CEE Banking - coping with the challenges of a new global environment

Debora Revoltella – CEE Chief Economist

UniCredit Group

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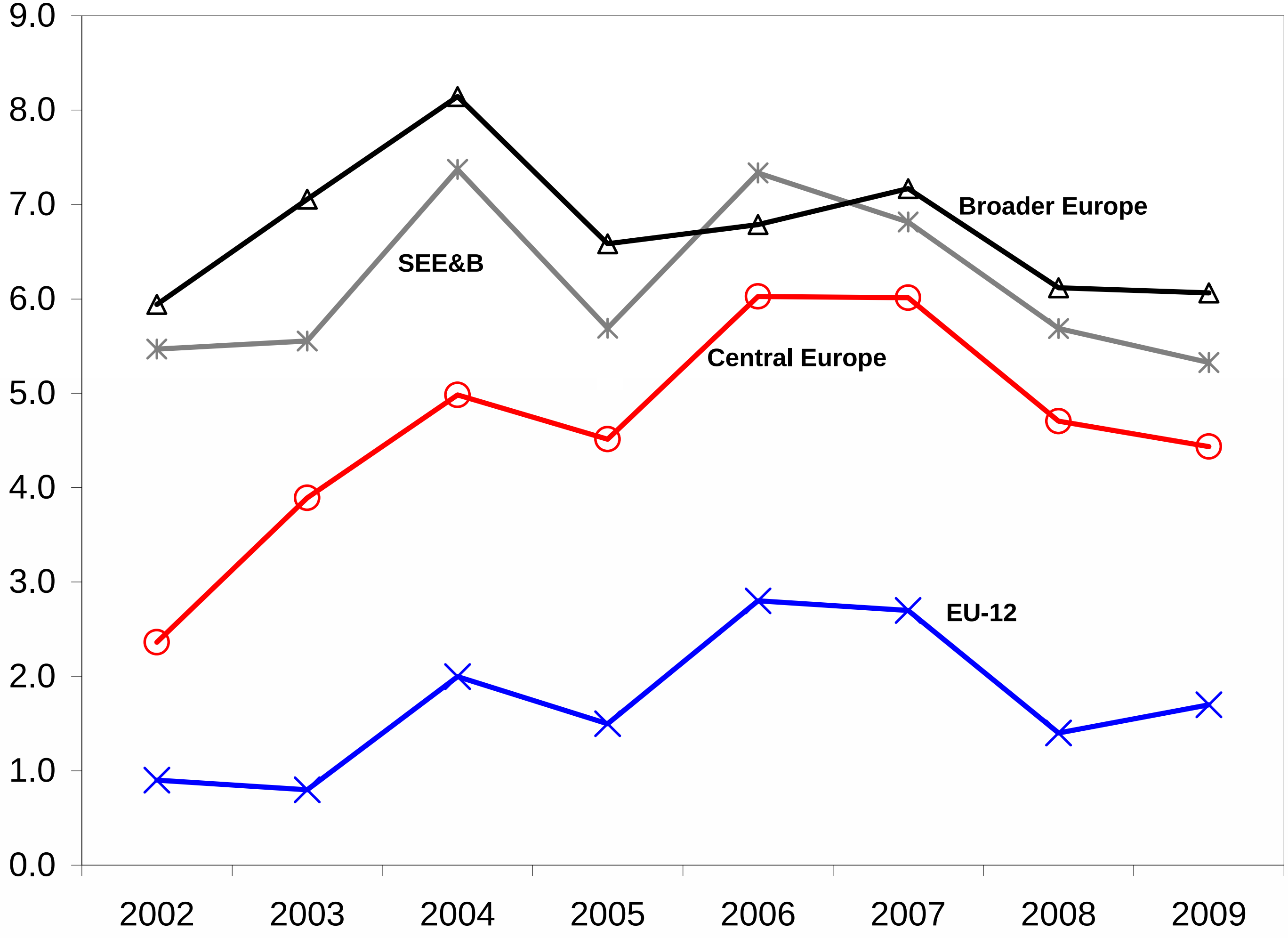
UniCredit Group

Agenda

- **Facing a new global environment**
  - Central Europe
  - South Eastern Europe and the Baltics
  - Broader Europe countries
- Conclusions

The cycle has peaked in 2006/07, but growth drivers hold in CEE

Real GDP growth



Note: Central Europe includes Poland, Czech Republic, Hungary, Slovakia and Slovenia. SEE&B (South Eastern Europe and Baltics) includes Romania, Bulgaria, Croatia, Serbia, Bosnia-H. and Baltics. Broader Europe countries includes Turkey, Russia, Ukraine and Kazakhstan
Source: UniCredit Group New Europe Research Network

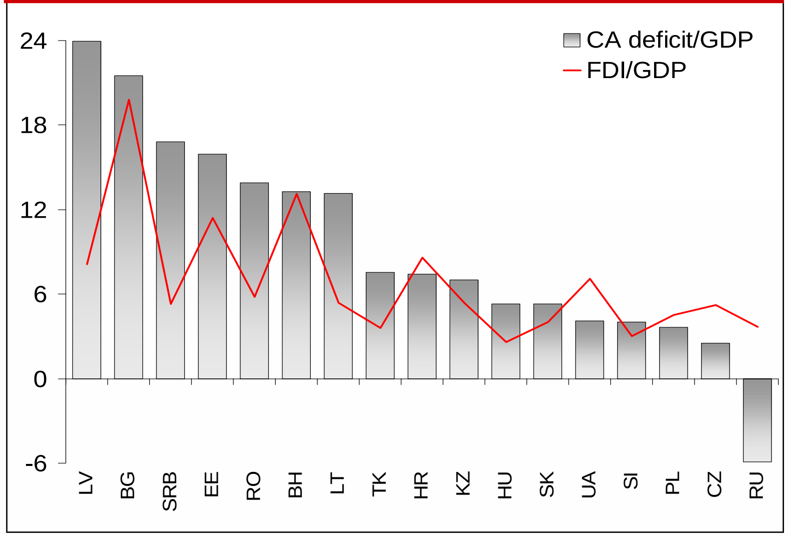
The new international environment reveals local vulnerabilities

A new international environment…

- High uncertainty and volatility
- International liquidity crunch and credit squeeze
- Lower growth in the US and expected lower growth in Europe
- More in terms of banking crisis
- Increasing risk aversion and repricing of risk at the international level

…local vulnerabilities

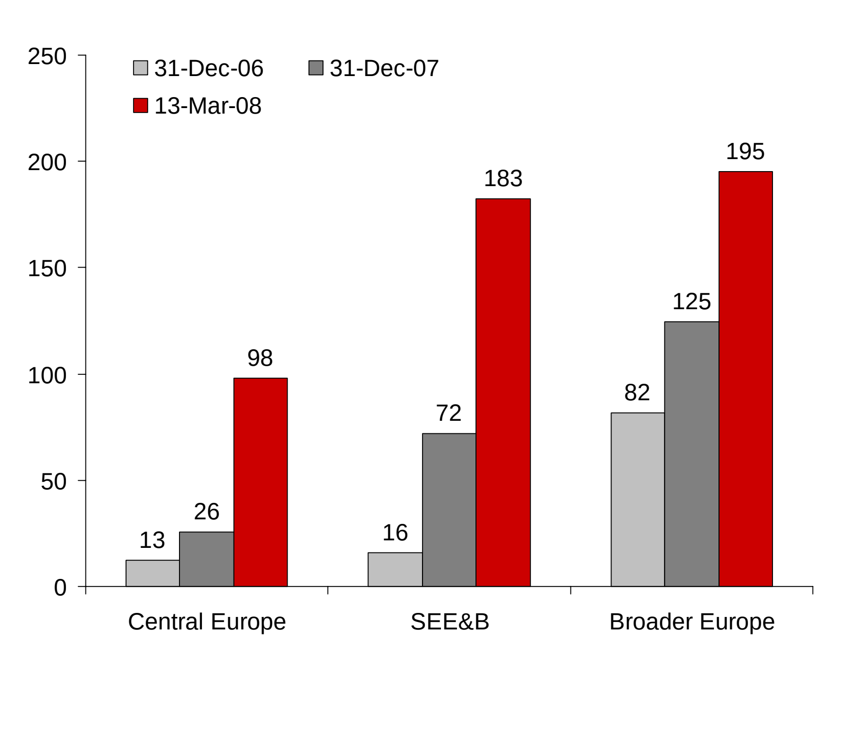
Current Account Deficit vs FDI over GDP, % (2007e)



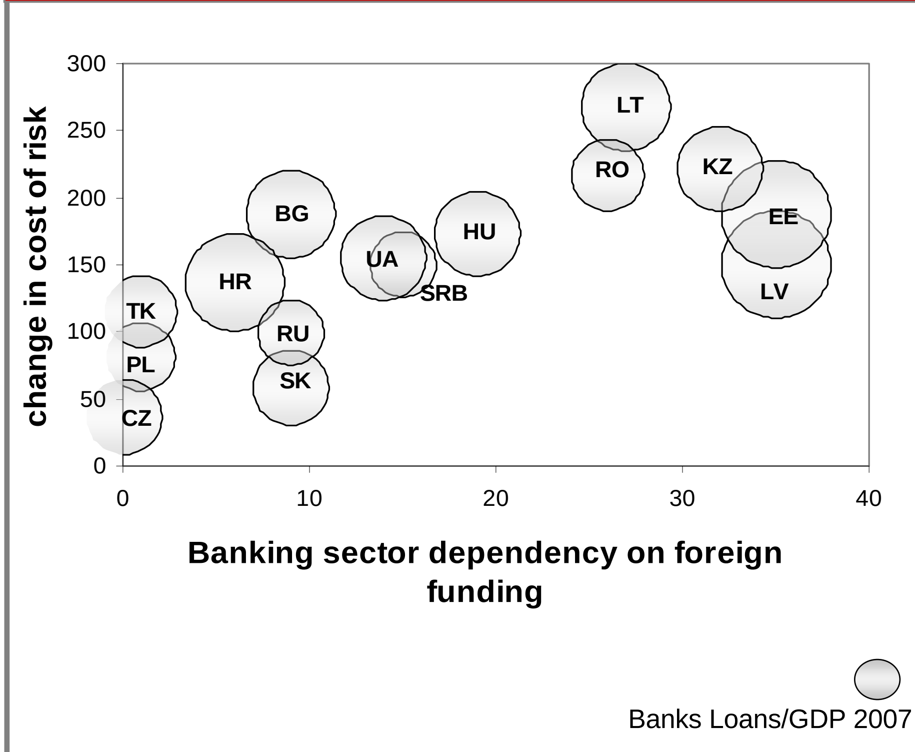
Source: UniCredit Group New Europe Research Network

Repricing of risk at the international level to affect the banking industry in CEE

Increase in the cost of risk at the country level
(5Y Credit Default Swaps USD, bps)



Sensitivity to a credit squeeze[1]



1\ change in cost of risk is delta 5Y CDS 13/03/2008 – 29/12/2006; Banking sector dependency on foreign funding is calculated as external liabilities minus external assets, divided by banks total assets, as of Nov.2007

Source: UniCredit Group New Europe Research Network, Bloomberg

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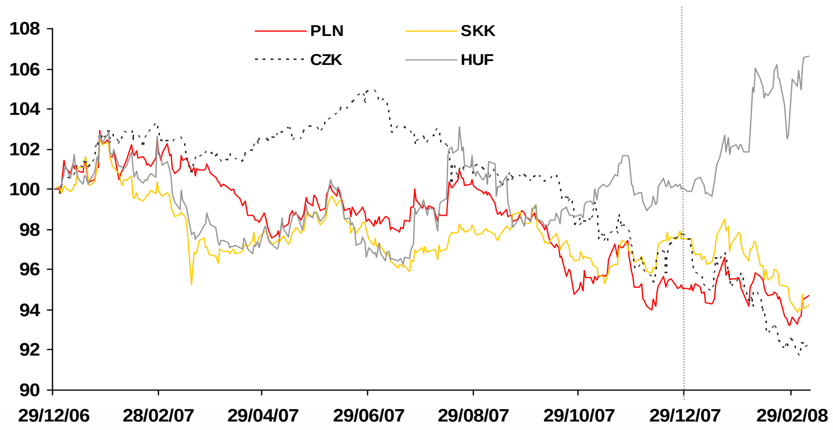
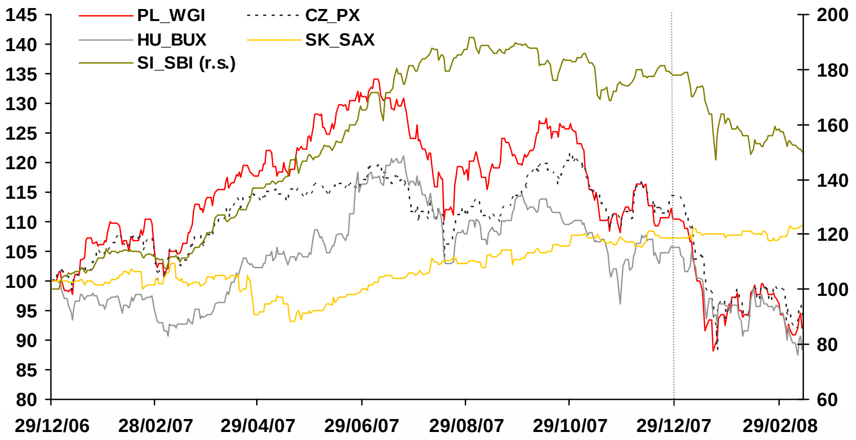
Impact of the international liquidity crisis on financial indicators in Central Europe, Hungary in particular

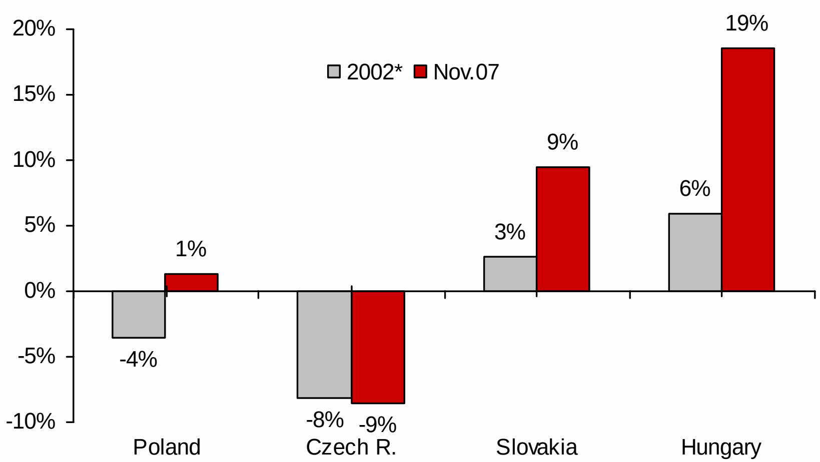
Market expectations on exchange rates
(1Y Forward vs EUR 29/12/2006=100)



Stock Exchange – (29.12.2006 = 100)



Banking sector dependency on foreign funding
(Ext liabilities- Ext Assets)/Total Assets



Increase in the cost of risk at the country level
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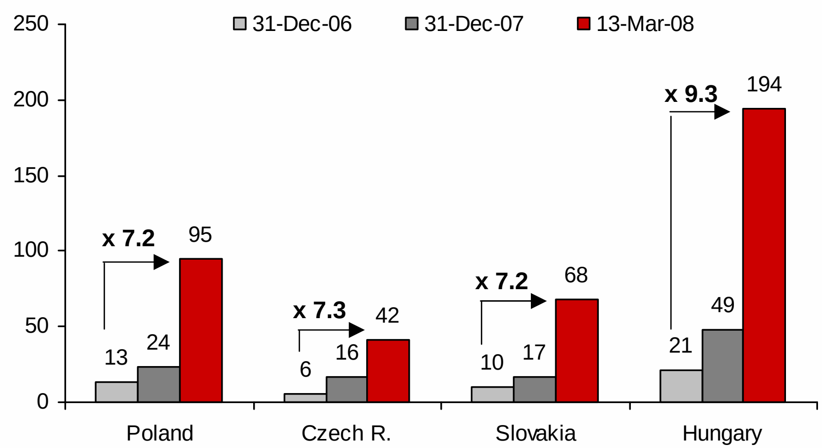
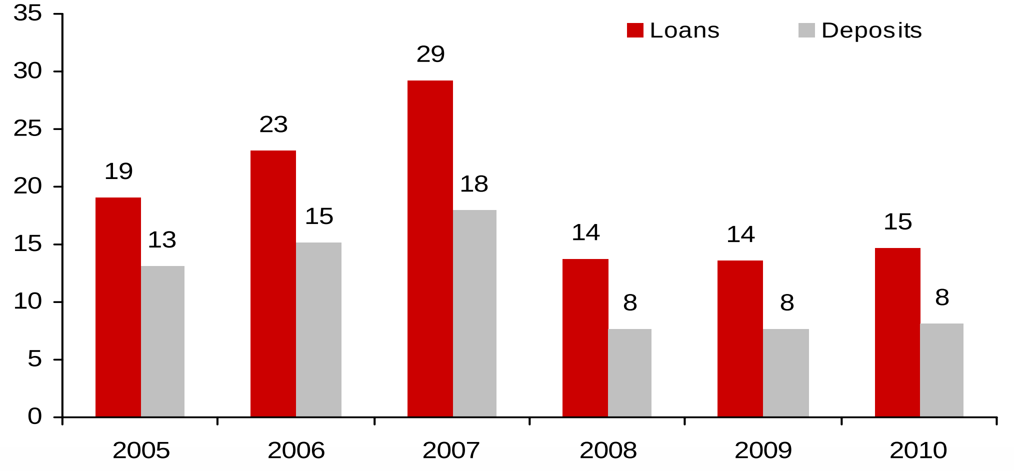


* For Slovakia 2003.

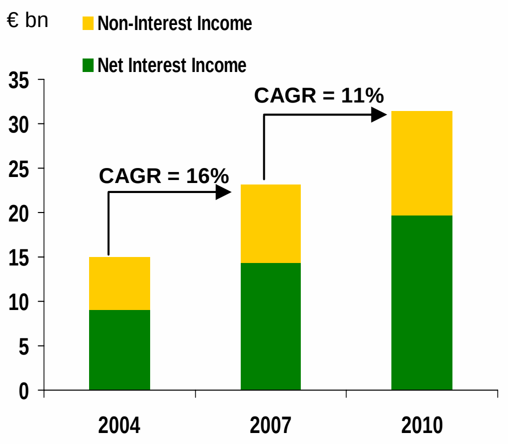
Source: UniCredit Group New Europe Research Network, Datastream

CE - Profitability of the banking sector to be preserved with some cyclical deceleration in volumes growth

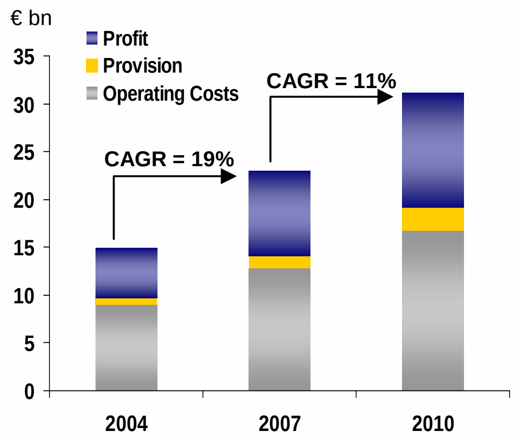
Loans´ and Deposits´ growth (yoy, %)



Revenues composition (€ bn)



Profit* (€ bn)



- **Some cyclical moderation in volume growth**
- **Still robust lending and deposit combined with tightened monetary conditions support net interest income**
- **Capital market volatility and lower demand for AuM influence non-interest income**
- **Profit growth expected to remain double digit in 2007-2010, though wage growth will exert some pressures on operating costs**

Note: CE (Central Europe) includes Poland, Czech R., Slovakia, Slovenia and Hungary. * Before tax and extraordinary items
Source: UniCredit Group New Europe Research Network

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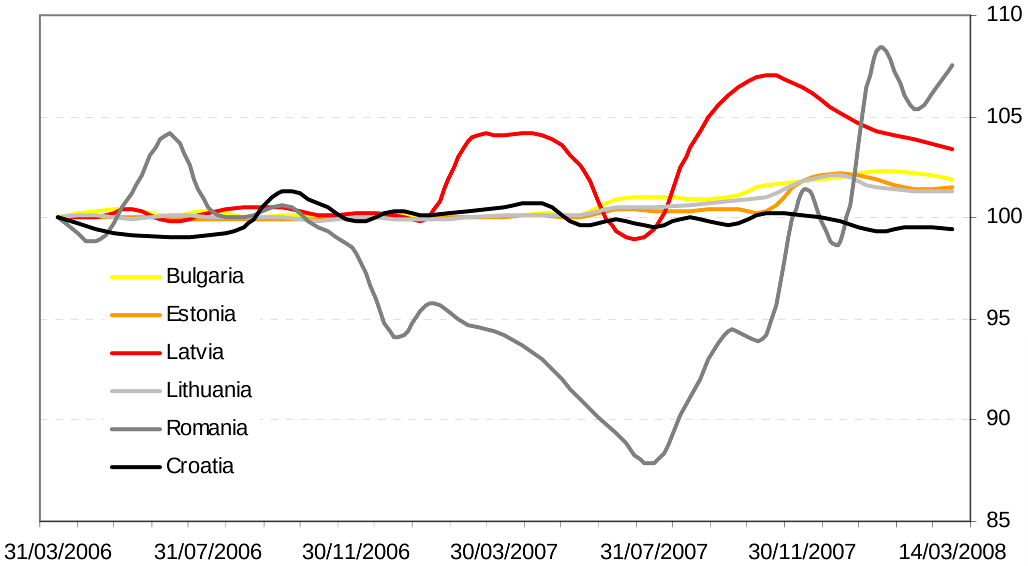
The new international environment highlights long lasting vulnerabilities in SEE and the Baltics

Market expectations on exchange rates
(1Y Forward vs EUR 31/03/2006=100)



CB regime/Tight managed float: BG, Baltics, HR

Managed float: RO

Higher values of the indexes correspond to expectations of nominal depreciation

Rating Actions in early 2008

Serbia: 11 Mar - S&P's negative outlook (on political instability and uncertainty)

Bulgaria, Estonia, Latvia and Romania: 31 Jan - Fitch's negative outlooks (on heightened macroeconomic risks)

Lithuania: 30 Jan - S&P's from A to A-/ negative outlook (on growing "downside economic risks")

Rating Actions in 2007

Latvia: 17 May - S&Ps from A- to BBB+ / negative outlook (on risks of 'hard landing')

Lithuania: 23 May - S&Ps negative outlook (on growing imbalances)

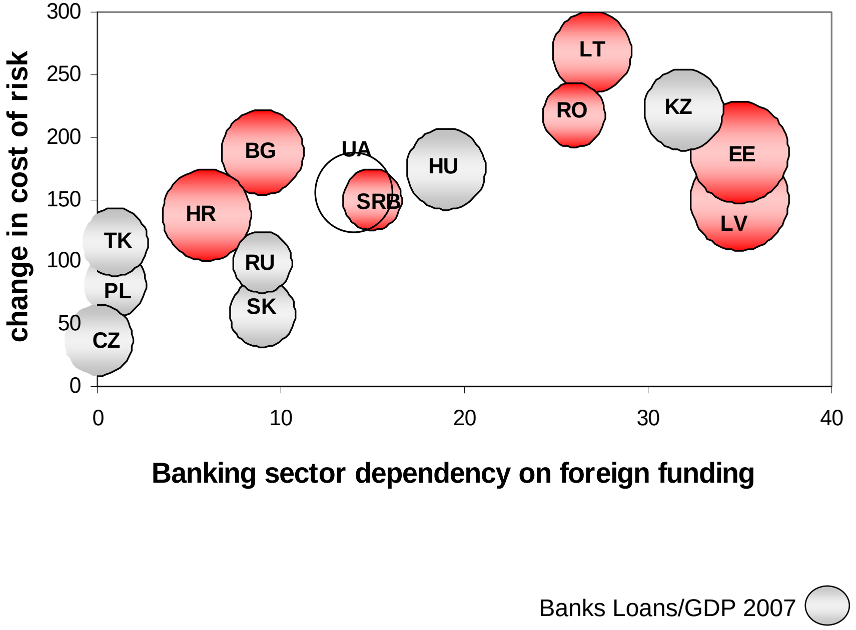
Estonia: 2 July - S&Ps negative outlook (on risks of a hard landing)

Romania: 5 Nov - S&Ps negative outlook (on rising external vulnerabilities and narrow government responses)

Source: UniCredit Group New Europe Research Network

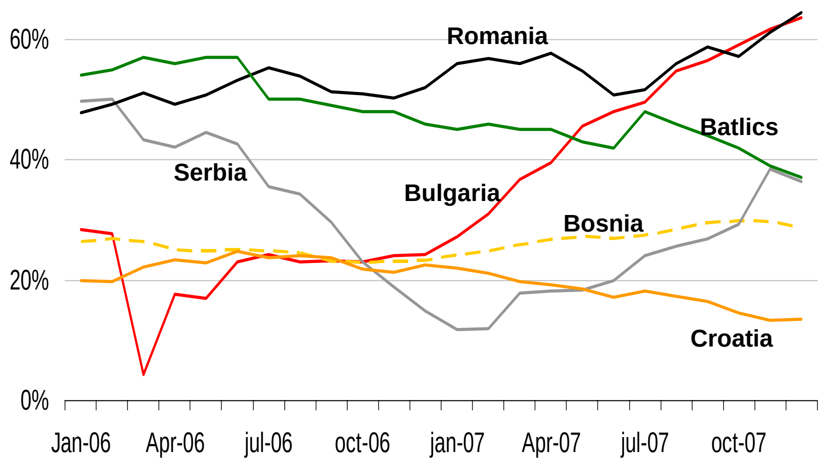
SEE – Some potential credit squeeze - which works in line with Central Banks aspirations

Sensitivity to a credit squeeze[1]



Total loans

(% yoy growth)[2]

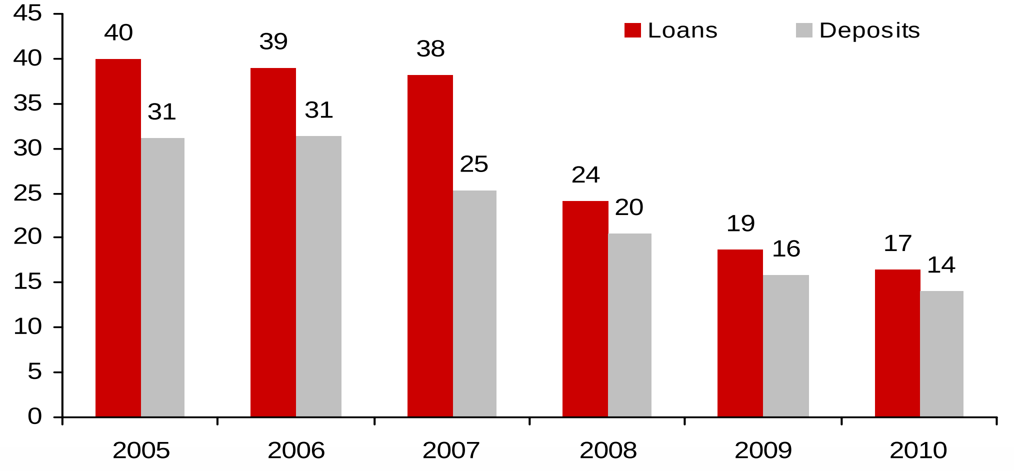


1\ change in cost of risk is delta 5Y CDS 13/03/2008 – 29/12/2006; Banking sector dependency on foreign funding is calculated as external liabilities minus external assets, divided by banks total assets, as of Nov.2007; 2\ Total loans include general govt, non-financial corporations and retail and where available NPISHs and Non-MFIs

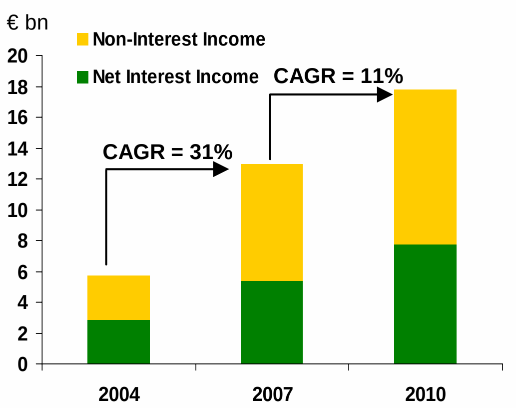
Source: UniCredit New Europe Research Network, Bloomberg

SEE&B - Stronger volume deceleration and increasing provisions constrain profit growth

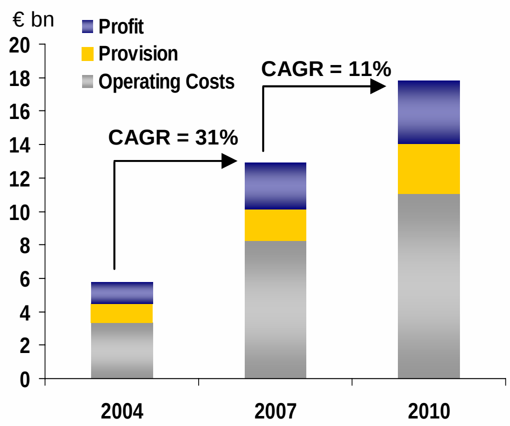
Loans´ and Deposits´ growth (yoy, %)



Revenues[1] composition (€ bn)



Profit[1/2] (€ bn)



- **Tightened monetary conditions, increasing cost of funding and high external indebtedness of the local banking sectors are behind lending growth deceleration**
- **Capital markets volatility, lower demand for AuM and for other commission generating products lead to a lower non-interest income growth in the coming years**
- **Increasing provisions, besides operating costs, constrain profit growth, still at 11% average per year**

Note: SEE&B includes Romania, Bulgaria, Croatia, Serbia, Bosnia and the Baltics. 1/ Excluding Baltics; 2/ Before tax and extraordinary items
Source: UniCredit Group New Europe Research Network

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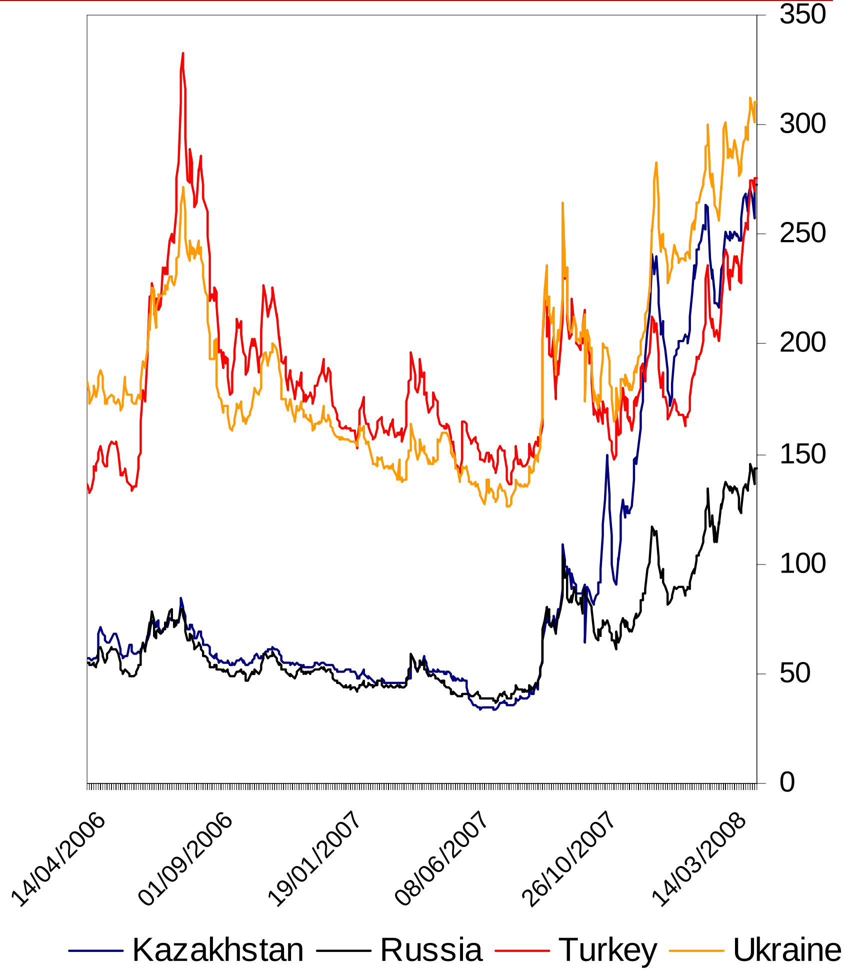
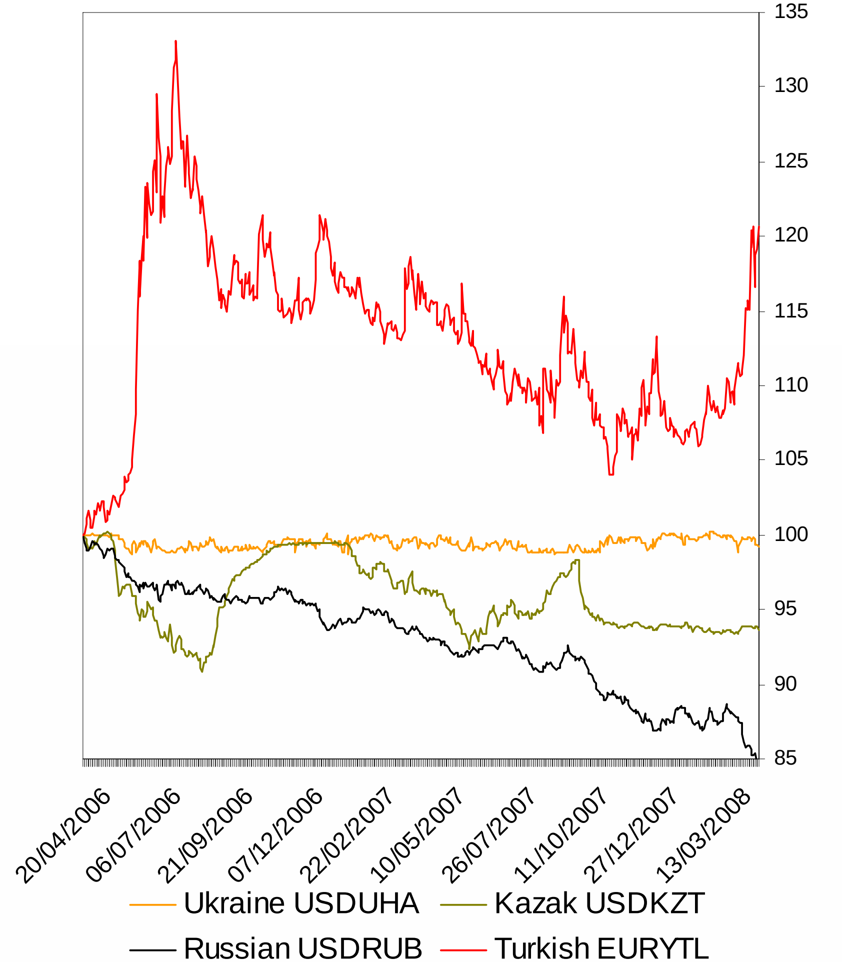
Broader Europe – More sensitive to capital markets´ mood

Increase in the cost of risk
(5Y Credit Default Swaps USD, bp)



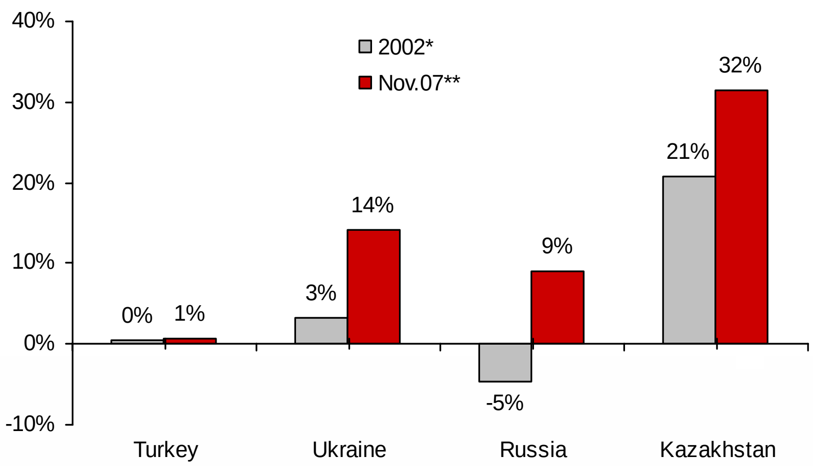
Exchange rates
(March 2006 = 100)



Source: Bloomberg data

Transmission channels from the new international environment differ

Banking Sector dependency on foreign funding
(Ext Liabilities- Ext Assets)/Tot. Assets (%)



Increase in the cost of risk
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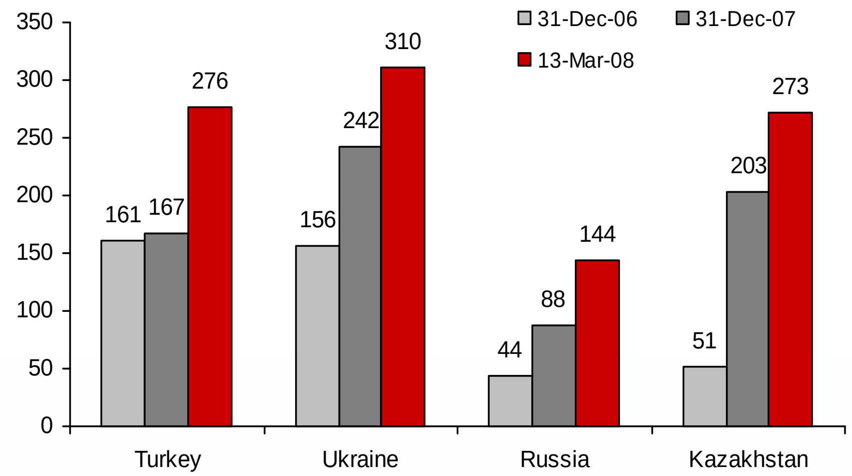


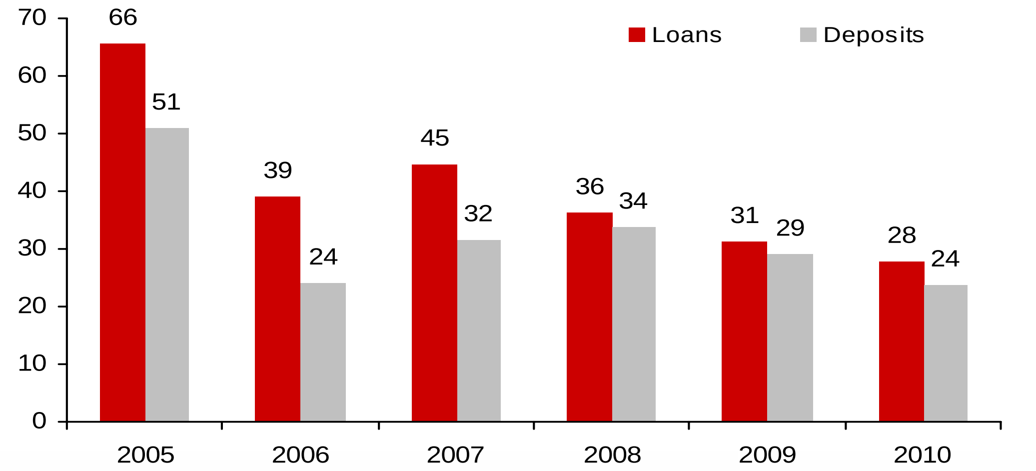
- Banks need of foreign funding and strong increase of cost of risk indicate Kazakhstan banking sector as vulnerable. A liquidity crunch is likely to translate into a bank credit squeeze
- Some funding problems might emerge, most probably affecting only a few players, with no systemic consequences, in both Russia and Ukraine
- While remaining sensitive to capital market volatility, Turkey is relatively less likely to face constraints to lending growth

* For Ukraine and Kazakhstan 2003. ** For Russia Sept. 07 and Turkey Oct.07

Source: UniCredit Group New Europe Research Network

Broader Europe – loan deceleration and higher cost of risk have no major impact on banking profitability

Loans´ and Deposits´ growth (yoy, %)



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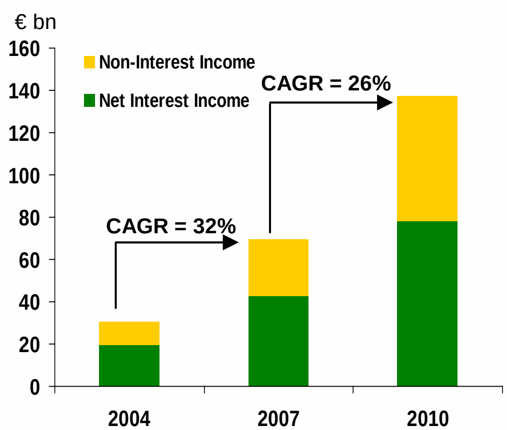
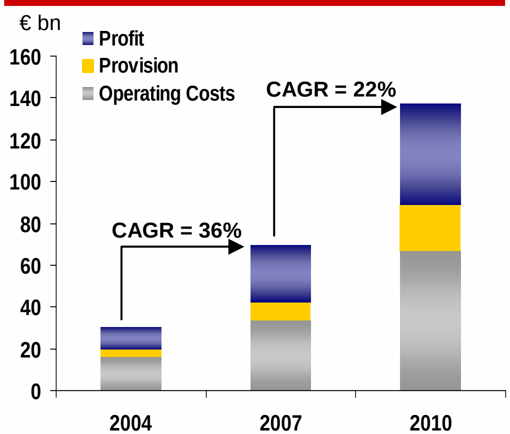


Profit* (€ bn)



- **A liquidity crunch with consequent credit squeeze, in Kazakhstan, while only a slight deceleration of loans in Turkey, thanks to the economic recovery**
- **Deposits to be encouraged in 2008 by higher cost of external funding besides increasing risk aversion of customers**
- **Non-interest Income expected to gain momentum especially once financial market volatility is over**
- **Lending deceleration, as well as increasing provisions and operating costs constrain profit growth, which however remains above 20% on annual average**

Note: Broader Europe includes Turkey, Ukraine, Russia and Kazakhstan. * Before tax and extraordinary items

Source: UniCredit Group New Europe Research Network

CONCLUSIONS

- A new international environment, with lower US and European growth, higher uncertainty and volatility and a general repricing of risk
- In CEE, the growth cycle has peaked in 2006–2007, but usual drivers still hold. Most countries were however relying on external savings to finance growth and, in the context of a general repricing of risk, this might lead to some deceleration in credit expansion
  - Central Europe (PL, SK, CZ, HU, SI) is likely to be generally untouched. We expect some cyclical tightening, on the wake of rising inflationary pressures and rising production capacity constraints and some possible negative impact from lower European growth
  - South Eastern Europe and the Baltics are more likely to feel the impact of a deteriorated international scenario and to face some deceleration in credit growth. Given the strong growth of the last years and overheating concerns, this works in line with Central Banks aspirations
  - Broader Europe countries (KZ, RU, UA, TK) are mostly sensitive to international repricing of risk. A liquidity crunch is visible and translating into a bank credit squeeze in Kazakhstan. Funding problems for banks might emerge (most probably affecting only a few relatively small players, with no systemic consequences) in both Russia and Ukraine. We believe however resources and commitment are enough to preserve long term potential of the economy in Kazakhstan and to prevent major setbacks even in the short to medium term in the other two countries. Though remaining sensitive to capital market volatility, Turkey is relatively less likely to face any constraint to bank lending growth
- On the overall, we believe the CEE can cope with the challenge, but risks and costs are increasing