

Euro-Visions

Economic and Capital Market Outlook – June 2009

US/Eurozone/CEE

GDP to recover in 2HY but no sustainable economic upswing yet

Reduction of global imbalances needed

Inflationary risks on medium-term horizon

Bond markets in US and Eurozone remain under pressure

Stable to rising prices in CEE

No signs of stabilization of credit quality

Overview

Following the rapid and hefty economic contraction that has by far exceeded any expectations anyone may have imagined and has shaken confidence in a predictable future among several private individuals and companies to the roots, there are now many **leading and sentiment indicators** that are **pointing** to an **economic trend reversal**. Does this mean that an economic upturn is imminent?

The change in direction of some indicators sent some clear **signals of an improvement** within the next six months. This will rather **be a stabilization at a low level** than the start of an upswing. Still, GDP growth rates q/q should become positive in the 2HY.

While inventory reduction has significantly boosted the economic downswing in 1Q, after the inventory adjustment cycle (2nd and 3rd quarters), we expect a short-lived acceleration of production. This should support the recovery of GDP in 2HY only temporarily, and **will not mean a sustainable upswing**.

The historic economic downturn has revealed the magnitude of the globalization of the world economy. There is no doubt that the US economy has determined events in the past years. Based on the high current account deficit, the “rest of the world” benefited from the – partly credit financed – demand from the US. Due to their dependence on exports, the economic downswing **affected** particularly **countries with high exposure to foreign trade**. It is possible that producing countries with strongly shrinking exports will not be able to return to their former growth levels for the time being, because the trend of debt-based consumption spending seems to be over for now.

The **financial system** has **stabilized** significantly since the failure of Lehman Brothers in September 2008 through the concerted actions of central banks and governments. Still, the **credit volume growth rates** are **decreasing** due to the declining demand for credit, the quickly deteriorating creditworthiness of borrowers and the changed framework conditions for banks (recapitalization, refinancing options). The further dynamic will depend significantly on the degree of confidence of households and companies in the economic upswing.

The labour market responds with a time lag. Based on our estimates for GDP growth rates and employment, the **unemployment rate** will **continue to rise**. We do not expect to see sinking unemployment rates before late 2010. This could keep consumption propensity low despite higher real incomes due to disinflation, and therefore, no major impulses are expected to come from private consumption.

The steep plunge in production means that it will be possible to satisfy any rise in demand in the foreseeable future with existing capacities. Therefore, we do **not expect any direct pressure on prices**, which is also indicated by the rising unemployment rates. However, there are a few risk factors (sluggish investment dynamic, money supply expansion, oil price trend) whose effects might become stronger and cause **rising inflation rates over the medium term**.

The yield curve has become much steeper in the past few months due to special effects. The interest rate spread between two-year and ten-year maturities has reached historic levels in **Germany** and in the **US**. We believe that the **negative aspects for government bonds** will continue to outweigh. By contrast, we expect a **solid value development** in both relative and absolute terms for the major bond markets in the **CEE** region.

A recovery has been observed on the EUR corporate bond market since the beginning of the year. The reason is the aggressive fiscal and monetary measures taken. The weaker-than-expected economic recovery and the uncertainty on how long it will last continue to pose a high risk and make a **correction of yield spreads** on credit markets quite feasible. However, we do not expect spreads to return to their highs of the autumn of 2008 (Lehman failure). In a breakdown by risk class, we have a **preference for solid investment grade issuers** that seem more attractive than government bonds. As regards the sectors, we still prefer utilities and telecoms, which may definitely be assessed as “safe havens”.

Contents

	Page
Overview/summary	1
Outlook	4
Out of the crisis	5
Turning point in sight?	5
Correction of global imbalances ahead	6
Global imbalances	6
Destocking	9
Financing of consumption and investments	10
How far has the easing on the credit markets progressed?	10
Labor market to react with time lag	12
Inflation/Monetary policy	14
Inflation risks despite crisis	14
Bond Market	17
No support in sight	17
Corporate Bonds	20
Review	20
Outlook	21
Conclusions	25
Country overview	26
Euroland	26
USA	28
Austria	30
Croatia	32
Czech Republic	34
Hungary	36
Poland	38
Romania	40
Serbia	42
Slovakia	44
Ukraine	46
Important web sites	48
Contacts	49

Forecasts

3M money market rates

End of the month	current	Sep-09	Dec-09	Mar-10	Jun-10
EURO	1.27	1.20	1.40	1.50	1.90
Japan	0.51	0.50	0.50	0.50	0.50
USA	0.63	0.60	0.70	0.90	1.00
Switzerland	0.40	0.40	0.25	0.25	0.30
Czech Republic	2.22	2.07	1.88	1.92	2.10
Hungary	9.65	9.00	8.50	7.90	7.40
Poland	4.53	3.70	3.40	3.70	4.35
Romania	10.62	9.75	9.50	9.00	8.65
Ukraine	10.40	16.00	13.50	9.00	8.00

Source: Erste Group Research

10-year yields

End of the month	current	Sep-09	Dec-09	Mar-10	Jun-10
Germany	3.72	3.90	4.10	4.20	4.30
Austria	4.50	4.40	4.60	4.70	4.80
Spread to GE	0.79	0.50	0.50	0.50	0.50
USA	3.83	4.00	4.20	4.40	4.50
Croatia	8.04	7.50	7.50	7.50	7.00
Czech Republic	5.32	4.80	5.00	5.00	5.20
Hungary	10.43	8.50	8.20	7.80	7.80
Poland	6.32	6.00	6.10	6.20	6.30
Romania*	11.30	10.20	9.80	9.10	8.80
Slovakia	5.17	5.25	5.20	5.10	5.10
Ukraine**	20.00	18.00	18.00	15.00	10.00

* 5Y Primary market, ** 2Y

Source: Erste Group Research

Exchange rates

End of the month	current	Sep-09	Dec-09	Mar-10	Jun-10
EURUSD	1.398	1.50	1.50	1.53	1.55
EURJPY	137.2	143	147	150	152
USDJPY	98.1	95	98	98	98
EURCHF	1.518	1.51	1.53	1.53	1.53
USDCHF	1.086	1.01	1.02	1.00	0.99
EURHRK	7.351	7.50	7.60	7.55	7.50
EURCZK	26.97	25.8	25.5	24.9	24.6
EURHUF	287.8	280	270	270	270
EURPLN	4.539	4.50	4.25	4	3.9
EURRON	4.215	4.30	4.30	4.10	4.00
EURUAH	10.73	12.76	13.6	13.28	12.75

Source: Erste Group Research

Forecasts

Economy

Change year-on-year

GDP growth	2007	2008	2009f	2010f
Austria	3.1	1.8	-2.7	0.4
Germany	2.7	0.8	-4.6	0.4
France	2.1	0.6	-3.0	0.4
Italy	1.4	0.1	-3.7	0.3
Spain	3.8	0.5	-3.5	0.0
Netherlands	3.5	1.8	-3.0	0.4
Euroland	2.6	0.7	-3.6	0.3
USA	2.2	1.4	-2.1	1.9
Japan	2.0	-0.7	-6.0	0.5
Switzerland	3.1	1.6	-3.0	0.6
Croatia	5.5	2.4	-4.5	1.0
Czech Republic	6.0	3.1	1.6	1.1
Hungary	1.1	0.5	-5.1	0.4
Poland	6.5	4.8	1.2	2.6
Romania	6.2	7.1	-2.1	2.0
Serbia	7.1	5.4	-2.1	1.9
Slovakia	10.4	6.4	-5.0	2.6
Ukraine	7.6	2.1	-8.0	3.0

Source: Erste Group Research

Inflation	2007	2008	2009f	2010f
Austria*	2.2	3.2	0.9	1.4
Germany	2.3	2.9	0.5	0.9
France	1.6	3.1	0.5	1.0
Italy	2.0	3.2	0.9	1.3
Spain	2.8	4.0	0.6	1.0
Netherlands	1.6	2.0	1.1	1.4
Euroland	2.1	3.2	0.6	1.2
USA	2.8	3.9	-0.5	2.0
Japan	0.1	1.4	-1.0	-0.5
Switzerland	0.7	2.4	-0.6	1.0
Croatia	2.9	6.1	2.9	4.0
Czech Republic	2.8	6.4	1.8	2.1
Hungary	8.0	6.1	4.0	4.1
Poland	2.5	4.2	2.5	2.2
Romania	4.8	7.9	5.9	4.5
Serbia	6.5	11.7	8.2	6.0
Slovakia	2.8	4.6	2.2	3.6
Ukraine	12.8	25.2	23.0	11.0

Source: Erste Group Research

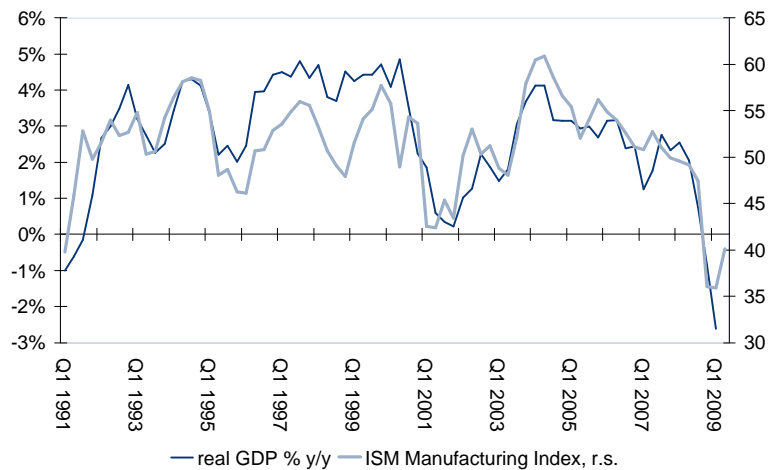
Out of the crisis

The global economic downturn has reached an extent not seen since the Second World War. The question arising is: How will things evolve from now on? Leading as well as sentiment indicators have stopped their free-fall and embarked on a trend reversal, thus pointing to stabilization, albeit at low levels. Additional support could come from government measures and the end of destocking. Nevertheless, this does not necessarily imply a sustainable recovery; prior to that, a correction of global imbalances and a relaxation on the credit markets must take place.

Turning point in sight?

Leading indicators - turning point in sight. Since March, aside from an improvement on the equity markets, several leading indicators have pointed to a trend reversal. In the US for example, the ISM Index, which reflects industrial sentiment, has improved continuously since December.

ISM Index and US GDP growth

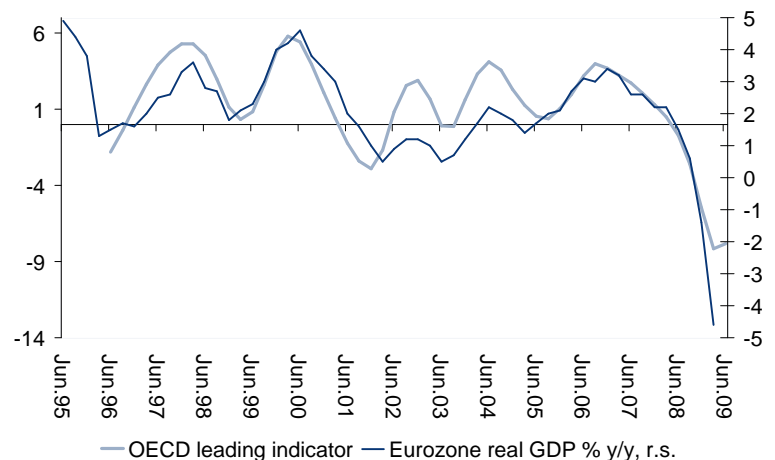


Source: Datastream, Erste Group Research

Imminent recovery ?

In the Eurozone too, the OECD's leading indicator has improved. Does this imply that a recovery is imminent?

OECD leading indicator and Eurozone GDP growth



Source: Bloomberg, Erste Group Research

Improvement of sentiment necessary for recovery. The rapidity and extent of the economic slump has exceeded expectations by far. As a consequence, confidence in the foreseeable future and stable earnings has been eroded. As expectations are crucial to the behavior of

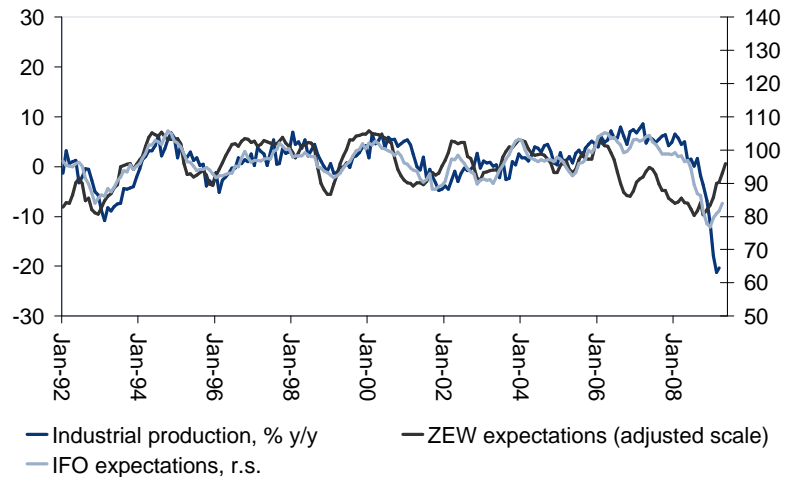
Out of the crisis

consumers and firms, an improvement in sentiment is necessary for an improvement in the economic situation. Thus, leading and sentiment indicators are very valuable for the assessment of the short-term evolution, in particular regarding turning points.

GE: positive growth in Q3 ?

For German companies, both the ZEW and the IFO Index have been sending clear signals for the last three months of an improvement within the next six months. This would imply that the downturn should lose momentum in the second quarter (at least in Germany). Later on, positive growth rates compared to the previous quarters could be within reach again.

ZEW, IFO and German industrial output



Source: Bloomberg, Erste Group Research

CEE: slowdown of downturn

We have seen the first signs of stabilization (but definitely not a recovery yet) in the CEE region as well, with the recent figures for the manufacturing sector and various confidence indicators. The fall of industrial output in export-oriented CEE countries has slowed down from the minus 20-30% y/y seen during the bottoming in December to minus 10-20% y/y. If production stays at the current level, the y/y dynamics of industrial output might gradually improve over the rest of this year and turn to black figures by year-end.

Consumer sentiment has also come back from the lows of the last months in the Eurozone, the US and Japan. This is a precondition for consumption to pick up, even though we expect that a deteriorating labor market will be a drag, implying that a positive contribution can only be expected with a delay from this side.

Indicators did not cross the border between growth and contraction

Stabilization, but no recovery. A turning point does not necessarily imply immediate growth thereafter. The extent of the downturn has by far exceeded expectations (in the charts above, a clear divergence between sentiment indicators and realized growth rates can be seen). In a similar way, the extent of the upturn could now be exaggerated and indicators might point to stabilization, rather than an immediate return to pre-crisis growth rates. This point of view is supported by the fact that most indicators still did not cross the line between contraction and expansion of the economy. On the whole, we think that a fundamental understanding of the origins of the current crisis is needed for a well-grounded assessment of the coming months

Correction of global imbalances ahead

Global imbalances

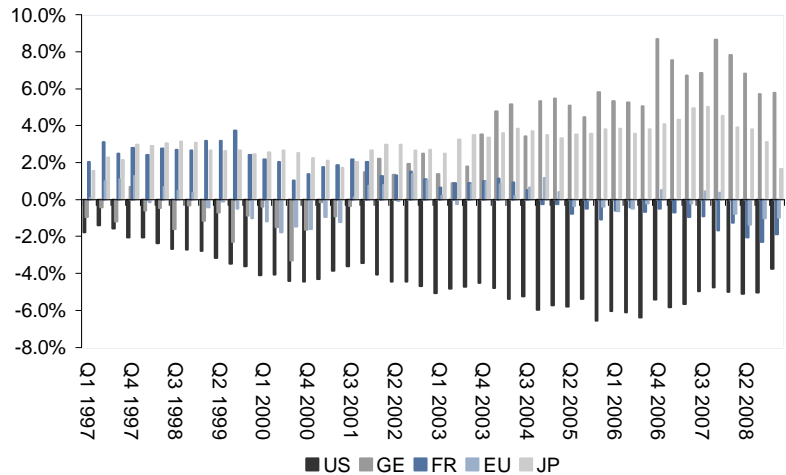
Without any doubt, the US economy has led the world economy in recent years. This might be partly due to the optimism generated by positive news from the US economy. However, via international trade, the "rest of the world" also benefited directly from the US economic growth.

Out of the crisis

Demand from the US: traditional growth driver

The US has a traditional current account deficit, implying that an important part of the goods consumed has been produced abroad, often representing a significant growth driver there.

Current account balance, % GDP

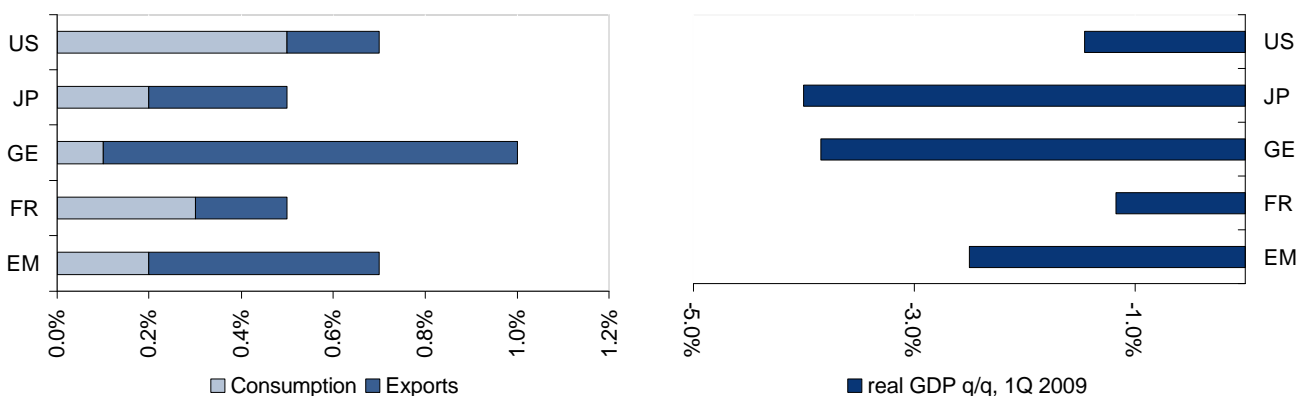


Source: Erste Group Research, Bloomberg, Datastream

Export-oriented countries suffer more

Export orientation explains differences in depth of crisis impact. This is a possible explanation for the fact that Germany and Japan have suffered more from the crisis than the US, even though the crisis originated there (see chart below juxtaposing the respective contributions from exports and consumption to growth in the past and the quarterly growth rates in Q1 2009). International trade has decreased significantly since the end of 2008. Thus, exports have been a drag on growth in countries with a trade balance surplus, while shrinking imports had a positive effect in trade balance deficit nations. In addition, foreign demand is often a growth driver in surplus countries, as second round effects stemming (for example) from the effect of booming exports on the labor market generate additional growth. As these effects are not taken into account in the chart below, the total contribution from exports to growth might be even higher.

Contributions to growth q/q in %, average 2002-2006 and GDP growth Q1 2009



Source: Erste Group Research, Bloomberg, Datastream

There are several reasons international trade has suffered more than domestic demand. A short-term reason might be the difficult access to trade credit. In the longer run, though, global imbalances with respect to demand and (related to these) the savings propensity represent the most important factor, implying that part of the growth seen in the past has not been sustainable, leading to lower growth rates for the near future.

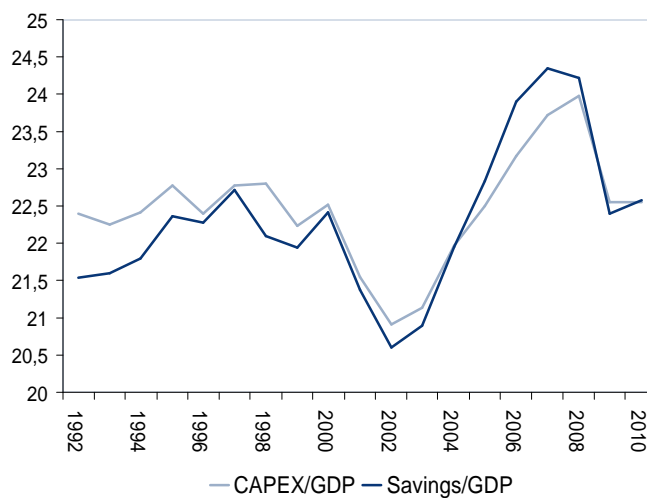
Out of the crisis

Countries with a current account surplus export goods and receive (foreign) currency in return. Either the national bank exchanges this into local currency (increasing currency reserves at the same time) or households and firms invest abroad, exchanging the currency in turn.

Saving nations invest in "debtor" countries

In any case, producer countries such as Germany, China and Japan are actually saving nations at the same time (i.e. they save more than what is invested domestically; see box). Excessive savings are in turn invested in deficit countries such as the US, either via the government, the central bank or directly, to permit them to buy goods from the producer countries. This evolution has lasted for a long time, leading to increasing imbalances. Permanently increasing savings worldwide have been transferred from savings nations into "debtor" nations, to be invested in the latter (see chart), for example in the housing market. This led to increasing debt at the same time.

Investments and savings worldwide



GDP Y is composed of consumption C , investments I , exports X and imports M (ex government):
 $Y = C + I + X - M$.
 The savings $S = Y - C$ are therefore the sum of investments I and net exports $X - M$, and are therefore either invested in the country or abroad:
 $S - I = X - M$.
 Countries with current account surpluses ($X > M$) are therefore savers and finance investments abroad.
 Countries with current account deficits finance part of investments via the import of capital.

Source: IMF

This increase in cross-border debt is not a problem in itself, as long as excess capital flows to investments with the highest sustainable yields. For example, if part of the money had been placed in investments with high future returns, these would have enabled a profitable payback. On the whole, it seems as if imbalances have been excessive, leading to distortions such as the housing bubble in the US or (too) low real interest rates. This has come to an abrupt halt.

Credit-financed demand to slow down

The uncertainty accompanying the bursting of the bubble in the housing market in the US has incited households to save in order to improve their balance sheets. The demand for goods has accordingly declined at the same pace as the demand for credit. Assuming that indebtedness - for instance, of US households - does not increase at the same pace as in the past, demand for goods will also be sluggish, implying that the sharp decline in exports of producer nations might not be offset any time soon.

Decreasing demand of durable goods

Export goods: Manufacturing sector hit hard. In addition, the reviving savings propensity is particularly a drag on the demand for durable consumer and investment goods. As these goods (cars, electrical, machinery) constitute an important share of exports (e.g. in Germany and Japan), the export-oriented manufacturing sector has been particularly hard hit by the crisis. Sharp decreases in demand led to an involuntary build-up of stocks that could accelerate the dynamics of production to either the upside or downside, thus representing an important factor for the coming months.

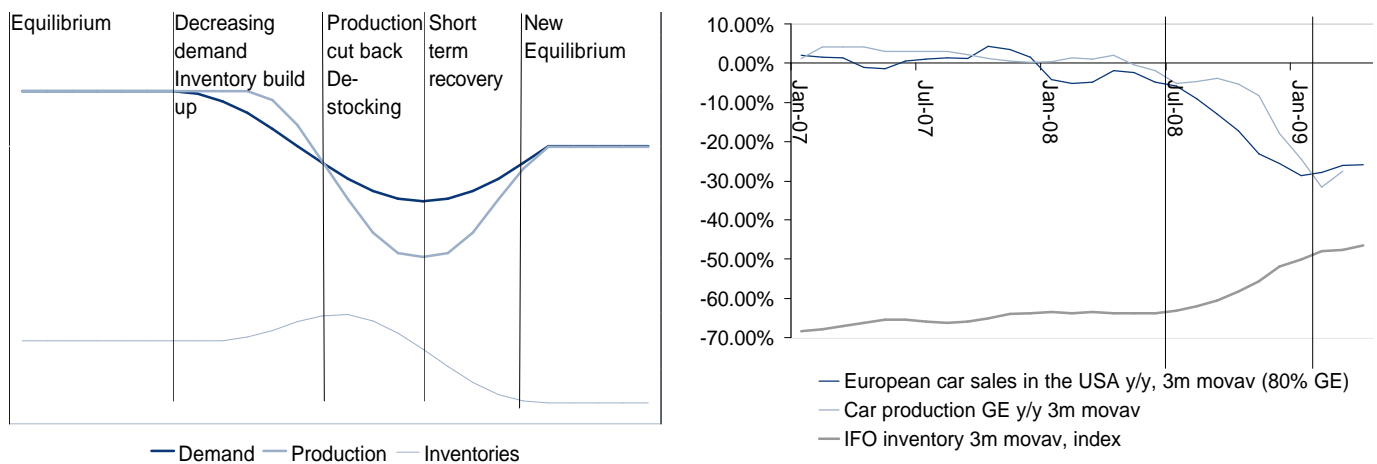
Out of the crisis

Destocking

Destocking amplifies the dynamics in the short term. Firms were surprised in Q4 2008 by the sharp decrease of demand and did not react with timely cut backs of production. This has led to an involuntary build up of stocks (see chart) that has been particularly pronounced for export goods due to delivery time. As a consequence, production has been cut back dramatically later, and part of demand has been met with existing stocks. This should have decreased stocks in the meantime.

Once inventories reach an appropriate level, production will still be lower than demand, and will have to be increased in the short term to meet demand again. Once consonance is achieved, production should grow at the same pace than demand, which might be lower than before the onset of the crisis.

Diagram of inventory adjustment cycle vs. the German automobile industry



Source: Erste Group Research, Bloomberg, Datastream

The German car industry is exemplary for this. In Q4 2008, sales of German cars in the US decreased sharply. In contrast, production reacted only with a delay of approximately two months, leading to inventory building up. Afterwards, in Q1 2009, production decreased more rapidly than demand (by 5%), which led to a slowdown in stock build up or even a decrease. As final demand is still at low levels though, a pick up could be short-lived and followed by a slowdown of growth of industrial production.

Generally, we expect an increase in production (in consonance with leading and sentiment indicators), but doubt the sustainability of growth rates. Once production meets demand again, both should grow at a slow pace for some time.

Production cut back implies low capacity utilisation.

Decreasing demand, high levels of inventories and resulting cut backs of production led to capacity utilisation well below average. In addition, financing conditions for companies and loss of confidence will also be a drag on investments, pointing to only moderate GDP growth in 2010 too.

Out of the crisis

Financing of consumption and investments

How far has the easing on the credit markets progressed?

Loss of confidence in stable demand dampens propensity to invest

Access to cheap and easy money is not sufficient motivation for companies and private individuals to consume more or realize investments. The pace and size of the economic contraction have definitely shattered the fundamental confidence of businesses in stable demand, which is in our view the strongest argument for the sluggish investment activity. However, the tension on the credit markets has made it harder to obtain low-cost capital (like before the crisis). Due to the changed conditions for banks (recapitalization, write-offs, limited long-term refinancing options), the deteriorating financial strength of borrowers and decreasing demand for credit have significantly slowed the growth rates of outstanding credit volumes.

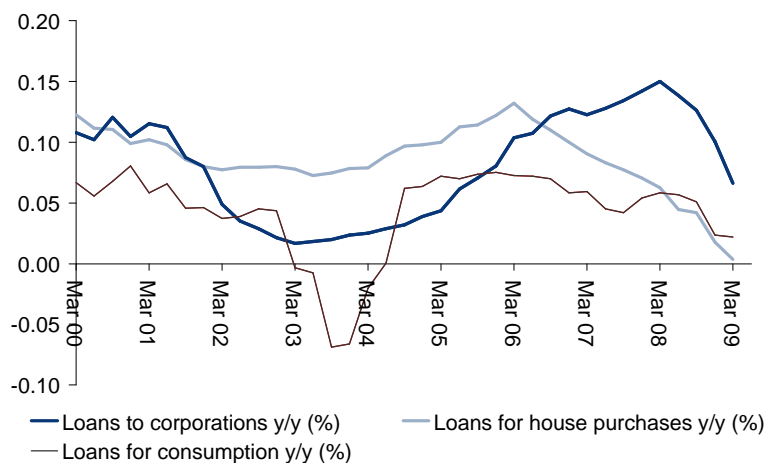
Flattening of loan volume

The ultimate cause of the flattening of credit volume is hard to identify - it seems to be a question of what came first, the chicken or the egg (supply/demand). A look at the available data shows that there is no credit crunch at first sight, or at a second one either – not in the US, the Eurozone or CEE. We believe that companies with financial strength will continue to be able to borrow the money they need. However, in the horizon of the next 6-12 months, banks, companies and private individuals will be more cautious in their assessments of further economic development and will take this heightened risk into account in their decisions.

Financial system saved from worst. Since the bankruptcy of Lehman Brothers in September 2008, the financial markets have stabilized considerably. In concerted actions, central banks and governments have succeeded in easing the situation and securing banks' access to short-term financing. Apart from the widening of collaterals, the longer maturities and massive interest rate cuts by central banks, governments are providing support by injecting capital, guaranteeing capital, providing deposit guarantees and offering the option of issuing government-guaranteed bonds.

Slower credit growth. The following charts show that the outstanding credit volumes in the Eurozone – for companies and households – have risen, but that growth rates have dropped significantly. If one omits the annual rate of change and instead looks at developments q/q, a slight shrinking in credit volume as of 4Q08 can be seen in the segment of private financing (for home purchases and consumer loans). At the same time, the average financing costs have decreased sharply, in line with the interest rate cutting cycle of the ECB.

Changes to outstanding loan volumes y/y



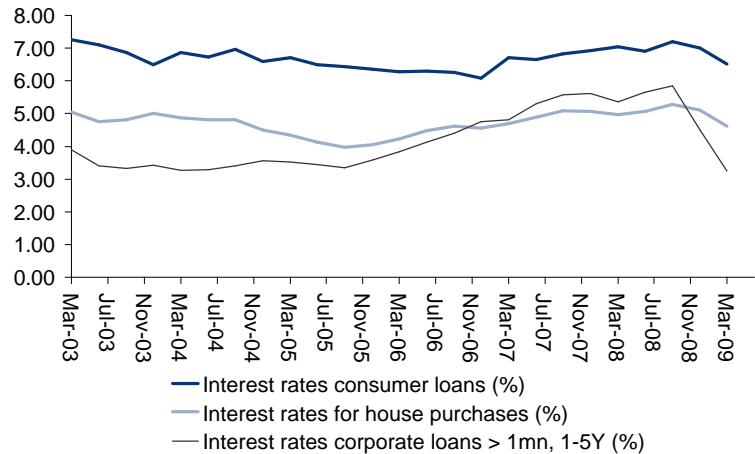
Source: ECB, Erste Group Research

The declining growth rates of the outstanding loan volume were in part caused by the changed conditions for banks (recapitalization, long-term refinancing options) and the higher financing costs until the end of 2008 (and thus to the credit supply side). However, the principal reason

Out of the crisis

seems to be a declining demand for loans, due to the insecurity of households and companies regarding further economic developments. This is reflected in the weakening loan growth and lower financing costs.

Financing costs



Source: ECB

Private demand for credit reflects wealth losses. Declining stock prices and decreasing home prices - and in some member states of the Eurozone also a much slower rise in home prices - have resulted in lower demand for loans from private individuals. When asset prices decline, the willingness to take the risk of rising debt (if it is not necessary) diminishes.

Credit quality is deteriorating. The current and future earnings expected by companies are dampening the desire for investment activity and thus demand for credit. Plunging revenues are an enormous challenge for companies with high debt ratios. Even though the liquidity situation of companies still seems to be good (according to the ECB Lending Survey), the internal financing power is suffering from decreasing revenues.

Rising credit volumes in US. In the US as well, loans granted by banks, which amount to some USD 7,000bn (corresponding to 30% of private debt), have risen by around 3% within the last 12 months, representing a slowdown in growth. One part is accounted for by real estate credit, with loans for home purchases more or less stagnating – similarly to Europe.

Innovation could be postponed. Technical innovations and the development of new products could become much harder in this phase of the economy. For high-technology projects that require large amounts of financing, external financing partners are very important. In the current economic phase, the opportunities and risks of such projects are harder to assess for external partners; this is why banks and other investors will probably exercise greater caution. In some areas, the emergence of a feedback loop between the financial and real economy cannot be ruled out.

Limited refinancing options. Apart from the interventions of central banks and governments described above, the refinancing options for international banks are much tighter, as (for example) the possibility of securitizing loans has been limited. In the US, the outstanding volume of commercial paper, i.e. the securitization of loans of different borrowers in short-term securities, has plunged since the start of the year by USD 320bn.

Investors demand recapitalization. After investors had called for higher indebtedness in the past years to increase profitability, since the aggravation of the financial crisis, they have switched to calling for higher capital adequacy requirements for banks. Investors explain their risk aversion by saying that they are not fully clear regarding the risks on the balance sheets of banks (depreciation of diverse assets, e.g. securities, credit portfolio). In the current economic

Out of the crisis

phase, this provides a certain challenge for banks and is often only manageable with state capital.

Confidence in economic recovery will influence demand for loans

Despite the enormous efforts to support credit markets with interest rate cuts and by making funds available, credit volume growth will depend decisively on the confidence that companies and households have in an economic recovery. Although stabilization is imminent, we expect greater caution to be exercised in private investment decisions, due to the exceptional steepness of the latest contraction. We have already pointed out that attractive investment conditions like cheap money alone are not enough to boost demand for credit.

Labor market to react with time lag

The decline in sales revenues and the lost confidence among companies in stable future demand for their products has prompted them to keep strict control over costs. Not only have investment projects been postponed, operating costs have also been cut. Like all economic contractions, this exceptional recession will also leave its mark on the labor market with a time lag.

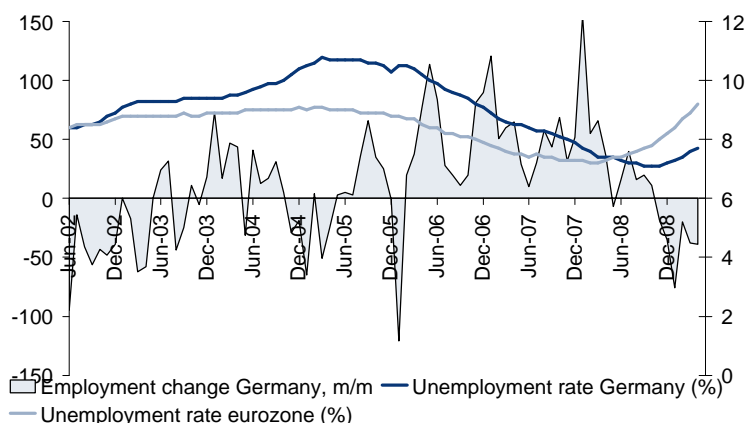
Rising unemployment rates are expected to put damper on consumption propensity/demand.

The surplus capacity is resulting in short time working for now, but if low demand lasts longer, it will lead to layoffs. Within the Eurozone, the short time working models have been extensively enlarged in some cases. The unemployment rate has already risen, reaching 9.2% in April after 8.9% in March; we expect a further increase to 9.3% on average and continued rising unemployment in 2010. In the CEE countries, the unemployment rate surged again after having hit a several-year low last summer. Since September 2008, the seasonally-adjusted rate has risen by around 0.9 to 1.5 percentage points in the region (excluding Ukraine), which is comparable to the rise in the Eurozone (1.2 percentage points), but much lower than in Spain (5pp) or in the Baltic countries (4.4-9pp). In the US, the unemployment rate has increased by 3.2% since September 2008.

Some sectors might face structural unemployment

Most unemployment is due to the economic cycle and it will balance out when the economy recovers again. However, some sectors (like the automotive industry) are affected by extremely high global overcapacities, and in this case, we might see the emergence of structural unemployment caused by the transformation of economic structures. This type of unemployment does not necessarily decrease with the next economic upswing – rather, it becomes necessary to retrain people. However, the aftermath of the overheated housing market could become a longer-lasting problem for employment, due to lacking impulses in the construction industry. Within the Eurozone, this concerns mainly Spain, where the construction sector has traditionally been one of the most important generators of new jobs, or Ireland, where the real estate market has been instrumental in increasing the unemployment rate.

Unemployment rate Germany, Eurozone (%)



Source: Datastream, Erste Group Research

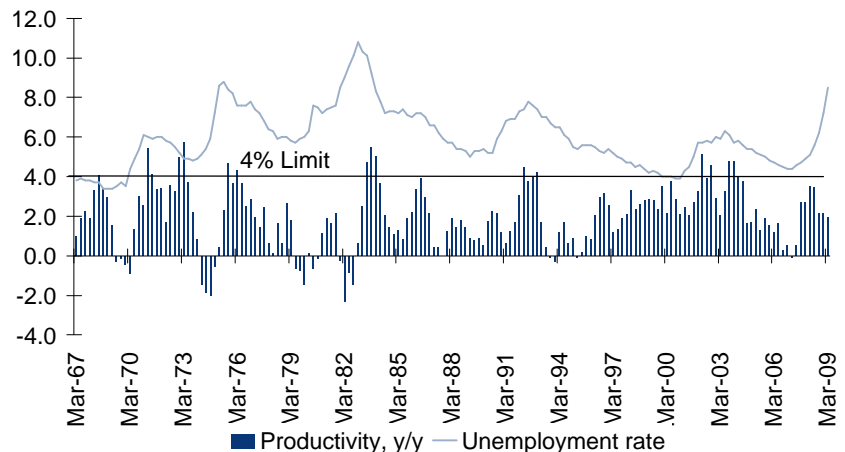
Out of the crisis

US unemployment rate will turn late in 2010

How will labor market respond to economic recovery in US? In this case, a distinction must be made between the employment and unemployment rates, which are compiled differently in the US. Employment responds relatively directly to the business cycle. Historically, the end of negative economic growth has been accompanied by immediately rising employment. The unemployment rate, in contrast, reacts to the business cycle with a delay. The divergence of the two indicators can be explained relatively easily by the population growth in the US. Only when employment starts to grow relatively more strongly than the pool of available labor does unemployment decrease again - employment growth alone is not enough. Furthermore, inconsistencies in the gathering of data have to be taken into account (for example, the fact that the unemployment rate is ascertained by telephone surveys).

An economic stimulus will come from the labor market only when employment actually grows more strongly than the pool of available labor. How long will this take? Experience has shown that employers wait with significant new hiring until a high capacity utilization of existing labor is achieved. This is indicated by productivity growth. An annual growth rate of 4% has in the past regularly signaled a trend reversal on the labor market. Productivity growth is a function of economic and employment growth; it reached 1.7% y/y in 1Q09.

Productivity and unemployment rate US



Source: Bloomberg, Erste Group Research

Based on our estimates for GDP growth rates and employment, the unemployment rate will rise further for now, albeit more slowly than it has recently. We do not expect any sinking unemployment figures before the end of 2010. A comparison with the preceding two recessions confirms this assumption. At that time as well, it took at least six quarters from the last negative GDP growth rate (q/q) until the unemployment rate decreased.

Inflation/Monetary policy

Inflation risks despite recession

Non-standard measures fuel inflation fears

The reason why the subject of inflation is highly topical also in times of crisis are the extreme measures taken by the central banks, but mainly by the US Fed. These interventions, which are now referred to as non-standard measures, have been very divergent. Since the outbreak of the crisis in August 2007 and especially since the collapse of the Lehman Brothers in September 2008 the prime concern has been to supply the banking sector with sufficient liquidity. This has been achieved essentially by granting commercial banks more or less unlimited credit backed by securities. Due to the persistent environment of insecurity, commercial banks hoarded the liquidity and became more restrictive in their lending policy. After the financial sector was largely stabilized, the US central bank started to directly buy securities to boost the credit cycle.

The purchase of fixed-interest securities by the central bank is not only one way of pumping liquidity into the market, but also aims to dampen long term interest rate levels. Thus, the purchases of mortgage-backed bonds by the Fed pushed the interest rates for 30-year loans to the lowest level in decades, although an increase was observed again recently.

ECB is following a different approach than the Fed

The ECB pursued a different policy from the start, even though it reacted the swiftest to the crisis. Already at the start of the financial market crisis in August 2007, the ECB made additional liquidity available and widened the group of securities eligible for collateral. As recently as in May 2009, the ECB took the decision to buy additional securities on the market, but only for a minor amount of EUR 60bn, the aim being the revival of the credit markets. The widening of credit had enlarged the balance sheet of the ECB by EUR 600bn. The US Fed enlarged its balance sheet by EUR 900bn before it started buying securities for a total amount of USD 1750bn. The sum is not only huge in absolute figures, but also in relation to US GDP (ca. 12%). Up to now, all of these measures have initiated a relative stabilization of the financial markets. Companies, banks and households still feel insecure and for this reason the measures taken by the central banks have had hardly any effect on demand up to now and have failed to create inflationary pressure.

Too much liquidity even for a flat economy

However, it seems as if the global economy is increasingly stabilizing. This does not mean a return to growth rates like before the crisis, but even for an only moderate upswing, there is too much liquidity in the system now; above all in the US but also in Euroland. Too much liquidity is a risk for renewed rapid credit expansion, which would ultimately result in inflation. The factor triggering the excessive liquidity was not the economy, but the tense situation in the financial sector. Accordingly, the expansion of the money supply, again especially in the US, is not in accordance with the business cycle and therefore carries the potential of inflation over the medium term.

Central banks emphasize exit strategy

However, this is contradicted by the central banks and they are constantly stressing their "exit strategy", i.e., the (timely) withdrawal of liquid funds as soon as it becomes necessary. Due to incomplete information, which moreover becomes available with a time lag and the fact that any monetary measure in reaction to such information has a delayed effect, it will not be easy to find the right dosage for liquidity. Adding to the difficulties will be that at the same time the US government debt will widen massively. The task of the Fed up to now was to put out a forest fire in which case it was hardly possible to use too much water. In the future, the challenge will be reforestation and thus the dosage of liquidity as a crucial determinant for success.

Huge challenges ahead for the Fed

The US central bank is in a much more difficult position than the ECB. First, the volume of liquidity pumped into the banking system is much larger, and second, it is more difficult to steer the liquidity made available by securities purchases. While the loans (repo transactions) of the central bank to commercial banks have fixed maturities (and thus a predefined end), the repurchase of securities is more difficult. As if determining the point in time and the volume were not hard enough already due to macroeconomic developments, the central bank also has to take the market forces into account. How does the Fed deal with a recovery of the economy and

Inflation/Monetary policy

thus with rising yields? If it starts withdrawing liquidity (= sells securities from its portfolio), this would result in further rising yields and throttle the economic upturn. Or should it try to keep yields down by further purchases? This would increase liquidity inflows and would revive inflationary fears.

Risks of current monetary policy are mid- to long term

Effects of this monetary policy on consumer prices are expected to become apparent at the earliest in the second half of 2010. A condition for inflation is sustained demand pressure something there are no signs of right now. Households and companies are still cautious. The plunge in production has resulted in high unused capacities in industry, and therefore, it will be possible to cover any increase in demand by using existing capacities in the foreseeable future and this will keep price pressure from forming. Moreover, we expect the unemployment rate to rise further, which will lead to a weak development of wages, and therefore, no cost pressure is expected from this side for companies.

The crisis could drive up inflation rates with a considerable time lag. Not only will it be very difficult to steer liquidity correctly, but one may assume that the US Fed will be more willing to enter into a risk as regards inflation rather than on the deflation side. The latter carries the greater threat for a highly indebted nation like the US. Neither is it clear if the central bank will be able to dispel the spirits it has conjured. Once lending starts working again, it will become harder to contain the effects. Because the effects of past liquidity injections could be multiplied (credit multiplier), as the funds of the Fed can be circulated several times. The Fed should therefore start withdrawing liquidity in a very early phase of the economic recovery if it wants to prevent inflation.

Price increases instead of higher capacity utilization. Another factor for the long term inflation outlook is that after their "near death experience" companies might be reluctant to invest and might tend to raise prices instead of widening capacities as soon as they reach the limits of their capacities.

Energy prices will remain an issue

Even earlier, an external price-driving factor could crop up that was temporarily suppressed by the crisis – you guessed correctly – we are talking about **energy prices**. The question behind this is how long oil extraction will be able to keep up with renewed growing demand. Speculations on the subject vary widely, but were one of the major reasons for the massive increase of the oil price until mid-2008. As nothing has changed on the supply side, a recovery in demand could create upwards pressure on prices again. This even more so if oil is rediscovered as an asset class by speculators.

Imbalances might trigger asset price inflation

Rising asset prices. Not all inflation risks have to materialise in consumer prices. Internationally, prices of the consumer basket have not been the problem in the past years (apart from summer 2007 to summer 2008), but rather those of assets. These include stocks (bubble of 2000) and real estate as seen in the well-known overvaluation in the US, UK and Spain. Central banks declared that they were not responsible for inflation in these areas, because their focus is clearly on the consumer price index.

Inflation risks hardly quantifiable

The outlook for medium- and long term inflation trends are very vague because at present none of the risk factors mentioned are showing any effects. Rather, we are dealing with risk factors that have attained a quite large dimension. The currently unused high capacities in the economy would even be suited to clearing the way for price declines. Companies might attempt to increase capacity utilization by lowering prices. But this seems improbable, especially since companies take recourse to this measure only after a long stretch of economic drought. Based on the relatively inflexible wages, this risk in Euroland is especially low.

Slow economy will not lead to inflation

Deflation is a more difficult problem for a national economy, also because at some point it can no longer be combated with the classical instrument of monetary policy – interest rates. Due to high real interest (nominal interest is very low less negative inflation rate = high real interest), keeping cash becomes attractive, thus creating purchasing restraint again which in turn drives deflation. This effect is heightened when expected price declines are included in the buying decisions of consumers. Then a deflation spiral has started. Consumers wait with their

Inflation/Monetary policy

decisions, because they have learned that prices go down. This becomes a self-fulfilling prophecy, because the weak demand forces producers to increase buy incentives, i.e., lower prices. Consumers then feel confirmed in their view that waiting is the best purchasing strategy.

The emergence of such deflationary spirals is a long-term process and one of the conditions is the hesitant adjustment of production capacities to consumption – which is what we are not seeing now. In our view, the topic on capital markets will be inflation. The fact that there are no signs right now of inflation is not a hindrance– on the contrary– it will fuel speculations.

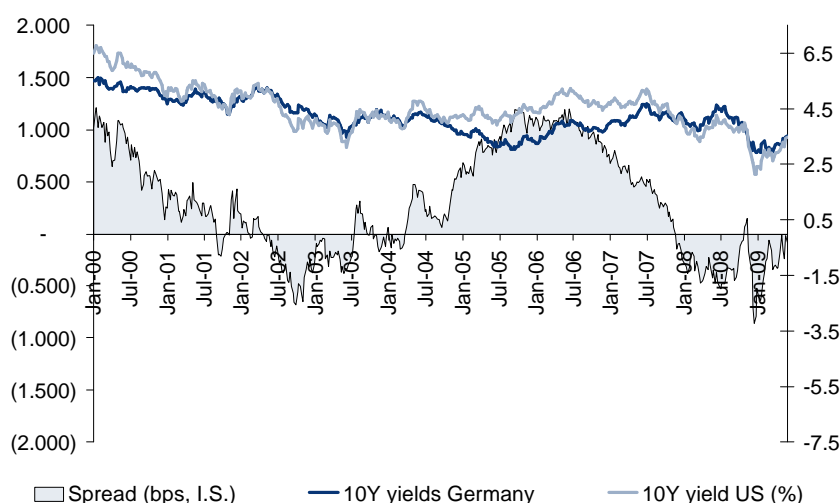
Summarizing, we do not expect deflation neither in the US nor in Euroland or CEE. Energy prices pose a risk for inflation already in the second half of the year. The effects of the current expansive monetary policy on inflation can only be assessed towards the end of 2010 the earliest. Accordingly the possible impact is difficult to quantify, but we think it should be limited to a few percentage points the most.

Bond market

No support in sight

In the past few months, the yield curve steepened massively. The slope of the yield curve reached historic levels in Germany at 225 bps and in the US at 267 bps. The yield spread between the US and Germany in the ten-year maturity segment has been negative since the end of 2007, but has narrowed considerably in the past few weeks and is expected to move into positive territory in 2HY. We believe that the negative aspects will continue to outweigh for bond markets. We expect the major bond markets in the CEE region to show a solid development in relative and in absolute terms.

Yield 10y government bonds Germany vs. US (%), Spread (bps)



Source: Datastream, Erste Group Research

Slope of major market yield curves at record levels

The yield curve has steepened due to special effects. Not only the fact that the key lending rates were cut to historically low levels or zero triggered the decline in yields at the short end, but also the greater risk aversion of investors and the parking of funds in money market instruments. At the same time, the yields on 10y maturities, which declined initially though not as sharply, began a rebound.

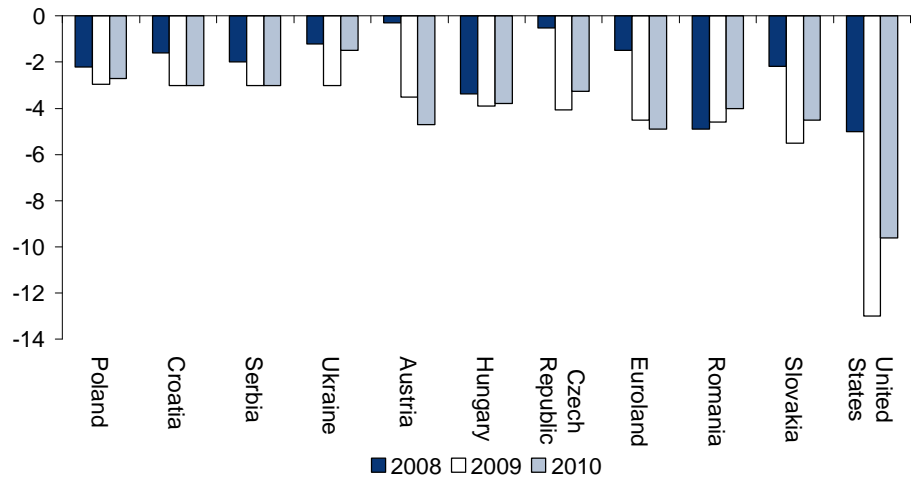
Fiscal deficits are rising

In fact, we have hardly been able to find reasons that could be deemed supportive of bond markets for the coming months. The question is only when the negative factors will have an effect and to which extent this effect has already been priced in. But the upwards pressure on yields will definitely continue to rise.

One of the most important factors is that the supply of government bonds will widen enormously. The financial crisis will result in a sharp increase in new debt, because the government budgets are not only burdened on the spending side by assistance and support measures, but also on the receipts side due to the weak economy. The shortfall in the budget will be very high in the US this year, and much lower in Euroland (but higher than in 2008), and for most CEE countries below the Euroland level.

Bond market

Fiscal deficits, in % GDP



Source: Erste Group Research

Normally, it would be assumed that higher supply in times of economic weakness meets with sufficient demand, because the interest in low-risk investments rises and demand for credit from consumers and businesses is sluggish. In the currently exceptional situation, investors might even lose confidence in the stability of the credit ratings and this could dampen demand.

Sovereign ratings to be a source of risk

Europe is more conservative. Europe is focused on the medium-term attainment of the stability pact which should mean more calculable. We do not expect the monetary union to collapse, even though a few member states have poor credit ratings. Anchoring mid-term inflationary expectations close to the price stability in Europe fixed by the ECB should be successful. Therefore, there are important reasons why the yield spread US – Germany should reverse into the positive range in the coming months.

For the US, risks play a role for credit ratings only long term because the level of indebtedness of the government is relatively low. In this respect, the situation is quite different within the monetary union. But this has not had any particularly high influence on the spread developments of EMU government debtors in the past. In the CEE countries, credit ratings will tend to depend on how fast economic growth is achieved again.

However, the increase in government debt cannot be viewed in isolation, but only globally. The high financing needs in the US will make funds scarce worldwide and in this manner could create upwards pressure on yields.

Inflation fears will weigh on bond markets

The next global negative factor for bond markets is the expected development of the economy. Closely related are fears of inflation. Even though these are not direct, because there are high unused capacities in the economies, but the liquidity injected by the central banks poses a risk in times of economic improvement (also refer to “Inflation and monetary policy”). The inflation risks are the highest in the US, but any effects on national bond markets would also be felt worldwide though in a milder form.

The only thing that could rescue the bond markets would be a renewed plunge of the economy and a trend reversal in expectations. This is not our core scenario and therefore it is not the basis of our forecasts.

CEE bond markets with clear out-performance

Yields will rise further, because the negative factors mentioned will increase. This will result in a rise in long-term yields in a first phase in the US and in Euroland. Yields in CEE countries are still influenced by the prevailing risk aversion, i.e. in relative terms too high. A calming of the situation on the financial markets is expected to weigh heavier than higher yields in Euroland and the US, and for this reason, we expect stable to falling yields for the CEE countries.

Bond market

US and Euroland yield curves to flatten by year end

Like in almost any cycle, the longer maturities will lead ahead of short ones. This will be the same this time as well – and even more so. Long-term yields of major markets bonds are expected to rise precisely because of the very strong long-term risks. As the economic downturn has been so steep that the central banks never tire of stressing their intention to keep interest rates low in the foreseeable future, short-term yields are expected to remain stable for now - at least in the US and Euroland. As the economy stabilizes, the markets will start to think about rising interest rates, which should be reflected in the short-term yields this year or by the latest in the first months of the coming year. In the CEE region, expectations regarding monetary policy are not that uniform. This means that in the individual countries, the short maturities will develop divergently (see Country Sections).

Twin deficits in the US will weigh on the US dollar. When a country has a budget deficit and a current account deficit, this is referred to as a twin deficit. The growing government debt is financed in part by foreign credit. However, this is possible only to a certain extent, because as the level of indebtedness rises, creditors become more nervous and demand higher risk compensation, i.e., higher yields. This could become a burden for the economy though, which would in turn increase the risk of default on debt. The apparent aggravation of the macroeconomic situation and the risk that it might not be possible to refinance maturing foreign debts would exert pressure on the currencies of such countries. This is the theory.

Downward pressure on the dollar to continue

Thus, there are many aspects that speak against the US dollar. Of course, there are no signs that the US will encounter problems in servicing its debt. But what is becoming apparent is the massive widening of its indebtedness from currently around 50% of GDP to 70% within the next four years. These debts need to be serviced and the costs will weigh on the growth of the US economy. Therefore, not only will the interest rate rise, but also the level of indebtedness. An additional burdening factor for the US dollar is the risky course steered by the central bank already described in a previous section. The conjunction of these factors could diminish the relative appeal of the US dollar as a global currency, which would be a further burden. Although no “milk and honey” will flow on the other side of the Atlantic, the fiscal and monetary policy risks are much lower. Nonetheless, we do not expect a massive plunge of the US dollar or a steep rise of the euro, because the structural dependence of Europe on exports will not change that fast. This means that as of a certain point of the US dollar decline, the economic outlook for the euro zone will deteriorate to an extent that will end the firming of the euro.

*Gudrun Egger
Mildred Hager
Juraj Kotian
Rainer Singer*

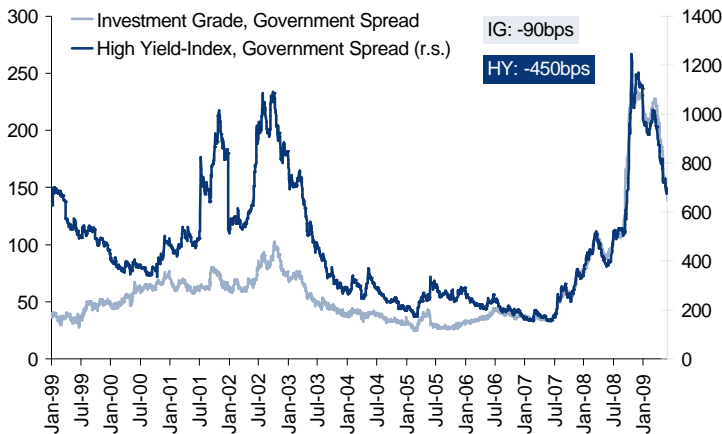
Corporate Bonds

Review

Sentiment improves on credit market

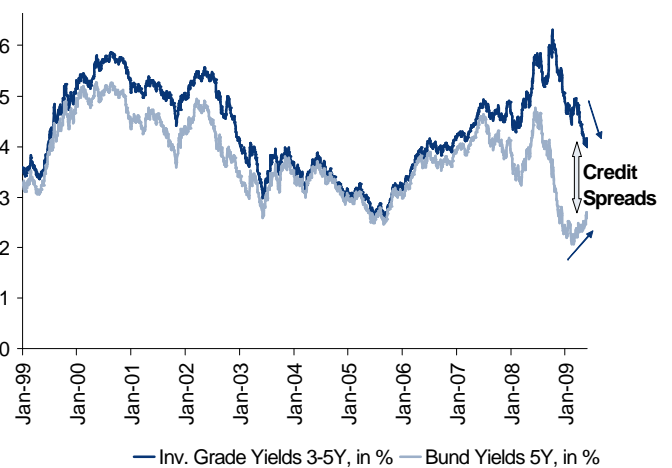
Since the end of 2008, the risks of corporate bonds have decreased substantially. The fiscal and monetary policy measures – including the aggressive economic stimulus programme of Obama and the massive interest rate cuts by the central banks – have contributed to lifting risk tolerance among investors. Risk aversion among investors (as measured by the VDAX Index) decreased from 74% in mid-October 2008 to currently 28% and is now only just above the historic average of 23%. Thus, risk premiums narrowed in the investment grade class by 90 bps and in the speculative segment by around 450 bps. Another reason for the downtrend in risk premiums was the most recent rise in yields on government bonds that was triggered by the increasing fears over the loss of top credit ratings of major economies (S&P lowered the rating outlook for Great Britain to "negative"). The search by investors for higher returns also caused portfolio switching from government bonds to attractively priced corporate bonds from the investment grade and high-yield segments and also triggered decreasing credits spreads.

Spread trend (Investment Grade and HY Index)



Source: Erste Group Research, JP Morgan Credit Index

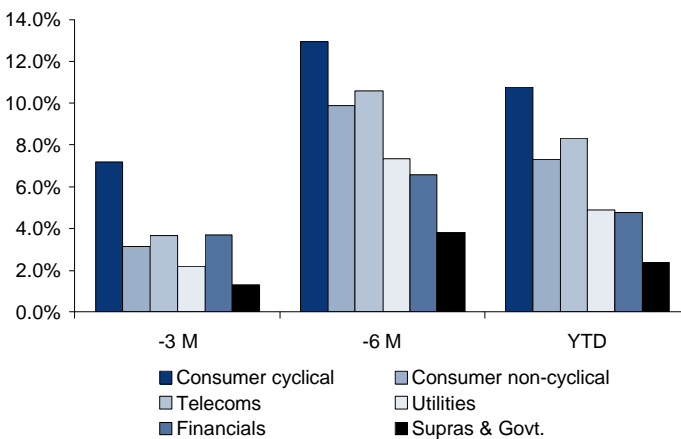
Investment Grade Yields vs. Bund Yields



All sectors show positive excess return

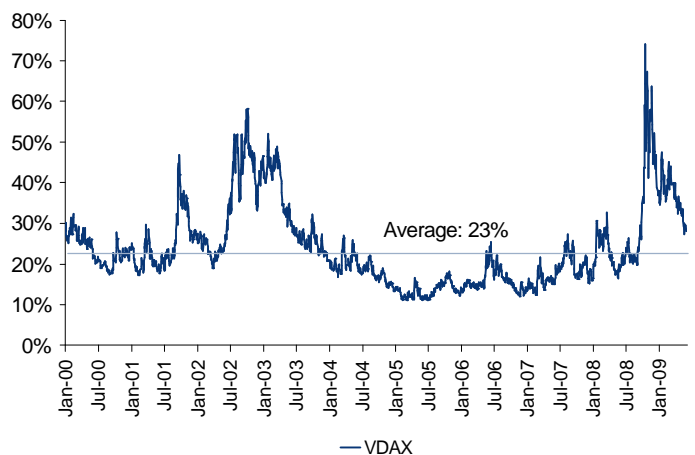
While government bonds were the best choice in 2008, since the start of 2009, corporate bonds with an overall performance of 8.1% have developed much better than government bonds (overall performance 2.4%). The calming on the credit markets was clearly observed in all sectors. With a performance of around 11%, cyclical consumption, which had suffered the most in 2008 due to the economic downturn, was the strongest.

Overall performance by sector



Source: Erste Group Research, JP Morgan Credit Index

Development of risk aversion



Corporate Bonds

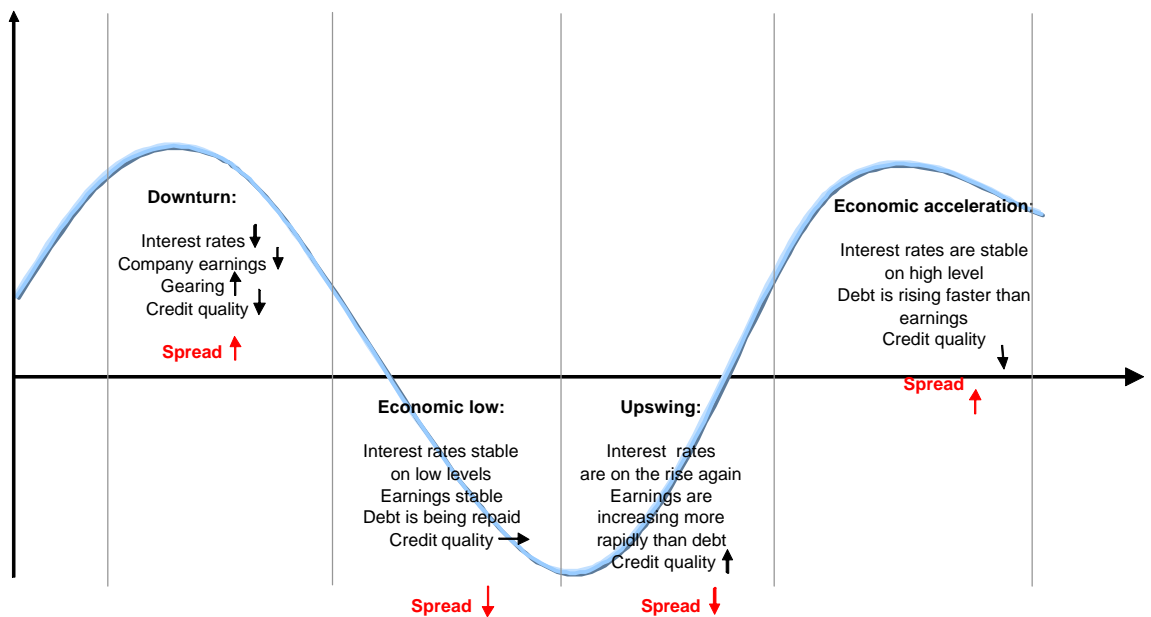
Outlook

Decisive for the further development of risk premiums are the economy, interest rates, risk aversion and credit quality.

Economy hits trough

As regards the macroeconomic environment, the most important leading and sentiment indicators in Euroland are already showing a trend reversal. This implies stabilization at a low level for the second half of 2009. We expect the economy to gradually recover only as of next year. Despite these slightly positive indicators at present, the uncertainty regarding the further course of the economy still prevails.

Relationship between the economy and the credit cycle



Source: Erste Group Research

Uncertainty regarding economic development weighs on credit quality

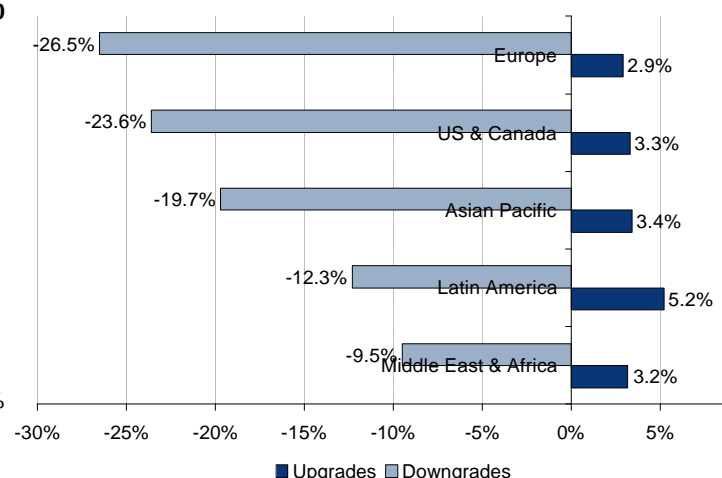
The reporting season for 1Q 2009 will soon be over. Most companies listed in the Stoxx 600 have already published their earnings figures. The average earnings dropped in 1Q by around 40% (y/y). In the current year as well, some significant drops in earnings – especially in the cyclical sector – are expected versus last year. Only in the financial sector do analysts expect earnings to rise more steeply in 2009 due to the negative base effects.

Corporate Bonds

Expected share-weighted earnings growth in Stoxx 600 (y/y)

	FY 2009	FY 2010
Stoxx 600 Index	10.04%	22.34%
Health Care	18.74%	7.99%
Utilities	4.42%	7.12%
Food&Beverage	4.34%	11.89%
Telecommunications	2.92%	1.58%
Personal&Household Goods	-4.76%	10.20%
Chemicals	-5.09%	21.62%
Retail	-11.52%	2.78%
Construction&Materials	-13.32%	-3.91%
Oil&Gas	-30.91%	29.45%
Basic Resources	-57.68%	23.63%
Automobiles&Parts	-106.46%	677.03%
Financials	349.80%	53.70%

Moody's Global Rating Actions 1Q 2009 - in % rated issuers by region

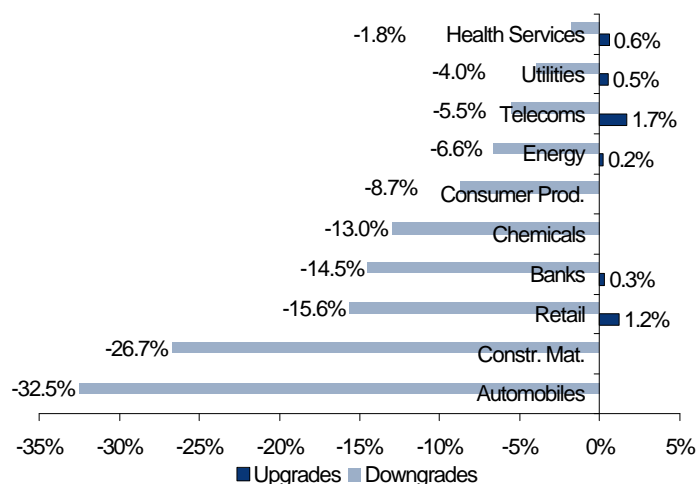


Source: Erste Group Research, Moody's, Bloomberg

Apart from the quarterly results reported, especially the earnings outlooks of companies are crucial to the further development of credit quality. There is hardly any corporation that dares to present a detailed outlook at present – not for this year or for next year. The reason is primarily the fact that an economic upswing cannot be expected before next year and economic growth is forecasted as only moderate for 2010 worldwide. These macroeconomic trends will burden mainly the credit quality of the cyclical sectors.

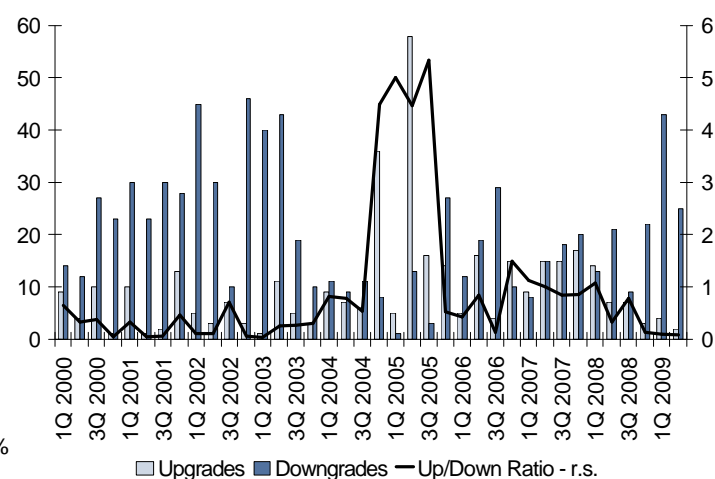
A breakdown by region shows that in 1Q it was mainly companies from Europe that came under pressure. Apart from high financing costs, the manufacturing sector was affected by the diminishing investment dynamic and decreasing capacity utilization. Lower gross capital expenditure and weaker exports will become the driving force behind the downswing in 2009.

Moody's Global Rating Actions 1Q 2009 - in % rated issuers by sector



Source: Erste Group Research, Moody's, Bloomberg

Moody's Upgrades & Downgrades Ratio Western Europe Investment Grade Non-financials



Corporate Bonds

High capex related with rating downside risk

While the negative rating actions in Western Europe were due mostly to the fundamental data of companies, the downgrading of companies from Central and Eastern Europe were done largely due to the negative rating development of some sovereigns. The high percentage of government stakes in many companies implies a high degree of default dependence between GRIs (government-related issuers) and the public sector (GRIs account for 54% of all rated firms in CEE). In 2009, however, Moody's expects the fundamental factors to play a key role in credit ratings in CEE as well. As driving force one has to mention, above all, higher capex that is being promoted by governments to stimulate the economy. In the currently insecure economic environment, high capital expenditure levels would generally trigger downgrading downside risk in Western Europe as well. We expect companies to tend to proceed more selectively in their investment programmes. At present, good credit ratings have high priority among companies in order to lower financing costs.

No stabilization of credit quality in sight

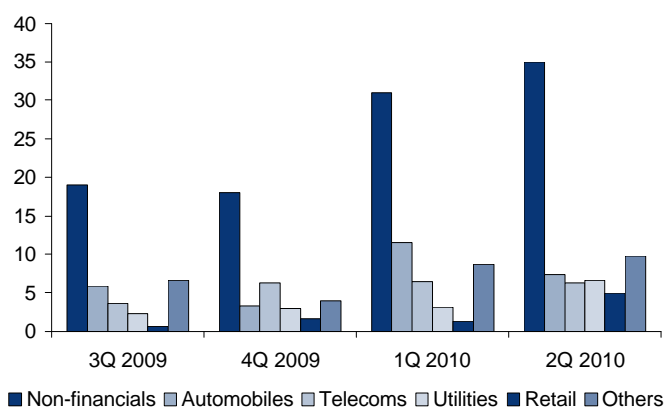
Even if sentiment on credit markets – as measured by sinking risk premiums – is currently quite positive, there are still no signs of any stabilization of credit quality among investment grade companies at present. A look at the ratio of upgrades to downgrades of ratings of non-financials in Western Europe shows that there was a clear excess in negative rating actions in 2Q as well. Should this development continue, we expect a similarly poor upgrade-to-downgrade ratio for 2009 just like in 2002 to 2003.

Nonetheless, it must be mentioned that defaults should remain limited in companies from the speculative range (high yields). In its April forecast, Moody's expects a default rate of 19.2% by the end of 2009 in Europe which is much higher than the global default rate of 10.4%. This will affect mainly producers of durable consumer goods in Europe. In addition to the negative operating environment, the higher refinancing risk is a driver of the negative development of credit quality in the high yield segment. Due to the high risk aversion among investors, these companies basically have not had access to the primary market for EUR corporate bonds since August 2007.

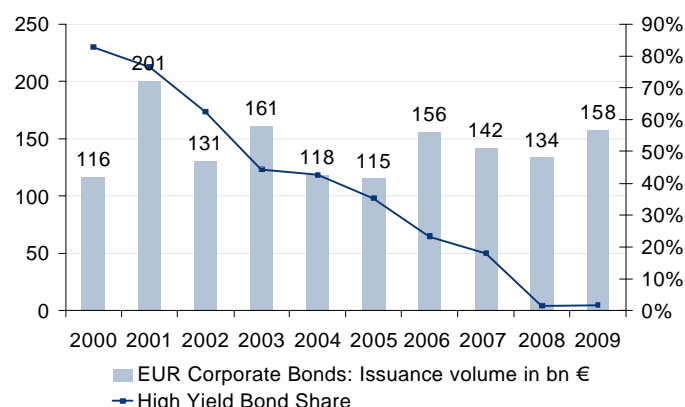
Primary market still active

Issuing activity has been very lively on the primary market for EUR corporate bonds since the beginning of the year. Short-term EUR refinancing needs of companies have already been covered, but at a high price. The average risk premium for the risk class Baa was around 600 basis points at the end of 1Q vs. 325 bps in 03/2008 and 110 bps in 03/2007.

Upcoming maturities of Non-financials EUR bond market – in EURbn



Issuing volumes on EUR corporate bond market



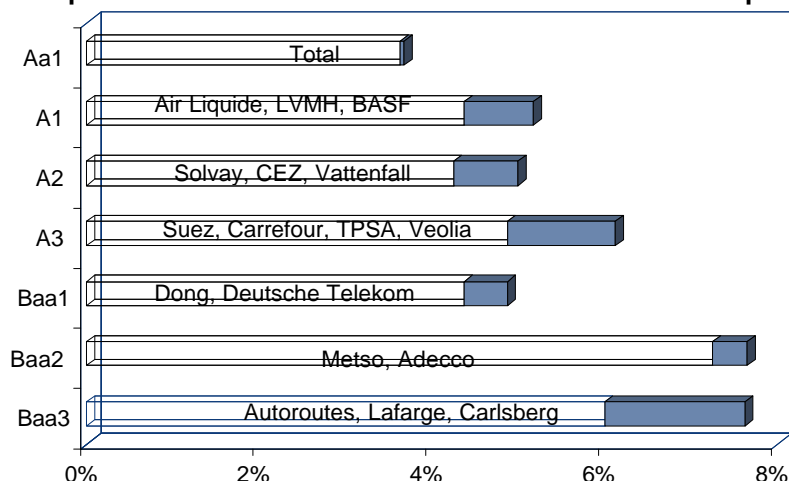
Corporate Bonds

New issues limited to quality securities

Since the beginning of the year, many companies have successfully placed bonds with a volume of EUR 158bn in order to optimize their debt structure and become more independent of banks. However, the new issues are limited to quality securities. The main reason is the risk aversion of investors. Bonds of companies with a rating of "AA" and "A" have accounted for up over 70% of total issuing volume in 2009. Especially utilities were the most active issuers on the primary market despite their stable cash flows and credit lines granted, tapping the market for a volume of around EUR 50bn. The defensive pharma groups (EUR 22.5bn) also attracted risk averse investors with attractive coupons to finance their large acquisitions. The smallest trading lot for most securities was EUR 50,000, meaning that the securities were placed mainly for institutional investors.

There was certainly a difference in risk premiums on EUR corporate bonds depending on the rating class. The broad range of coupons on new issues within the same rating class is due to the fact that investors demand additional premiums for all types of risks (including the degree of cyclicity and the defensive features of sectors).

Coupons of selected 5Y new bond issues on the EUR Corporate Bond Market (May 2009)



Source: Erste Group Research, Bloomberg

"Forward start facility" as an alternative to bond markets

As an alternative to the bond markets, many major European companies have decided to secure their liquidity by prematurely renegotiating their lines of credit in the past few months. New lines of credit are being opened with a so-called "forward start facility". These permit companies to obtain credit lines – at higher prices and fees - that will replace existing credit lines at a later point in time upon their maturity.

Therefore, liquidity is available but expensive. Because of the current scarcity of alternatives to the bond markets, we expect companies from the solid investment grade segment to continue to take advantage of the attractive spread window. Cyclical securities by contrast will have to offer additional premiums in the current insecure environment in order to attract investors.

Access to primary market remains very limited for high yields

By contrast to the investment grade segment, only few companies from the high yield segment have access to the EUR bond markets. The stable business profile is viewed as the decisive factor for a successful bond issue in this context. Therefore, since August 2007 only four companies (Fresenius Ba1/BB, UPC B2/B-, Pernod-Ricard Ba1/BB+ and Stora Enso Ba2/BB-) have issued EUR bonds from the speculative segment. The rapid economic downswing could cause more frequent covenant breaches in this segment¹. Therefore, negotiations on new covenant terms are crucial for many companies from the speculative segment in order for them to avoid liquidity problems.

¹ A covenant is an additional agreement or provision to a credit agreement with companies. It places the obligation on borrowers to achieve certain conditions -- e.g. minimum financial ratios such as cash flow to net debt.

Corporate Bonds

Conclusions

The recovery on the EUR credit market has been driven since the start of the year by aggressive fiscal and monetary policy measures. Large-scale fiscal economic stimulus packages, a massive easing of monetary policy and bailout plans for financial institutions were the driving force that restored investor confidence.

Will spreads continue to narrow?

The question of by how much risk premiums will still narrow needs to be addressed with caution. The weaker-than-expected economic recovery and the uncertainty regarding its duration continue to pose a high risk and make a correction on credit markets feasible. We do not expect spreads to reach their all-time high of the autumn of 2008 (Lehman failure) though.

To counteract the effects of a recession, the focus of companies is unchanged on cost reductions and optimization of capex plans. Differentiated by risk class, we still favour solid investment grade issuers that are apparently more attractive than government bonds. Despite the latest rally among the high yields, we are still cautious, because the more difficult access to the capital market carries high refinancing risks.

Preference for defensive sectors

As regards the sectors, the sustained global economic weakness will continue to drive investors towards the defensive sectors. Even though the potential for a further narrowing of spreads will probably remain limited in the defensive industries, especially the utilities and telecoms may be assessed as "safe havens" due to the sound development of operating results, robust cash flows and stable sector credit ratings.

*Alihan Karadagoglu
Elena Statelov*

Plunging exports and investments

Analyst: Gudrun Egger
gudrun.egger@erstegroup.com

	2007	2008	2009f	2010f
GDP per capita (EUR)	28 780	29 804	28 716	28 990
GDP (real y/y, %)	2.6	0.6	-3.6	0.3
CPI (y/y, average %)	2.1	3.3	0.6	1.2
Private Consumption (real y/y, %)	1.6	0.3	-0.9	-0.4
Investments (real y/y, %)	4.7	-0.3	-8.1	0.1
Exports (y/y, %)	8.1	4.2	-12.5	5.4
Imports (y/y, %)	7.4	4.3	-9.6	5.1
Unemployment (average, %)	7.3	7.5	9.3	10.2
Current account balance (% of GDP)	0.1	0.2	-0.2	-0.1
Govt. budget balance (% of GDP)	-0.6	-1.5	-4.5	-4.9
Public debt (% of GDP)	66.1	68.5	73.0	76.0

Economy and inflation

Investments at -8.1%, driving recession

Almost all components of GDP are set to shrink in 2009. In particular, private investments will hardly recover until year-end, as households and companies are postponing or cutting major spending due to lost confidence and uncertainty. Even though a few sentiment indicators are already showing a trend reversal, it is still too early for optimism regarding an economic upswing. Apart from government spending (consumption, investments), all components of GDP will shrink.

Correction on real estate market has negative impact

At the beginning of the economic downswing, the real estate market was overheated in some countries (Spain, Ireland). Especially the construction industry (and the labour market) is suffering from the price corrections on the real estate market and the related restraint in investment activity. The corrections on the real estate market mean that any economic recovery will be only moderate.

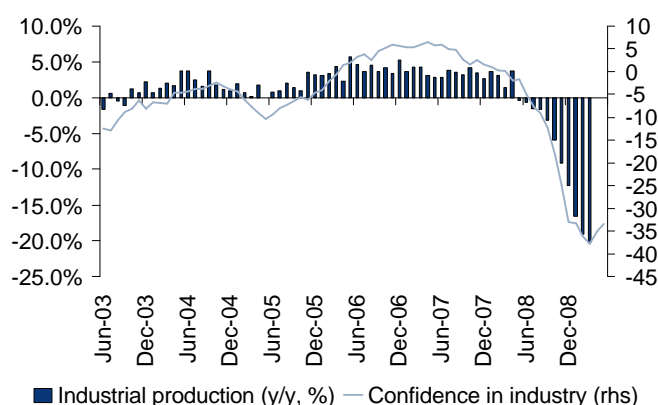
Exports plunge

1Q weighed down by foreign trade and inventory reduction. Germany has an export share of 60% in GDP. Capital goods and durable capital goods (GE: highly priced cars) are among the most important export goods. Germany is therefore more harshly affected by the collapse in demand than other member states. Overall, the current account balance in the euro zone was - and still is - relatively balanced. Exports might be stimulated earlier than expected, but the expected strengthening of the euro could pose a risk.

Inventory reduction weighs down 1HY

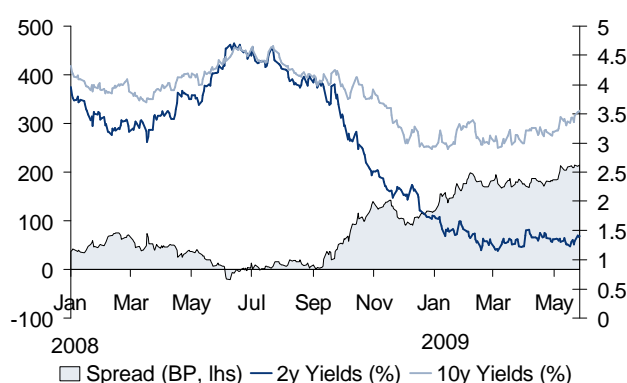
Stabilisation in 2Q. Inventory reduction will contribute significantly to the decline in GDP in the first half-year 2009. As soon as inventories reach the desired level, demand will lead to an increase in industrial output – possibly above average in the short term, which would trigger temporary growth impulses, albeit not sustainable.

Industrial output (y/y, %), production expectations



Source: Datastream, Erste Group Research

Steepening yield curve in the last 9M



Source: Datastream, Erste Group Research

Euroland

Private consumption possibly more stable in 2 HY

Private consumption expected to be negative in 2009. Nominal wage increases are expected to be lower in 2009 and 2010 at around 1.5 – 2% than in the preceding two years, but the strong disinflation will lead to rising real incomes. Despite the rising unemployment rate, revived confidence and thus consumption propensity might set in boosted by brighter economic data (e.g. recovery of industrial output) in 2HY 2009. This could result in private consumption being more stable than expected.

No short-term inflation risk (2009: 0.6%, 2010: 1.2%)

Inflation at 0% y/y in May. Declining energy prices and the weak demand caused by recession have resulted in fast disinflation. However, there is hardly any deflation risk in the Eurozone in the light of inflexible labour markets and the prevailing competitive situation. At this point in the economic cycle, inflation from demand can be ruled out. However, commodity markets could again become attractive to investors as an asset class. Geopolitical risks are increasing the possibilities of inflation due to cost pressure, but a basic condition is a more stable demand situation. We do not expect any inflation rates to exceed the targets defined by the ECB for price stability (around 2%) in the next 12 months.

Monetary policy

Interest rate cutting cycle over

The ECB lowered key lending rate to a historic low of 1.0%. ECB President Trichet said that this level was appropriate in the light of all available information and analyses. Even though Trichet did not rule out that 1% is the floor, this statement was a signal in our view that the interest rate cutting cycle is over. We believe that the key lending rate will only then be lowered further if the economy were to worsen even more than expected from today's perspective and the resulting medium-term downwards price pressure were to become stronger, which is a scenario that we do not expect. The ECB has taken a number of non-standard measures since the aggravation of the financial crisis (e.g. unlimited liquidity to banks at fixed rate for 12m, widening of collaterals). Additionally, a purchasing programme for covered bonds (EUR 60bn) is planned to be implemented to support credit markets. In the case of all measures, it should be ensured that it will be possible to rapidly absorb liquidity if this becomes necessary to effectively counteract the risk of medium-term price increases.

ECB stresses exit strategy

Bond Market

We expect further price drops on bond market

The steady increase in prices on the bond market now belongs to the past. At the short end, we expect stable, low yields for now because a recovery of the economy and rising key lending rates are not expected for the next six months. In the case of ten-year maturities, we expect yields to rise further in the course of the year. The reasons are the massive financing needs of governments due to rising indebtedness and the reviving risk appetite of investors. Furthermore, you also have the potential disappointment of those market participants who still believe that the ECB will launch a purchasing programme for government bonds - something that we do not believe in. The yield curve steepened to 225 bps. We believe that the curve could steepen even further over the short term.

	05-Jun	30-Sep	31-Dec	31-Mar	30-Jun
CB core rate	1.00	1.00	1.00	1.00	1.50
3M Libor	1.26	1.20	1.40	1.50	1.90
10Y yield	3.71	3.90	4.10	4.20	4.30
EURUSD	1.39	1.50	1.50	1.53	1.55

Source: Reuters, Bloomberg, Erste Group Research

USA

Huge challenges for the Fed ahead

Analyst: Rainer Singer
rainer.singer@erstegroup.com

	2007	2008	2009f	2010f
GDP per capita (EUR)	33 578	32 852	33 238	33 608
GDP (real y/y, %)	2.0	1.1	-2.1	1.9
CPI (y/y, average %)	2.8	3.9	0.9	1.7
Private Consumption (real y/y, %)	2.8	0.2	-0.3	1.3
Investments (real y/y, %)	-5.3	-6.7	-22.0	4.2
Exports (y/y, %)	16.7	22.3	-1.8	1.4
Imports (y/y, %)	6.7	9.1	-16.2	5.6
Unemployment (average, %)	4.6	5.8	9.0	8.5
Current account balance (% of GDP)	-5.5	-5.0	-2.8	-3.5
Govt. budget balance (% of GDP)	-1.2	-5.0	-13.0	-9.6
Public debt (% of GDP)	36.8	40.8	57.0	64.0

Economy and inflation

Gradual recovery in 2HY

The worst seems over for the US economy. Even though GDP likely shrunk once again in 2Q, the signs of an imminent improvement of the situation cannot be overlooked. Therefore, the question that arises is what course the recovery will follow. We expect only a gradual upwards trend over the medium term, because the US economy is still feeling the impacts of the overheated real estate market, the excessive indebtedness of households and the uncertainty prevailing in the financial sector.

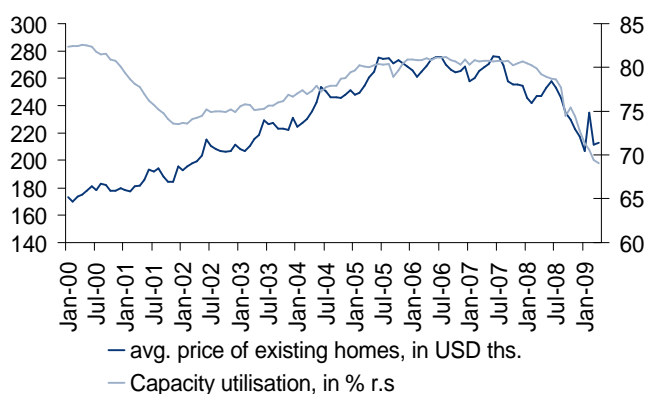
Inventory adjustments and fiscal stimulus veil actual economic development

Still, the third quarter might see a steep upwards movement versus the second quarter. Inventory reductions seem to be quite advanced. The GDP calculations consider changes in inventories. So even unchanged inventories in 3Q would contribute significantly to GDP growth assuming further inventory reduction in Q2. Once the inventory cycle has turned contributions to GDP growth should drop. Overall the growth rates achieved by US economy ultimately in 2 HY and afterwards will veil the real situation of the US economy. Because these growth rates will be supported by new debt of the public sector at historic volume. This means that part of the expansion will be generated again by debt and be in anticipation of future growth.

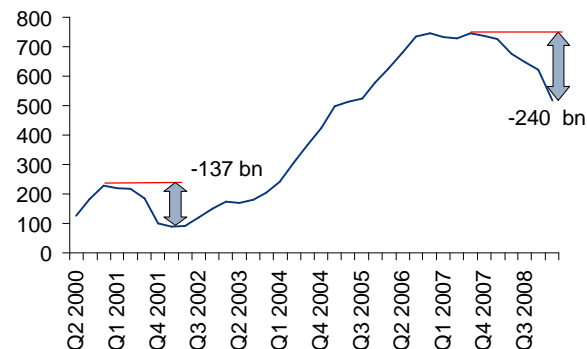
Private demand to remain weak

Apart from this supportive factor, other areas of the economy only carry the potential of minor growth dynamic. Household spending will be burdened by the loss in value of homes, the high level of indebtedness as well as the continued rise of unemployment. In this environment, companies will invest – if at all – very cautiously. In the industrial sector, the high level of overcapacities has rendered expansion investments superfluous in the foreseeable future.

Price of existing homes and capacity utilisation



Aggreg. inventory change, real USD bn



Source: Bloomberg, Bureau of Economic Analysis

USA

No inflationary pressure for now

Persistent overcapacities in industry will help to keep price pressure down even if demand goes up. This means that our most probable scenario is a rise in inflation in 2HY, but this will be due more or less exclusively to the decreasing basis of comparison of oil prices. In our view, there are risks of higher inflation over the short term in a renewed rise of energy prices fueled by speculations. Over the medium to long term, the overblown money supply carries risks but their effect – if at all – would only be felt around the end of 2010. This will depend on how resolutely the central bank is willing to withdraw the liquidity from the economy again.

Monetary policy

The Fed's job will get harder

Even as it seems that the economy were stabilizing, the US central bank will not be able to return to business as usual for some time. This endeavour may even become more difficult, because in the coming quarters, the main issue will be to correctly steer liquidity supply. Even for an only sluggishly growing economy there is too much liquidity at present. Liquidity will have to be withdrawn to an extent that will not throttle the economy in the short term but neither should it trigger a bout of inflation over the long term. As information on the economy becomes known incompletely and with a delay and the measures of the central bank only become effective with a time lag, the Fed is faced with a great challenge. The task is made even harder because nervous capital markets and the financing of the massive budget deficits have to be taken into account. Doubts about the Fed's capability to master this task are justified and will define discussions about monetary policy. We do not expect any changes to interest rates until 2010.

Bond market

Yields should increase

Ever since the signs of an economic stabilization have become clearer, the mix of extremely expansive monetary and fiscal policy has had a negative impact on the bond market. The negative risks will also continue to outweigh. The new debt of the public sector will remain high in the coming years, and therefore, in the coming four years, overall debt will rise from currently almost 50% of GDP to over 70% of GDP. Purchases by the Fed could counteract this trend. The only problem is that when the economy recovers it will become increasingly hard for central banks to reconcile such moves with their mandate to preserve price stability. Our core scenario forecasts a limited rise in yields, because as yields rise, the downside risks for the economy will increase and this should have a corrective effect.

US dollar

US dollar on downslide

The risks emanating from the US fiscal and monetary policy point to a weaker US dollar. In Euroland, the government deficits will not reach levels anywhere near those of the US. Furthermore, the ECB has not been as extreme in its monetary policy as the US Fed. As we do not expect any shift in interest rate spreads that could compensate the higher US risks, we believe that the US currency will weaken.

	05-Jun	30-Sep	31-Dec	31-Mar	30-Jun
CB core rate	0.00	0.00	0.00	0.15	0.25
3M Euribor	0.6	0.6	0.7	0.9	1.0
10Y yield	3.9	4.0	4.2	4.4	4.5
EUR/USD	1.40	1.50	1.50	1.53	1.55

Source: Reuters, Bloomberg, Erste Group Research

Austria

Tailwind for Q2

Analyst: Thomas Karall
thomas.karall@erstebank.at

	2007	2008	2009f	2010f
GDP per capita (EUR)	32 571	33 847	33 318	33 654
GDP (real y/y, %)	3.1	1.8	-2.7	0.4
CPI (y/y, average %)	2.2	3.2	0.9	1.4
Private Consumption (real y/y, %)	0.9	0.9	0.4	0.4
Investments (real y/y, %)	3.6	4.8	-6.3	-1.9
Exports (y/y, %)	9.1	1.5	-9.5	2.8
Imports (y/y, %)	8.4	1.8	-6.7	1.5
Unemployment (average, %)	4.4	3.8	5.3	6.1
Current account balance (% of GDP)	3.2	2.9	1.6	1.3
Govt. budget balance (% of GDP)	-0.4	-0.3	-3.5	-4.7
Public debt (% of GDP)	59.5	62.5	68.5	70.0

Economy and inflation

Economy nearing trough

Growth forecast 2009 revised to -2.7%. In 1Q, GDP was 3.6% lower than in the previous year. The main reason was the decline in exports (-4.4%). Companies responded to the collapse in global trade by a sharp drop in investment activity. Thus, investment spending declined accordingly by 4.4%. A stabilizing effect came from consumer spending of private households by contrast, which stagnated y/y. A weak gain of 0.4% is forecasted for 2009, with the downside risk stemming from a much higher unemployment rate.

Sentiment reached the bottom

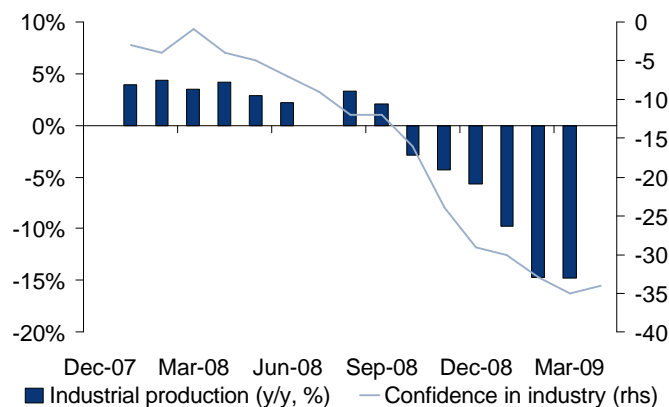
Why should the downtrend weaken in 2Q? The improved confidence indicators and the expectations of companies on future business trends indicate a weakening of the downswing in 2Q. The tax reform and the scrapping premium took effect only as of April and should bolster private consumption in the remaining course of the year. Therefore, the confidence indicator for retail was not as negative in April (-22) as in March (-27).

Plunge of industry stopped

Indicators reach record lows. According to the current Wifo business sentiment test, production expectations in industry were more favourable in April again. This is also shown by the confidence indicator for industry that improved slightly in April (-34) versus the previous month (-35). The production index seems to have stopped its free fall since October 2008, posting a decline of 14.8% in March y/y.

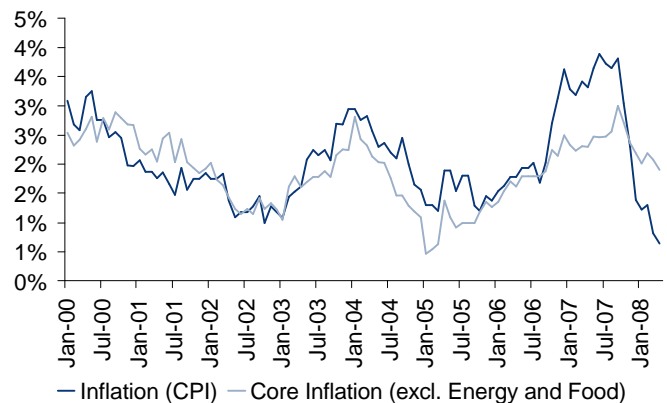
Too early for optimism. In the surveys conducted by Wifo, the share of companies that believe that they will have to cut production in the coming months still outweighs by far. The forecast for 2009 states a decrease in industrial production by 5.5%.

Production index and industry sentiment indicator



Source: Statistik Austria, OeNB (European Commission), WIFO

Inflation and core inflation (%)



Austria

Dampening effects from oil prices

The inflation rate for April 2009 was 0.7%. This has been the lowest value since September 1999. This low level reflects mainly the effects of the fuel price trends. The inflation rate would have been 2.0% without the sharp drop in fuels and heating oil. The forecast states an inflation rate for the full year 2009 of 0.9%.

Monetary policy

We expect no further rate cuts

Since the ECB lowered key lending rates to a historic low of 1.0%, ECB President Trichet has repeated that this level is appropriate in the light of all available information and analyses. Even though Trichet has not ruled out that the 1% is the floor, this statement is a signal in our view that the interest rate cutting cycle is over. The ECB has taken a number of non-standard measures since the aggravation of the financial crisis (e.g. unlimited liquidity to banks at fixed rates with up to 12M maturity, widening of collaterals) and plans to implement a purchasing programme for covered bonds (EUR 60bn) to support the credit markets. In the case of all measures, it should be ensured that liquidity can be rapidly absorbed if necessary to effectively counteract the risk of medium-term price increases.

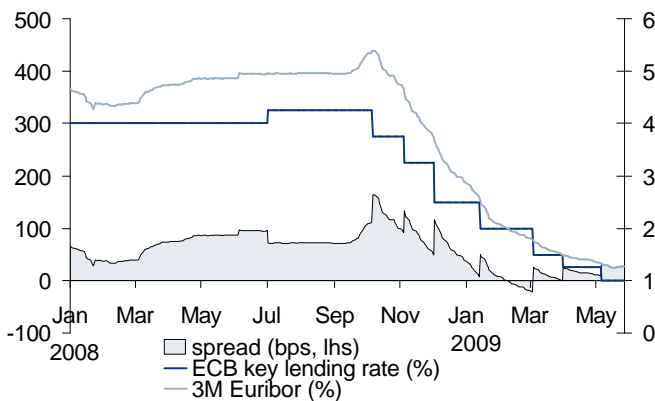
Bond market

Spread should narrow against German bonds, but...

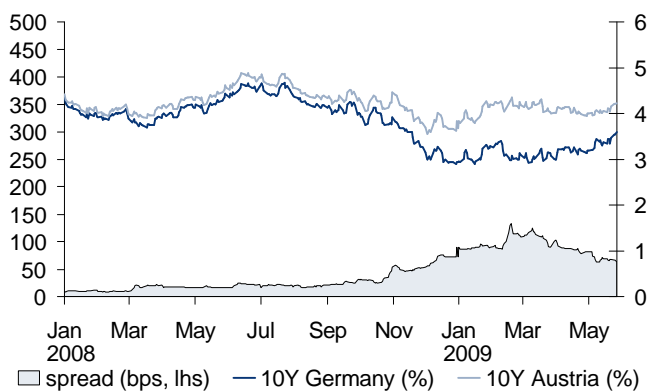
The yield spread of 10-year Austrian government bonds narrowed versus 10-year German government bonds to 77 bps, which reflects a good relative performance. Apparently, the risk assessment of investors has improved again vis-à-vis Austria's exposure to CEE. The risk aversion of investors and the related investments in money market securities have caused the 2Y yields to drop steeply in the past few months. At the short end, we do not expect any massive price declines considering the presently still lacking signs of recovery of the economy and the low key lending rate. Ten-year maturities started their trend of rising yields in the last few days sooner than expected. We expect a further spread narrowing among ten-year Austrian government bonds versus German government bonds, but only by around 20 to 30 basis points. Overall, price declines of ten-year Austrian government bonds should be more moderate than those of German government bonds.

...overall, we expect further yield increases.

Key lending rate vs. 3m Euribor (%), Spread I.S. (bps) Yield spread 10y Austria-Germany



Source: Bloomberg, Datastream, Erste Group Research



Source: Datastream, Erste Group Research

Croatia

Handling imbalances remains critical

Analyst: Alen Kovac
akovac2@erstebank.com

	2007	2008	2009f	2010f
GDP per capita (EUR)	9 729	10 766	10 184	10 702
GDP (real y/y, %)	5.5	2.4	-4.5	1.0
CPI (y/y, average %)	2.9	6.1	2.9	4.0
Private Consumption (real y/y, %)	6.2	0.9	-6.4	1.0
Investments (real y/y, %)	6.5	8.3	-9.0	0.1
Exports (y/y, %)	8.8	4.4	-7.2	3.7
Imports (y/y, %)	11.0	8.9	-15.3	4.3
Unemployment (average, %)	9.7	8.9	12.5	13.0
Current account balance (% of GDP)	-7.5	-9.4	-6.3	-5.8
Govt. budget balance (% of GDP)	-1.4	-1.6	-3.0	-3.0
Public debt (% of GDP)	41.7	38.5	39.4	40.7

Economy and Inflation

1Q09 to confirm strong economic slump

GDP is expected to contract by 4.5% in 2009, driven by deteriorating domestic demand. The overall net export contribution is seen shifting in a positive direction, supported by contracting imports. Private consumption is continuing to suffer from decelerating wages and declining employment on one side and slowing credit on the other side. While consumer confidence may have bottomed out in 1Q, we still see room for only a minor recovery throughout 2009, given the burdening effect of the above-mentioned factors. Investment spending, on the other hand, should remain constrained by the weak business environment and tight access to credit.

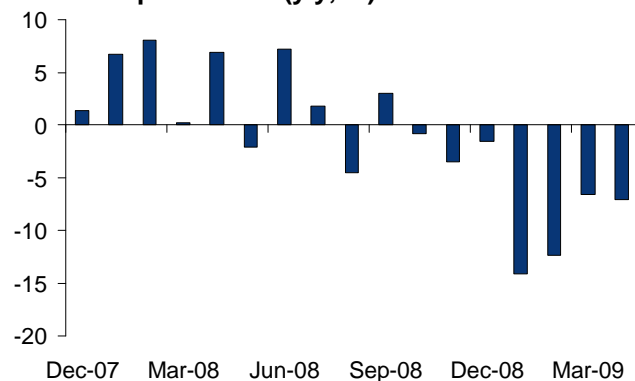
Trade balance pressures easing

Current account deficit is seen narrowing significantly in 2009, given the softer trade balance pressures. The import side showed a more pronounced contraction, as domestic demand has slumped even more than on the export side, resulting in a trade deficit narrowing of one third. The service account is expected to suffer from the weaker tourist season, thus offsetting part of the trade balance gains. Overall, we anticipate the current account deficit landing in the 6-7% of GDP region.

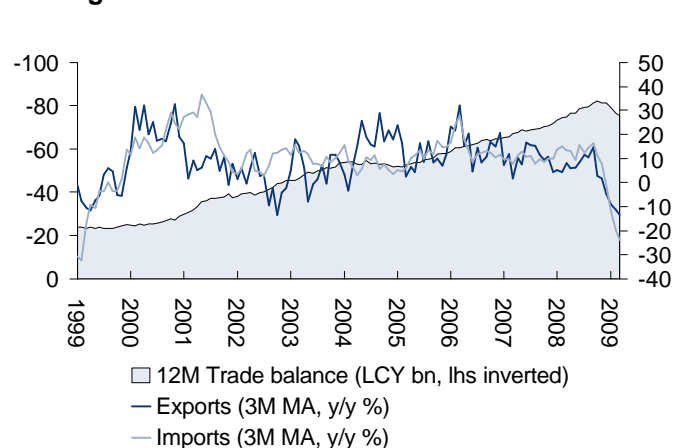
Dependence on capital inflows pronounced

Major risks remain on the financing side, despite the narrowing of the C/A deficit. Financing needs will stay high and the ability to roll over maturing debt in 2009 will be critical. The foreign debt structure remains favorable and liquidity indicators are stable overall, given the largely untouched FX reserves. Hence, the risks have failed to materialize so far. However, given the declining FDI inflows, external stability will remain dependant on attracting fresh foreign debt.

Industrial production (y/y, %)



Foreign trade



Source: Croatian Statistical Office

Croatia

The inflation outlook brings little surprise, despite some administrative prices hikes and pressure from oil prices in 1Q09. Weaker demand pressures are expected to dampen the inflation pressures, while supply side pressures are not expected to surge significantly in the coming quarters. The average inflation forecast for 2009 stands unchanged at 3%, with increased risks seen in 2010.

Monetary Policy

FX rate stability remains top priority

The exchange rate remains the monetary policy anchor. The CNB confirmed its strong commitment to this goal with its comprehensive prudential measures and FX interventions. We do not anticipate any changes in the policy regime, while the CNB should continue to use open market operations to fine-tune both system liquidity and exchange rate movements. In that respect, we see the CNB REPO rate flat at 6%.

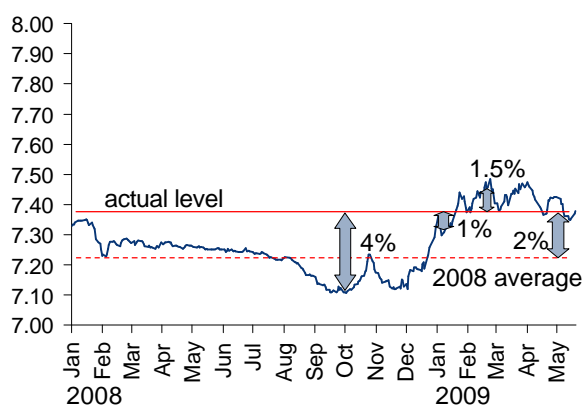
Risks pronounced – CNB remains prudent

Autumn brings elevated risks to the FX market. After a turbulent 1Q, the FX market stabilized in 2Q, with the stabilization of the external environment, the approaching tourist season and successful government refinancing actions on external markets. Towards the year-end, we again anticipate more pronounced volatility and greater pressures on the depreciation side, as refinancing and fresh capital needs will remain substantial. Hence, FX rate developments will again be largely dependent on the external environment. Also, keeping the fiscal side under control would ease efforts to maintain exchange rate stability. We see the rate moving in the 7.30-7.60 band, supported by the still largely untouched FX reserves.

Bond Market

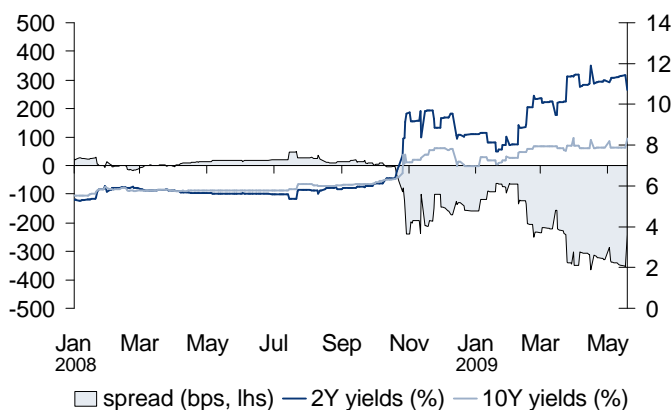
The bond market has remained thin in recent quarters, as investors continue to focus on the MM. The yield curve for kuna bonds stands above 8%, indicating a substantial premium in comparison to FX-linked bonds, which stand around 7%, indicating that investors are pricing in some FX risks. The outlook remains unclear, given the low liquidity and potential downgrade, limiting the space for spread narrowing.

FX development (HRK/EUR)



Source: Reuters

Yields and spreads



Source: Zagreb Stock Exchange, Reuters

	05-Jun	30-Sep	31-Dec	31-Mar	30-Jun
CB core rate	6.00	6.00	6.00	6.00	6.00
3M Zibor	9.1	9.0	9.0	8.5	8.0
10Y yield	8.1	7.5	7.5	7.5	7.0
HRK/EUR	7.33	7.50	7.60	7.55	7.50

Source: Reuters, CNB

Czech Republic

Waiting for Eurozone to recover

Analyst: Martin Lobotka
MLobotka@csas.cz

	2007	2008	2009f	2010f
GDP per capita (EUR)	12 366	14 425	13 645	15 730
GDP (real y/y, %)	6.0	3.1	-1.6	1.2
CPI (y/y, average %)	2.8	6.4	1.3	1.9
Private Consumption (real y/y, %)	5.2	2.9	0.6	0.2
Investments (real y/y, %)	6.7	3.1	-2.0	2.5
Exports (y/y, %)	15.6	0.5	-14.6	-1.3
Imports (y/y, %)	13.4	0.3	-2.4	-2.1
Unemployment (average, %)	6.6	5.4	8.0	8.9
Current account balance (% of GDP)	-2.5	-1.9	-3.1	-1.4
Govt. budget balance (% of GDP)	-1.9	-0.5	-4.1	-3.3
Public debt (% of GDP)	24.5	25.0	28.7	29.9

Economy and Inflation

Economy hit hard by savage downturn in EU

Economy was hit hard in 1Q09 – According to preliminary estimates, GDP dropped 3.4%, supposedly on the drop in investments and net exports. As the Czech economy is very open (mainly towards Western Europe) and heavily industry-oriented (one third of the economy), the drop of foreign demand is felt acutely. Some relief for industry came from the scrap premium implemented in neighboring countries (Germany, Slovakia). However, this is only a one-off effect and, barring overall improvement in foreign demand, industry will revert back to low levels once the scrap premium is gone. Household consumption held up in 1Q09, as falling prices offset low nominal wage growth – rising unemployment will drag it down in 2H09 and in 2010.

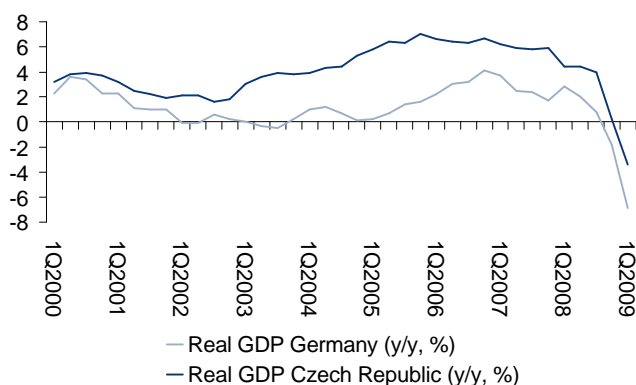
Indicators cautiously optimistic

Leading indicators give us reason for cautious optimism – PMI bottomed out at around 30 in January, but grew to 38.6 in April. While still well below the 50 line, separating contraction from expansion, the downturn becomes progressively less brutal – a necessary condition for bottoming out. We think that, just as the Czech economy followed that of Europe in its downturn, it will closely follow Europe when it picks up – which will, at best, be in late 2009. Overall growth of the Czech economy for 2009 is estimated at around -2%.

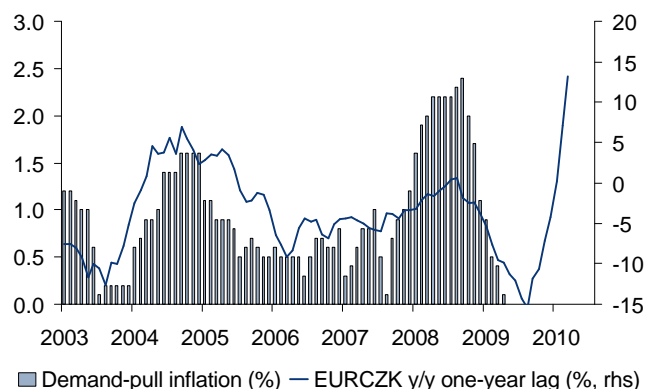
Inflation no medium-term risk - CZK to gradually lift prices

Inflation is heading downward, as expected – y/y growth of prices in April reached 1.8%. In summer, inflation will fall even lower, by 0-1%, mainly on the base effects (oil prices) and delayed effect of the strong CZK (summer 2008). Thereafter, however, two opposing forces will be at play. On one hand, the real economy will remain anti-inflationary (weak growth this year and next), while on the other hand, the weak CZK from 1Q09 will gradually filter into prices. Inflation will remain below 2% this year and will only get slightly above that at the end of 2010.

Real GDP growth



Inflation and exchange rate



Source: Bloomberg, CS

Czech Republic

Monetary Policy

Rates at bottom, stability ahead

In line with our December 2008 forecast, we see the **bottom of the rates at 1.50%**. The risks for the rates are, in our view, balanced – the weaker and volatile CZK poses a pro-inflationary risk, which would be more pronounced in the unlikely event of a faster recovery. On the other hand, the real economy will likely remain anti-inflationary (low wage growth, rising unemployment, excess capacity) and the transmission mechanism between the CNB repo rate and market rates is still imperfect.

Market rates to gradually shed risk premium

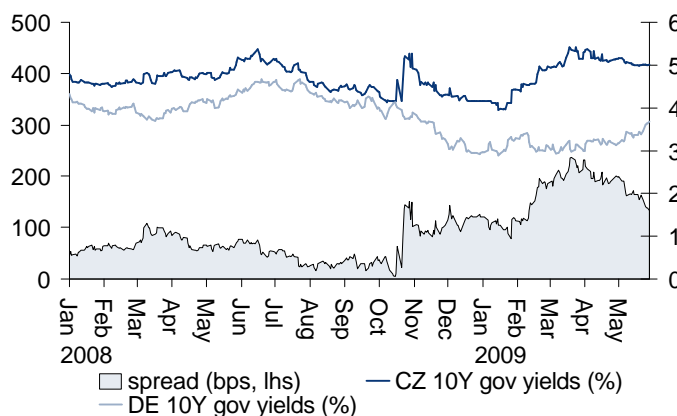
3M PRIBOR thus can still benefit from (and the short end of the curve can fall on) the disappearance of the risk premium. Although much lower than it was around the end of 2008 and the beginning of 2009, it remains high (3M PRIBOR minus repo at around 70bp). The normalization process will in all likelihood be gradual and might take a longer time. The CNB appears content with the fact that its cutting campaign managed to halve the spread and depress market rates. As for the repo rate, the CNB will gradually move toward hiking - it will be modest, though. End-2010 should see the repo rate at around 2.50%.

Bond Market

Long bonds to further fall on better sentiment

Year-end 2008 and the beginning of 2009 saw the widening of the spread between Czech and Euro bond yield curves. The 10Y bond CZ-EU spread got almost as wide as 2.5pp, a level not seen since 2000. This was the direct consequence of the bad sentiment toward the region as a whole. Additionally, rising bond yields pulled swap rates up as well – swap rates thus now imply a higher implicit trajectory of rates than we think will be the reality and are thus ripe for correction.

Yields and spreads



Source: source

	05-Jun	30-Sep	31-Dec	31-Mar	30-Jun
CB core rate	1.50	1.50	1.50	1.75	2.00
3M Pribor	2.3	2.1	1.9	1.9	2.1
10Y yield	5.1	4.8	5.0	5.0	5.2
CZK/EUR	26.95	25.80	25.50	24.86	24.60

Source: Reuters, CNB

Hungary

Fiscal consolidation

Analyst: Orsolya Nyeste
orsolya.nyeste@erstebank.hu

	2007	2008	2009f	2010f
GDP per capita (EUR)	10 057	10 506	9 023	9 695
GDP (real y/y, %)	1.1	0.5	-5.1	0.4
CPI (y/y, average %)	8.0	6.1	4.8	4.8
Private Consumption (real y/y, %)	-1.8	-0.1	-6.5	0.5
Investments (real y/y, %)	1.5	-2.6	-8.0	3.5
Exports (y/y, %)	11.4	5.7	-1.1	-3.1
Imports (y/y, %)	7.1	6.1	-4.0	-2.7
Unemployment (average, %)	7.7	8.0	10.7	9.8
Current account balance (% of GDP)	-6.5	-8.4	-5.4	-4.6
Govt. budget balance (% of GDP)	-5.0	-3.4	-3.9	-3.8
Public debt (% of GDP)	65.8	73.0	77.0	75.0

Economy and Inflation

Drop of industrial exports driving recession

The domestic economy is shrinking more rapidly than previously anticipated. The recession is driven by the sharp drop of industrial exports, while the contribution of domestic demand is not sufficient to offset the negative effects stemming from falling demand for Hungarian export products.

The contribution of net exports to GDP growth could remain in positive territory in 2009.

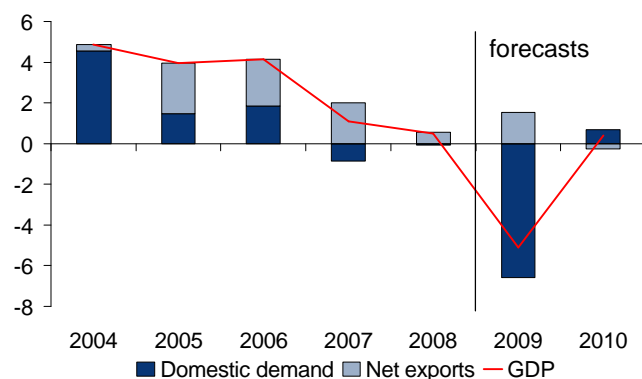
The reason is that the dip in exports should bring an even greater decline in imports, as a significant part of imports is related to the performance of exports, while imports for consumption and investment purposes could also decrease. On the other hand, the contribution of domestic demand to GDP growth will be deeply negative. Private consumption will decline, mainly due to the drop in real disposable income of households, while tighter credit conditions provide less opportunity for them to smooth out their consumption. And, last but not least, there is no scope for stimulating domestic demand from budget sources, as fiscal policy is contractionary, in order to decrease the external financing needs of the state and, consequently, the financial vulnerability of the country.

Recovery depends on Eurozone's prospects

The latest industrial output figures suggest that the performance of industry could have bottomed out in 1Q09 and that the economic downturn is to be the deepest in 1H. There are, however, many uncertainties around a possible recovery in 2H, and the state of the real economy is still seen as fragile.

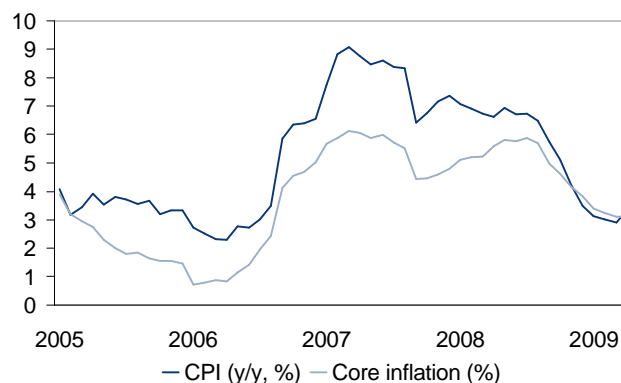
We predict a 5.1% decline in economic growth for this year, followed by only a minimal recovery in 2010. A possible revival depends mainly on how long the global economic crisis negatively affects the biggest economies of the Euro Area.

GDP contributors



Source: CSO, NBH

Inflation and core inflation



Source: CSO, NBH

Hungary

Inflation reached target, but will again rise from July

Lower food and oil prices and the poor economic growth prospects support a continuation of the disinflation process, despite the weaker forint exchange rate. Inflation reached the central bank's mid-term target of 3% y/y in 1Q. The normal VAT rate will be raised from 20% to 25% from July 1. The higher VAT rate will raise the CPI again from July. However, in a recessionary environment, the price-increasing effects could be less sharp. Nevertheless, the 2009 average inflation is expected to reach 4.8% y/y, while the 12-month rate, which excludes the price-increasing effect of one-off tax changes, should remain around the target. Inflation is expected to revert to the mid-term target of 3% y/y in 2H10.

Monetary Policy

Rate cuts could come in 2H

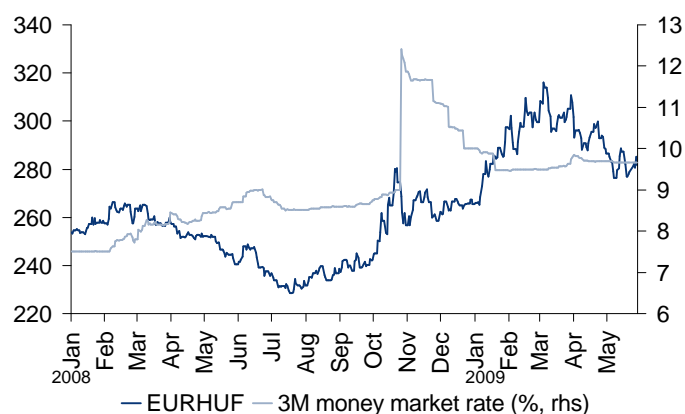
The monetary council suspended the rate cuts and accepted a more cautious stance in 1Q, due to concerns about forint falls, which could have a negative impact on financial stability, given the high FX indebtedness of the private sector. More stabilization on the markets and improvement in global risk appetite suggest cautious rate reductions in 2H, despite the fact that the inflation rate will again be put on a rising path from July. Given the central bank's view on inflation (it is worth focusing on the CPI index, which excludes the price-increasing effects of one-off tax changes), we see room for a 100bp rate reduction altogether for this year.

Bond Market

Market is slowly improving

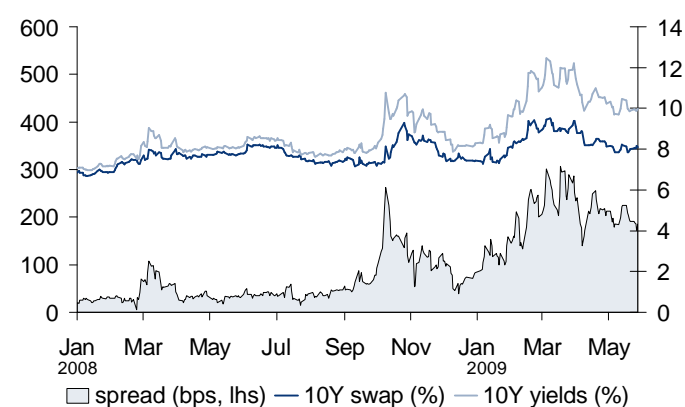
The situation on the domestic bond market has consolidated. but the overall state of the market is still far from normal. The budget is still largely financed by the joint financing package of international institutions and not by government papers sold on the market. The Debt Management Agency restarted regular bond auctions from the end of April. However, for the time being, the offered amounts of papers are very small. One reason could be that foreign investors still tend to stay away from the market. However, the continuation of bond auctions could help to restore market confidence, while the expected improvement in global risk appetite and more disciplined fiscal policy could make the current high yields attractive for investors. In tandem with the coming rate cuts, long-term bond yields are expected to decrease in 2H.

3M rates and the forint



Source: NBH, Reuters

Spread between 10Y T-bond yields and 10Y swaps



Source: GDMA, NBH

	05-Jun	30-Sep	31-Dec	31-Mar	30-Jun
CB core rate	9.50	9.00	8.50	8.00	7.50
3M Bubor	9.7	9.0	8.5	7.9	7.4
10Y yield	10.4	8.5	8.2	7.8	7.6
HUF/EUR	287.40	280.00	270.00	270.00	270.00

Source: Reuters, CNB

Poland

Avoiding recession

Analyst: Jana Krajcova
JKrajcova@csas.cz

	2007	2008	2009f	2010f
GDP per capita (EUR)	8 151	9 486	7 986	9 789
GDP (real y/y, %)	6.5	4.8	1.2	2.6
CPI (y/y, average %)	2.5	4.2	2.5	2.2
Private Consumption (y/y, %)	5.0	5.4	4.4	5.0
Private Consumption (real y/y, %)	17.6	7.9	4.0	8.5
Investments (real y/y, %)	10.0	9.8	12.2	7.3
Imports (y/y, %)	15.9	11.3	12.1	7.6
Unemployment (average, %)	9.6	7.1	10.5	11.4
Current account balance (% of GDP)	-4.2	-5.0	-5.0	-4.7
Govt. budget balance (% of GDP)	-2.0	-2.2	-3.0	-2.7
Public debt (% of GDP)	44.9	43.8	43.1	42.4

Economy and Inflation

Potential to avoid recession in 2009

1Q GDP grew by 0.8% y/y. We expect the crisis to peak in 2Q, with negative y/y growth for that period. The economy should start improving in 3Q. The economy of Poland is less open than those of its regional peers and consumer demand has been a strong and robust growth contributor even in times with increased levels of unemployment (and the recent data suggests that this might remain so). This makes Poland one of the few candidates to avoid recession in 2009. We expect 2009 full-year growth at 1.2% y/y.

Industry will likely experience more slumps...

Industrial production has rebounded recently, likely driven by a temporary effect of scrap subsidies in neighboring countries. The automotive industry contributes some 4% to GDP and about 11% to total industrial production; it represents about 16% of total national exports, with the major purchaser being Germany. Therefore, in the coming months, after the effect of scrap subsidies wears off, more slumps in industrial production could come. The timing of a more permanent recovery will then depend on recovery in Euroland, especially in Germany.

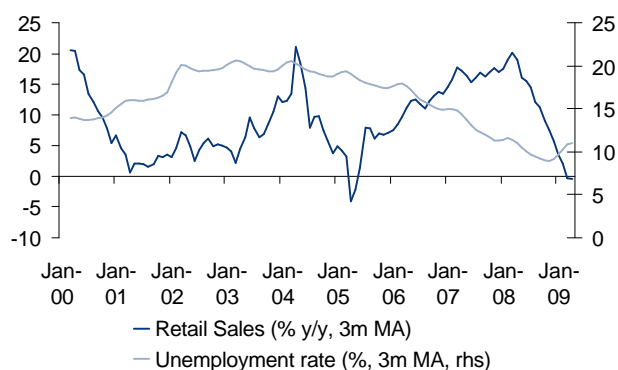
...and April PMI suggests so, as well

Total PMI index dropped by 0.1 points in April and the output sub-index by 1.6 points, suggesting that managers also expect some further worsening. Even though the index remains below 50, which means contraction, it has remained above 40 in 2009, which is still relatively high compared to e.g. the Czech Republic and Hungary.

Unemployment rising

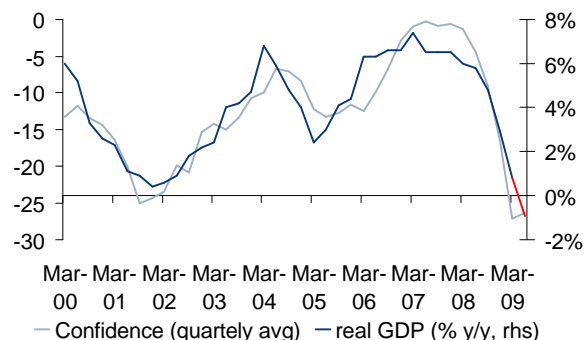
Early this year, the unemployment rate returned to double-digit territory. In the last two months, the start of seasonal work brought about a certain stabilization. However, the improvement in the unemployment rate is clearly lower than a year ago, due to the crisis. The economic slowdown typically translates into the labor market with a certain lag. Therefore, further increases in unemployment rates will come. We expect unemployment to climb to some 13.3% this year, peaking next year at close to 14%.

Link between unemployment and retail sales



Source: Bloomberg, CSAS

Confidence indicator predicting GDP



Source: Bloomberg, CSAS

Poland

Inflation should return to target in summer

Inflation climbed to 4% y/y in April, due to the weak zloty and rise in administered prices. These effects should start to fade away and inflation should return close to the target (2.5% +/- 1%) in the coming months, under the pressures resulting from weak demand. We expect inflation to embark on a rising path towards the end of the year, as the economy should start to revive. At the end of this year, we expect (consumer) inflation at 2.8% y/y.

Monetary Policy

Bottom of key rate at 3.25%

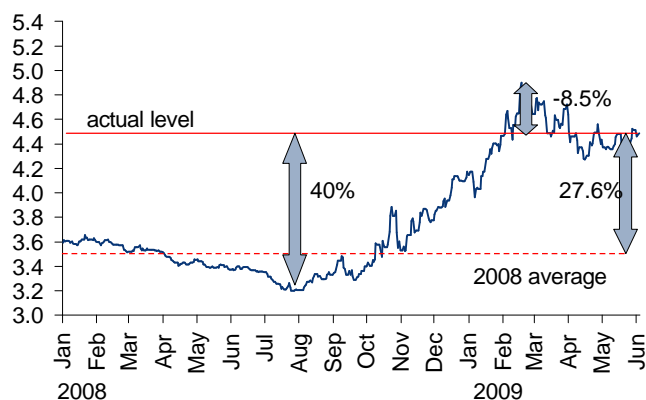
Despite keeping rates on hold in April and May, the CB remains in an easing bias. After cuts of 225bp in total, monetary easing was put on hold in April, due to the elevated inflation and the weak zloty (also supported by better macro data). In May, the CB decided to add the required reserve rate cut (from 3.5 to 3%). We expect more mild cuts to come in summer (the first one of 25bp in June), when the new inflation projection is ready; it is likely to confirm the ongoing deceleration of prices. After that, we see room for one milder cut, followed by a flat rate of 3.25% until the end of the year. After the economy starts to pick up, the CB will need to withdraw excess liquidity; therefore, monetary tightening will likely come at the beginning of 2010.

Bond market

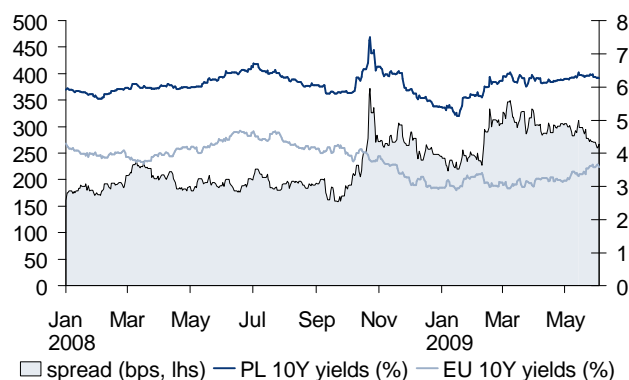
Yield curve due south

Risk appetite has been an important variable for the yield curve. A gradual improvement in sentiment should drag the risk premium down in the coming months and a fall in both bond and swap yields can be expected. Swap yields rose in recent months, due to asset swap arbitrage. Further (mild) monetary easing and lower inflation in the medium term will pull swap yields down. We expect the asset swap spread to narrow.

FX development (PLN/EUR)



Yields and spread



Source: Bloomberg

	05-Jun	30-Sep	31-Dec	31-Mar	30-Jun
CB core rate	3.75	3.25	3.25	3.50	4.00
3M Wibor	4.6	3.7	3.4	3.7	4.4
10Y yield	6.3	6.0	6.1	6.2	6.3
PLN/EUR	4.51	4.50	4.25	4.00	3.90

Source: Reuters, CNB

Romania

External imbalance correction

Analyst: Eugen Sinca
eugen.sinca@bcr.ro

	2007	2008	2009f	2010f
GDP per capita (EUR)	5 749	6 365	5 988	6 814
GDP (real y/y, %)	6.2	7.1	-2.1	2.0
CPI (y/y, average %)	4.8	7.9	5.9	4.5
Private Consumption (real y/y, %)	9.8	8.4	-2.7	2.1
Investments (real y/y, %)	29.0	19.3	-4.2	2.4
Exports (y/y, %)	8.1	25.6	-14.4	4.5
Imports (y/y, %)	19.1	20.8	-23.0	4.5
Unemployment (average, %)	4.1	4.4	7.2	6.8
Current account balance (% of GDP)	-13.5	-12.3	-8.2	-7.3
Govt. budget balance (% of GDP)	-2.3	-4.9	-4.6	-4.0
Public debt (% of GDP)	12.7	13.6	17.3	19.6

Economy and Inflation

Better results possible towards year-end

After nine years of constant economic growth, 2009 is expected to bring economic contraction. Lower external demand, along with fading support from some specific domestic factors (level of agricultural output), is expected to result in negative economic growth. Domestic demand might contract on both the consumption and investment sides. Worsening labor market conditions and a significant slowdown in retail loans will have a negative impact on households' consumption. The contribution of external demand to economic growth could become positive, following a steeper decline in imports compared to exports.

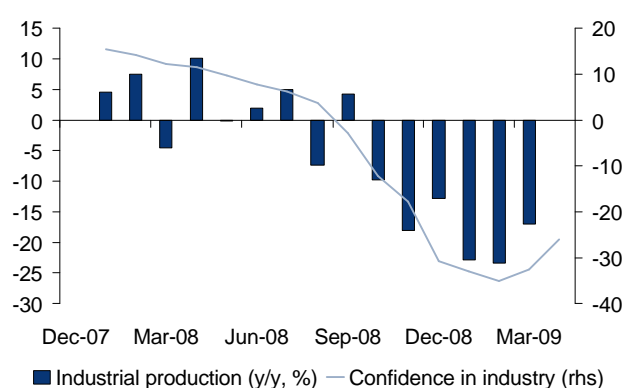
Vague optimism induced by sentiment indicators

The Economic Sentiment Indicator (ESI) rebounded in April. In April, the business sentiment indicator released by the European Commission picked up for the first time in the last seven months, supported by industry and services. The introduction of government incentives for the replacement of old cars in Romania and Germany played an important part in the tentative revival of industrial production.

Significant correction in C/A deficit

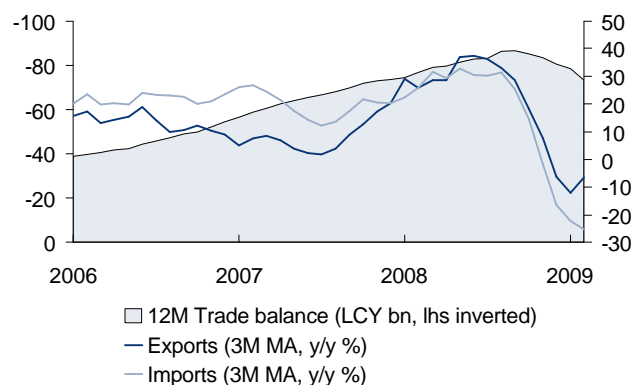
There is lower external vulnerability. The trade deficit might continue to adjust throughout the rest of the year, although at a lower pace, as imports are likely to fall more rapidly than exports, amid diminishing internal demand. The income balance deficit might narrow further, while the surplus of net current transfers will receive the largest support from the inflows of European funds. The remittances of Romanian workers will shrink, due to worsening economic conditions in other EU member countries. A more cautious approach of foreign investors towards emerging markets is likely to result in lower FDIs in 2009. However, the good news is that they could finance a large part of the C/A deficit.

Industrial production and confidence



Source: National Institute of Statistics, European Commission

Foreign trade



Source: National Institute of Statistics

Romania

Slow disinflation process

The inflation rate embarked on a downward path as of March. The disinflation process will be supported by the contraction of aggregate demand, a more favorable development of administered prices in an election year and lower risks of RON depreciation (due to the recent joint agreement with the IMF and EU, the rapid adjustment of the external imbalance and the central bank's interest in avoiding high FX rate volatility). Agricultural output, an insufficient coherence of macroeconomic policies and the persistence of rigidities in price setting behavior are the main risks for the disinflation process.

Monetary Policy

Gradual monetary policy easing

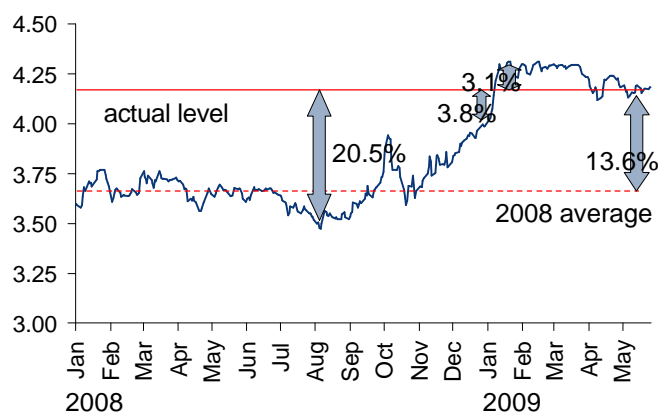
We expect further key rate cuts in small steps in the coming months. Further cuts in minimum reserve requirements are conditional upon the re-launch of healthy lending activities. At the same time, the commitments made recently in Vienna and Brussels by the largest foreign banks to maintain their aggregate exposures to Romania might consolidate the downward trend of the minimum reserve requirements, with positive effects on lending activities in the mid run. The downward trend of state security yields will continue once the Ministry of Finance receives the first tranche of EUR 1.5bn from the European Commission in July.

Bond Market

Eurobond issue to be launched later this year

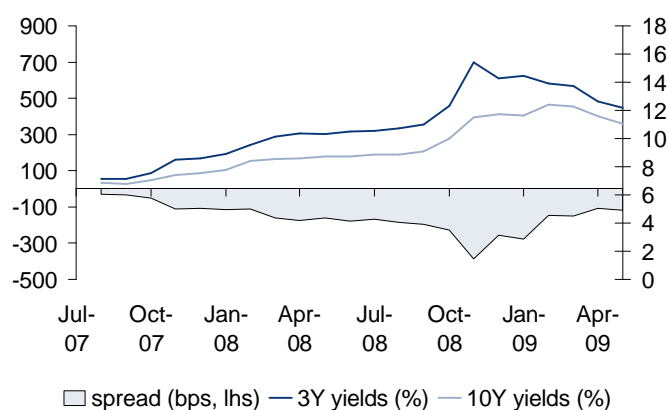
The Ministry of Finance could start preparations for a Eurobond issue that could be launched later this year, in light of the significant improvement in CDS spreads, after the agreement with the IMF and EU and better liquidity worldwide (compared to the immediate post-Lehman period of financial strains). At the same time, officials are looking to change their budget deficit financing strategy by putting more emphasis on the issuance of long-term securities. The Ministry of Finance might create new EUR-denominated instruments to offer an alternative to the FX investments of local banks, following the reduction in mandatory reserve requirements.

FX development (RON/EUR)



Source: Reuters

Yields and spreads



Source: NBR

	05-Jun	30-Sep	31-Dec	31-Mar	30-Jun
CB core rate	9.50	8.75	8.50	8.00	7.75
3M Bubor	10.6	9.8	9.5	9.0	8.7
5Y yield	11.3	10.2	9.8	9.1	8.8
RON/EUR	4.21	4.30	4.30	4.10	4.00

Source: Reuters, CNB

Serbia

IMF-support stabilises exchange rate

Analyst: Alen Kovac
akovac2@erstebank.com

	2007	2008	2009f	2010f
GDP per capita (EUR)	3 930	4 547	4 063	4 456
GDP (real y/y, %)	7.1	5.4	-2.1	1.9
CPI (y/y, average %)	6.5	11.7	8.2	6.0
Exports (y/y, %)	18.8	16.9	-5.2	3.4
Imports (y/y, %)	21.1	18.8	-11.1	3.4
Unemployment (average, %)	18.1	14.0	18.0	17.0
Current account balance (% of GDP)	-13.2	-17.4	-12.7	-13.3
Govt. budget balance (% of GDP)	-1.9	-2.0	-3.0	-3.0
Public debt (% of GDP)	29.4	26.3	27.8	28.7

Economy and Inflation

Economy seeing hard landing in 2009

The economy is seen contracting by up to 5% in 2009. Although our current forecasts stand at a slightly more positive level, downside risks are piling up, supporting overall more negative developments. Domestic demand is expected to show lasting weakness, as credit remains constrained, while disposable income could be negatively affected by slowing wages and declining employment. Further currency depreciation would negatively affect purchasing power. Investment activity depends on the government's ability to accelerate infrastructure projects.

Current account narrowing

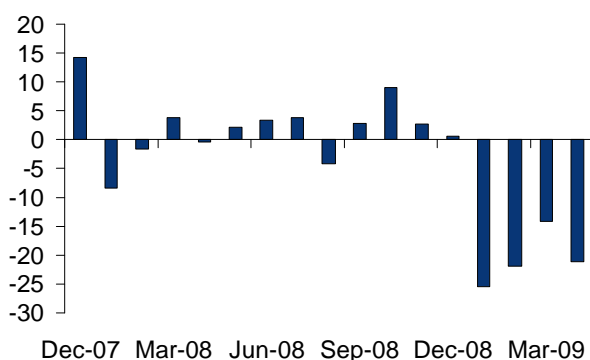
Current account trends are reversing. Trade balance pressures narrowed significantly in 1Q (approx. 30% y/y), with both exports and imports taking strong hits, confirming the strong domestic demand slump. Other C/A components offered less turbulent developments, with current transfers performing in a very stable manner. With the trade balance continuing to exert significantly less pressure than has been seen in recent years, the C/A deficit is expected to narrow to the 12-13% of GDP region.

External position strongly supported by IMF

Risks on the financing side diminished with the IMF deal. The stand-by arrangement with the IMF worth approx. EUR 3bn gave the NBS some breathing space, given the ongoing strong pressures on FX reserves during 4Q08 and 1Q09 and the stabilizing exchange rate. Other financing options remain constrained, as cross-border lending activity fell and FDI inflows are expected at significantly lower levels. Thus, the orientation should remain on arrangements with the EBRD, EIB, etc.

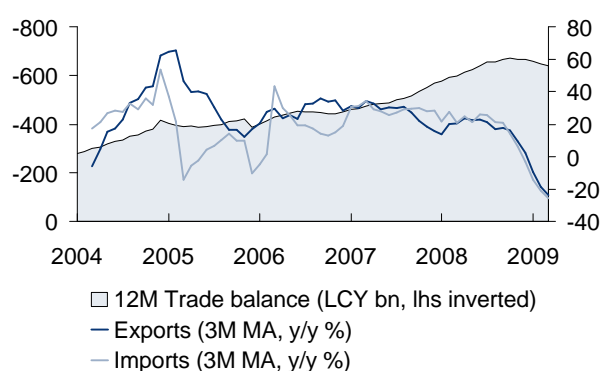
The fiscal deficit is widening, with the revenue side strongly underperforming as the economy slows down. The government pledged to keep the deficit under 3% of GDP when it signed the deal with the IMF, emphasizing the need to cut on the expenditures side (as suggested by the first budget rebalance). Overall, with the worsening of the economic prospects, pressures on the fiscal deficit to widen further should arise.

Industrial production (y/y, %)



Source: Statistical Office of the Republic of Serbia

Foreign trade



Source: Statistical Office of the Republic of Serbia

Serbia

Inflation pressures remain pronounced, boosted by administrative price hikes and the depreciating currency (although the pass-through effect has had a limited impact so far). Overall pressures are expected to ease, based on weaker domestic demand and tighter fiscal policy, while the main upside risks remain related to the exchange rate and resurgence of supply-side pressures. Our forecast is close to the middle of the NBS' 6-10% target range for 2009.

Monetary Policy

Potential for further monetary easing

The NBS is in an easing mode. After tackling FX rate instabilities with a series of rate hikes, the NBS switched to a loosening stance, entering a rate cutting cycle quite aggressively (with a cumulative 375bp in cuts to 14%). We see the NBS' orientation as logical, given the insensitivity of the FX rate to the interest rate differential, the relatively comfortable inflation outlook and the need to support the economy to some extent. We see some potential for further rate cuts in 2009, if inflation and the exchange rate remain on track.

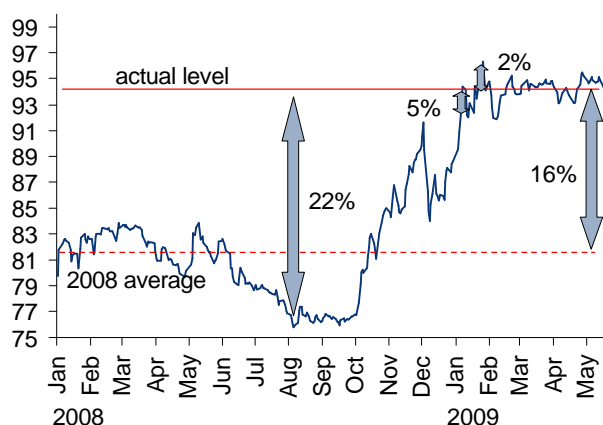
Exchange rate stability supported by IMF deal

The exchange rate has stabilized, but risks remain. Recently, the exchange rate stabilized around 95 RSD per EUR, showing less pronounced volatility than was seen in recent periods. Overall risks remain clearly pronounced on the upside, given the refinancing needs and C/A deficit, but the IMF umbrella definitely removed a significant proportion of the risks. Finally, the exchange rate should remain dependent on external factors. If external risks fail to materialize, we see the exchange rate remaining in the double-digit region.

Bond Market

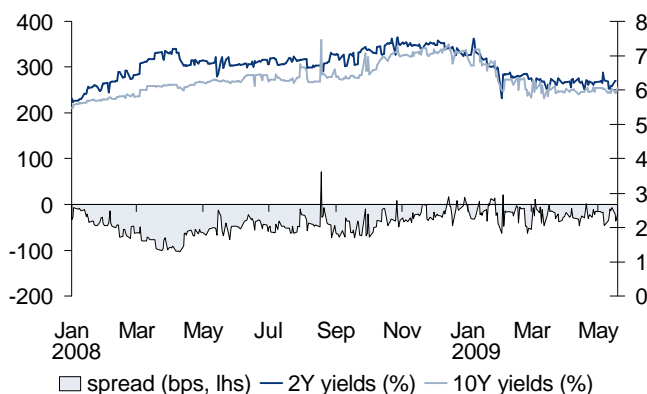
The bond market remains underdeveloped, with no new bond issues. The government is using T-bill auctions to cover the financing gap and investors remain focused on MM instruments, to which the NBS repo rate sets the firm benchmark.

FX development (RSD/EUR)



Source: Reuters

Yields and spreads



Source: Zagreb Stock Exchange, Reuters

	05-Jun	30-Sep	31-Dec	31-Mar	30-Jun
CB core rate	14.00	13.25	12.50	12.00	12.00
3M offer rate	15.2	14.3	13.3	12.8	12.8
10Y yield	6.0	6.0	6.0	6.0	6.0
RSD/EUR	94.17	96.00	96.00	95.00	95.00

Source: Reuters, CNB

Slovakia

Economy in flux

Analyst: Michal Musak
musak.michal@slsp.sk

	2007	2008	2009f	2010f
GDP per capita (EUR)	337	397	396	415
GDP (real y/y, %)	10.4	6.4	-5.0	2.6
CPI (y/y, average %)	2.8	4.6	1.9	3.2
Private Consumption (real y/y, %)	7.1	6.1	-1.0	2.4
Investments (real y/y, %)	10.4	8.2	-12.0	5.6
Exports (y/y, %)	15.2	5.1	-12.9	8.5
Imports (y/y, %)	10.2	4.9	-11.0	9.1
Unemployment (average, %)	11.0	9.6	12.7	13.2
Current account balance (% of GDP)	-5.3	-6.5	-6.3	-5.3
Govt. budget balance (% of GDP)	-1.9	-2.2	-5.5	-4.5
Public debt (% of GDP)	29.4	27.6	34.3	37.2

Economy and Inflation

Sharp turnaround of Slovak economy

Slovakia experienced an abysmal performance in 1Q09, as the economy contracted by 5.4% y/y, according to the preliminary figure released by the Statistical Office, well below estimates. This marks a significant reversal of economic performance, after Slovak GDP grew by 6.4% in 2008. The main culprit is the recession in Europe, which used to buy Slovak products. However, foreign demand fell significantly (Slovak industrial output was down more than 20% y/y in the first quarter). In response, Slovak companies laid off employees and domestic demand also dropped. Contrary to previous assumptions, Slovak GDP performance in the first quarter turned out to be worse than most European countries.

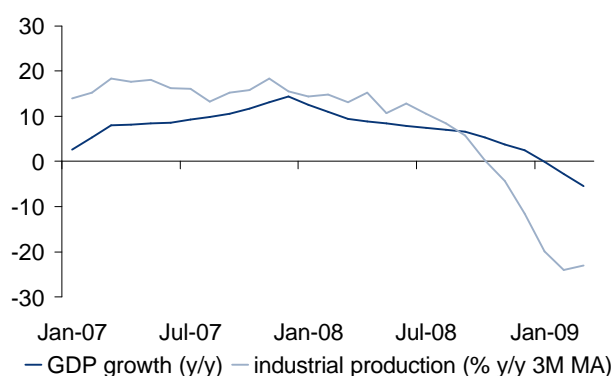
Investments announced, but little near-term impact

Some late good news includes the announced Volkswagen investment in a new production line (the euro adoption likely played a role in this decision) and a reported (but unconfirmed) LCD panel plant. However, it will take time until these bear fruit. Upcoming quarters of 2009 are unlikely to bring visible moderation of the annual decline and GDP could shrink by around 5% in 2009. The timing of the recovery is closely tied to the performance in the Eurozone. However, we remain confident in the medium-term convergence prospects of Slovakia.

Inflation slowing down, due to lower demand and cross-border shopping

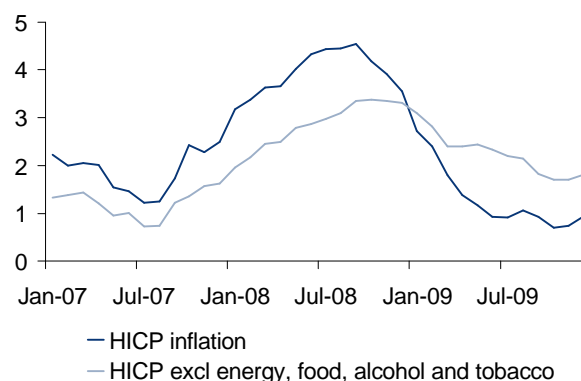
Price pressures have subsided markedly, as economic turmoil means lower demand. Also, some retailers have cut their prices to counter cross-border competition. Increasing number of Slovaks shopped in foreign border regions to take advantage of the weakening of CE3 currencies. CPI inflation decelerated from 4.4% y/y in December to 2.3% in April. Prices of heating, food and tradable goods were all down compared to the end of last year. HICP inflation slowed down to 1.4% y/y in April. We expect further deceleration of inflation in the coming months. The latest figures point to possible deceleration of CPI inflation towards 1% by the end of the third quarter.

GDP fell to negative numbers



Source: Statistical Office, SLSP

HICP inflation slowing down



Source: Eurostat, SLSP

Slovakia

Bond Market

Financial needs to be well over original plan

Recession-hit tax intake means that the government will have to raise more money via other means. While the original budget plan projected a fiscal deficit worth 1.7% of GDP in 2009, we now see the figure closer to 5.5% of GDP. Thus far, the government has issued EUR 4.7bn of new debt this year, including a EUR 2bn over-subscribed Eurobond issue (the original plan spoke of about EUR 1bn); in our view, another EUR 2-3bn of new issuance will be needed by year-end (please note that a debt agency official estimated the remaining issuance at around EUR 1bn in May; however, this estimate might have stemmed from the original budget plan).

Spreads to tighten by year-end, but short-term pressures ambiguous

The Slovak bond market should see two countervailing forces in the coming period. On one hand, higher issuance and legislative changes motivating pension companies to sell bonds from their portfolios (we estimate the sell-off at some EUR 0.5-0.7bn by 2Q09, but some of this was probably realized already) should work in favor of higher spreads. On the other hand, the improved global sentiment has led to the decline of 5Y CDS to 120bp (i.e. 70bp above Germany for ask prices), but less so in the case of bond spreads, which hover around 155-165bp over Germany at the long end. As the sentiment gets better, there should be a downward pressure on bond spreads. The short-term direction is unclear, but we see some spread tightening by the year-end to about 100-120bp.

Ukraine

Recovery ahead?

Analyst: *Mariyan Zablotskyy*
maryan.zablotskyy@erstegroup.com

	2007	2008	2009f	2010f
GDP per capita (EUR)	2 211	2 687	1 746	2 207
GDP (real y/y, %)	7.6	2.1	-8.0	3.0
CPI (y/y, average %)	12.8	25.2	23.0	11.0
Private Consumption (real y/y, %)	17.1	9.0	-17.0	4.0
Investments (real y/y, %)	24.8	3.0	-20.0	6.0
Exports (y/y, %)	28.4	35.2	-25.0	10.0
Imports (y/y, %)	34.7	39.3	-35.3	10.0
Unemployment (average, %)	6.9	7.0	12.0	9.0
Current account balance (% of GDP)	-4.2	-6.7	0.0	2.0
Govt. budget balance (% of GDP)	-1.1	-1.2	-3.0	-1.5
Public debt (% of GDP)	13.0	20.0	28.0	20.0

Economy and Inflation

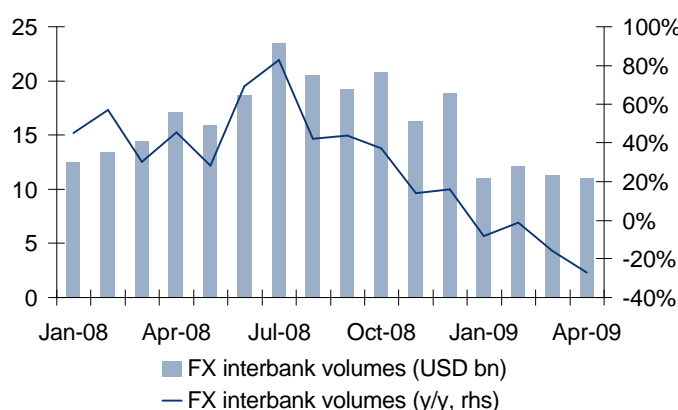
Parts of economy have gone into shadow

The government will publish the 1Q GDP data at the last possible date, July 29, when it is obliged to do so by the IMF. The shadow economy, which is officially estimated at just 30%, makes it exceptionally hard to estimate the current economic development. Based on industrial output and the PPI effect on GDP, we can estimate the 4M09 GDP decline at 17% y/y. It is still an open question whether the banking, real estate and retail sectors have contributed to a greater economic decline. We are more worried about significant parts of the economy having moved into the shadows, erasing part of the official GDP. These factors give rise to our concern that the official 1Q09 GDP figures may prove quite distressing.

Sentiment has improved

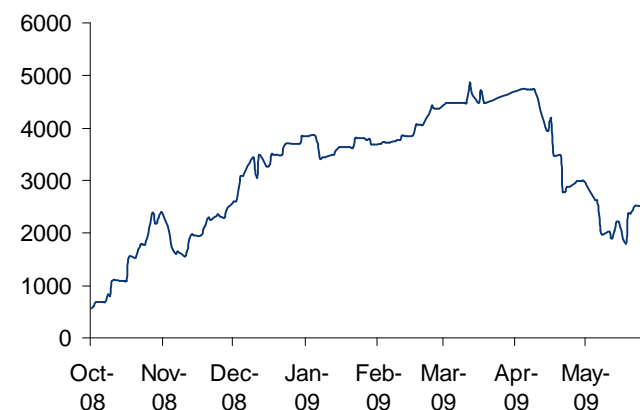
Consumer sentiment bottomed out in February. The outflow of deposits from the banking system slowed significantly. Indeed, in April, there was even a deposit inflow from private individuals. However, it is still a tough call on whether the real economy indicators have bottomed out. In any case, improved sentiment may help limit further economic deterioration. We believe that Ukraine may suffer the worst economic deterioration in CEE in 2009.

Ukrainian interbank market



Source: National Bank of Ukraine

Spread on 1Y CDS (sovereign debt, bps)



Source: Bloomberg

Inflation is expected to remain high this year

Inflation promises to remain high - we expect it to reach 19% by year-end. Ukraine will increase its monetary base significantly, despite the sharp economic contraction, as funds are needed for the banking recapitalization program and commercial bank refinancing. Additional pressure may come if agriculture does not sustain current production volumes. The National Bank and government are making efforts to unblock the credit freeze in the agricultural sector

Ukraine

by issuing direct loans to the sector. Support of the agricultural sector is part of the agreement with the IMF.

Monetary Policy

National Bank will not lower key rates this year

The National Bank will try to maintain the exchange rate with very limited flexibility until year-end. The move to a more flexible exchange will come no earlier than in 2010. The National Bank will not lower key rates this year, as part of the agreement with the IMF, and may tighten liquidity if the local currency moves away from the targeted levels. For the coming months, interest rates will most likely remain at single-digit levels, but will probably increase in case support for the hryvnia exchange rate becomes necessary. The National Bank's policy of issuing loans to the banking sector may be revised and become more transparent. The National Bank was obliged by the IMF to conduct an independent audit of its refinancing and FX intervention operations.

Bond Market

Risks of sovereign default have diminished

We think that chance of a sovereign default this year is very low. The IMF has agreed to parts of the loan issued to Ukraine being used to finance the budget deficit (more precisely, to refinance maturing external sovereign debt). After the news on the second tranche from the IMF and its issuance, sovereign CDS spreads collapsed from their peak of 6000bp to 1800bp. The yields on sovereign Eurobonds decreased markedly, from nearly 100% on short-term Eurobonds to 25%. The yields on foreign currency-denominated obligations will remain dependent on news on the cooperation between the government and the IMF.

	05-Jun	30-Sep	31-Dec	31-Mar	30-Jun
CB core rate	18.00	18.00	18.00	16.00	16.00
3M offer rate	10.4	16.0	13.5	9.0	8.0
2Y yield	20.0	18.0	18.0	15.0	10.0
UAH/EUR	10.82	12.75	13.60	13.28	12.75

Source: Reuters, NBU

Important web pages

ERSTE BANK

Erste Bank	http://www.erstebank.at
Erste Bank Treasury	http://treasury.erstebank.com
Sparkassen	http://www.sparkasse.at
ecetra.com	http://ecetra.com
Brokerjet	http://www.brokerjet.at
Erste Netbanking	http://www.netbanking.at

International Organisations

OECD	http://www.oecd.org
Internationaler Währungsfond	http://www.imf.org
Weltbank	http://www.worldbank.org

European Institutions

Europäischer Rat	http://ue.eu.int/de/summ.htm
Europäische Kommission	
http://europa.eu.int/comm/index_de.htm	
Europäisches Parlament	http://www.europarl.eu.int/home/
Europäischer Gerichtshof	http://curia.eu.int/de/index.htm

Statistical Offices

Europa	Eurostat	http://europa.eu.int/comm/eurostat/
Dänemark	Denmark Statistics	http://www.dst.dk
Deutschland	Statistisches Bundesamt	http://www.destatis.de/
Finnland	Statistics Finland	http://www.stat.fi
Frankreich	I.N.S.E.E.	http://www.insee.fr
Irland	Central Statistics Office	http://www.cso.ie
Italien	Instituto Nazionale di Statistica	http://www.istat.it
Luxemburg	Service Central de la Statistique	http://www.statec.lu
Niederlande	Central Bureau vor de Statistiek	http://www.cbs.nl
Österreich	Österreichisches Statistisches Zentralamt	http://www.statistik.at
Portugal	Instituto Nacional des Estatistica	http://www.ine.pt
Schweden	Statistics Sweden	http://www.scb.se
Spanien	Instituto National de Estadistica	http://www.ine.es
UK	Office for National Statistics	http://www.statistics.gov.uk

Central banks

Euroland	Europäische Zentralbank	http://www.ecb.int
Belgien	Nationale Bank van België	http://www.bnb.be
Dänemark	Danmarks Nationalbank	http://www.nationalbanken.dk
Deutschland	Deutsche Bundesbank	http://www.bundesbank.de
Finnland	Suomen Pankki	http://www.bof.fi
Frankreich	Banque de France	http://www.banque-france.fr
Italien	Banca d'Italia	http://www.bancaditalia.it
Luxemburg	Banque Centrale du Luxembourg	http://www.bcl.lu
Niederlande	De Nederlandsche Bank	http://www.dnb.nl
Österreich	Oesterreichische Nationalbank	http://www.oenb.at
Portugal	Banco de Portugal	http://www.bportugal.pt
Spanien	Banco de España	http://www.bde.es
Schweden	Sveriges Riksbank	http://www.riksbank.se
UK	Bank of England	http://www.bankofengland.co.uk
Schweiz	Schweizer Nationalbank	http://www.snb.ch/

Stock exchanges

Wiener Börse AG	http://www.wienerboerse.at
Deutsche Börse AG	http://www.deutsche-boerse.com
LIFFE	http://www.liffe.com
Matif	http://www.matif.fr

Erste Bank does not accept any responsibility for the completeness and accuracy of this information of web pages which does not belong to Erste Bank. Using content of information from these sites is at your own risk.

Contacts

Group Research

Head of Group Research

Friedrich Mostböck, CEFA +43 (0)5 0100 - 11902

CEE Equity Research

Co-Head: Günther Artner, CFA +43 (0)5 0100 - 11523

Co-Head: Henning Eßkuchen +43 (0)5 0100 - 19634

Günter Hohberger (Banks) +43 (0)5 0100 - 17354

Franz Hörll, CFA (Steel, Construction) +43 (0)5 0100 - 18506

Gernot Jany (Banks, Real Estate) +43 (0)5 0100 - 11903

Daniel Lion, CIIA (IT) +43 (0)5 0100 - 17420

Martina Valenta, MBA (Transp., Paper) +43 (0)5 0100 - 11913

Christoph Schultes, CIIA (Ins., Util.) +43 (0)5 0100 - 16314

Thomas Unger (Telecom) +43 (0)5 0100 - 17344

Vladimira Urbankova (Pharma) +43 (0)5 0100 - 17343

Gerald Walek, CFA (Machinery) +43 (0)5 0100 - 16360

International Equities

Hans Engel (Market strategist) +43 (0)5 0100 - 19835

Stephan Lingnau (Europe) +43 (0)5 0100 - 16574

Ronald Stöferle (Asia) +43 (0)5 0100 - 11723

Macro/Fixed Income Research

Head: Gudrun Egger, CEFA (Euroland) +43 (0)5 0100 - 11909

Alihan Karadagoglu (Corporates) +43 (0)5 0100 - 19633

Rainer Singer (US) +43 (0)5 0100 - 11185

Elena Statelov, CIIA (Corporates) +43 (0)5 0100 - 19641

Mildred Hager (SW, Japan) +43 (0)5 0100 - 17331

Macro/Fixed Income Research CEE

Co-Head CEE: Juraj Kotian (Macro/FI) +43 (0)5 0100 - 17357

Co-Head CEE: Rainer Singer (Macro/FI) +43 (0)5 0100 - 11185

Editor Research CEE

Brett Aarons +420 233 005 904

Research, Croatia/Serbia

Head: Miladen Dodig +381 11 22 00 866

Damir Cukman (Equity) +385 62 37 2812

Alen Kovac (Fixed income) +385 62 37 1383

Iva Cerovsky (Fixed income) +385 62 37 1716

Davor Spoljar (Equity) +385 62 37 2825

Research, Czech Republic

Head: David Navratil (Fixed income) +420 224 995 439

Petr Bartek (Equity) +420 224 995 227

Jana Krajcova (Fixed income) +420 224 995 232

Radim Kramule (Equity) +420 224 995 213

Martin Lobotka (Fixed income) +420 224 995 192

Lubos Mokras (Fixed income) +420 224 995 456

Jakub Zidon (Equity) +420 224 995 340

Research, Hungary

Head: József Miró (Equity) +361 235-5131

Bernadett Papp (Equity) +361 235-5135

Gergely Gabler (Equity) +361 253-5133

Orsolya Nyeste (Fixed income) +361 373-2830

Research, Poland

Head: Artur Iwanski (Equity) +48 22 330 6253

Magda Jagodzinska (Equity) +48 22 330 6250

Tomasz Kasowicz (Equity) +48 22 330 6251

Piotr Lopaciuk (Equity) +48 22 330 6252

Marek Czachor (Equity) +48 22 330 6254

Wiktor Tymochowicz (Equity) +48 22 330 6253

Research, Romania

Head: Lucian Claudiu Anghel +40 21 312 6773

Mihai Caruntu (Equity) +40 21 311 27 54

Dumitru Dulgheru (Fixed income) +40 21 312 6773 1028

Treasury - Erste Bank Vienna

Saving Banks & Sales Retail

Head: Thomas Schaufler +43 (0)5 0100 - 84225

Equity Retail Sales

Head: Kurt Gerhold +43 (0)5 0100 - 84232

Fixed Income & Certificate Sales

Head: Markus Kaller +43 (0)5 0100 - 84239

Treasury Domestic Sales

Head: Gottfried Huscava +43 (0)5 0100 - 84130

Corporate Desk

Head: Leopold Sokolicek +43 (0)5 0100 - 84601

Alexandra Blach +43 (0)5 0100 - 84141

Markus Pistracher +43 (0)5 0100 - 84100

Cristian Mladin (Fixed income) +40 21312 6773 - 1028

Loredana Oancea (Equity) +40 21311 2754

Eugen Sinca (Fixed income) +40 21312 6773 - 1028

Raluca Ungureanu (Equity) +40 21311 2754

Research, Slovakia

Head: Juraj Barta (Fixed income) +421 2 4862 4166

Michal Musak (Fixed income) +421 2 4862 4512

Maria Valachyova (Fixed income) +421 2 4862 4185

Research, Ukraine

Victor Stefanyshyn (Fixed Income) +38 044 593 - 1784

Svitlana Bazilevich (Equity) +38 044 593 - 9286

Maryan Zablotsky (Fixed income) +38 044 593 - 9188

Institutional Sales

Head of Sales Equities & Derivatives

Michal Rizek +44 20 7623 - 4154

Brigitte Zeitberger-Schmid +43 (0)5 0100 - 83123

Equity Sales Vienna XETRA & CEE

Hind Al Jassani +43 (0)5 0100 - 83111

Werner Fuerst +43 (0)5 0100 - 83114

Josef Kerekes +43 (0)5 0100 - 83125

Cormac Lyden +43 (0)5 0100 - 83127

Stefan Raidl +43 (0)5 0100 - 83113

Simone Rentschler +43 (0)5 0100 - 83124

Sales Derivatives

Christian Luig +43 (0)5 0100 - 83181

Manuel Kessler +43 (0)5 0100 - 83182

Sabine Kircher +43 (0)5 0100 - 83161

Christian Klikovich +43 (0)5 0100 - 83162

Armin Pflingstl +43 (0)5 0100 - 83171

Roman Rafeiner +43 (0)5 0100 - 83172

Equity Sales, London

Dieter Benesch +44 20 7623 - 4154

Tatyana Dachyshyn +44 20 7623 - 4154

Jarek Dudko, CFA +44 20 7623 - 4154

Federica Gessi-Castelli +44 20 7623 - 4154

Declan Wooloughan +44 20 7623 - 4154

Sales, Croatia

Zeljka Kajkut (Equity) +38 562 37 28 11

Damir Eror (Equity) +38 562 37 28 13

Sales, Czech Republic

Michal Brezna (Equity) +420 224 995-523

Ondrej Cech (Fixed income) +420 224 995-577

Michal Rizek +420 224 995-537

Jiri Smehlik (Equity) +420 224 995-510

Pavel Zdichynec (Fixed income) +420 224 995-590

Sales, Hungary

Gregor Glatzer (Equity) +361 235-5144

Krisztián Kandik (Equity) +361 235-5140

Istvan Kovacs (Fixed income) +361 235-5846

Sales, Poland

Head: Andrzej Tabor +4822 330 62 03

Pawel Czuprynski (Equity) +4822 330 62 12

Lukasz Mitan (Equity) +4822 330 62 13

Jacek Krynski (Equity) +4822 330 62 18

Sales, Slovakia

Head: Dusan Svitek +48 62 56 20

Rado Stopiak (Derivatives) +48 62 56 01

Andrea Slesarova (Client sales) +48 62 56 27

Roman Friesacher +43 (0)5 0100 - 84143

Helmut Kirchner +43 (0)5 0100 - 84144

Christian Skopek +43 (0)5 0100 - 84146

Fixed Income Institutional Desk

Head: Thomas Almen +43 (0)5 0100 - 84323

Martina Fux +43 (0)5 0100 - 84113

Fixed Income International & High End Sales Vienna

Jaromir Malak/ Zach Carvell +43 (0)5 0100 - 84254

U. Inhofner/ P. Zagan/ C. Mitu +43 (0)5 0100 - 84254

Fixed Income International Sales London

Paul Osment/ Simone Pilz +44 20 7623 4159

Publisher: Erste Group Bank AG
Graben 21; A-1011 Vienna, P.O. Box 162
Telex 11-5818,
Phone +43 (0)5 0100 ext.

Printed by: Chris Fowler Int.

Published and printed in: Vienna

Responsible for contents: Mag. Friedrich Mostböck

Sent to print on: June 10, 2009

This report is meant as supplementary economic information for our clients and is based on information available on the date of sending to print and will not be updated thereafter. Our analysis and conclusions are of a general nature and do not take into account the individual circumstances or needs of investors such as income potential, tax situation or the level of risk he or she is prepared to undertake. Information about previous performance does not guarantee future performance. Although we judge our sources to be reliable, we do not accept any responsibility for the completeness and accuracy of our information. This report is neither an offer to sell nor an offer to buy any securities.