening trend, in anticipation of a slowdown of growth in the second half of the year, which will likely push state budget deficits to the centre of discussion again (and thus negatively impact domestic currency and bonds). Regarding POLGBs, we'd opt to stick to the short end, as markets seem to be ignoring positive news (sharp fall in inflation in 1H10, likely towards 2% yoy from 3.5% yoy expected for end-2009) and staying alert to 2010 supply fears.

Monetary Policy to remain relatively stable during 2010

Monetary policy will likely remain stable, as CPI is to peak in Dec'09 at the upper end of the MPC inflation target (1.5%-3.5%), and maintain a stable downward trend until mid-2010, to rebound towards the central target (2.5%) by year-end. Therefore, no need to hike in 1H10. In 2H10 we expect GDP growth to lose momentum, and the Council will not be too eager to hike. In our core scenario we expect one hike of 25bp, but we would not be very surprised to see no hikes in 2010. However, we do not yet fully know who is going to be in the next MPC (beginning of a new term in Jan-Feb 2010), and hence that call will have to be validated when we know the distribution of "doves" vs. "hawks" in the new MPC.

The medium- and long-term worrisome issue for the broader picture is the lack of adequate policy response to state deficits. Although a probable 7% public sector deficit in 2010 does not look that different to many other countries, it is nonetheless a big problem – and the political calendar (presidential elections in autumn 2010, parliamentary elections in 2011) creates a problem, as politicians are unlikely to announce spending cuts in an election year. That will likely increase volatility in FX and bond yields – we expect 1Q10 to be relatively positive in that respect (relatively strong growth smoothing worries), but the second half of the year might bring renewed fears over public finances (not only domestic), which would likely push the currency weaker and POLGBs yields higher.

Presidential elections in autumn without a relevant impact on markets

Politically the situation remains very stable, with the ruling Civic Platform (PO) continuing to see strong support and thus keeping the risk of tumult in politics very low. Presidential elections will be held in autumn 2010, but they will likely be ignored by the markets. Theoretically, if a candidate from the ruling party won the elections, that would mean better cooperation between Parliament and President – but it is uncertain whether that would mean (public finance) reforms. Even if so, that would not materialize in 2011 – when parliamentary elections will be held.

Sovereign credit rating outlook

Rating agencies are signaling no changes in the credit outlook, but suggest if there's no public finance reform in the near future, that could prompt them to consider revisions.

Romania

Outlook

Romania's economy is estimated to have contracted by -7% yoy in 2009, slightly better than previously expected but deteriorating wages and labor market uncertainties will drag down consumption while investment recovery will be slow. Fiscal slippage remains one of the main country risks given the rigidity of social spending and depressed budget revenues on the back of weak economic performance. On the positive side, with a new government in place there is more likelihood of implementing the extensive public sector restructuring that was announced before the elections.

Author: Rozália Pál, Ph.D., Macro and Strategic Analysis Coordinator (UniCredit Tiriac Bank)
+40 21 203 2376, rozalia.pal@unicredit.ro

	Moody's	S&P	Fitch
Long-term foreign currency credit rating	**Baa3 stable**	**BB+ negative**	**BB+ negative**

MACROECONOMIC DATA AND FORECASTS

	2007	2008	2009E	2010F	2011F
GDP (EUR bn)	123.7	136.9	118.4	124.1	144.2
Population (mn)	21.5	21.4	21.3	21.2	21.1
GDP per capita (EUR)	5745	6391	5552	5852	6832
GDP (constant prices yoy %)	6.2	7.1	-7.0	0.4	3.5
Private Consumption, real, yoy (%)	9.8	8.4	-11.5	0.6	4.6
Fixed Investment, real, yoy (%)	29.0	19.3	-20.5	1.0	5.0
Public Consumption, real, yoy (%)	7.6	3.7	0.7	2.0	2.7
Exports, real, yoy (%)	7.9	19.4	-5.4	4.0	7.0
Imports, real, yoy (%)	27.2	17.5	-25.1	8.5	11.0
CPI (average, yoy %)	4.8	5.7	5.6	4.0	3.9
Central bank reference rate	7.50	10.25	8.00	6.50	5.75
Gross Monthly wage, nominal (EUR)	312	348	323	343	394
Unemployment rate (%)	4.3	4.0	6.3	8.5	7.0
Budget balance/GDP (%)	-2.3	-4.8	-8.0	-7.0	-5.0
Current account balance (EUR bn)	-16.7	-16.9	-5.9	-6.7	-8.1
Current account balance/GDP (%)	-13.5	-12.3	-5.0	-5.4	-5.7
Net FDI (EUR bn)	7.2	9.0	4.9	5.0	5.8
FDI % GDP	5.8	6.6	4.1	4.0	4.0
Gross foreign debt (EUR bn)	38.7	51.4	63.2	72.1	79.1
Gross foreign debt (% of GDP)	31.3	37.6	53.4	58.1	54.9
International reserves (EUR bn)	27.2	28.3	30.9	30.2	28.7
(Cur.Acc-FDI)/GDP (%)	-7.7	-5.7	-0.9	-1.4	-1.7
Int. reserves/Gross foreign debt (%)	70.2	55.0	48.8	42.0	36.3
Exchange rate to USD eop	2.45	2.88	2.95	2.84	2.84
Exchange rate to EUR eop	3.58	4.03	4.23	4.20	4.00
Exchange rate to USD AVG	2.43	2.50	3.04	2.81	2.85
Exchange rate to EUR AVG	3.34	3.68	4.24	4.30	4.10

Source: UniCredit Research

STRENGTHS

- Significant IMF and EU balance of payments support
- Low public sector debt levels
- High roll-over rates of banks' external financing

WEAKNESSES

- High public deficit with risk of overshooting
- High FX leverage in domestic private sector
- Some political risk

New government convey ample public sector restructuring

Romania's economy is set for a very slow recovery of 0.4% during 2010

The Romanian economy contracted by 7.1% yoy in 3Q, slightly up on the 8.7% yoy drop in 2Q. As expected, exports and inventories entered positive territory. Meanwhile, investment contracted by 28.6% yoy, while consumption dropped by 12.7% yoy. On the supply side, agriculture surprised positively, as it rose by 2.4% yoy (10% yoy drop in 1H) while the worst performer remains the construction sector, which contacted by 17.4% yoy. For 2010, two opposing forces will be at work: On the one hand, exports will drive a further improvement in industrial production, as reflected by the leading sentiment indicators, while the turning of the inventory cycle will also give a boost. On the other hand, domestic demand will remain weak, with further contraction in consumer spending and depressed investment levels. On balance therefore we expect a very modest recovery during 2010, with full-year growth of just 0.4%.

Disinflation trend to continue in 2010

Weak local demand will help the disinflation trend to continue with end-2009 inflation at 4.7% yoy, slightly above our previous expectation driven by fuel price growth and the excise duties hike in September, but this is still very close to the CB's target band of 3.5% +/-1%. We expect inflation to stay relatively low during 2010, ending the year at 4.2%.

Huge C/A correction amid good FDI coverage. Balanced external trade in 2010

Another positive side effect of the recession is that the C/A deficit has contracted sharply, by 72% yoy in the first 10M of 2009 to EUR 4bn, driven by the narrowing trade deficit (-67% yoy) but also helped by current transfers, less affected by the crisis (-31% yoy), and by a sharp reduction in outflows on the incomes balance (-49% yoy). Moreover, FDI (EUR 3.7bn) coverage of the deficit remained high at 94%. We expect this improvement to continue, and forecast the C/A deficit at 5% of GDP in 2009.

Monetary policy softening to continue in 2010

Uncertainties on the local inter-bank market and Central Bank (CB) support of the local currency kept interest rates high (200-250bp above the policy rate). Moreover, the CB adopted a more cautious monetary stance at its November meeting by holding the key rate at 8%. We see total 150bp interest rate cuts during 2010, accompanied by further MRR reduction.

Budget deficit slippage remains the major risk for 2010 although with improved outlook for ample public sector restructuring

On the fiscal side, the 11M public sector deficit reached 6% of GDP. We see a significant risk of the budget deficit overshooting, ending 2009 at around 8% of GDP. The Parliament will begin talks on the 2010 budget bill on Jan, 11. Deficit target is set at 5.9% of GDP (with 1.3% GDP growth).The proposed budget envisages up to 100,000 public sector job cuts and freezing on pension and wages. Despite of this, the mandatory spending on pensions and social welfare is estimated to increase to 14.9% of GDP, compared to some 13% of GDP in 2009. After the delay of the third IMF tranche worth EUR 1.5bn, Romania faced some public financing pressure, but the Central Bank provided some help by lowering the MRR ratio on FX liabilities with residual maturities of up to two years to 25% from 30%. For 2010, public financing pressures will remain intact with the outlook for a deficit of around 7%.

Newly elected president means also new government that got parliamentary approval at the end of 2009

The 2009 presidential elections have received special importance in shaping the new government, given that the new Prime Minister has been nominated by the newly elected president. The incumbent President Traian Basescu won the elections with a tight margin and Romania's new centrist coalition won parliamentary approval on 23 December. The new government is built around his Democrat-Liberal party with Emil Boc as PM and comprises an ethnic Hungarian party, other minorities and independent allies. The cabinet faces three years with no elections if it can complete its term (given that its majority is slim).

Sovereign credit rating outlook still dependent on fiscal performance

Fiscal performance and external financing, conditional on the IMF/EU stand-by-agreement, continues to be crucial for the credit outlook. It should be noted that financing through IMF tranches is expected to resume in February 2010, while the strong balance of payment correction should bring some stability. Given these risks we keep our previous call of 4.2 EUR/RON for end -2010. Still, some stronger RON strengthening cannot be ruled out on the back of relatively high rates, improved C/A and the catch up potential vs. the CEE peers.

Slovakia

Outlook

As the CEE reform-leader in the mid-2000s, the country still benefits from the flat tax and the euro adoption. Even during the downturn in investment projects, the country attracted a new car model and a new electronics producer (EUR 500mn projects to be put to work in 2011). We are more optimistic than the fiscal authorities on the growth prospects, but still do not discount a “W-shaped” recovery.

Author: Jan Toth, Chief Economist (UniCredit Bank)
+421 2 4950 2267, jan.toth@unicreditgroup.sk

	Moody's	S&P	Fitch
Long-term foreign currency credit rating	**A1 stable**	**A+ stable**	**A+ stable**

MACROECONOMIC DATA AND FORECASTS

	2007	2008	2009E	2010F	2011F
GDP (EUR bn)	54.9	64.8	63.1	65.9	70.1
Population (mn)	5.4	5.4	5.4	5.4	5.4
GDP per capita (EUR)	10165	11968	11673	12200	12977
GDP (constant prices yoy %)	10.6	6.2	-5.0	2.6	3.8
Private Consumption, real, yoy (%)	7.1	6.1	-0.6	0.4	2.0
Fixed Investment, real, yoy (%)	9.1	1.8	-11.4	6.8	5.6
Public Consumption, real, yoy (%)	0.1	5.3	4.5	3.0	2.0
Exports, real, yoy (%)	14.3	3.2	-16.8	6.0	7.0
Imports, real, yoy (%)	9.2	3.1	-18.5	7.0	6.3
CPI (average, yoy %)	2.8	4.6	1.6	1.3	3.5
Central bank reference rate	4.25	2.50	1.00	1.00	2.50
Monthly wage, nominal (EUR)	669	723	742	760	798
Unemployment rate (%)	11.0	9.6	11.8	13.0	12.6
Budget balance/GDP (%)	-1.9	-2.3	-6.1	-5.8	-5.3
Current account balance (EUR bn)	-3.3	-4.2	-3.9	-3.1	0.0
Current account balance/GDP (%)	-5.3	-6.5	-4.2	-4.6	-3.2
Net FDI (EUR bn)	2.7	1.7	1.2	1.8	0.0
FDI % GDP	4.4	2.5	1.8	2.7	2.2
Gross foreign debt (EUR bn)	32.4	35.9	33.9	33.3	40.8
Gross foreign debt (% of GDP)	59.0	55.4	53.8	50.5	58.2
(Cur.Acc-FDI)/GDP (%)	-1.1	-3.9	-4.4	-1.9	0.0
Exchange rate to EUR AVG	33.78	31.29	30.13	EUR	EUR

Source: UniCredit Research

STRENGTHS

- Banking sector in good shape
- Some FDI interest due to euro adoption
- Euro adoption prevents short-term currency volatility

WEAKNESSES

- Euro adoption does not allow currency depreciation to improve price competitiveness
- Very dependent on world trade as industry the main engine of growth (autos, electronics, steel)
- No reform agenda, ballooning deficit even without the need to help banks

Still working the old magic, but no new reform agenda

Slovak 2010 GDP forecasts

	prev.	new
NBS	2.9	3.1
MinFin	1.1	1.9
UCB	**2.1**	**2.6**

Slovak 2011 GDP forecasts

	prev.	new
NBS	4.2	4.3
MinFin	3.4	4.1
UCB	**3.5**	**3.8**

"W" scenario continues to be a real risk for Slovak industry for 2H10

The Slovak economy posted an above-average turnaround in 2Q-3Q09 after a dramatic 10% qoq collapse in 1Q09. As expected, the inventory build-up and fiscal stimuli pushed international trade volumes up. Slovakia, as one of the most open and industry-oriented economies in the EU reacted accordingly. However, the economy was still 6% below its pre-crisis level in 3Q09. As manufacturing recovers (3% below the pre-crisis level), the pain transfers to domestic sectors such as retail&wholesale (10% below the pre-crisis level), construction (15% below the pre-crisis level) and tourism. Rising unemployment together with euro adoption (and regional currencies weakness) does not bode well for these sectors. More pain is on the way as the 5% newly unemployed are about to lose the financial support of unemployment benefits. Once, the fiscal stimuli ends in EU-15, a more benign industry outlook coupled with the recessionary domestic sector could bring qoq growth back to 0% or even dip into negative territory over the summer. We do not expect much worse. In the meantime, the trade balance should be in surplus as local consumption falls and investment tumbles. The government-sponsored infrastructure construction sector will get a huge boost from PPP projects in 2010 with highway construction spending almost tripling in the election year 2010. This has prompted us to revise up our 2010 growth forecast slightly (2.6% instead of 2.1%) after a 5% fall in 2009. The pre-crisis level should be reached as late as in early 2012.

Slovakia continues to enjoy zero real interest rates

Slovakia still enjoys zero real interest rates. The 10Y spread has continued to narrow from 140bp to 100bp despite the immediate fallout from the downgrade of Greece.

Government does not have a plan to consolidate the fiscal accounts, hopes for recovery

Public debt at 42% of GDP in 2010, up from 28% of GDP in 2008

The Greek downgrade is very likely to put more pressure on countries with higher debt levels (not Slovakia's case as debt represents 42% of GDP in 2010) and not credible deficit reduction plans (Slovakia's case). Inflation should stay below 2% levels in 2010 before rising to more "normal" +3% levels in 2011. But the fiscal deficit target at 5.5% of GDP does not include PPP projects (outside official figures). In addition, there was no need for bank recapitalization. For Slovakia, the global crisis translated into the slowdown of very high potential growth while the budget faces a one-off adjustment of the potential output. There are no reforms in place to account for that, either on the spending or revenue side. Without stronger than expected growth, there is a danger of tax hikes after the elections. So far, fiscal deficit consolidation is left to automatic stabilizers. What is troubling is that business conditions continue to gradually worsen; corruption is likely on the rise. Lower growth in the medium term is the likely consequence.

Higher unemployment cuts into popularity premium of the coalition

As unemployment continues to grow, the popularity of the coalition parties will fall. But there is still a sizable difference between the government parties (53% popularity share) and the more market-oriented opposition parties (40% popularity). The ruling populist/leftist SMER is very likely to win the elections, according to the polls which put a high probability on a government led by SMER.

Slovak elections scheduled for June 2010

However, it is worth noting that as more junior parties approach the 5% minimum threshold to get into parliament, a broad mix of election outcomes is possible. Despite this, the expected scenario is a government with a similar structure to the existing one winning a new term.

Slovenia

Outlook

The improved international outlook points to a consolidation of the already visible signs of recovery for the Slovenian economy. The government is pursuing a countercyclical fiscal policy and relatively low public debt will allow it to do so comfortably. On the other hand, however, the budget deficit will only return to within the Maastricht criteria ceiling of 3% of GDP in 2013. Even though we forecast a rise in public debt (to near 40% of GDP in 2010), access to international finance for the government will not be a problem.

Author: Goran Šaravanja, Chief Economist (Zagrebačka banka)
+ 385 1 6006 678, goran.saravanja@unicreditgroup.zaba.hr

	Moody's	S&P	Fitch
Long-term foreign currency credit rating	**Aa2 stable**	**AA stable**	**AA stable**

MACROECONOMIC DATA AND FORECASTS

	2007	2008	2009E	2010F	2011F
GDP (EUR bn)	34.5	37.1	34.6	35.3	36.6
Population (mn)	2.0	2.0	2.0	2.1	2.1
GDP per capita (EUR)	17169	18366	16950	17242	17753
GDP (constant prices yoy %)	6.8	3.5	-7.8	0.6	1.5
Private Consumption, real, yoy (%)	5.3	2.2	-2.0	0.0	1.5
Fixed Investment, real, yoy (%)	11.9	6.6	-21.5	0.9	3.9
Public Consumption, real, yoy (%)	2.5	3.7	4.4	1.8	1.7
Exports, real, yoy (%)	13.8	3.4	-16.8	-5.9	1.1
Imports, real, yoy (%)	15.7	3.8	-19.3	-6.6	2.2
CPI (average, yoy %)	3.6	5.7	1.0	1.6	2.0
Central bank reference rate	4.00	2.50	1.00	1.00	2.50
Monthly wage, nominal (EUR)	1284	1391	1421	1448	1498
Unemployment rate (%)	4.9	4.5	5.8	7.5	7.3
Budget balance/GDP (%)	0.0	-1.8	-5.9	-6.6	-6.5
Current account balance (EUR bn)	-1.5	-2.3	0.0	-0.6	-0.7
Current account balance/GDP (%)	-4.2	-6.2	0.0	-1.8	-1.9
Net FDI (EUR bn)	-0.3	0.4	-0.6	-0.2	0.1
FDI % GDP	-0.8	1.0	-1.7	-0.6	0.3
Gross foreign debt (EUR bn)	34.8	39.0	41.8	43.5	45.5
Gross foreign debt (% of GDP)	100.7	105.1	120.7	123.1	124.4
(Cur.Acc-FDI)/GDP (%)	-5.0	-5.1	-1.7	-2.4	-1.7
Exchange rate to EUR AVG	239.64	EUR	EUR	EUR	EUR

Source: UniCredit Research

STRENGTHS

- Low public debt levels and EMU membership
- Foreign debt essentially denominated in local currency
- Export orientation can lever off any Euro zone recovery

WEAKNESSES

- Highly leveraged banking sector
- Corporate sector relatively weak
- Lower price competitiveness

Encouraging signs, but don't overplay the recovery

Ugly headline GDP numbers but underlying data do point to a mild recovery in growth in 2010

The most recent data points to acceleration in the Slovenian economy, despite the base effect of a 7.8% contraction in 2009. In 3Q09 GDP fell 8.3% yoy, led by a 23.8% yoy drop in gross fixed capital expenditure; even though the headline GDP figures in Slovenia seem unattractive, the seasonally adjusted qoq data point to an expansion of 1.0%, one of the first confirmations of recovery. This comes after an expansion of 0.6% qoq in the second quarter. At the same time industrial production has risen in mom seasonally adjusted terms in each of the three months to October, according to our estimates. Confidence in the manufacturing sector in November is at its highest level since October 2008, while orders in industry were up 8.3% in 3Q compared to 2Q (largely on the back of a large increase in domestic orders in September of 30.6% mom).

Weak domestic demand generates a current account surplus and keeps inflation low

Current account moved in surplus at end September. The sharp drop in merchandise imports (down 22.5% yoy) has seen the trade deficit narrow 85%, to EUR 266mn in the nine months to September. This was the main driver of the current account surplus over this period. On the inflation front, although water charges were increased 27% in November, the headline CPI rose just 1.7% yoy. Our estimates of core inflation point to a figure marginally lower than zero in November: weak domestic demand has clearly influenced dynamics.

GDP growth in 2010 seen at 0.6% with the current account back in a minor deficit

We see the Slovenian economy posting a positive growth rate in 2010 (+0.6%) and the current account back in deficit. While we certainly detect some encouraging signs in the Slovenian economy, we wouldn't overplay the extent of the recovery either. One reason is rising unemployment, which hit 6.2% in 3Q09 and may rise further. And while recent data on the Euro zone have been encouraging, the recovery there will be mild. Meanwhile, we forecast another year of recession in Southeast Europe, important as an export destination for Slovenia. And the Slovenian banking sector exhibits high dependence on external funding (also visible in terms of loan/deposit ratios, for instance), which will constrain lending activity, despite a EUR 1.2bn guarantee scheme being in place to kick start lending to business. Hence, all in all we forecast growth of 0.6% in 2010 and 1.5% in 2011. After 2009 where the current account likely moved into surplus, we see it returning to a deficit of 1.8% of GDP as inventories are rebuilt and domestic demand recovers from the nadir reached last year. At the same time, we see inflation averaging 1.6% in 2010 and 2.0% in 2011.

Fiscal stimulus drives widening of the budget deficit…

…as public debt looks set to top 40% of GDP at the end of 2010

Weak economy leaves a mark on fiscal policy. The authorities have revised up their budget deficit forecast for 2009 to 5.9% of GDP (which is essentially what we forecast in the previous CEE Quarterly) as tax revenues have underperformed. The 2010 budget also aims for the same deficit (we forecast it marginally higher). The government intends to pursue a counter-cyclical fiscal policy in an effort to support growth. Relatively low public debt will allow it to do so comfortably. At the same time, however, the announcement by the Ministry of Finance that the budget deficit will return to within the Maastricht criteria ceiling of 3% of GDP in 2013 only is less reassuring. On the basis of budget plans for 2010 and 2011 we project that public debt will experience a significant rise, from 22.5% of GDP at the end of 2008 to 42.9% at the end of 2011.

Minimum wage enters the policy debate

Heading into 2010 **the main policy debate locally centers on initiatives to increase the minimum wage**. On one side, this would certainly prove popular with employees and be supportive for some low income earners; on the other, there is a possible risk that any increase in the minimum wages would to some extent damage Slovenia's price competitiveness, thus dampening the contribution of exports to the economic recovery.

Sovereign credit rating stable on low public debt

Slovenia's low public debt and EMU membership are a big plus for the solidity of its sovereign credit rating. Even though we forecast a rise in public debt to near 40% of GDP this year, access to international finance for the government is not a problem.

Bosnia & Herzegovina

Outlook – A complicated political scene and still weak domestic demand are the two main leitmotifs for 2010. Fractious political environment persists, EU accession path remains stalled: the October 2010 general elections could further complicate the political scene and progress on EU accession could suffer. However, the reliance on the IMF will see most budget reforms take place (the IMF is seeking additional austerity measures before approving the second trance of the stand-by agreement). At the same time the outlook for domestic demand is still weak: we continue to forecast negative economic growth in 2010 as the currency board agreement and the fiscal restraint will not allow enough policy room for any significant stimulus.

Author: Goran Šaravanja, Chief Economist (Zagrebačka banka)
+ 385 1 6006 678, goran.saravanja@unicreditgroup.zaba.hr

	Moody's	S&P	Fitch
Long-term foreign currency credit rating	**B2 Stable**	**B+ Stable**	**–**

MACROECONOMIC DATA AND FORECASTS

	2007	2008	2009E	2010F	2011F
GDP (EUR bn)	11.1	12.6	12.2	12.2	12.6
Population (mn)	3.8	3.9	3.9	3.9	3.9
GDP per capita (EUR)	2876	3282	3176	3177	3260
GDP (constant prices yoy %)	6.8	5.4	-3.0	-1.0	0.8
CPI (average, yoy %)	1.5	7.4	-0.2	1.1	1.8
Monthly wage, nominal (EUR)	488	568	614	613	622
Unemployment rate (%)	44.0	40.3	41.5	43.0	42.5
Budget balance/GDP (%)	-0.1	-4.0	-5.2	-4.5	-4.2
Current account balance (EUR bn)	-1.2	-1.9	-0.9	-0.7	-0.8
Current account balance/GDP (%)	-10.4	-14.9	-7.2	-6.0	-6.5
Net FDI (EUR bn)	1.5	0.7	0.3	0.5	0.6
FDI % GDP	13.8	5.7	2.1	4.2	5.1
(Cur.Acc-FDI)/GDP (%)	3.4	-9.2	-5.1	-1.9	-1.4
Exchange rate to USD eop	1.34	1.40	1.37	1.32	1.39
Exchange rate to EUR eop	1.96	1.96	1.96	1.96	1.96
Exchange rate to USD AVG	1.43	1.33	1.40	1.28	1.36
Exchange rate to EUR AVG	1.96	1.96	1.96	1.96	1.96

Source: UniCredit Research

STRENGTHS

- Significant IMF and EU support
- Currency Board arrangement reduces policy uncertainty
- Foreign-owned banks supporting subsidiaries

WEAKNESSES

- Domestic demand set to remain weak
- Dependence on commodities and steel exports
- Fractious political environment persists.
  Election year complicates the political scene

Recession set to continue in 2010

Domestic demand remains weak…

Domestic demand, which is taking the brunt of adjustment in 2009-10 given the limited scope for monetary policy under the currency board agreement, remains weak. The unemployment rate is rising (42.2% in September) and with the **IMF seeking additional austerity measures before approving the second trance of money from the stand-by agreement**, the outlook for private consumption is weak. Although gross wages were growing over 8% yoy during 2009, pay cuts in the public sector in 2009 have sharply altered wage dynamics. Moreover, credit growth has continued to slow, falling 2.8% yoy in October, with the reduction more evident for the household sector (-4.6% yoy). Merchandise import data moved in the same direction: in the first 10 months of 2009 imports recorded a fall of 26.2% yoy. The low growth-low inflation scenario is further confirmed by the information stemming from headline CPI, which has been negative in yoy terms since May (at -1.4% in October). While base effects should help the headline figure return to positive territory in yoy terms in December, inflation is set to remain low in 2010 trailing weak domestic demand.

…inflation and current account deficit forecasts lowered

We maintain our GDP forecast unchanged (negative growth in 2009 and also in 2010, -3% and -1% respectively), while we revised lower the CPI and the current account forecasts. The need to continue tightening fiscal policy, rising unemployment and minimal credit growth will act as a brake on growth, while the contribution of net exports will not be enough to record a positive rate of growth. Moreover, while industrial production in Republika Srpska recorded double digit growth in 2009, as an oil refinery reopened and the transport equipment sector saw new investments come on line, such growth will not be repeated in 2010. Additionally, given the currency board arrangement we see a scenario of wage growth close to zero this year with minimal growth in 2011. We see average inflation at around 1.0% yoy this year (with some risks to the downside). Weak domestic demand will also be the main driver behind the continued reduction in the C/A deficit to an estimated 6.0% of GDP.

The need for further work on fiscal deficit slows the disbursement of funds

IMF is seeking revisions in social spending and pensions before releasing the EUR 95mn second trance of the stand-by agreement. Tax revenue shortfalls have seen the IMF agree to higher consolidated general government budget deficit targets of 5.2% of GDP in 2009 and 4.5% of GDP in 2010. Nonetheless, the IMF sought action on pension policy and improving the targeting of the social welfare system before seeking Board approval for the disbursement of the second trance of funds from the stand-by agreement. At the same time, a World Bank loan of USD 100mn for budget assistance which was supposed to be released in December 2009 will likely be delayed until February 2010 as long as amendments to legislation governing cash transfers to individuals are approved by Bosnia's entity parliaments.

Fractious political environment persists, EU accession path remains stalled

The political situation in 2009 has been characterized by international community concern over the lack of progress on EU accession: so much in fact that the international community delayed in November a decision until February 2010 on whether to close the Office of the High Representative (OHR). At the same time, **the relations between Bosnia's two entities have progressively worsened. General elections in October further complicate the political scene** and are the main event for the year. Indeed, the focus in the political sphere will increasingly turn to presidential and parliamentary elections in October 2010. Reliance on IMF and World Bank financial assistance will ensure some progress in economic policy spheres, but the country's EU accession path remains stalled and it is not yet clear if visa-free travel to the EU during 2010 will become a reality.

No change to sovereign rating expected

S&P affirmed Bosnia's B+ (stable) credit rating in December. A further piece of positive news in this domain is the issuance of a 2.5% BAM 346mn frozen foreign exchange deposit bond by the Federation of Bosnia and Herzegovina. The first BAM 50.2mn installment was issued on 31 December 2009. We base our view regarding the stability of the rating on the solidity of the currency board and adherence by the authorities to the IMF agreement.

Croatia

Outlook

Economic growth remains weak but EU convergence has resumed. We forecast negative GDP growth in 2010 as well. On EU, our core scenario envisages the completion of accession talks this year, which would remove some of the uncertainty surrounding the private sector, thus increasing the likelihood of an investment revival during the second half of the year. The EU has offered 2012 as a possible accession year, if talks are completed in time – can policymakers grasp the nettle?

Author: Goran Šaravanja, Chief Economist (Zagrebačka banka)
+ 385 1 6006 678, goran.saravanja@unicreditgroup.zaba.hr

	Moody's	S&P	Fitch
Long-term foreign currency credit rating	**Baa3 stable**	**BBB negative**	**BBB- negative**

MACROECONOMIC DATA AND FORECASTS

	2007	2008	2009E	2010F	2011F
GDP (EUR bn)	42.8	47.4	45.0	45.7	47.8
Population (mn)	4.4	4.4	4.4	4.4	4.4
GDP per capita (EUR)	9654	10681	10144	10297	10779
GDP (constant prices yoy %)	5.5	2.4	-6.0	-1.0	1.3
Private Consumption, real, yoy (%)	6.2	0.8	-8.5	-1.9	1.3
Fixed Investment, real, yoy (%)	6.5	8.2	-11.0	-4.1	1.9
Public Consumption, real, yoy (%)	3.4	1.9	1.8	0.0	1.0
Exports, real, yoy (%)	4.3	1.7	-15.5	-5.7	1.7
Imports, real, yoy (%)	6.5	3.6	-18.6	-8.0	2.7
CPI (average, yoy %)	2.9	6.1	2.5	3.2	3.1
Monthly wage, nominal (EUR)	961	1044	1050	1074	1112
Unemployment rate (%)	9.6	8.4	9.4	10.0	9.6
Budget balance/GDP (%)	-2.0	-0.8	-3.9	-3.5	-3.0
Current account balance (EUR bn)	-3.2	-4.4	-2.5	-1.8	-1.8
Current account balance/GDP (%)	-7.6	-9.3	-5.6	-3.9	-3.7
Net FDI (EUR bn)	3.5	3.2	1.2	1.7	2.3
FDI % GDP	8.1	6.8	2.7	3.7	4.7
Gross foreign debt (EUR bn)	33.3	39.0	42.5	45.5	48.5
Gross foreign debt (% of GDP)	77.7	82.4	94.5	99.6	101.5
FX reserves (EUR bn)	9.3	9.1	9.3	9.7	10.0
(Cur.Acc-FDI)/GDP (%)	0.6	-2.5	-2.9	-0.2	1.0
FX reserves/Gross foreign debt (%)	28.0	23.4	21.9	21.3	20.6
Exchange rate to USD eop	5.03	5.28	5.09	5.03	5.25
Exchange rate to EUR eop	7.33	7.37	7.30	7.45	7.40
Exchange rate to USD AVG	5.35	4.91	5.26	4.83	5.12
Exchange rate to EUR AVG	7.34	7.22	7.34	7.39	7.37

Source: UniCredit Research

STRENGTHS

- EU accession in 2012 looks likelier
- Credible monetary policy response
- External imbalances adjusting quickly

WEAKNESSES

- Uncertainty over public sector borrowing requirement
- High FX leverage in household and private sector
- 2009 tax increases adversely affected domestic demand

EU entry in 2012 becomes a distinct possibility

Domestic demand remains weak heading into 2010…

Economic growth in 2009 likely to be around -6%. The Croatian economy contracted 5.7% yoy in 3Q 2009 with investment activity contracting 10.5% yoy and private consumption still weak. Seasonally adjusted industrial production data for November showed a 0.4% mom decrease, suggesting industrial production should have contracted by 8.8% yoy in 2009. Also, inflationary pressures are waning, the November headline CPI figure coming in at only 1.8%.

We continue to see a contraction in GDP in 2010, despite expectations that EU accession talks should end this year

We expect the Croatian economy to contract by around 1.0% in 2010. Coming into 2010 we continue to see headwinds for the private sector – rising unemployment and minimal wage growth is limiting scope for private consumption growth, while payment arrears further undermine business sentiment. The one undoubted positive in 2010 is the EU accession process. **Our core scenario envisages the completion of EU accession talks this year, which would remove some of the uncertainty** surrounding the private sector heading into 2010, thus increasing the likelihood of investment and new hiring during the second part of the year. Despite a 15% increase in gas prices at the start of 2010 our weak domestic demand scenario means we see inflation averaging 3.2% yoy this year.

External imbalances will continue to narrow, although external debt service remains high

External imbalances are narrowing, but EUR/HRK may see more pressures. The merchandise trade deficit in the first 11 months 2009 has narrowed by over EUR 3.3bn yoy. n late 2009 the central bank announced it was prepared to free up an additional HRK10bn in liquidity if this money is made available to the private sector – a fund for supporting the private sector is being discussed by the government and a more detailed policy announcement is expected during 1Q 10. With the current account deficit and external debt service obligations lower this year, fundamentals point in favor of EUR/HRK stability (the stability of the currency is key as over two-thirds of lending is in FX or FX-indexed). Nonetheless, 2009 saw in excess of EUR1bn in 12M fx-linked t-bill issued by the government – in effect lengthening the FX position of banks and other buyers of this paper and thus helping keep the currency stable. How demand at auctions for the refinancing of this paper from 2Q10 onwards plays out will determine short-term movements in the EUR/HRK and may yet, despite improving external imbalances, see the central bank tighten policy during the year to maintain currency stability.

2010 budget contains no reform initiatives …

Unfortunately, the 2010 budget lacks reform initiatives. The government is aiming for a budget deficit of HRK 8.6bn compared to HRK 9.3bn in 2009, looking to increase expenditure by just 0.75% yoy while it expects revenues to increase 1.5% yoy. Given increased spending on EU accession related activities and obligations, and a projected increase in interest payments of HRK 1bn, it remains to be seen how the government will achieve its expenditure targets. An increase in VAT revenue by 5.4% (due in part to the full year effect of the 1% increase to 23% in August 2009) will be tested in what we expect to be another year of economic contraction in real terms. Our key conclusion though is that a reform agenda to rein in government spending in the medium-long term is still missing.

…assumptions underlying budget suggest deficit will exceed target

Focus on completing EU accession talks

Focus of completing EU accession talks. Former PM Sanader was expelled from the main coalition party the HDZ in early January after attempting a comeback following his unexpected retirement in July 2009. Widespread support for this decision will enable PM Kosor's government to continue combating corruption and reforming the public sector. As a result, with presidential elections already out of the way, our core scenario is that in the remainder of the year the focus will be on making sure EU accession talks are completed in time to ensure EU accession on 1 January 2012.

EU talks and narrowing external imbalances positives for sovereign rating

Commencement of work on the accession treaty and EUR 3.5bn funding for Croatia point to EU accession in 2012. While fiscal policy settings will remain in the spotlight, the completion of EU accession talks in 2010 and the expected further narrowing of external imbalances this year could even see a rating upgrade during the next twelve months.

Kazakhstan

Outlook

We estimate real GDP growth for 2009 at -0.9%, and +2.5% in 2010 on the back of higher commodity prices and large projects in road construction, power stations, oil and gas. Moreover, we anticipate a KZT revaluation to take place in early 2010. But credit quality is low and the restructuring of about 40% of the foreign liabilities of the banking system is still pending, implying that credit growth will remain slow in 2010. Fiscal policy will tighten.

Author: Hans Holzhacker, Chief Economist (ATF Bank)
+7 727 244 1463, h.holzhacker@atfbank.kz

	Moody's	S&P	Fitch
Long-term foreign currency credit rating	**Baa2 negative**	**BBB- stable**	**BBB- stable**

MACROECONOMIC DATA AND FORECASTS

	2007	2008	2009E	2010F	2011F
GDP (EUR bn)	76.1	89.8	76.6	85.2	102.7
Population (mn)	15.5	15.7	15.8	16.0	16.1
GDP per capita (EUR)	4912	5729	4838	5337	6373
GDP (constant prices yoy %)	8.9	3.3	-0.9	2.5	5.0
Private Consumption, real, yoy (%)	10.8	3.8	-1.3	0.8	4.0
Fixed Investment, real, yoy (%)	17.3	1.7	-18.3	8.9	12.1
Public Consumption, real, yoy (%)	14.0	5.5	4.2	6.2	3.7
Exports, real, yoy (%)	9.0	1.8	-16.0	7.0	11.0
Imports, real, yoy (%)	25.5	-11.5	-15.0	6.0	14.0
CPI (average, yoy %)	10.8	17.2	7.3	6.4	7.4
Central bank reference rate	11.00	10.50	7.00	6.50	7.00
Monthly wage, nominal (EUR)	313	343	324	352	420
Unemployment rate (%)	7.6	6.6	6.6	6.5	6.4
Budget balance/GDP (%)	5.2	1.2	-5.2	-4.5	-2.0
Current account balance (EUR bn)	-6.0	4.7	-3.6	-3.8	-5.3
Current account balance/GDP (%)	-7.9	5.3	-4.7	-4.5	-5.2
Net FDI (EUR bn)	8.1	9.9	9.2	9.9	12.6
FDI % GDP	10.7	11.0	12.0	11.7	12.2
Gross foreign debt (EUR bn)	65.8	77.3	77.8	77.5	79.5
Gross foreign debt (% of GDP)	86.5	86.0	101.6	90.9	77.4
FX reserves (EUR bn)	12.7	14.8	13.0	13.9	16.9
(Cur.Acc-FDI)/GDP (%)	2.8	16.3	7.3	7.2	7.1
FX reserves/Gross foreign debt (%)	19.3	19.1	16.8	18.0	21.3
Exchange rate to USD eop	120.68	120.88	148.39	135.00	135.00
Exchange rate to EUR eop	176.06	168.87	212.50	199.80	190.35
Exchange rate to USD AVG	122.54	120.32	147.65	136.00	135.00
Exchange rate to EUR AVG	168.00	177.01	205.95	208.08	194.40

Source: UniCredit Research

STRENGTHS

- Export-driven recovery in industrial output
- Resilient FDI
- Large infrastructure and oil, gas projects in 2010/11

WEAKNESSES

- Sharp deterioration in bank asset quality
- Restructuring of 40% of banks' foreign liabilities pending
- Switch from strong fiscal expansion to tightening

Commodities & projects drive recovery, tenge to strengthen

GDP: -0.9% in 2009, 2.5% in 2010, and 5% in 2011

Real GDP fell 1.5% yoy in Jan-Sep 2009, significantly less than the 2.4% yoy of Jan-June. Industry has started to lead the recovery, with growth in value added accelerating from -2.9% yoy in Jan-June and to -0.6% yoy in Jan-Sept. We estimate real GDP growth to have amounted to -0.9% in 2009, and foresee +2.5% for 2010 on the back of higher commodity prices and large projects in road construction, power stations, oil and gas. Factors preventing faster growth include lower quasi-fiscal spending by the Oil Fund and slow credit growth. For 2011, we expect real GDP growth of 5% thanks to strong demand for Kazakh fuels and metals and the multiplier effects trickling through from large infra-structure projects. Fiscal spending will rise again in late 2011 in the up-run to the presidential elections of 2012.

Fiscal policy will tighten, despite Republican Budget loosening

In November, parliament passed the “Republican Budget for 2010-2012”. Assumptions in the bill include: an average oil price (Brent) of USD 50 per barrel in 2010 and of USD 60 in 2011-2012; real GDP growth increasing from 2.4% in 2010 to 3.9% in 2012; December inflation of 7.5%-8% in 2010, falling to 7% by 2012. Revenues in 2010 are expected at KZT 3,076bn (17.6% of GDP), of this KZT 1,646bn from taxes and KZT 1,341bn in Oil fund transfers, and spending at KZT 3,796bn (21.7% of GDP), with the deficit set at 4.1% of GDP in 2010, 3.8% in 2011 and 3.5% in 2012. The macro-assumptions look prudent and the 2010 revenue projection as % of GDP is conservatively estimated with turnout below that of former years. The authorities made clear that Oil fund spending will be more restrictive in 2010, after almost 5% of GDP spent in 2009.This will result in fiscal tightening despite Republican Budget loosening. We forecast a narrowing of the public deficit – including government-sponsored Oil fund spending – from some 5% of GDP in 2009 to 4.5% in 2010.

Credit growth to remain slow because of ongoing bank restructuring and tighter regulation

As a result of high provisioning the aggregate profit of the banking system turned negative in 2009 as did equity. Two of the formerly largest 4 banks by assets defaulted on their foreign debt. Restructuring of about 40% of the foreign liabilities of the banking system is pending. In addition, regulation is tightening, including higher demands for capital adequacy, foreign funding, FX-lending and provisioning. Credit growth will thus remain slow in 2010.

Robust FDI inflows keep import cover above 12 months

The C/A turned into a deficit of USD 3.9bn in 1Q-3Q09 from a surplus of USD 6.8bn in 1Q-3Q08 according to central bank estimates. Exports decreased 47% yoy in USD terms, mostly on lower commodity prices, but imports also fell an impressive 27% yoy. The C/A deficit will remain below our previous forecast at perhaps 4.7% of GDP in 2009, while that for 2010 is expected at a deficit of 4.5% of GDP thanks to higher export prices, offset however by a reacceleration in import growth. Net inward FDI inflows remained at a robust USD 8.9bn in 1Q-3Q09 (only 14% lower than in 2008), and are expected to easily finance the C/A deficits. Central bank reserves stood at USD 23.9bn in November 2009, foreign assets of the Oil fund at USD 24.2bn, sufficient to cover imports (goods and services) of more than 12 months.

Refinancing rate to be further cut

In 2009 the central bank cut its refinancing rate stepwise to 7% (350bp in 2009), citing disinflation. We see some inflation pressures in 2010 as consumer demand continues to recover along with a generally brighter outlook. We nevertheless expect a further rate cut by 50-100bp in 2010 as the central bank will allow the KZT to appreciate.

Central bank widens tenge corridor, we see appreciation

The central bank announced that it will widen the current corridor of KZT/USD 150 +/-5 to 150 +15/-22.5 as of 5 February 2010. To us this suggests potential for KZT appreciation in early 2010, especially given that the KZT has eased back to 2007 levels in real effective terms. Other reasons for the move include the recovery of commodity prices that restore the profitability of resources companies and thus also the transfers to the Oil Fund. Kazakhstan has thus room for maneuver and can allow higher exchange rate variability, which can help to absorb external shocks from commodity fluctuations. We now expect an average KZT/USD rate of 136 in 2010.

Russia

Outlook

Likelihood of positive surprises remains limited to low base effect on worse-than-expected 2009, which could trigger a stronger recovery in 2010. The sharp slowdown of inflation is the main positive backdrop of the slowdown. We expect the RUB to continue to benefit from strong capital inflows arising from loose monetary policies in developed countries.

Author: Vladimir Osakovskiy, Ph.D., Head of Strategy and Research (UniCredit Bank Russia)
+7 495 258 7258 ext. 7558, vladimir.osakovskiy@unicreditgroup.ru

	Moody's	S&P	Fitch
Long-term foreign currency credit rating	**Baa1 stable**	**BBB negative**	**BBB negative**

MACROECONOMIC DATA AND FORECASTS

	2007	2008	2009E	2010F	2011F
GDP (EUR bn)	945.2	1139.8	918.0	1050.4	1144.6
Population (mn)	142.0	141.6	141.3	141.0	140.4
GDP per capita (EUR)	6656	8049	6497	7450	8151
GDP (constant prices yoy %)	8.1	5.6	-8.6	2.7	5.2
Private Consumption, real, yoy (%)	13.6	11.5	-7.2	2.6	5.0
Fixed Investment, real, yoy (%)	21.1	9.1	-18.5	4.5	6.0
Public Consumption, real, yoy (%)	3.4	2.5	2.1	-3.1	3.2
Exports, real, yoy (%)	6.4	0.2	-6.3	2.3	3.5
Imports, real, yoy (%)	26.6	17.7	-29.6	16.4	9.9
CPI (average, yoy %)	9.0	14.1	11.7	7.4	7.7
Central bank reference rate	6.05	9.17	5.75	5.00	5.50
Monthly wage, nominal (EUR)	386	471	416	449	505
Unemployment rate (%)	5.6	6.3	8.8	8.0	7.3
Budget balance/GDP (%)	6.0	4.8	-7.7	-5.2	-3.8
Current account balance (EUR bn)	55.6	67.9	64.2	56.4	57.1
Current account balance/GDP (%)	5.9	6.0	7.0	5.4	5.0
Net FDI (EUR bn)	38.3	28.7	21.3	25.5	30.6
FDI % GDP	4.1	2.5	2.3	2.4	2.7
Gross foreign debt (EUR bn)	314.0	340.8	347.0	322.3	352.9
Gross foreign debt (% of GDP)	35.9	36.2	38.1	31.3	30.3
FX reserves (EUR bn)	326.4	302.9	308.2	323.8	338.5
(Cur.Acc-FDI)/GDP (%)	9.9	8.5	9.3	7.8	7.7
FX reserves/Gross foreign debt (%)	104.0	88.9	88.8	100.5	95.9
Exchange rate to USD eop	24.60	30.54	30.04	30.43	32.45
Exchange rate to EUR eop	35.89	42.66	43.01	45.03	45.76
Exchange rate to USD AVG	25.55	24.78	31.64	29.08	31.54
Exchange rate to EUR AVG	35.02	36.46	44.13	44.49	45.42

Source: UniCredit Research

STRENGTHS

- Strong balance of payments
- Low public debt and significant fiscal reserves
- Low leverage of the economy in general

WEAKNESSES

- Dependence on commodities prices
- Structural inefficiencies, lack of domestic investment
- High NPL ratios

Low base effect as the main driver of stronger recovery

More macro data provide indications of economic stabilization

The Russian economy continues to generate firmer signs of economic stabilization, with some important indicators starting to move back into growth territory for the first time since 2009. Thus, industrial output has rebounded to 1.5% yoy growth in November, although almost entirely on low base effects. Going forward, in 1Q10 strong base effects are expected to push other indicators like investment demand, cargo turnover and shipments into expansion mode in yoy terms. The economy is also expected to benefit from the recovery in corporate profits and further opening up of capital markets, which ought to feed through into economic activity in various sectors of the economy. Consumer demand too, which was on a persistent downward spiral throughout the whole of 2009, seems to have stabilized on weaker than expected unemployment growth and more resilient real disposable income dynamics.

Even consumer demand stopped deteriorating

Improvements are largely driven by low base effects. PMI suggests resuming contraction

However, all positive trends in the economy are yet to prove sustainable, which does not allow us to talk about the start of the recovery. Thus, most improvements in yoy terms are currently driven by increasingly strong low base effects, as some indicators suggest that domestic demand remains weak. In particular, manufacturing PMI which was improving since the trough in December 2008 and briefly peaked above the threshold 50 level in September, has fallen back below it in October-November, indicating the resumption of contraction. Overall, the economic improvement was weaker than expected, with real 3Q09 GDP falling by 8.9% yoy, vs. our expectations of a more moderate decline of 7% yoy.

3Q09 real GDP drops worse than expected

Lower inflation is slowing and should fall below 7% by mid-2010

We see a sharp slowdown of inflation as the most important positive backdrop of economic weakness. Pressured by consumer weakness and effects of monetary contraction, inflation has slowed to 9.1% yoy in November, breaking even our rather optimistic forecast for the 2009 year-end. With strong high base effects of inflationary 1H09, we expect inflation to fall to below 7% yoy by mid-2010, pushing it to a record low of 7.4% as an average for the year.

We hike our 2010 real GDP outlook to 2.7%, mostly due to stronger 8.6% drop in 2009

We continue to think that economic recovery in 2010 is likely to be linked to low base effects of poor 2009, rather than genuine economic growth. Thus, on the poor 3Q09 result, we downgrade our real GDP forecast to -8.6% in 2009, which should support slightly stronger 2.7% growth in 2010. Among factors, which may prevent an economic rebound we see the potential for a strong double-digit recovery of imports in 2010 following the close to 30% slump in 2009. Additionally, the local banking system is likely to continue to struggle with the accumulated asset quality problems for at least another few quarters.

Reversal of fiscal stimulus to add pressure on the economy in 2010

Planned withdrawal of fiscal stimulus is set to put additional drag on the economy. Thus, the approved federal budget envisages practically no nominal change in public spending in 2010 (at RUB 9,887bn), vs. RUB 9,700bn in 2009, implying a considerable contraction in real terms. Moreover, the potential for positive surprises from the fiscal side also appears limited by the some RUB 3,000bn (close to 7% of GDP) budget deficit in 2010, which the government is intent on cutting before any extra spending is made.

We see stronger RUB, on stronger capital inflows

We expect the RUB to continue to benefit from strong capital inflows arising from loose monetary policies in developed countries. As a result, we expect RUB to recover its losses of late 2009 in 1H10, following the end of seasonal liquidity inflows from the budget. However, with the reversal of USD weakness on the rising likelihood of a rate hike by the FED starting from 2Q10, as well as further rate cuts by the CBR, we expect devaluation pressures on the RUB to resume. As a result, we expect the RUB to reach RUB/basket 37, or RUB/EUR 46 by the end of 2010. Among major devaluation risks to the RUB we continue to see unstable oil prices, as well as a possible reversal of market optimism towards all emerging markets following the end of the massive QE programs in the US and EU in 1Q10.

… but strong devaluation risks persist

Serbia

Outlook

Although the government is seeking to boost investment activity to foster growth in 2010, we see plenty of challenges ahead, and retain our forecast for ongoing negative GDP growth. An intact IMF program is supportive, as are borrowings from Russia and multilateral lenders to fund infrastructure projects. While the unfreezing of EU accession talks is a welcome boost to 2010 sentiment.

Author: Goran Šaravanja, Chief Economist (Zagrebačka banka)
+ 385 1 6006 678, goran.saravanja@unicreditgroup.zaba.hr

	Moody's	S&P	Fitch
Long-term foreign currency credit rating	**Not rated**	**BB- stable**	**BB- negative**

MACROECONOMIC DATA AND FORECASTS

	2007	2008	2009E	2010F	2011F
GDP (EUR bn)	29.5	34.0	31.0	31.4	32.9
Population (mn)	7.4	7.4	7.3	7.3	7.3
GDP per capita (EUR)	4002	4624	4230	4310	4538
GDP (constant prices yoy %)	6.9	5.5	-3.2	-0.5	1.3
CPI (average, yoy %)	6.5	11.7	8.3	6.3	5.7
Central bank reference rate	10.00	17.75	9.50	7.50	10.00
Monthly wage, nominal (EUR)	484	561	473	485	504
Unemployment rate (%)	18.1	18.0	18.5	19.0	18.2
Budget balance/GDP (%)	-1.5	-2.0	-4.5	-4.0	-3.5
Current account balance (EUR bn)	-4.6	-5.8	-2.3	-1.9	-2.2
Current account balance/GDP (%)	-15.6	-17.0	-7.4	-6.1	-6.8
Net FDI (EUR bn)	1.8	1.8	1.5	1.8	2.3
FDI % GDP	6.2	5.3	4.8	5.6	6.8
Gross foreign debt (EUR bn)	17.8	21.8	22.8	24.8	27.0
Gross foreign debt (% of GDP)	60.2	64.1	73.5	78.8	81.9
FX reserves (EUR bn)	9.6	8.2	9.6	10.0	10.5
(Cur.Acc-FDI)/GDP (%)	-9.5	-11.7	-2.6	-0.5	0.0
FX reserves/Gross foreign debt (%)	54.2	37.4	42.2	40.4	38.9
Exchange rate to USD eop	54.01	64.27	67.20	67.57	70.92
Exchange rate to EUR eop	78.79	89.79	96.23	100.00	100.00
Exchange rate to USD AVG	58.35	55.40	67.44	64.13	69.44
Exchange rate to EUR AVG	80.00	81.50	94.07	98.12	100.00

Source: UniCredit Research

STRENGTHS

- Significant IMF balance of payments support
- Weaker FX helps adjustment, C/A deficit narrowing sharply
- Unfreezing of EU accession talks a welcome boost

WEAKNESSES

- Macro forecasts put fiscal deficit projections at risk
- Monetary policy too loose?
- High FX leverage in domestic private sector

Official optimism and plenty of uncertainty

Contraction in GDP smaller than expected, but domestic demand remains very weak

While the economy contracted 3.5% yoy in 9M 2009 the in seasonally adjusted qoq terms it returned to growth during 3Q 09. The fall in industrial production has slowed, recording a contraction of 10.6% yoy in 3Q09 and only 5.8% and 4.2% yoy in October and November respectively. This was influenced largely by a resumption of steel production at the end of 2Q. In late October however, US Steel, the largest producer and exporter, announced it would slash output by the end of 2009. This will also impact on merchandise exports going forward which in 3Q09 contracted 24.5% yoy, but in November 2009 fell only 2.4% yoy. At the same time merchandise imports were down 33.8% yoy and 9.2% yoy respectively, reflecting very weak domestic demand. This is also being borne out by retail sales data which in October recorded a drop of 15.3% yoy and 10.7% yoy for the first 10M of 2009. The value of construction work rose 10.2% qoq in 3Q09 in real terms on the back of infrastructure and other investment activity. Nonetheless, the construction sector is set for a 15% plus contraction this year. Inflation is coming down, falling to 5.8% yoy in November, but we expect it to rise by year-end toward 7.5% yoy.

We see a contraction in GDP of 0.5% in 2010. Inflation will remain near the lower bound of the NBS range if the currency remains stable

In 2010 we expect the economy to contract further. Even though the authorities have put together a budget based on a 1.5% expansion of GDP in 2010, we still believe a mild contraction of 0.5% yoy is the likelier outcome – with the risks to the downside. Domestic demand will remain weak as unemployment rises while planned public sector investment projects will take time to get off the ground and their impact on growth will be felt over a number of years. Nor will the contribution of net exports in 2010 to growth be anywhere near as large as in 2009. The current account deficit in 2009 likely contracted by 10pp of GDP to 7.4% of GDP and we expect it to narrow further to 6.1% of GDP this year.

The NBS may have signaled further cuts in the policy rate in 2010, but this will only transpire if the EUR/RSD remains stable

The National Bank of Serbia flags further rate cuts in 2010. Late November saw the EUR/RSD head above 96 as seasonal corporate demand for FX in a thin market combined with lower demand for RSD from non-resident investors on reduced carry on the currency as a result of persistent rate cuts by the central bank. The EUR/RSD ended the year at 96.2. Although IMF funds will provide scope for defending the currency and borrowing from multilateral lenders and governments such as Russia and China will also generate FX inflows, intermittent episodes of currency weakness such the one in late November 2009 cannot be ruled out. While current NBS rhetoric suggests to us scope for a further 200bp in rate cuts, episodes of upward pressure on the EUR/RSD such as November 2009 would constrain the planned continuation of rate cuts in our opinion. We see the EUR/RSD at 100 by end 2010. Serbia's foreign debt rose to an estimated 75% of GDP at end 2009 and is set to rise further as IMF funding, Russia's USD 1bn loan and borrowing from multilateral lenders to fund infrastructure initiatives takes place.

The 2010 budget has enough in it to ensure the payment of the next tranche of IMF money

Pensions and public sector salaries frozen in 2010. The key to gaining IMF support was a decision by the government to freeze public sector salaries and pensions for 2010. The government has made a virtue of boosting resources for investment spending. The budget deficit will narrow to 4.0% of GDP from 4.5% in 2009. Revenue forecasts are exposed to the risk of disappointing given official expectations of 1.5% growth this year. From the perspective of the public sector borrowing requirement, that could well lead to greater reliance on the domestic financial system's resources, which would crowd out some private sector borrowing activity.

EU unblocks Serbia's accession process, but a long path to entry remains

Unfreezing of EU accession talks welcome boost to sentiment. On 7 December the EU agreed to unfreeze the application of the interim agreement between Serbia and itself, essentially unblocking Serbia's EU accession process, while Serbia submitted its request for EU membership in late December. While we see foreign indebtedness approaching 80% of GDP in 2010, adherence to the IMF stand-by agreement appears fine. As a result we expect no deterioration in the country's credit rating in the next 12 months.

Turkey

Outlook

Following the significant deterioration of the Turkish economy in 2009, we see economic growth to resume relatively soon and we expect GDP growth to move to +4% levels in 2010. Moody's and Fitch's recent decision to upgrade the Turkish rating is a recognition of the strong degree of resilience of the Turkish economy.

Author: Cevdet Akcay, Ph.D., Chief Economist (Yapi Kredi)
+90 212 319 8430, cevdet.akcay@yapikredi.com.tr

	Moody's	S&P	Fitch
Long-term foreign currency credit rating	**Ba2 stable**	**BB- stable**	**BB+ stable**

MACROECONOMIC DATA AND FORECASTS

	2007	2008	2009E	2010F	2011F
GDP (EUR bn)	472.1	498.3	441.8	481.0	551.0
Population (mn)	70.6	71.5	71.9	72.7	73.5
GDP per capita (EUR)	6688	6968	6145	6617	7497
GDP (constant prices yoy %)	4.6	0.9	-5.4	4.5	4.5
Private Consumption, real, yoy (%)	4.6	0.8	-2.6	3.5	4.6
Fixed Investment, real, yoy (%)	5.4	-7.1	-21.5	7.0	7.0
Public Consumption, real, yoy (%)	6.5	1.9	4.1	3.0	4.1
Exports, real, yoy (%)	7.3	2.3	-5.5	5.4	5.8
Imports, real, yoy (%)	10.7	-3.8	-15.4	7.0	8.0
CPI (average, yoy %)	8.8	10.5	6.3	8.3	5.8
Central bank reference rate	15.75	15.00	6.50	7.75	8.25
Monthly wage, nominal (EUR)	907	943	750	705	775
Unemployment rate (%)	9.9	11.0	14.8	14.5	14.0
Budget balance/GDP (%)	-1.6	-1.8	-6.3	-4.8	-3.9
Current account balance (EUR bn)	-28.0	-28.3	-7.2	-13.7	-22.1
Current account balance/GDP (%)	-5.9	-5.7	-1.6	-2.8	-4.0
Net FDI (EUR bn)	16.1	12.3	5.7	6.5	8.3
FDI % GDP	3.4	2.5	1.3	1.4	1.5
Gross foreign debt (EUR bn)	182.1	188.8	204.6	211.9	253.5
Gross foreign debt (% of GDP)	38.6	37.9	46.3	44.0	46.0
FX reserves (EUR bn)	48.4	50.2	49.3	49.3	54.6
(Cur.Acc-FDI)/GDP (%)	-2.5	-3.2	-0.3	-1.5	-2.5
FX reserves/Gross foreign debt (%)	26.6	26.6	24.1	23.3	21.5
Exchange rate to USD eop	1.18	1.54	1.50	1.51	1.48
Exchange rate to EUR eop	1.72	2.15	2.15	2.23	2.08
Exchange rate to USD AVG	1.30	1.30	1.55	1.46	1.50
Exchange rate to EUR AVG	1.79	1.91	2.16	2.24	2.16

Source: UniCredit Research

STRENGTHS

- The banking sector is solid
- Positive rating momentum
- Growth potential

WEAKNESSES

- Still weak investment activity
- EU convergence process stalling
- Uncertain government support for a potential IMF package

Sustainable growth as the big challenge for 2010

Growth at -8.4% in the first three quarters of 2009

Economic growth contracted 8.4% yoy in the first three quarters of 2009. The latest available GDP numbers (3Q09) came in at -3.3% yoy while there were also downward revisions to 1Q and 2Q09 data (from -14.3% to -14.7% in 1Q and from -7.0% to -7.9% in 2Q). The most relevant surprise in the 3Q data was the reduction in the pace of contraction in private consumption. This improvement is quite encouraging for the upcoming periods. We see economic growth to resume relatively soon and GDP growth is expected to move to 4% levels in 2010 (higher than consensus) and become one of the highest in Europe for the year. Inflation ended the year with a 6.53% headline figure, a sour end note with a figure higher than the Central Bank's estimate of 5.5% and our estimate of 5.8%. Food prices are the main culprit behind the high December headline figure of 0.53%; their contribution of 2.77 percentage points to the annual inflation figure of 6.53% is by far the largest. There is a non-food worsening in inflationary dynamics as well, and our homemade index excluding only food and beverage category displays the worsening dynamics there. After having bottomed out at 2.8% in July 2009, inflation in this category surged to 3.8% as of December 2009 with half of the change coming only in December. Moreover, all special index inflation figures were up on an annual basis with the exception of the CBRT's favorite index I, and most increases seem to display traits that are somewhat more serious than those of a one-off nature.

GDP growth can resume relatively soon

Inflation moved higher

The contraction in the current account deficit is eye catching: 12M rolling balance as of November stands at USD 13.0bn, in sharp contrast to the USD 44.0bn figure in the same period in 2008. The 2009 year-end figure will tend towards USD 10bn which corresponds to roughly 1.5% of GDP. As regards the fiscal side, the budget balance displays little improvement as the year end approaches. The increase in real terms in 12-month rolling non-interest expenditures stands at around 14% while the recovery in revenues remains limited. We expect the 2009 deficit to GDP ratio to be 6.3% and 4.8% in 2010, while the inability to create primary surpluses in both years is likely to put some pressure on rollovers and thus on interest rates.

Budget balance displays little improvement

The easing bias is here to stay

We anticipated that the Central Bank (CBT) would try to cut rates as much as possible yet not allow any kind of "overdoing" perception in the market. That turned out to be 6.5% when the Monetary Policy Council chose to pause in its last meeting of the year. The CBRT emphasized in its latest inflation report that maintaining the level at whichever point the pause call is made is more important than the level itself. It is quite unlikely that the Bank will be able to come up with any cuts from these levels and it should be safe to bet that it will start hiking towards the end of 2010 and bring the policy rate to around 8% levels. We expect hikes in policy rates no sooner than the third quarter of the year at best, and most presumably in the last quarter of 2010.

The controversial ruling on DTP at center stage

The Constitutional Court (CC) made another historic and controversial ruling and shut down the Kurdish DTP party and banned 37 members from politics for five years. This is a blow to the democratic system and thus a step backwards, but some constructive options could emerge from all this as well as there is a genuine desire for an end to the notorious problem on both sides.

Fitch and Moody's increased Turkish rating by two notches and the other agencies can follow

Fitch Ratings upgraded Turkey's LT foreign currency rating to "BB+" from "BB-" at the beginning of December 2009, a bold increase by two notches. Fitch specifically referred to Turkey's "resilience to the severe stress test of the global financial crisis and some easing in prior acute constraints related to inflation, external finances and political risk". Moody's followed suit after a few weeks and upgraded Turkey by one notch to Ba2 (stable) from Ba3 (positive) which leaves us still two notches below investment grade. An IMF deal is still being rumored around, but it has been for the last year and a half and we do not assign much credence to these hearsays. Our stance is that a deal with the Fund has become less and less feasible from the viewpoint of the AKP Government with every rating increase and that they had no intention of signing one in the first place. Keeping the markets guessing to gain time still seems to be the strategy adopted by the Government.

Ukraine

Outlook

A swift post election agreement will be instrumental for normalizing confidence, and as each successive political hurdle is jumped, the market ought to regain some of its shine. A gentle recovery should be evident in 2010, with base effects and external demand dominating. But once bank recapitalization is fully implemented, we anticipate some recovery in domestic demand, helping to push growth back up, closer to potential.

Author: Dmitry Gourov, Economist (CAIB)
+43 5 05 05 82364, dmitry.gourov@caib.unicreditgroup.eu

	Moody's	S&P	Fitch
Long-term foreign currency credit rating	**B2 negative**	**CCC+ stable**	**B- negative**

MACROECONOMIC DATA AND FORECASTS

	2007	2008	2009E	2010F	2011F
GDP (EUR bn)	103.1	123.4	83.5	91.5	126.6
Population (mn)	46.6	46.4	46.1	45.8	45.5
GDP per capita (EUR)	2210	2661	1811	1998	2780
GDP (constant prices yoy %)	7.6	2.1	-14.0	2.0	4.0
Private Consumption, real, yoy (%)	17.1	11.6	-14.0	-1.0	3.0
Fixed Investment, real, yoy (%)	24.8	4.2	-50.0	7.0	14.0
Public Consumption, real, yoy (%)	2.8	-0.4	-1.2	0.9	0.7
Exports, real, yoy (%)	2.8	6.7	-24.5	10.0	9.0
Imports, real, yoy (%)	20.2	17.5	-39.0	8.3	10.0
CPI (average, yoy %)	12.8	25.2	16.0	10.9	10.4
Central bank reference rate	8.00	12.00	10.25	9.50	9.75
Monthly wage, nominal (EUR)	195	234	174	179	229
Unemployment rate (%)	6.4	6.4	10.5	9.4	8.2
Budget balance/GDP (%)	-1.4	-1.3	-8.0	-5.1	-3.8
Current account balance (EUR bn)	-4.1	-8.5	-1.0	0.3	-0.6
Current account balance/GDP (%)	-3.9	-6.9	-1.2	0.4	-0.4
Net FDI (EUR bn)	6.3	7.1	3.1	4.1	6.6
FDI % GDP	6.1	5.8	3.8	4.4	5.2
Gross foreign debt (EUR bn)	56.7	72.9	67.5	67.3	75.3
Gross foreign debt (% of GDP)	55.0	59.0	80.8	73.5	59.5
FX reserves (EUR bn)	21.8	19.4	17.9	11.5	15.2
(Cur.Acc-FDI)/GDP (%)	2.2	-1.2	2.6	4.8	4.8
FX reserves/Gross foreign debt (%)	38.4	26.6	26.6	17.1	20.2
Exchange rate to USD eop	5.09	7.82	8.05	7.40	6.90
Exchange rate to EUR eop	7.42	10.92	11.52	10.95	9.73
Exchange rate to USD AVG	5.05	5.24	8.07	7.72	7.15
Exchange rate to EUR AVG	6.92	7.71	11.25	11.82	10.30

Source: UniCredit Research

STRENGTHS

- Improving C/A balance, and improved export performance
- Significant NBU FX reserves
- Significant spare capacity

WEAKNESSES

- Rising NPL ratios
- Potential risks from upcoming presidential elections
- Fiscal deterioration and lack of reform

Recovering the shine despite multiple hurdles

Normalization after the political cycle is key for further growth

The 2010 political cycle is set to alter the power structure for the coming five years, but not the main players. We think that the ability of politicians to come to a swift post election agreement will be key for normalizing confidence. Although the probability of a prolonged political cycle is still high, we believe that economic realities will force politicians to come to a quick resolution. On the whole, we see significant potential, and the market ought to recover some of its shine, as each hurdle is jumped in 1H10.

Base effects and rebound in global trade pulling the economy out of the slump

We expect the recovery story to maintain its pace in 2010, with growth ticking higher to 2% on the year, but base effects will dominate the recovery, and external demand will play a role in maintaining confidence. Base effects in key monthly parameters such as industrial production and retail sales will be particularly sharp in 1Q and 2Q10, as many categories witness double digit yoy growth, after double digit falls in 2009. We forecast a 7.5% increase in industrial production for 2010, after a 20% fall in 2009, but much will depend on commodity-related sectors (i.e. steel and chemicals), which have been showing signs of recovery in 4Q09 with capacity utilization in the steel sector rising to 75%. A more broad based recovery is only likely to take place once bank recapitalization and consolidation is implemented. The latter would support domestic demand, and open up financing for the investment projects, helping the country push growth back up, closer to the 5% potential.

IMF program likely to be resumed after the election cycle

In the meantime the NBU has sufficient FX reserves

But lack of an approved 2010 budget is a headwind

Inflationary pressure out of the way for now, and shock from gas hikes

The temporary-loss of the IMF program is not a worry for the next 6M as policy makers have sufficient FX reserves (USD 27bn) to maintain their obligations (if the next tranche were to be released early it would most likely go towards fulfillment of social obligations, much the way the last USD 3.3bn was injected into the budget). With only one sovereign bond issue due in December 2010: a Samurai bond worth JPY 35bn; risk to the sovereign is limited from this side and stems mostly from the sovereign guarantees issued in the previous years. Arguably monthly gas payments, could prove to be difficult at some point in early 2Q if the political vacuum persists, especially as the average 2010 price is estimated to be some 15%-30% higher than in 2009. But we still think that international support will remain firm for Ukraine, and the authorities will renegotiate the IMF program after the election. In the meantime, with no 2010 budget in place, the spending capacity of the government is limited, and will need to be revised for the next IMF tranche, with the likely deficit not to exceed 5% (a reasonable deficit will need to be maintained if the government is to go ahead with the potential Eurobond issue in 2H10, worth some USD 1-2bn). Some form of monetization is likely to surface, but inflationary pressures ought to be contained, amid the ongoing demand pullback.

FX likely to remain volatile, but macro improvements a major support factor going forward 2H10

In the run-up to the January presidential elections, and straight after, we see some potential for UAH volatility, but reckon that the central bank has enough FX reserves to maintain a stable FX for the next 6M – especially given the level of interventions on the FX market has subsided (and the bank has been buying FX to avoid a too rapid appreciation). Having said that, more stringent measures might need to be implemented beyond the 6M horizon should FX reserves start to run short and IMF support is not forthcoming. Debt roll-over ratios have been close to 80% in 2009 and we expect a similar number for 2010, with the gross borrowing requirement at USD 25bn in 2010 and C/A being broadly in balance, while FDI has remained surprisingly robust in 2009 with 11M YTD number being at USD 4.3bn.

We maintain a fairly bullish attitude towards USD/UAH 2H10 onwards, as the economic recovery becomes more pronounced with the end of 2010 cross seen at 7.4 and that in 2011 at 6.9 (this is in contrast to the forward market where the 1Y USD/UAH trades at 9.65 mid and 2Y USD/UAH at 12 mid). The anticipated change of leadership at the NBU ought not to be disruptive, as we expect an independent team to be installed as one of the IMF demands, but only after the election cycle is over. In terms of CDS, potential towards further tightening is most likely, but the market is likely to remain thin during the election cycle.

Notes

Notes

Disclaimer

Our recommendations are based on information obtained from, or are based upon public information sources that we consider to be reliable but for the completeness and accuracy of which we assume no liability. All estimates and opinions included in the report represent the independent judgment of the analysts as of the date of the issue. We reserve the right to modify the views expressed herein at any time without notice. Moreover, we reserve the right not to update this information or to discontinue it altogether without notice.

This analysis is for information purposes only and (i) does not constitute or form part of any offer for sale or subscription of or solicitation of any offer to buy or subscribe for any financial, money market or investment instrument or any security, (ii) is neither intended as such an offer for sale or subscription of or solicitation of an offer to buy or subscribe for any financial, money market or investment instrument or any security nor (iii) as an advertisement thereof. The investment possibilities discussed in this report may not be suitable for certain investors depending on their specific investment objectives and time horizon or in the context of their overall financial situation. The investments discussed may fluctuate in price or value. Investors may get back less than they invested. Changes in rates of exchange may have an adverse effect on the value of investments. Furthermore, past performance is not necessarily indicative of future results. In particular, the risks associated with an investment in the financial, money market or investment instrument or security under discussion are not explained in their entirety.

This information is given without any warranty on an "as is" basis and should not be regarded as a substitute for obtaining individual advice. Investors must make their own determination of the appropriateness of an investment in any instruments referred to herein based on the merits and risks involved, their own investment strategy and their legal, fiscal and financial position. As this document does not qualify as an investment recommendation or as a direct investment recommendation, neither this document nor any part of it shall form the basis of, or be relied on in connection with or act as an inducement to enter into, any contract or commitment whatsoever. Investors are urged to contact their bank's investment advisor for individual explanations and advice.

Neither UniCredit Bank AG, UniCredit Bank AG London Branch, UniCredit CAIB AG, UniCredit Bank AG Milan Branch, UniCredit CAIB Securities UK Ltd., UniCredit Securities, UniCredit Menkul Değerler A.Ş., UniCredit Bulbank, Zagrebačka banka, UniCredit Bank, Bank Pekao, Yapi Kredi, UniCredit Tiriac Bank, ATFBank nor any of their respective directors, officers or employees nor any other person accepts any liability whatsoever (in negligence or otherwise) for any loss howsoever arising from any use of this document or its contents or otherwise arising in connection therewith.

This analysis is being distributed by electronic and ordinary mail to professional investors, who are expected to make their own investment decisions without undue reliance on this publication, and may not be redistributed, reproduced or published in whole or in part for any purpose.

Responsibility for the content of this publication lies with:

a) UniCredit Bank AG, Am Tucherpark 16, 80538 Munich, Germany, (also responsiblefor the distribution pursuant to §34b WpHG). The company belongs to UCI Group.
Regulatory authority: "BaFin" – Bundesanstalt für Finanzdienstleistungsaufsicht, Lurgiallee 12, 60439 Frankfurt, Germany.

b) UniCredit Bank AG London Branch, Moor House, 120 London Wall, London EC2Y 5ET, United Kingdom.
Regulatory authority: "BaFin" – Bundesanstalt für Finanzdienstleistungsaufsicht, Lurgiallee 12, 60439 Frankfurt, Germany and subject to limited regulation by the Financial Services Authority (FSA), 25 The North Colonnade, Canary Wharf, London E14 5HS, United Kingdom. Details about the extent of our regulation by the Financial Services Authority are available from us on request.

c) UniCredit Bank AG Milan Branch, Via Tommaso Grossi, 10, 20121 Milan, Italy, duly authorized by the Bank of Italy to provide investment services.
Regulatory authority: "Bank of Italy", Via Nazionale 91, 00184 Roma, Italy and Bundesanstalt für Finanzdienstleistungsaufsicht, Lurgiallee 12, 60439 Frankfurt, Germany.

The UniCredit CAIB Group, consisting of
d) UniCredit CAIB AG, Julius-Tandler-Platz 3, 1090 Vienna, Austria
Regulatory authority: Finanzmarktaufsichtsbehörde (FMA), Praterstrasse 23, 1020 Vienna, Austria

e) UniCredit CAIB Securities UK Ltd., Moor House, 120 London Wall, London EC2Y 5ET, United Kingdom
Regulatory authority: Financial Services Authority (FSA), 25 The North Colonnade, Canary Wharf, London E14 5HS, United Kingdom

f) UniCredit Securities, Boulevard Ring Office Building, 17/1 Chistoprudni Boulevard, Moscow 101000, Russia
Regulatory authority: Federal Service on Financial Markets, 9 Leninsky prospekt, Moscow 119991, Russia

g) UniCredit Menkul Değerler A.Ş., Büyükdere Cad. No. 195, Büyükdere Plaza Kat. 5, 34394 Levent, Istanbul, Turkey
Regulatory authority: Sermaye Piyasası Kurulu – Capital Markets Board of Turkey, Eskişehir Yolu 8.Km No:156, 06530 Ankara, Turkey

h) UniCredit Bulbank, Sveta Nedelya Sq. 7, BG-1000 Sofia, Bulgaria
Regulatory authority: Financial Supervision Commission, 33 Shar Planina str.,1303 Sofia, Bulgaria

i) Zagrebačka banka, Paromlinska 2, HR-10000 Zagreb, Croatia
Regulatory authority: Croatian Agency for Supervision of Financial Services, Miramarska 24B, 10000 Zagreb, Croatia

j) UniCredit Bank, Na Príkope 858/20, CZ-11121 Prague, Czech Republic
Regul. authority: CNB Czech National Bank, Na Příkopě 28, 115 03 Praha 1, Czech Rep.

k) Bank Pekao, ul. Grzybowska 53/57, PL-00-950 Warsaw, Poland
Regulatory authority: Polish Financial Supervision Authority, Plac Powstańców Warszawy 1, 00-950 Warsaw, Poland

l) UniCredit Bank, Prechistenskaya emb. 9, RF-19034 Moscow, Russia
Regulatory authority: Federal Service on Financial Markets, 9 Leninsky prospekt, Moscow 119991, Russia

m) UniCredit Bank, Šancova 1/A, SK-813 33 Bratislava, Slovakia
Regulatory authority: National Bank of Slovakia, Stefanikovo nam. 10/19, 967 01 Kremnica, Slovakia

n) Yapi Kredi, Yapi Kredi Plaza D Blok, Levent, TR-80620 Istanbul, Turkey
Regulatory authority: Sermaye Piyasası Kurulu – Capital Markets Board of Turkey, Eskişehir Yolu 8.Km No:156, 06530 Ankara, Turkey

o) UniCredit Tiriac Bank, Ghetarilor Street 23-25, RO-014106 Bucharest 1, Romania
Regulatory authority: CNVM, Romanian National Securities Commission, Foişorului street, no.2, sector 3, Bucharest, Romania

p) ATFBank, 100 Furmanov Str., KZ-050000 Almaty, Kazakhstan
Regulatory authority: Agency of the Republic of Kazakhstan on the state regulation and supervision of financial market and financial organisations, 050000, Almaty, 67 Aiteke Bi str., Kazakhstan

POTENTIAL CONFLICTS OF INTEREST

UniCredit Bank AG acts as a Specialist or Primary Dealer in government bonds issued by the Italian, Portuguese and Greek Treasury. Main tasks of the Specialist are to participate with continuity and efficiency to the governments' securities auctions, to contribute to the efficiency of the secondary market through market making activity and quoting requirements and to contribute to the management of public debt and to the debt issuance policy choices, also through advisory and research activities.

ANALYST DECLARATION

The author's remuneration has not been, and will not be, geared to the recommendations or views expressed in this study, neither directly nor indirectly.

ORGANIZATIONAL AND ADMINISTRATIVE ARRANGEMENTS TO AVOID AND PREVENT CONFLICTS OF INTEREST

To prevent or remedy conflicts of interest, UniCredit Bank AG, UniCredit Bank AG London Branch, UniCredit CAIB AG, UniCredit Bank AG Milan Branch, UniCredit CAIB Securities UK Ltd., UniCredit Securities, UniCredit Menkul Değerler A.Ş., UniCredit Bulbank, Zagrebačka banka, UniCredit Bank, Bank Pekao, Yapi Kredi, UniCredit Tiriac Bank, ATFBank have established the organizational arrangements required from a legal and supervisory aspect, adherence to which is monitored by its compliance department. Conflicts of interest arising are managed by legal and physical and non-physical barriers (collectively referred to as "Chinese Walls") designed to restrict the flow of information between one area/department of UniCredit Bank AG, UniCredit Bank AG London Branch, UniCredit CAIB AG, UniCredit Bank AG Milan Branch, UniCredit CAIB Securities UK Ltd., UniCredit Securities, UniCredit Menkul Değerler A.Ş., UniCredit Bulbank, Zagrebačka banka, UniCredit Bank, Bank Pekao, Yapi Kredi, UniCredit Tiriac Bank, ATFBank and another. In particular, Investment Banking units, including corporate finance, capital market activities, financial advisory and other capital raising activities, are segregated by physical and non-physical boundaries from Markets Units, as well as the research department. In the case of equities execution by UniCredit Bank AG Milan Branch, other than as a matter of client facilitation or delta hedging of OTC and listed derivative positions, there is no proprietary trading. Disclosure of publicly available conflicts of interest and other material interests is made in the research. Analysts are supervised and managed on a day-to-day basis by line managers who do not have responsibility for Investment Banking activities, including corporate finance activities, or other activities other than the sale of securities to clients.

ADDITIONAL REQUIRED DISCLOSURES UNDER THE LAWS AND REGULATIONS OF JURISDICTIONS INDICATED

Notice to Austrian investors

This document does not constitute or form part of any offer for sale or subscription of or solicitation of any offer to buy or subscribe for any securities and neither this document nor any part of it shall form the basis of, or be relied on in connection with or act as an inducement to enter into, any contract or commitment whatsoever.

This document is confidential and is being supplied to you solely for your information and may not be reproduced, redistributed or passed on to any other person or published, in whole or part, for any purpose.

Notice to Czech investors

This report is intended for clients of UniCredit Bank AG, UniCredit Bank AG London Branch, UniCredit CAIB AG, UniCredit Bank AG Milan Branch, UniCredit CAIB Securities UK Ltd., UniCredit Securities, UniCredit Menkul Değerler A.Ş., UniCredit Bulbank, Zagrebačka banka, UniCredit Bank, Bank Pekao, Yapi Kredi, UniCredit Tiriac Bank, ATFBank in the Czech Republic and may not be used or relied upon by any other person for any purpose.

Notice to Italian investors

This document is not for distribution to retail clients as defined in article 26, paragraph 1(e) of Regulation n. 16190 approved by CONSOB on October 29, 2007.

In the case of a short note, we invite the investors to read the related company report that can be found on UniCredit Research website **www.research.unicreditgroup.eu.**

Notice to Russian investors

As far as we are aware, not all of the financial instruments referred to in this analysis have been registered under the federal law of the Russian Federation "On the Securities Market" dated April 22, 1996, as amended, and are not being offered, sold, delivered or advertised in the Russian Federation.

Notice to Turkish investors

Investment information, comments and recommendations stated herein are not within the scope of investment advisory activities. Investment advisory services are provided in accordance with a contract of engagement on investment advisory services concluded with brokerage houses, portfolio management companies, non-deposit banks and the clients. Comments and recommendations stated herein rely on the individual opinions of the ones providing these comments and recommendations. These opinions may not suit your financial status, risk and return preferences. For this reason, to make an investment decision by relying solely on the information stated here may not result in consequences that meet your expectations.

Notice to Investors in Japan

This document does not constitute or form part of any offer for sale or subscription for or solicitation of any offer to buy or subscribe for any securities and neither this document nor any part of it shall form the basis of, or be relied on in connection with or act as an inducement to enter into, any contract or commitment whatsoever.

Notice to UK investors

This communication is directed only at clients of UniCredit Bank AG, UniCredit Bank AG London Branch, UniCredit CAIB AG, UniCredit Bank AG Milan Branch, UniCredit CAIB Securities UK Ltd., UniCredit Securities, UniCredit Menkul Değerler A.Ş., UniCredit Bulbank, Zagrebačka banka, UniCredit Bank, Bank Pekao, Yapi Kredi, UniCredit Tiriac Bank, ATFBank in the Czech Republic who (i) have professional experience in matters relating to investments or (ii) are persons falling within Article 49(2)(a) to (d) ("high net worth companies, unincorporated associations, etc.") of the United Kingdom Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 or (iii) to whom it may otherwise lawfully be communicated (all such persons together being referred to as "relevant persons"). This communication must not be acted on or relied on by persons who are not relevant persons. Any investment or investment activity to which this communication relates is available only to relevant persons and will be engaged in only with relevant persons.

Notice to U.S. investors

This report is being furnished to U.S. recipients in reliance on Rule 15a-6 ("Rule 15a-6") under the U.S. Securities Exchange Act of 1934, as amended. Each U.S. recipient of this report represents and agrees, by virtue of its acceptance thereof, that it is such a "major U.S. institutional investor" (as such term is defined in Rule 15a-6) and that it understands the risks involved in executing transactions in such securities. Any U.S. recipient of this report that wishes to discuss or receive additional information regarding any security or issuer mentioned herein, or engage in any transaction to purchase or sell or solicit or offer the purchase or sale of such securities, should contact a registered representative of UniCredit Capital Markets, Inc. ("UCI Capital Markets").

Any transaction by U.S. persons (other than a registered U.S. broker-dealer or bank acting in a broker-dealer capacity) must be effected with or through UCI Capital Markets.

The securities referred to in this report may not be registered under the U.S. Securities Act of 1933, as amended, and the issuer of such securities may not be subject to U.S. reporting and/or other requirements. Available information regarding the issuers of such securities may be limited, and such issuers may not be subject to the same auditing and reporting standards as U.S. issuers.

The information contained in this report is intended solely for certain "major U.S. institutional investors" and may not be used or relied upon by any other person for any purpose. Such information is provided for informational purposes only and does not constitute a solicitation to buy or an offer to sell any securities under the Securities Act of 1933, as amended, or under any other U.S. federal or state securities laws, rules or regulations. The investment opportunities discussed in this report may be unsuitable for certain investors depending on their specific investment objectives, risk tolerance and financial position. In jurisdictions where UCI Capital Markets is not registered or licensed to trade in securities, commodities or other financial products, transactions may be executed only in accordance with applicable law and legislation, which may vary from jurisdiction to jurisdiction and which may require that a transaction be made in accordance with applicable exemptions from registration or licensing requirements.

The information in this publication is based on carefully selected sources believed to be reliable, but UCI Capital Markets does not make any representation with respect to its completeness or accuracy. All opinions expressed herein reflect the author's judgment at the original time of publication, without regard to the date on which you may receive such information, and are subject to change without notice.

UCI Capital Markets may have issued other reports that are inconsistent with, and reach different conclusions from, the information presented in this report. These publications reflect the different assumptions, views and analytical methods of the analysts who prepared them. Past performance should not be taken as an indication or guarantee of future performance, and no representation or warranty, express or implied, is provided in relation to future performance.

UCI Capital Markets and any company affiliated with it may, with respect to any securities discussed herein: (a) take a long or short position and buy or sell such securities; (b) act as investment and/or commercial bankers for issuers of such securities; (c) act as market makers for such securities; (d) serve on the board of any issuer of such securities; and (e) act as paid consultant or advisor to any issuer.

The information contained herein may include forward-looking statements within the meaning of U.S. federal securities laws that are subject to risks and uncertainties. Factors that could cause a company's actual results and financial condition to differ from expectations include, without limitation: political uncertainty, changes in general economic conditions that adversely affect the level of demand for the company's products or services, changes in foreign exchange markets, changes in international and domestic financial markets and in the competitive environment, and other factors relating to the foregoing. All forward-looking statements contained in this report are qualified in their entirety by this cautionary statement

This document may not be distributed in Canada or Australia

Banking network

UniCredit Group CEE banking network – Headquarters

Azerbaijan

Yapi Kredi Azerbaijan
G28 May Street,5
AZ-1014 Baku, Azerbaijan
Phone: +994 12 497 77 95
E-mail: yapikredi@yapikredi.com.az

The Baltics

UniCredit Bank Estonia Branch
Liivalaia Street 13/15,
EST-10118 Tallinn
Phone: +372 66 88 300
www.unicreditbank.ee

UniCredit Bank Lithuania Branch
Vilniaus Gatve 35/3,
LT-01119 Vilnius
Phone: +370 5 2745 300
www.unicreditbank.lt

UniCredit Bank (Latvia)
Elizabetes Iela 63,
LV-1050 Riga
Phone: +371 708 5500
www.unicreditbank.lv

Bosnia and Herzegovina

UniCredit Bank
Kardinala Stepinca b.b.,
BH-88000 Mostar
Phone: +387 36 312112
E-mail: info@unicreditgroup.ba
www.unicreditbank.ba

UniCredit Bank Banja Luka
Marije Bursac 7,
BH-78000 Banja Luka
Phone: +387 51 243 295
E-mail: info-bl@unicreditgroup.ba
www.unicreditbank-bl.ba

Bulgaria

UniCredit Bulbank
Sveta Nedelya Sq. 7,
BG-1000 Sofia
Phone: +359 2 923 2111
www.unicreditbulbank.bg

Croatia

Zagrebačka banka
Paromlinska 2,
HR-10000 Zagreb
Phone: +385 1 6305 250
www.zaba.hr

Czech Republic

UniCredit Bank
Na Príkope 858/20
CZ-11121 Prague
Phone: +420 221 112 111
E-mail: info@unicreditgroup.cz
www.unicreditbank.cz

Hungary

UniCredit Bank
Szabadság place 5-6,
H-1054 Budapest,
Phone: +36 1 301 12 71
E-mail: info@unicreditbank.hu
www.unicreditbank.hu

Kazakhstan

ATFBank
100, Furmanov Str.
KZ-050000 Almaty
E-mail: info@atfbank.kz
Phone: +7 (727) 2 583 111
www.atfbank.kz

Kyrgyzstan

ATFBank Kyrgyzstan
493, Zhibek Zholu Ave.
KG-720070 Bishkek
Phone: +7 312 67 00 47
E-mail: bank@atfbank.kg
www.atfbank.kg

Macedonia

Bank Austria Representative Office
Dimitrie Cupovski 4-2/6,
MK-1000 Skopje
Phone: +389 2 3215 130
E-mail: office@ba-ca.com.mk

Montenegro

Bank Austria Representative Office
Hercegovacka 13,
ME-81000 Podgorica
Phone: +382 81 66 7740
E-mail: ba-ca@cg.yu

Poland

Bank Pekao
ul. Grzybowska 53/57,
PL-00-950 Warsaw
Phone: +48 42 6838 232
www.pekao.com.pl

Romania

UniCredit Tiriac Bank
Ghetarilor Street 23-25,
RO-014106 Bucharest 1,
Phone: +40 21 200 2000
E-Mail: office@unicredittiriac.ro
www.unicredit-tiriac.ro

Russia

UniCredit Bank
Prechistenskaya emb. 9,
RF-19034 Moscow
Phone: +7 495 258 7200
www.unicreditbank.ru

Serbia

UniCredit Bank
Rajiceva 27-29,
RS-11000 Belgrade
Phone: +381 11 3204 500
E-mail: office@unicreditgroup.rs
www.unicreditbank.rs

Slovakia

UniCredit Bank
Săncova 1/A,
SK-813 33 Bratislava
Phone: +42 1 44 547 6870
www.unicreditbank.sk

Slovenia

UniCredit Bank
Šmartinska cesta 140,
SI-1000 Ljubljana
Phone: +386 1 5876 600
E-mail: info@unicreditbank.si
www.unicreditbank.si

Turkey

Yapi Kredi
Yapi Kredi Plaza D Blok, Levent,
TR-34330 Istanbul
Phone: +90 212 339 70 00
www.yapikredi.com.tr

Ukraine

UniCredit Bank
14, D. Galitsky St.,
UA-43016 Lutsk
Phone: +380 332 776210
www.unicredit.com.ua

Ukrsotsbank
29 Kovpak Street,
UA-03150 Kiev
Phone: +380 44 230 3203
E-mail: info@ukrsotsbank.com
www.usb.com.ua

UniCredit Group CEE banking network – Corporate customers

Austrian contact

Bank Austria

Sonja Holland
Phone: +43 5 05 05 56344

Petra Keinberger
Phone: +43 5 05 05 42777

E-mail: business_development@unicreditgroup.at

German contact

UniCredit Bank AG

Ulrich Burghardt
Phone: +49 89 378 27472
E-mail: ulrich.burghardt@unicreditgroup.de
(Azerbaijan, Czech Republic, Slovakia, Slovenia, Turkey)

Monika Jurowicz-König
Phone: +49 89 378 25647
E-mail: monika.jurowiczkoenig@unicreditgroup.de
(Austria, Poland)

Sebastian Modlmayr
Phone: +49 89 378 28546
E-mail: sebastian.modlmayr@unicreditgroup.de
(Estonia, Kazakhstan, Kyrgyzstan, Latvia, Lithuania, Russian Federation, Ukraine, Hungary)

Steffen Reiser
Phone: +49 89 378 25639
E-mail: steffen.reiser@unicreditgroup.de
(Bulgaria, Romania)

Peter Ulbrich
Phone: +49 89 378 25282
E-mail: peter.ulbrich@unicreditgroup.de
(Bosnia and Herzegovina, Croatia, Serbia)

Italian contact

UniCredit Corporate Banking

Stefano Coceancigh
Phone: +39 0422 654 006
E-mail: stefano.coceancigh@unicreditgroup.eu

International contact

Azerbaijan

Yusuf Sevinc
Phone: +994 12 497 7095
E-mail: yusufs@yapikredi.com.az

Bosnia and Herzegovina

UniCredit Bank
Ilvana Dugalija
Phone: +387 33 562 755
E-mail: ilvana.dugalija@unicreditgroup.ba

UniCredit Bank Banja Luka
Kristina Grozdanic
Phone: +387 51 243 295
E-mail: kristina.grozdanic@unicreditgroup.ba

Bulgaria

Aldo Andreoni
Phone: +359 2 923 2846
E-mail: aldo.andreoni@unicreditgroup.bg

Vanya Buchova
Phone: +359 2 923 2933
E-mail: vanya.buchova@unicreditgroup.bg

Florian Mahiny
Phone: +359 2 9232 783
E-mail: florian.mahiny@unicreditgroup.bg

Croatia

Zoran Ferber
Phone: +385 1 6305 437
E-mail: zoran.ferber@unicreditgroup.zaba.hr

Czech Republic

Miroslav Hrabal
Phone: +420 2 2111 6271
E-mail: miroslav.hrabal@unicreditgroup.cz

Estonia

Diana Safoskina
Phone: +372 66 88 358
E-mail: diana.safoskina@unicreditgroup.ee

Hungary

Paolo Garlanda
Phone: +36 1 301 1207
E-mail: paolo.garlanda@unicreditbank.hu

Kazakhstan

Can Tekin Yildirimer
Phone: +7 727 2598 692
E-mail: dzhan-tekin@atfbank.kz

Latvia

Inga Cernova
Phone: +371 7085 551
E-mail: inga.cernova@unicreditgroup.lv

Lithuania

Joana Kucinskaite
Phone: +370 5 2745 353
E-mail: joana.kucinskaite@unicreditgroup.lt

Macedonia

Milan Djordjevic
Phone: +389 23215130
E-mail: milan.djordjevic@unicreditgroup.rs

Montenegro

Milan Djordjevic
Phone: +382 81 66 77 40
E-mail: milan.djordjevic@unicreditgroup.rs

Poland

Tomasz Pelc
Phone: +48 22 6560 784
E-mail: tomasz.pelc@pekao.com.pl

Romania

Christian Staller
Phone: +40 21 200 1616
E-mail: christian.staller@unicredit.ro

Russia

Inna Maryasina
Phone: +7 495 554 5352
E-mail: inna.maryasina@unicreditgroup.ru

Serbia

Vladimir Ivanovic
Phone: +381 11 3204 602
E-mail: vladimir.ivanovic@unicreditbank.rs

Slovakia

Katarina Hajnikova
Phone: +421 2 4950 4004
E-mail: katarina.hajnikova@unicreditbank.sk

Slovenia

Branka Cic
Phone: +386 1 5876 512
E-mail: branka.cic@unicreditgroup.si

Turkey

Kristina Mestric
Phone: +90 212 339 7119
E-mail: kristina.mestric@yapikredi.com.tr

Ukraine

Nicola Longo-DentePetra Kellner
Phone: +38 044529 0583
E-mail: petra.kellner@unicredit.com.ua

UniCredit Research*

Thorsten Weinelt, CFA
Global Head of Research & Chief Strategist
+49 89 378-15110
thorsten.weinelt@unicreditgroup.de

Dr. Ingo Heimig
Head of Research Operations
+49 89 378-13952
ingo.heimig@unicreditgroup.de

Economics & FI/FX Research

Marco Annunziata, Ph.D., Chief Economist
+44 20 7826-1770
marco.annunziata@unicreditgroup.eu

Economics & Commodity Research

Global Economics

Dr. Davide Stroppa, Global Economist
+39 02 8862-2890
davide.stroppa@unicreditgroup.de

European Economics

Andreas Rees, Chief German Economist
+49 89 378-12576
andreas.rees@unicreditgroup.de

Marco Valli, Chief Italian Economist
+39 02 8862-8688
marco.valli@unicreditgroup.de

Stefan Bruckbauer, Chief Austrian Economist
+43 50505 41951
stefan.bruckbauer@unicreditgroup.at

Tullia Bucco
+39 02 8862-2079
tullia.bucco@unicreditgroup.de

Chiara Corsa
+39 02 8862-2209
chiara.corsa@unicreditgroup.de

Dr. Loredana Federico
+39 02 8862-2209
loredana.federico@unicreditgroup.eu

Alexander Koch, CFA
+49 89 378-13013
alexander.koch1@unicreditgroup.de

Chiara Silvestre
chiara.silvestre@unicreditgroup.de

US Economics

Dr. Harm Bandholz, CFA
+1 212 672 5957
harm.bandholz@us.unicreditgroup.eu

Commodity Research

Jochen Hitzfeld
+49 89 378-18709
jochen.hitzfeld@unicreditgroup.de

Nikolaus Keis
+49 89 378-12560
nikolaus.keis@unicreditgroup.de

EEMEA Economics & FI/FX Strategy

Cevdet Akcay, Ph.D., Chief Economist, Turkey
+90 212 319-8430, cevdet.akcay@yapikredi.com.tr

Matteo Ferrazzi, Economist, EEMEA
+39 02 8862 8600, matteo.ferrazzi@unicreditgroup.eu

Dmitry Gourov, Economist, EEMEA
+43 50505 823-64, dmitry.gourov@caib.unicreditgroup.eu

Hans Holzhacker, Chief Economist, Kazakhstan
+7 727 244-1463, h.holzhacker@atfbank.kz

Anna Kopetz, Economist, Baltics
+43 50505 823-64, anna.kopetz@caib.unicreditgroup.eu

Marcin Mrowiec, Chief Economist, Poland
+48 22 656-0678, marcin.mrowiec@pekao.com.pl

Vladimir Osakovsky, Ph.D., Head of Strategy and Research, Russia
+7 495 258-7258 ext.7558, vladimir.osakovskiy@unicreditgroup.ru

Rozália Pál, Ph.D., Macro and Strategic Analysis Coordinator, Romania
+40 21 203-2376, rozalia.pal@unicredit.ro

Kristofor Pavlov, Chief Economist, Bulgaria
+359 2 9269-390, kristofor.pavlov@unicreditgroup.bg

Goran Šaravanja, Chief Economist, Croatia
+385 1 6006-678, goran.saravanja@unicreditgroup.zaba.hr

Pavel Sobisek, Chief Economist, Czech Republic
+420 2 211-12504, pavel.sobisek@unicreditgroup.cz

Gyula Toth, Economist/Strategist, EEMEA
+43 50505 823-62, gyula.toth@caib.unicreditgroup.eu

Jan Toth, Chief Economist, Slovakia
+421 2 4950-2267, jan.toth@unicreditgroup.sk

Global FI/FX Strategy

Michael Rottmann, Head
+49 89 378-15121, michael.rottmann1@unicreditgroup.de

Dr. Luca Cazzulani, Deputy Head, FI Strategy
+39 02 8862-0640, luca.cazzulani@unicreditgroup.de

Chiara Cremonesi, FI Strategy
+44 20 7826-1771, chiara.cremonesi@unicreditgroup.co.uk

Dr. Stephan Maier, FX Strategy
+39 02 8862-8604, stephan.maier@unicreditgroup.eu

Giuseppe Maraffino, FI Strategy
+39 02 8862-2027, giuseppe.maraffino@unicreditgroup.de

Armin Mekelburg, FX Strategy
+49 89 378-14307, armin.mekelburg@unicreditgroup.de

Roberto Mialich, FX Strategy
+39 02 8862-0658, roberto.mialich@unicreditgroup.de

Kornelius Purps, FI Strategy
+49 89 378-12753, kornelius.purps@unicreditgroup.de

Herbert Stocker, Technical Analysis
+49 89 378-14305, herbert.stocker@unicreditgroup.de

Publication Address

UniCredit Research
Corporate & Investment Banking
UniCredit Bank AG
Arabellastrasse 12, D-81925 Munich
Tel. +49 89 378-12559
Fax +49 89 378-13024

Bloomberg
UCGR

Internet
www.research.unicreditgroup.eu

*UniCredit Research is the joint research department of UniCredit Bank AG (UniCredit Bank), UniCredit CAIB Group (UniCredit CAIB), UniCredit Securities (UniCredit Securities), UniCredit Menkul Değerler A.Ş. (UniCredit Menkul), UniCredit Bulbank, Zagrebačka banka, UniCredit Bank, Bank Pekao, Yapi Kredi, UniCredit Tiriac Bank and ATFBank