

# Central & Eastern European Strategy

2<sup>nd</sup> quarter 2014

## Political clouds over economic recovery

- Central Europe emerges as the growth leader
- Ukraine and Russia suffering most
- CIS corporates: Mired in event risk
- Differentiated equity market outlook



**Raiffeisen  
RESEARCH**

# Central & Eastern European Strategy

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## Explanation:

e ... estimate  
f ... forecast  
p ... preliminary figures  
n.v. ... no value

## Abbreviations

### Currencies and Countries

ALL	Albanian lek
BAM	Bosnian marka
BGN	Bulgarian lev
BYR	Belarusian rouble
CZK	Czech koruna
EKK	Estonian kroon
HUF	Hungarian forint
HRK	Croatian kuna
ITL	Lithuanian litas
IVL	Latvian lats
PLN	Polish zloty
RON	Romanian leu
RSD	Serbian dinar
RUB	Russian rouble
SIT	Slovenian tolar
SKK	Slovak koruna
TRY	Turkish lira
UAH	Ukrainian hryvnia

## Economic abbreviations

%-chg	Percentage change (not in percentage points)
avg	average
bp	basis points
C/A	Current Account
CPI	Consumer Price Index
FCY	Foreign Currency
FDI	Foreign Direct Investments
FX	Foreign Exchange
FY	Full year
GDP	Gross Domestic Product
LCY	Local Currency
mmav	month moving average
mom	month on month
O/N	overnight rate
pp	percentage points
PPI	Producer Price Index
qoq	quarter on quarter
T/B	Trade Balance
ULC	Unit Labour Costs
yoy	year on year
ytd	year-to-date

## Stock Exchange Indices

BELEX15	Serbian stock index
BET	Romanian stock index
BUX	Hungarian stock index
CROBEX10	Croatian stock index
PX	Czech stock index
MICEX	Russian stock index
SASX-10	Bosnian stock index
WIG 20	Polish stock index

## Equity related

DY	Dividend yield
EG	Earnings growth
ITG	Long term (earnings) growth
P/B	Price book ratio
P/E	Price earnings ratio
RS	Recommendation suspended
UR	Under Revision
<i>Euro area</i>	<i>Austria, Belgium, Cyprus, Estonia, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Malta, Netherlands, Portugal, Slovenia, Slovakia, Spain</i>
<i>CE</i>	<i>Central European countries - Poland, Hungary, Czech Republic, Slovakia, Slovenia</i>
<i>SEE</i>	<i>South East European countries - Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Kosovo, Romania, Serbia</i>
<i>CIS</i>	<i>European CIS (Commonwealth of Independent States) countries - Russia, Ukraine, Belarus</i>
<i>CEE</i>	<i>Central and Eastern Europe (CE + SEE + CIS)</i>



## Geopolitical tensions as a negative factor

- Conflict between Ukraine and Russia exacerbates sluggish economic performance in the CIS region
- Improving economic forecasts for Central Europe for 2014
- In the baseline scenario, no major problems for Poland et al. from the Ukraine/Russia conflict

Since February, the dominant topic has been the conflict between Ukraine and Russia, which has now resulted in the annexation of Crimea by Russia. In our main scenario, we continue to expect that Russia will not extend its territorial claims into eastern Ukraine. This scenario includes the possibility of temporary disputes about security issues in eastern Ukraine, but does not feature an escalation with military means or severe economic embargoes between the EU/USA and Russia. However, just these elevated tensions and the acrimonious mood between Moscow and Kiev are enough to make the negative effects for both economies and their financial markets even worse. For example, we recently downgraded the 2014 GDP forecast for Russia from 1.7% to 1% and we also lowered the 2015 forecast. Radical restructuring in Ukraine with an IMF programme and budget cuts will likely result in a massive decline of 3% to 7% in Ukraine's 2014 GDP. By contrast, prospects for Poland, the Czech Republic and Hungary have continued to improve in the first few months of 2014, prompting us to revise our GDP growth projections upwards. There is hardly any change in the outlook for South-eastern Europe. For Austria, our GDP estimates have remained unchanged for more than a year now. Of course, this improvement in the economic situation in Central Europe would have to be downgraded in any scenario involving an escalation of the situation, with severe reciprocal economic sanctions between the EU and Russia and/or military conflict. It is also clear that the negative implications for Russia would be worse over the long term than they would be for Europe.

### Impact on monetary policy and exchange rates

The geopolitical tensions have already resulted in significant outflows of capital from both countries involved in the crisis. Since open conflict broke out, Russians have wound up savings in roubles and US dollars and converted them into euros, yen and Swiss francs. The Russian central bank has reacted to the faster pace of RUB depreciation since the autumn of 2013 with modest intervention on the FX market and gradual widening of the bands of the currency basket (55% USD/45% EUR) and one significant increase in the key rate. By contrast, the Ukrainian central bank has had to take more restrictive administrative measures to keep control over UAH depreciation, despite its interventions. We believe that the rouble will remain weak (above 37.2 versus USD) until June, followed by a countermove. UAH/USD parity should settle in between 10.5 and 11.5 over the medium term. We also project a mild recovery for PLN and CZK by year-end.

### Impact on the bond and equity markets

Yields have increased sharply in Russia (over 9% for 10y gov. bonds), reflecting investor scepticism about the country's political and economic reliability. We hardly see any signs for an easing of tensions on the CEE bond markets in the second quarter, and consequently further increases in yields must be anticipated in Poland, Hungary and the Czech Republic. The weak start to the year on the CEE stock exchanges hardly comes as a surprise in light of the geopolitical tensions. We see some possibility for further setbacks in the second quarter, but as the year progresses we expect more focus on fundamental data and thus a rebound in stock prices.

Financial analyst: Peter Brezinschek

### MARKET STRATEGY\*

	Eurobonds		LCY Bonds			FX
	EUR	USD	2y	5y	10y	
BG	H	-	-	-	-	-
HR	S	S	-	-	-	H
CZ	H	H	H	H	H	B
HU	B	H	H	H	S	S
PL	H	H	H	H	S	B
RO	H	H	H	H	H	H
RU	-	H	B	B	H	S
RS	-	H	-	-	-	H
SK	-	-	-	-	-	-
SI	-	-	-	-	-	-
TR	B	B	B	H	B	H
UA	S	S	-	-	-	S

\*based on absolute expected performance:  
 - LCY bond: absolute performance in LCY  
 - Eurobonds: based on expected spread change  
 RU, TR, UA FX recommendations against USD, others against EUR  
 horizon: end 2nd quarter 2014  
 B: buy; H: hold; S: sell  
 Source: Raiffeisen RESEARCH

### Recommendations<sup>1</sup> - stock markets

Indices	
<b>Buy</b>	ATX, WIG 20, PX, BET, BIST Nat. 100
<b>Hold</b>	BUX, MICEX
<b>Sell</b>	CROBEX10
Equities	
<b>OMV</b>	Current share price: EUR 32.25 <sup>1</sup> Target price: EUR 39.50
<b>Polytec</b>	Current share price: EUR 7.76 <sup>1</sup> Target price: EUR 9.50
<b>Netia</b>	Current share price: PLN 4.97 <sup>1</sup> Target price: PLN 5.90
<b>PKP Cargo</b>	Current share price: PLN 91.00 <sup>1</sup> Target price: PLN 103.0
<b>Enel OGG-5</b>	Current share price: RUB 0.849 <sup>1</sup> Target price: RUB 1.23

### Recommendations<sup>1</sup> - debt markets

Corporate bonds	
<b>Buy</b>	HSBKKZ 7.25% due 2017, GAZPRU 6.212% due 2016

<sup>1</sup> horizon: end 2nd quarter 2014  
<sup>2</sup> the indicated price is the last price as available at 6.30 a.m. (CET) on 20 March 2014  
<sup>3</sup> unhedged (performance in EUR)  
 Source: Raiffeisen RESEARCH

**Real GDP (% yoy)**

Countries	2012	2013	2014e	Consensus	2015f	Consensus
Poland	1.9	1.6	3.1	3.0	3.3	3.5
Hungary	-1.7	1.1	2.0	2.1	2.0	2.1
Czech Rep.	-0.9	-0.9	2.3	2.0	2.4	2.6
Slovakia	1.8	0.9	2.2	2.3	3.0	3.0
Slovenia	-2.3	-2.0	-0.5	-0.6	1.5	0.9
<b>CE</b>	<b>0.6</b>	<b>0.8</b>	<b>2.5</b>	<b>2.4</b>	<b>2.8</b>	<b>3.0</b>
Croatia	-2.0	-1.0	0.0	0.0	1.0	1.2
Bulgaria	0.8	0.8	2.0	1.7	3.5	2.4
Romania	0.6	3.5	2.3	2.8	2.5	3.4
Serbia	-1.7	2.2	1.0	1.3	2.0	2.4
Bosnia a. H.	-1.1	1.9	1.5	2.1	3.5	3.1
Albania	1.6	1.3	2.0	2.0	3.0	2.5
Kosovo	2.5	3.0	3.0	n.av.	4.0	n.v.
<b>SEE</b>	<b>-0.1</b>	<b>2.1</b>	<b>1.7</b>	<b>1.9</b>	<b>2.4</b>	<b>2.7</b>
Russia	3.4	1.3	1.0	1.3	1.5	2.1
Ukraine	0.2	0.0	-5.0	-1.4	1.5	1.8
Belarus	1.7	0.9	0.5	1.6	1.5	2.8
<b>CIS</b>	<b>3.1</b>	<b>1.2</b>	<b>0.5</b>	<b>1.1</b>	<b>1.5</b>	<b>2.1</b>
<b>CEE</b>	<b>2.2</b>	<b>1.2</b>	<b>1.2</b>	<b>1.5</b>	<b>1.9</b>	<b>2.4</b>
Turkey	2.2	3.9	2.0	2.2	4.0	3.8
<b>Austria</b>	<b>0.9</b>	<b>0.4</b>	<b>1.5</b>	<b>1.5</b>	<b>2.3</b>	<b>1.9</b>
Germany	0.9	0.5	1.8	1.8	2.5	2.0
<b>Euro area</b>	<b>-0.6</b>	<b>-0.4</b>	<b>1.5</b>	<b>1.1</b>	<b>2.0</b>	<b>1.4</b>

Source: Thomson Reuters, Bloomberg, Consensus Economics, Bloomberg, Raiffeisen RESEARCH

**Consumer prices (avg, % yoy)**

Countries	2012	2013	2014e	2015f
Poland	3.7	0.9	1.2	2.1
Hungary	5.7	1.7	1.1	3.2
Czech Rep.	3.3	1.4	1.3	2.0
Slovakia	3.6	1.4	0.7	2.7
Slovenia	2.6	1.8	1.8	2.0
<b>CE</b>	<b>3.8</b>	<b>1.2</b>	<b>1.2</b>	<b>2.3</b>
Croatia	3.4	2.2	1.6	2.0
Bulgaria	3.0	1.2	2.2	3.5
Romania	3.3	4.0	2.1	3.3
Serbia	7.8	7.8	5.5	5.5
Bosnia a. H.	2.1	-0.1	2.5	2.5
Albania	2.0	1.9	2.3	2.5
Kosovo	2.5	1.8	3.0	2.5
<b>SEE</b>	<b>3.7</b>	<b>3.4</b>	<b>2.4</b>	<b>3.3</b>
Russia	5.1	6.8	6.1	5.5
Ukraine	0.6	-0.2	6.0	7.5
Belarus	59.2	18.3	21.0	20.0
<b>CIS</b>	<b>6.3</b>	<b>6.6</b>	<b>6.5</b>	<b>6.1</b>
<b>CEE</b>	<b>5.4</b>	<b>4.8</b>	<b>4.7</b>	<b>4.8</b>
Turkey	8.9	7.5	7.4	7.3
<b>Austria</b>	<b>2.6</b>	<b>2.1</b>	<b>1.8</b>	<b>1.8</b>
Germany	2.1	1.6	1.5	2.0
<b>Euro area</b>	<b>2.5</b>	<b>1.4</b>	<b>1.1</b>	<b>1.5</b>

Source: Thomson Reuters, Raiffeisen RESEARCH

**Current account balance (% of GDP)**

Countries	2012	2013	2014e	2015f
Poland	-3.5	-1.3	-2.8	-4.1
Hungary	1.8	2.8	3.4	4.2
Czech Rep.	-2.4	-1.0	-0.5	-0.1
Slovakia	2.3	2.4	2.8	2.6
Slovenia	3.3	7.1	7.0	4.9
<b>CE</b>	<b>-1.7</b>	<b>0.1</b>	<b>-0.6</b>	<b>-1.3</b>
Croatia	0.1	0.5	0.0	-0.2
Bulgaria	-1.3	1.5	0.7	-0.5
Romania	-4.4	-1.1	-2.0	-2.5
Serbia	-10.7	-4.8	-5.1	-5.8
Bosnia a. H.	-9.8	-5.9	-8.6	-10.2
Albania	-8.8	-9.1	-9.2	-9.2
Kosovo	-8.0	-7.0	-7.7	-7.8
<b>SEE</b>	<b>-4.4</b>	<b>-1.5</b>	<b>-2.4</b>	<b>-3.0</b>
Russia	3.6	1.6	2.3	2.0
Ukraine	-8.5	-9.1	-5.9	-4.2
Belarus	-2.9	-9.7	-4.0	-6.1
<b>CIS</b>	<b>2.5</b>	<b>0.4</b>	<b>1.4</b>	<b>1.1</b>
<b>CEE</b>	<b>0.7</b>	<b>0.1</b>	<b>0.4</b>	<b>-0.1</b>
Turkey	-6.2	-7.8	-6.7	-5.6
<b>Austria</b>	<b>1.6</b>	<b>2.6</b>	<b>2.5</b>	<b>2.3</b>
Germany	7.4	7.5	7.0	6.5
<b>Euro area</b>	<b>1.3</b>	<b>2.3</b>	<b>1.9</b>	<b>1.5</b>

Source: Thomson Reuters, Raiffeisen RESEARCH

**General budget balance (% of GDP)**

Countries	2012	2013	2014e	2015f
Poland	-3.9	-4.1	-3.2	-2.8
Hungary	-1.9	-2.9	-2.9	-2.9
Czech Rep.	-4.4	-2.5	-2.7	-2.9
Slovakia	-4.4	-2.8	-2.6	-2.4
Slovenia	-3.8	-7.0	-5.0	-4.0
<b>CE</b>	<b>-3.8</b>	<b>-3.6</b>	<b>-3.1</b>	<b>-2.9</b>
Croatia	-5.0	-5.8	-4.9	-4.6
Bulgaria	-0.5	-1.9	-1.8	-1.3
Romania	-3.0	-2.5	-2.5	-2.3
Serbia	-6.4	-4.8	-6.9	-5.9
Bosnia a. H.	-2.0	-1.5	-1.0	-1.0
Albania	-3.4	-6.0	-6.6	-4.5
Kosovo	-2.7	-2.7	-2.0	-2.0
<b>SEE</b>	<b>-3.3</b>	<b>-3.3</b>	<b>-3.3</b>	<b>-2.9</b>
Russia	0.4	-1.0	-0.5	-0.6
Ukraine	-5.5	-7.0	-4.0	-3.0
Belarus	0.5	0.0	0.0	0.0
<b>CIS</b>	<b>-0.1</b>	<b>-1.4</b>	<b>-0.8</b>	<b>-0.8</b>
<b>CEE</b>	<b>-1.4</b>	<b>-2.2</b>	<b>-1.6</b>	<b>-1.5</b>
Turkey	-2.1	-1.2	-2.5	-2.0
<b>Austria</b>	<b>-2.5</b>	<b>-1.6</b>	<b>-2.6</b>	<b>-0.9</b>
Germany	0.1	-0.1	0.0	0.0
<b>Euro area</b>	<b>-3.7</b>	<b>-3.1</b>	<b>-2.6</b>	<b>-2.5</b>

Source: Thomson Reuters, Raiffeisen RESEARCH

**Public debt (% of GDP)**

Countries	2012	2013	2014e	2015f
Poland	55.6	57.1	49.9	49.8
Hungary	80.2	79.2	81.6	80.9
Czech Rep.	46.2	46.3	47.3	48.3
Slovakia	52.2	54.8	56.9	56.5
Slovenia	54.0	65.0	70.0	72.0
<b>CE</b>	<b>56.4</b>	<b>57.9</b>	<b>55.1</b>	<b>55.3</b>
Croatia	55.5	66.5	69.2	73.0
Bulgaria	18.5	19.0	22.0	20.0
Romania	38.0	37.9	38.4	38.5
Serbia	59.7	60.8	64.1	64.6
Bosnia a. H.	39.7	41.5	39.6	38.5
Albania	61.5	68.0	72.0	68.0
Kosovo	18.0	20.0	22.0	22.0
<b>SEE</b>	<b>40.9</b>	<b>43.2</b>	<b>44.8</b>	<b>45.0</b>
Russia	10.5	12.0	13.0	14.0
Ukraine	36.8	40.3	52.0	53.0
Belarus	31.5	33.0	34.4	34.6
<b>CIS</b>	<b>13.1</b>	<b>14.8</b>	<b>16.6</b>	<b>17.6</b>
<b>CEE</b>	<b>27.4</b>	<b>29.1</b>	<b>29.7</b>	<b>30.4</b>
Turkey	39.8	38.5	38.2	37.3
<b>Austria</b>	<b>74.0</b>	<b>74.4</b>	<b>79.4</b>	<b>77.3</b>
Germany	81.0	79.6	77.3	74.5
<b>Euro area</b>	<b>90.6</b>	<b>93.2</b>	<b>93.6</b>	<b>93.2</b>

Source: Thomson Reuters, Raiffeisen RESEARCH

**Gross foreign debt (% of GDP)**

Countries	2012	2013	2014e	2015f
Poland	72.7	71.0	68.7	66.5
Hungary	131.1	123.6	121.3	114.4
Czech Rep.	50.5	51.1	49.8	49.3
Slovakia	71.5	81.6	82.9	83.9
Slovenia	115.7	113.6	115.2	115.5
<b>CE</b>	<b>77.6</b>	<b>77.0</b>	<b>75.2</b>	<b>72.8</b>
Croatia	102.3	104.5	103.6	101.4
Bulgaria	94.9	91.4	89.1	82.4
Romania	75.7	67.5	65.5	64.1
Serbia	86.9	78.2	76.2	73.4
Bosnia a. H.	63.3	62.2	62.0	60.3
Albania	24.7	62.5	25.9	26.8
Kosovo	14.8	14.4	13.9	13.4
<b>SEE</b>	<b>80.4</b>	<b>75.1</b>	<b>73.1</b>	<b>70.7</b>
Russia	30.9	34.1	42.3	43.0
Ukraine	74.4	78.9	107.1	106.3
Belarus	51.7	49.0	59.4	54.7
<b>CIS</b>	<b>34.8</b>	<b>38.0</b>	<b>47.1</b>	<b>47.5</b>
<b>CEE</b>	<b>50.8</b>	<b>52.2</b>	<b>58.2</b>	<b>57.4</b>
Turkey	42.0	44.1	51.9	53.2
<b>Austria</b>	<b>n.v.</b>	<b>n.v.</b>	<b>n.v.</b>	<b>n.v.</b>
Germany	n.v.	n.v.	n.v.	n.v.
<b>Euro area</b>	<b>n.v.</b>	<b>n.v.</b>	<b>n.v.</b>	<b>n.v.</b>

Source: Thomson Reuters, Raiffeisen RESEARCH

**Exchange rate EUR/LCY (avg)**

Countries	2012	2013	2014e	2015f
Poland	4.19	4.19	4.16	4.00
Hungary	290.0	297.5	315.0	321.3
Czech Rep.	25.1	26.0	27.1	26.0
Slovakia	euro	euro	euro	euro
Slovenia	euro	euro	euro	euro
Croatia	7.52	7.57	7.64	7.66
Bulgaria	1.96	1.96	1.96	1.96
Romania	4.46	4.42	4.51	4.48
Serbia	113.1	113.2	116.0	119.0
Bosnia a. H.	1.96	1.96	1.96	1.96
Albania	139.0	140.3	140.0	140.0
Kosovo	euro	euro	euro	euro
Russia	39.7	42.2	49.7	49.3
Ukraine	10.39	10.83	14.51	14.63
Belarus	10718	11788	14590	17197
Turkey	2.31	2.54	2.94	2.85
<b>Austria</b>	<b>euro</b>	<b>euro</b>	<b>euro</b>	<b>euro</b>
Germany	euro	euro	euro	euro
<b>USA</b>	<b>1.29</b>	<b>1.33</b>	<b>1.35</b>	<b>1.33</b>

Source: Thomson Reuters, Raiffeisen RESEARCH

**Ratings<sup>1</sup>**

Countries	S&P	Moody's	Fitch
Poland	A-	A2	A-
Hungary	BB	Ba1	BB+
Czech Rep.	AA-	A1	A+
Slovakia	A	A2	A+
Slovenia	A-	Ba1	BBB+
Croatia	BB	Ba1	BB+
Bulgaria	BBB	Baa2	BBB-
Romania	BB+	Baa3	BBB-
Serbia	BB-	B1	B+
Bosnia a. H.	B	B3	not rated
Albania	B	B1	not rated
Kosovo	not rated	not rated	not rated
Russia	BBB	Baa1	BBB
Ukraine	CCC	Caa2	CCC
Belarus	B-	B3	not rated
Turkey	BB+	Baa3	BBB-
<b>Austria</b>	<b>AA+</b>	<b>Aaa</b>	<b>AAA</b>
Germany	AAA	Aaa	AAA

<sup>1</sup> for FCY, long-term debt

Source: Bloomberg, Raiffeisen RESEARCH

## Exchange rate forecast

Countries	19-Mar <sup>1</sup>	Jun-14	Sep-14	Mar-15
<b>vs EUR</b>				
Poland	4.20	4.18	4.15	4.05
Hungary	310.83	315.0	315.0	320.0
Czech Rep.	27.48	27.2	27.0	26.2
Croatia	7.66	7.58	7.64	7.66
Romania	4.49	4.50	4.55	4.45
Serbia	115.84	116.0	115.0	118.0
Albania	140.47	140.0	139.0	141.0

Countries	19-Mar <sup>1</sup>	Jun-14	Sep-14	Mar-15
<b>vs USD</b>				
Russia	36.0	37.2	37.4	36.7
Ukraine	10.16	11.00	11.25	11.50
Belarus	9860	10800	11400	12600
Turkey	2.22	2.22	2.15	2.15

EUR/USD	1.39	1.35	1.30	1.35
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<sup>1</sup> 5:00 p.m. (CET)

Source: Bloomberg, Raiffeisen RESEARCH

## 2y LCY yield forecast

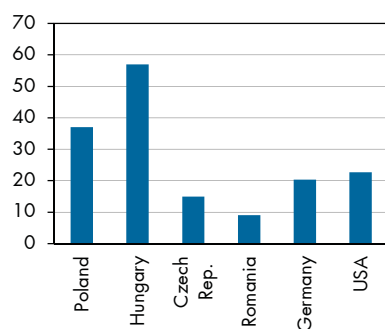
Countries	19-Mar <sup>1</sup>	Mar-14	Jun-14	Dec-14
Poland	2.90	3.3	3.4	3.7
Hungary*	4.50	5.0	5.1	5.6
Czech R.	0.03	0.6	0.8	1.1
Croatia	2.70	2.9	3.2	3.6
Romania	3.63	3.8	4.0	4.3
Russia	7.48	8.0	7.3	7.8
Turkey	10.98	11.0	10.9	10.5

Austria	0.16	0.3	0.3	1.1
Germany	0.17	0.2	0.2	1.0
USA	0.42	0.5	0.6	1.2

<sup>1</sup> 5:00 p.m. (CET); \* 3y LCY yields

Source: Bloomberg, Raiffeisen RESEARCH

## Expected yield change



Bp-change of 10y gov. bond yield in next 3 months

Source: Bloomberg, Raiffeisen RESEARCH

## Key interest rate forecast

Countries	19-Mar <sup>1</sup>	Jun-14	Sep-14	Mar-15
Poland	2.50	2.50	2.50	3.25
Hungary	2.70	2.40	2.40	2.40
Czech R.	0.05	0.05	0.05	0.25
Romania	3.50	3.50	3.50	3.50
Russia	7.00	7.00	6.00	6.00
Turkey	10.00	10.00	10.00	10.00

Euro area	0.25	0.25	0.25	0.25
USA	0.25	0.25	0.25	0.50

<sup>1</sup> 5:00 p.m. (CET)

Source: Bloomberg, Raiffeisen RESEARCH

## 5y LCY yield forecast

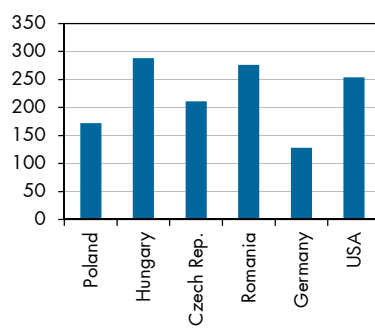
Countries	19-Mar <sup>1</sup>	Jun-14	Sep-14	Mar-15
Poland	3.76	3.9	4.0	4.2
Hungary	4.78	5.3	5.4	6.0
Czech R.	0.89	1.2	1.4	2.0
Croatia	4.20	4.4	4.5	4.6
Romania	4.67	4.9	5.0	5.3
Russia	7.90	9.0	8.4	8.8
Turkey	10.74	11.2	11.1	10.4

Austria	0.78	1.0	1.3	2.0
Germany	0.64	0.8	1.1	1.9
USA	1.71	1.9	2.1	2.5

<sup>1</sup> 5:00 p.m. (CET)

Source: Bloomberg, Raiffeisen RESEARCH

## Yield structure



Bp-spread between 10y and 3m maturity

Source: Bloomberg, Raiffeisen RESEARCH

## 3m money market rate forecast

Countries	19-Mar <sup>1</sup>	Jun-14	Sep-14	Mar-15
Poland	2.51	2.71	2.79	3.54
Hungary	2.75	2.70	2.80	3.00
Czech R.	0.04	0.10	0.20	0.35
Croatia	0.37	0.90	1.10	1.50
Romania	2.55	2.90	2.95	3.05
Russia	9.32	9.75	9.30	9.40
Turkey	11.80	11.70	11.30	11.30

Euro area	0.31	0.30	0.30	0.40
USA	0.23	0.30	0.30	0.70

<sup>1</sup> 5:00 p.m. (CET)

Source: Bloomberg, Raiffeisen RESEARCH

## 10y LCY yield forecast

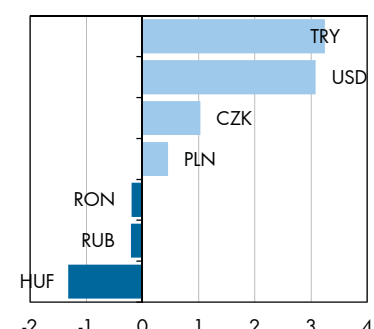
Countries	19-Mar <sup>1</sup>	Jun-14	Sep-14	Mar-15
Poland	4.23	4.6	4.7	4.9
Hungary	5.63	6.2	6.3	7.0
Czech R.	2.15	2.3	2.5	3.2
Croatia	4.61	5.5	5.5	5.5
Romania	5.31	5.4	5.6	5.8
Russia	9.15	9.5	8.7	9.0
Turkey	10.66	10.6	10.7	9.9

Austria	1.87	2.1	2.2	2.9
Germany	1.60	1.8	2.0	2.7
USA	2.77	3.0	3.3	3.6

<sup>1</sup> 5:00 p.m. (CET)

Source: Bloomberg, Raiffeisen RESEARCH

## LCY changes vs. EUR (% qoq)<sup>1</sup>



<sup>1</sup> forecasts for 30-Jun 2014 in comparison to 19-Mar 2014

Source: Bloomberg

## Stock market indicators

	Earnings growth		Price/earnings ratio	
	14e	15f	14e	15f
ATX	30.4%	24.2%	13.6	11.0
WIG 20	2.0%	10.7%	13.2	11.9
BUX	-11.1%	15.1%	9.8	8.5
PX <sup>1</sup>	46.8%	14.9%	13.2	11.4
MICEX	3.7%	0.4%	4.7	4.7
BET	30.2%	-1.9%	10.1	10.3
CROBEX10	-18.3%	-5.2%	26.9	28.4
BIST Nat. 100	8.2%	19.0%	9.5	8.0

<sup>1</sup> Czech Rep. (PX): excl. Tatry Mountain Resorts

Source: Thomson Reuters, IBES, Bloomberg, Raiffeisen RESEARCH

## Stock market forecasts

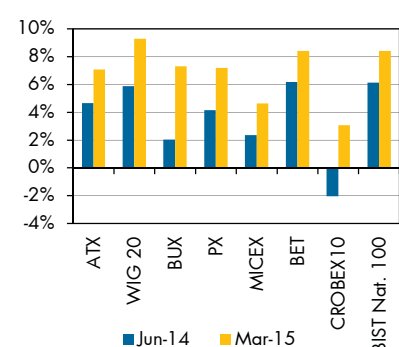
	Index estimates			
	19-Mar <sup>1</sup>	Jun-14	Dec-14	Mar-15
ATX	2,484	2,600	2,700	2,660
WIG 20	2,361	2,500	2,600	2,580
BUX	17,053	17,400	18,600	18,300
PX	989	1,030	1,080	1,060
MICEX	1,319	1,350	1,400	1,380
BET	6,272	6,660	6,850	6,800
CROBEX10	980	960	1,000	1,010
BIST Nat. 100	65,487	69,500	72,000	71,000

<sup>1</sup> 11:59 p.m. (CET)

In local currency

Source: Bloomberg, Raiffeisen RESEARCH

## Expected index performance



Source: Raiffeisen RESEARCH

## Mixed start to 2014

- Crimean crisis makes for tough market conditions in CEE
- Equities versus bonds – risky assets suffer the most from the elevated uncertainty
- Romania stands out in the equity segment

### Sum of last quarter<sup>1</sup>

RBI portfolio (in EUR)	-5.99%
Benchmark (in EUR)	-5.70%
<b>RBI outperformance (in EUR)</b>	<b>-0.29%</b>
by weighting of equities vs. bonds	-0.36%
regional equity weightings	0.05%
weighting of EB vs. LCY bonds	0.00%
country weightings of LCY bonds	0.01%
country weightings of EB EUR	0.00%
country weightings of EB USD	0.00%
joint effects / duration	0.01%

1 31 Dec 2013 - 19 Mar 2014

EB...Eurobonds

Source: Thomson Reuters, Raiffeisen RESEARCH

### Period 1: 31 Dec 2013 - 29 Jan 2014

RBI portfolio (in EUR)	-3.35%
Benchmark (in EUR)	-3.30%
<b>RBI outperformance (in EUR)</b>	<b>-0.06%</b>
by weighting of equities vs. bonds	-0.10%
regional equity weightings	0.04%
weighting of EB vs. LCY bonds	0.00%
country weightings of LCY bonds	0.00%
country weightings of EB EUR	0.00%
country weightings of EB USD	0.00%
joint effects / duration	0.00%

EB...Eurobonds

Source: Thomson Reuters, Raiffeisen RESEARCH

### Period 2: 29 Jan 2014 - 3 Mar 2014

RBI portfolio (in EUR)	-3.40%
Benchmark (in EUR)	-3.18%
<b>RBI outperformance (in EUR)</b>	<b>-0.22%</b>
by weighting of equities vs. bonds	-0.26%
regional equity weightings	0.03%
weighting of EB vs. LCY bonds	0.00%
country weightings of LCY bonds	0.00%
country weightings of EB EUR	0.00%
country weightings of EB USD	0.00%
joint effects / duration	0.00%

EB...Eurobonds

Source: Thomson Reuters, Raiffeisen RESEARCH

### Period 3: 3 Mar 2014 - 19 Mar 2014

RBI portfolio (in EUR)	0.77%
Benchmark (in EUR)	0.78%
<b>RBI outperformance (in EUR)</b>	<b>-0.02%</b>
by weighting of equities vs. bonds	0.00%
regional equity weightings	-0.02%
weighting of EB vs. LCY bonds	0.00%
country weightings of LCY bonds	0.00%
country weightings of EB EUR	0.00%
country weightings of EB USD	0.00%
joint effects / duration	0.00%

EB...Eurobonds

Source: Thomson Reuters, Raiffeisen RESEARCH

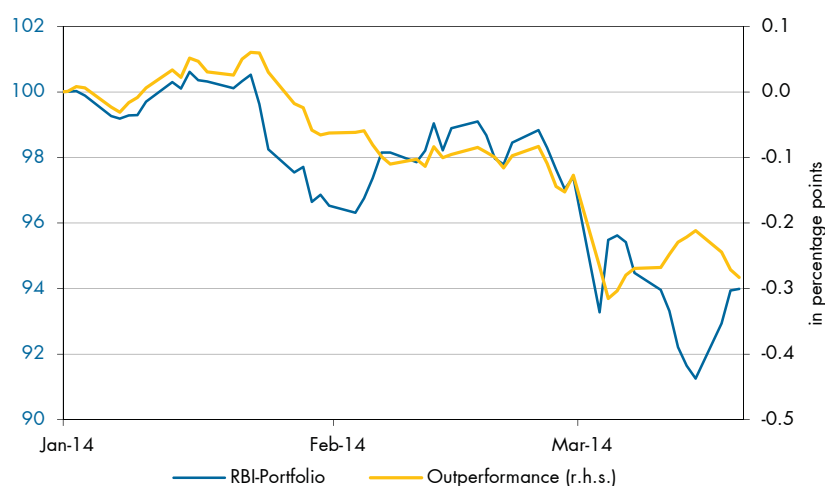
The geopolitical developments in Ukraine also triggered turbulence on the financial markets. This resulted in higher volatility for the equity markets and currencies, and consequently the portfolio's performance fell short of the benchmark by 29bp. In particular, the overweighting of equities versus bonds in the first period and partially in the second period resulted in underperformance of 36bp and was a main factor behind the mixed start to 2014.

Within the **equity segment**, outperformance of around 5bp was recorded, despite the difficult conditions in CEE. The overweighting on Romanian equities, financed from Russia, generated an outperformance of almost 7bp. While the Czech Republic posted a gain of nearly 1bp compared to Croatia, the positionings in the Hungarian and Polish equity markets resulted in a negative contribution of almost 3bp.

Within the **local currency bond segment**, Romania was overweighted in the first period and early in the second period, financed from Turkey and the Czech Republic. On the whole this position led to a neutral result. In the middle of the second period, we took a more positive view of Romanian bonds compared to Czech bonds. Nevertheless, this position was then quickly closed with underperformance of over half a bp. At the end of the second period, Russian bonds were underweighted and Polish bonds were overweighted. This positioning was maintained in the third period and resulted in performance of around 2bp. All in all, local currency bonds recorded outperformance of around 1bp, and thus only had a minor impact on the portfolio as a whole.

Financial analyst: Stefan Theußl

### Performance 2014



Source: Thomson Reuters, Raiffeisen RESEARCH

### CEE portfolio

	2012	2013	Year to date
Benchmark	21.90%	-2.41%	-5.73%
Portfolio	21.07%	-2.54%	-6.01%
Relative Performance	-0.83%	0.12%	-0.29%

Source: Thomson Reuters, Raiffeisen RESEARCH

## Geopolitical uncertainty undermines equity market sentiment

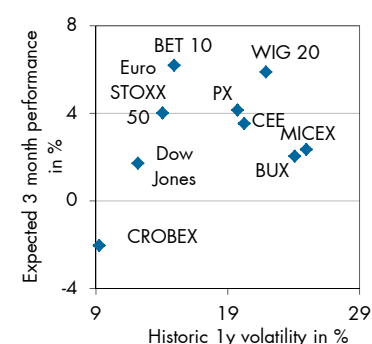
- CEE is hit most strongly by the Crimean crisis
- Elevated uncertainty on the equity markets calls for caution
- Currencies take centre stage

Compared to the established markets, **volatility was already higher in CEE** and this has been further exacerbated by the Crimean crisis. Despite the economic support from the fledgling recovery in the euro area and attractive valuations on the equity markets, the **risk-reward profile for equities has deteriorated**. The reasons for this are mostly related to the risks. Historical volatility has not only increased for the equity indices, but also for exchange rates. Capital outflows from both the equity segment and local currency bonds confirm the prevailing scepticism among many investors, in particular with regard to Russia and Ukraine. From a portfolio perspective, performance was mixed during the first quarter. Equity markets reacted negatively, due to the events in Ukraine. Nevertheless, if there is no further escalation of the conflict in Crimea (which is our baseline scenario), we expect the **equity markets** in CEE to move **sideways** at this level. A calmer period should also be seen for the currencies. As the rate-cutting cycle gradually comes to an end (exceptions: Hungary, Turkey), price gains for **bonds** should probably not really be expected any more. Compared to the developed markets, the **level of yields is very attractive**, but currency developments and the US Fed's ongoing tapering measures could lead to elevated volatility.

Furthermore, there is still a risk that if the situation escalates even more, the West will impose further sanctions on Russia, which would put additional pressure on the equity markets and exchange rates again. On the other hand, a quick political resolution to the crisis would probably trigger a strong upswing for the asset classes that have been sold off. Consequently, on the whole we remain **neutral on equities and bonds** in the CEE portfolio.

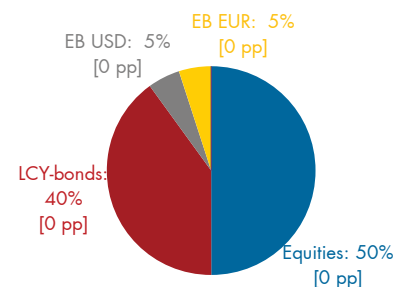
Financial analyst: *Stefan Theußl*

**Risk-return (%)**



In local currency  
Source: Thomson Reuters, Raiffeisen RESEARCH

**CEE portfolio weightings Q2 2014**



LCY...local currency, EB ... Eurobonds  
[ ], [+] = Over-/underweight versus benchmark  
[0] = no change  
Source: Raiffeisen RESEARCH

**Historical volatility & performance (%)**

	Equities <sup>1</sup>						Bonds					
	Volatility <sup>2</sup>		Performance YTD		Performance 5Y yoy <sup>3</sup>		Volatility <sup>2</sup>		Performance YTD		Performance 5Y yoy <sup>3</sup>	
Countries	EUR	LCY	EUR	LCY	EUR	LCY	EUR	LCY	EUR	LCY	EUR	LCY
Czech Republic	18.5	18.1	3.5	4.0	-1.1	-0.6	2.9	1.4	0.9	1.3	7.0	7.5
Hungary	27.0	24.0	-13.3	-9.4	6.6	7.3	10.8	4.0	-3.5	0.9	12.3	13.0
Poland	22.2	19.9	-1.6	-0.7	13.3	11.2	6.7	3.0	0.1	1.0	9.3	7.3
Romania	16.0	15.4	-2.4	-1.7	22.1	23.1	3.9	1.0	-0.4	0.3	4.7	5.6
Russia	33.9	29.0	-19.8	-13.0	8.0	9.7	16.3	9.0	-13.5	-4.5	7.5	9.4
Turkey	35.6	26.9	-7.1	-2.9	14.2	20.7	18.8	7.8	-4.4	-0.1	4.1	10.0
Croatia	9.3	9.1	-7.3	-6.8	3.4	3.9	2.5	2.5	1.8	1.8	8.2	8.2
CEE	23.8	-	-5.7	-	-	-	5.5	-	-1.4	-	-	-

<sup>1</sup> MSCI indices

<sup>2</sup> Three months volatility annualised

<sup>3</sup> Five-year annual return

LCY...local currency

Source: Thomson Reuters, Raiffeisen RESEARCH



## Risk aversion as the dominant factor

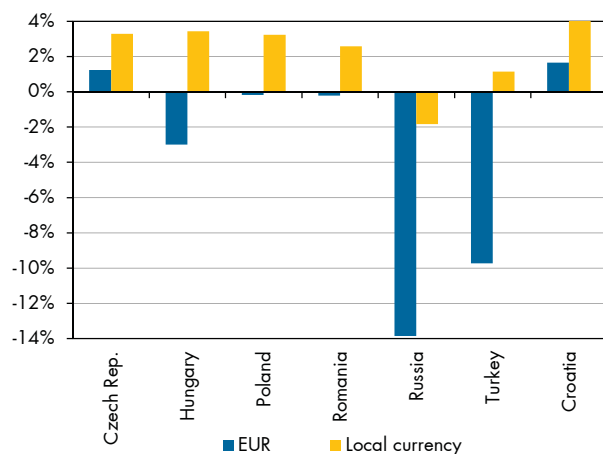
- Little potential for price gains due to low interest rates
- Risks from exchange rate volatility appear rather high
- Further outflows of capital from Russia are likely

### Portfolio weightings: bonds\*

	Portfolio	Benchmark	Difference
EB USD	10.0%	10.0%	0.0%
EB EUR	10.0%	10.0%	0.0%
LCY	80.0%	80.0%	0.0%
Czech Republic	21.0%	20.0%	1.0%
Hungary	19.0%	20.0%	-1.0%
Poland	45.0%	45.0%	0.0%
Romania	6.0%	5.0%	1.0%
Russia	4.0%	5.0%	-1.0%
Turkey	5.0%	5.0%	0.0%
Croatia	0.0%	0.0%	0.0%

\* share in percentage points  
Source: Raiffeisen RESEARCH

### Historical relative performance\*



\* since 3 months, local currency bonds versus portfolio bond benchmark  
Source: Thomson Reuters, Raiffeisen RESEARCH

The geopolitical tensions stemming from the conflict between the European Union and Russia has led to outflows of capital from Eastern Europe, which has impacted the exchange rates of the CEE currencies versus the euro. As there is no way of telling which direction the conflict will go, we tend to expect **larger volatility** in the performance of CEE bonds. Furthermore, the potential for more price increases for bonds is limited, due to the predominant completion of the rate-cutting cycle.

The Czech central bank is likely to leave its key rate at the record low level of 0.05%. As for the exchange rate of the euro and the Czech koruna, we expect that EUR/CZK will move sideways at around 27.00 over the medium term. In the past, a degree of co-movement has developed between Czech and German bonds, which implies that the Czech Republic is seen as a "safe haven in CEE". With this in mind, we overweight the bond segment in the Czech Republic by 1pp. Yields on 10-year Romanian bonds look very attractive in relative terms and should remain roughly at the current levels in an environment of stable money market rates. We thus overweight Romanian bonds by 1pp, due to the relatively stable EUR/RON exchange rate.

In order to keep supporting the Hungarian economy, we believe that further indirect measures by the central bank will result in more depreciation of the forint versus the euro. Accordingly, we expect to see negative performance by Hungarian bonds, prompting us to underweight them by 1pp. In the event of further escalation of the Crimean crisis, there is exchange rate risk for the Russian rouble, even from the currently low level. Consequently, we underweight Russian bonds by 1pp, despite the anticipated decline in yields.

Financial analyst: Stefan Memmer

### Expected bond market performance (%)

Countries	3m		6m		9m		12m	
	EUR	LCY	EUR	LCY	EUR	LCY	EUR	LCY
Czech Republic	0.4	-0.6	-0.2	-1.9	-1.8	-5.6	-2.0	-6.6
Hungary	-3.3	-2.4	-2.2	-1.4	-5.2	-2.9	-6.9	-4.6
Poland	-1.5	-2.3	-0.4	-1.9	0.9	-1.8	2.5	-1.5
Romania	1.0	1.1	-0.6	0.6	1.0	1.1	2.7	1.6
Russia	-0.8	-0.6	12.1	9.0	12.8	10.4	12.0	10.9
Turkey	6.6	3.1	16.2	4.8	15.6	5.8	25.7	17.7
Croatia	2.4	1.3	3.0	2.7	3.8	4.1	5.5	5.5

Not annualised; 10y treasury bond, LCY...local currency  
Source: Raiffeisen RESEARCH



## Defensive weighting preferred

- Volatility high for the time being, due to political tensions
- Czech Republic and Romania as potential outperformers
- Limited growth prospects in Hungary

Due to the tensions between the European Union and Russia about the Crimea conflict, stock indices in the CEE region suffered sharp losses beforehand. As it is very difficult to estimate the outcome of the crisis, we believe that the performance of CEE equities may exhibit more volatility than the established markets.

Against this backdrop, we prefer a defensive allocation within our portfolio by overweighting Romania and the Czech Republic. In Romania, the low **level of interest rates** and **political reforms** by the government should support the upward trend on the stock market quite well. Other positive factors for an overweighting of Romanian stocks are the solid-looking valuations and positive earnings prospects. By contrast, Czech securities are attractive thanks to their **high dividend yields**, and thus we expect outperformance from these assets in the future, in an environment of very low interest rates. With this in mind, we overweight the equity segment in Romania and the Czech Republic by 1pp each. In our opinion, it is still questionable as to whether the recovery in economic growth in Hungary will continue at the previous pace, furthermore, Hungarian stocks are looking relatively expensive. Accordingly, there are not really any major factors that suggest a good performance by Hungarian stocks. In Russia, over the medium term we expect to see more weak economic growth. Furthermore, sanctions by the European Union could additionally push capital outflows from the Russian market. With this in mind and in order to hedge our portfolio against significant downside risks, we underweight Russian and Hungary stocks by 1pp each.

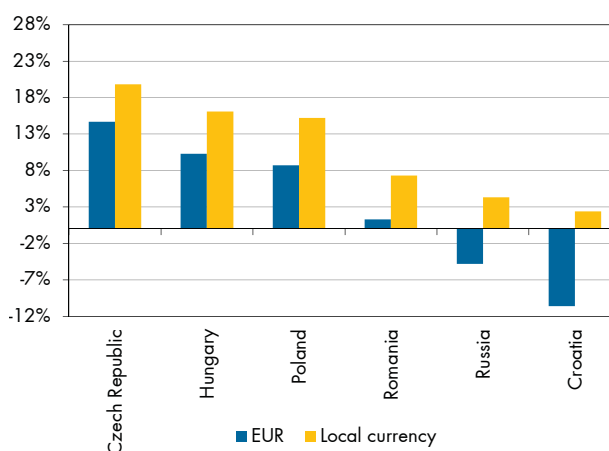
Financial analyst: Stefan Memmer

### Portfolio weightings: stocks

	Portfolio	Benchmark	Difference
Czech Republic	16.0%	15.0%	1.0%
Hungary	11.0%	12.0%	-1.0%
Poland	25.0%	25.0%	0.0%
Russia	39.0%	40.0%	-1.0%
Croatia	3.0%	3.0%	0.0%
Romania	6.0%	5.0%	1.0%

Source: Raiffeisen RESEARCH

### Historical relative performance\*



\* to MSCI CEE, since 3 months

Source: Thomson Reuters, Raiffeisen RESEARCH

### Expected stock market performance (%)

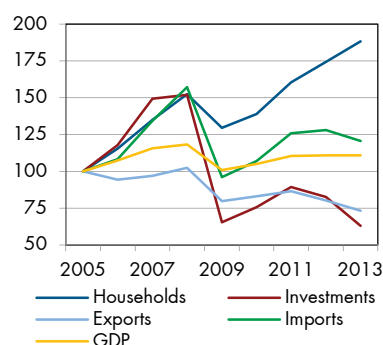
Countries	3m		6m		9m		12m	
	EUR	LCY	EUR	LCY	EUR	LCY	EUR	LCY
Poland	6.7	5.9	3.2	1.7	13.1	10.1	13.7	9.3
Hungary	1.2	2.0	-0.6	0.3	6.4	9.1	4.7	7.3
Czech Republic	5.2	4.1	5.0	3.1	13.7	9.2	12.4	7.2
Russia	2.1	2.4	3.7	0.8	8.4	6.1	5.6	4.6
Romania	6.1	6.2	3.2	4.4	9.1	9.2	9.5	8.4
Croatia	-1.0	-2.0	-3.8	-4.1	1.8	2.0	3.1	3.1

Not annualised, LCY...local currency  
Source: Raiffeisen RESEARCH

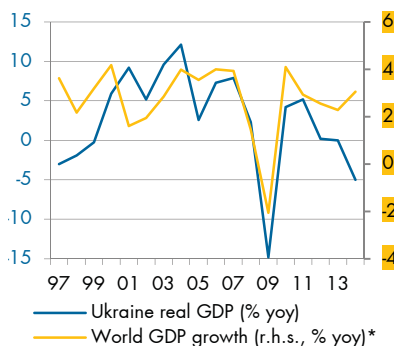
## Ukraine: Between a rock and a hard place

- **Baseline scenario with acceptance of status quo in Crimea; not much further interference by Russia**
- **Economic stabilisation requires implementation of IMF/EU support package and conditionality in 2014 and beyond**
- **Political stability key to avoiding a deeper recession, devaluation and additional Russian indirect/direct interference**
- **Another round of escalation would hit world economy and Ukraine's economy in particular**

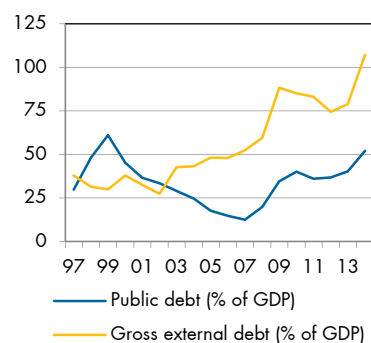
### Growth skewed to household demand\*



### Ukraine vs. World GDP growth



### UA: Public and external debt



### Baseline scenario

Our **baseline scenario** for Ukraine, to which we assign the highest probability (and which also forms the **foundation** for all our CEE and Western economic and **financial market forecasts** as they stand at present), assumes that the current tense situation in Ukraine itself and between Russia and the West regarding the integrity of Ukraine **will not escalate** significantly further. That said, our baseline scenario assumes that Ukraine and the West will accept the current status quo with regards to Crimea, while **Russia** will clearly **refrain** from any meaningful additional indirect and/or direct **interference** in Ukraine. Moreover, a certain diplomatic dialogue between Russia and the West regarding the political and economic future of Ukraine (which may also require some support from Russia for Ukraine) is expected to take place within such a scenario. Within a scenario of partial de-escalation, we would expect **Ukrainian GDP** to **shrink by 3-7%** in 2014. Consumer price **inflation** is likely to shoot up to the low **double digits** (10-14% yoy) from levels of virtually zero in 2013. There could be some upside for GDP growth in 2015 already, partially supported by the recent UAH weakening and IMF structural reforms. Nevertheless, a much-needed **adjustment recession** for 2014 will be mostly induced by the already accumulated economic fallout from domestic political standoff as well as much-needed painful **correction** of the high **twin deficits**. The expected large-scale IMF/EU financing for Ukraine will target substantial shifts in the broadly unsustainable fiscal and external position to more stable levels. Moreover, from a political point of view, **structural reforms** and **public expenditure cuts** should be carried out in a **front-loaded** way (i.e. by the current interim government in Kiev), as a protracted adjustment (and recession) would itself be a danger for political stability. In our base scenario, we would assume more or less orderly further **USD/UAH depreciation** towards a level around **11.5** by year-end 2014 (which would amount to devaluation of 30-40% from pre-adjustment USD/UAH levels at 8.2). The IMF seems to be highly concerned about the shape of the banking sector and potential risks and recapitalisation needs, while overall sums the IMF can provide to Ukraine will be limited (i.e. there is no interest in putting too much resources into the banking sector). Therefore, we tend to think that the IMF/EU support package will not impose overly large near-term burdens on the domestic banking sector. The transition to more **exchange rate flexibility** will most likely be **spread over time**, while LCY public debt restructuring (currently a market fear) would also put too much burden on Ukrainian banks.

It goes without saying that even our fairly optimistic **base scenario** will result in a great deal of **economic pain** and would require **decisive reforms** (e.g. on the fiscal front), backed by a fairly stable political situation in Kiev and throughout the whole country. For instance, the Ukrainian public debt-to-GDP ratio or its level of external debt as a percentage of GDP are likely to reach their highest levels over the last 10-15 years (partially also driven by debt-creating parts of the IMF/EU financial support package). Moreover, **reform momentum** and commitment to **stability-oriented economic policies** must be maintained beyond 2014. Only within such a scenario can the much needed **IMF/EU support package** stay **on track** in

**2014 and beyond.** Certain changes to the political system look inevitable, but would most likely be limited to broader autonomy for the regions. At the same time, we believe that overall economic and political uncertainty will remain elevated – at least until presidential elections in late May.

### What could go wrong?

Any **change** to some of the **mentioned parameters** of our base scenario can give rise to substantial economic **downside scenarios in Ukraine and beyond**. If broad-based **political stabilisation** is not achieved in Ukraine, the looming recession is likely to be deeper and more protracted. This assumption is largely based on the fact that the southern and south-eastern provinces make significant contributions to Ukraine's GDP and by and large constitute Ukraine's export base. Potential downsides to Ukrainian GDP growth in 2014 and 2015 in a more adverse environment can be approximated by looking at past **GDP contractions in other countries** that experienced a bad combination of at least a deep **transition crisis** and severe **financial market stress** and in some cases also on top a **challenging domestic and/or international political environment** with conflicts (in some cases also including a **state collapse** and **secession**). In such cases, a cumulative GDP contraction of around **16%** was the average outcome in a country sample. Usually this 16% cumulative GDP drop was spread over at least two years, with an initial average GDP drop by 6-7% in the first year of crisis followed by another drop of 8-10% in the second year of crisis. That said, a significant drop in Ukrainian GDP in 2014 (at least in the higher single-digit range), with downside risks of another year of contraction in 2015 cannot be ruled out.

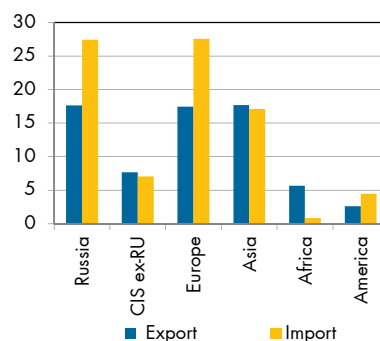
The absence of near-term and broad-based **political stabilisation** could also complicate the much-needed **implementation** of the **IMF/EU support package** for Ukraine. However, partial implementation of the IMF/EU programme conditions would entail significant downside risks. For instance, UAH depreciation pressure is likely to increase under such circumstances, which may lead to USD/UAH levels at around USD/UAH 12-13 by year-end 2014. It goes without saying that such a downside scenario would also significantly increase pressure on the banking sector.

Moreover, the **absence** of broad-based **political stabilisation** also entails the **risk** of increasingly indirect and/or direct **Russian involvement** in Ukraine. Such a scenario would clearly add to the already tense situation between the West and Russia in terms of political and economic relations. Another round of escalation seems likely under those circumstances. However, our baseline scenario is founded on a fairly supportive global economic backdrop for Ukraine (e.g. compared to the situation back in 2008). The latter would clearly deteriorate significantly in the case of **harsh Western economic and financial sanctions against Russia**.

Further escalation of tensions between Russia and the West, finally resulting in the phasing in of broad-based economic and financial sanctions against Russia, would also exert significant additional **pressure** on **Russia's** already **weak economy**, Russian assets and RUB in particular. Such developments would also then have significant **second-round effects** for the **Ukrainian economy**. Trade relations between Russia and Ukraine will suffer from severe damage in such a scenario. Moreover, broad-based additional exchange rate pressure on a major CIS currency such as RUB would lead to additional UAH devaluation pressure.

Financial analysts: Gunter Deuber, Andreas Schwabe, CFA

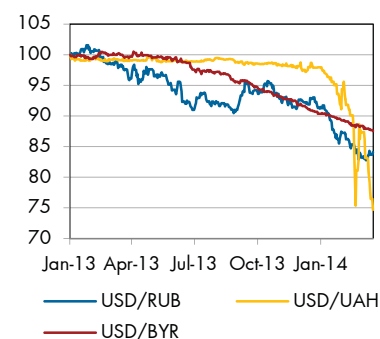
### Goods exports and imports\*



\* USD bn, 2012

Source: Ukraine State Statistics Committee

### UAH comparison to CIS peers\*



\* Indexed chart: January 2013 = 100

USD/RUB: 5y high 36.63, 5y low 27.28

USD/UAH: 5y high 10.7, 5y low 7.6

USD/BYR: 5y high 9870, 5y low 2711

Source: Bloomberg, Raiffeisen RESEARCH

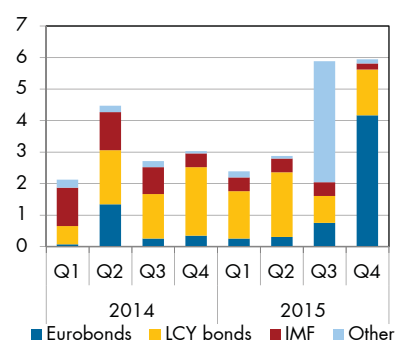
### Cumulative crisis-induced GDP drop\*

Croatia 1990-1993	-48
Slovakia 1990-1993	-27
Slovenia 1990-1992	-19
Czech Rep. 1990-1992	-13
Serbia 1999	-11
Georgia 2009	-4
Ukraine 2009	-15
Average (Median)	-16

\*percentage points

Source: wiiv, IMF, Raiffeisen RESEARCH

### Ukraine public debt schedule\*



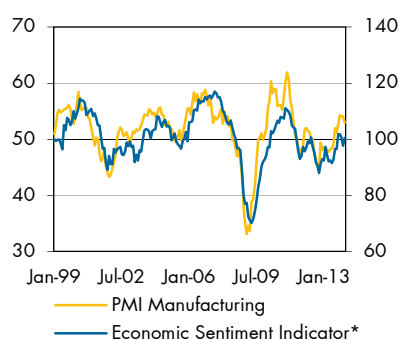
\* all figures in USD bn

Source: Bloomberg, IMF, Raiffeisen RESEARCH

## Moderate economic recovery goes according to plan

- Tentative economic revival started in H2 2013
- Domestic demand should gather pace and become the driving force behind the recovery
- Although employment growth remains by and large subdued, it is expected to accelerate
- Lower inflation facilitates real wage growth

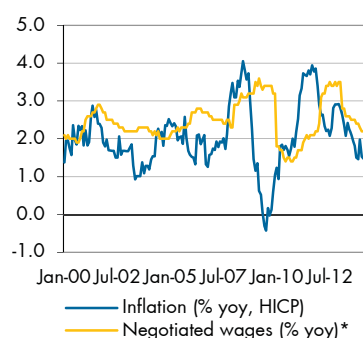
### Upward trend remains intact



\*European Commission, r.h.s.

Source: Thomson Reuters, Markit, Raiffeisen RESEARCH

### Lower inflation supports real wages



\*OeNB (Austrian central bank) Negotiated Standard Wage Rate Index

Source: Thomson Reuters, Austrian central bank, Raiffeisen RESEARCH

The **weakness in the Austrian economy** was **overcome** in the second half of 2013. For instance, real GDP in Q3 and Q4 grew at rates of 0.2% qoq and 0.3% qoq, respectively. Even though the economic recovery continued to be borne to a large extent by external trade, domestic demand stabilised more and more as 2013 progressed and made positive contributions to quarterly GDP growth again starting from the second quarter of 2013. At the same time, to a large degree this was due to public consumption, whereas private consumption stagnated. The tentative expansion of gross fixed capital formation on the other hand can be attributed exclusively to the construction sector, which was able to offset the decline in equipment investment (qoq). For 2013 as a whole, GDP expanded at a rate of 0.4% in real terms, after 0.9% in the previous year (2012).

Key leading indicators such as the economic sentiment indicator and the purchasing managers' index for the manufacturing sector have been posting mild declines since December 2013. In particular with respect to the latter indicator, however, this was preceded by a sharp rise during the second half of 2013, and thus modest declines can be seen as a temporary consolidation. Furthermore, the purchasing managers' index for the manufacturing sector is still clearly in expansion territory. Consequently, leading indicators suggest that the **recovery will continue to accelerate in the course of 2014**. The high point in economic activity should be reached during the winter half year 2014/2015. At the same time, the pace of this recovery is expected to remain more subdued than it was in past periods of economic upturn. As such, average quarterly real GDP growth should amount to 0.5% in 2014 followed by 0.6% in 2015, which is quite moderate by historical standards.

One major source of momentum for the economy should come from the improvement in external conditions, which should be reflected in rising exports. Nevertheless, foreign trade is expected to make smaller contributions to quarterly

### Key economic figures and forecasts

	2012	2013	2014e	2015f
Real GDP (% yoy)	0.9	0.4	1.5	2.3
Private consumption (% yoy)	0.5	-0.2	0.8	1.6
Gross fixed capital formation (% yoy)	1.6	-0.9	2.0	4.1
Nominal exports (% yoy)	3.8	5.0	7.0	8.4
Nominal imports (% yoy)	2.3	2.7	6.4	8.6
Trade balance (goods and services, EUR bn)	9.9	14.0	15.9	17.0
Current account balance (EUR bn)	4.9	8.1	8.1	7.7
General budget balance (EUR bn)*	-7.7	-4.9	-8.4	-3.0
General budget balance (% of GDP)*	-2.5	-1.6	-2.6	-0.9
Unemployment rate (avg, %, EU definition)	4.4	4.9	4.8	4.7
Consumer prices (avg, % yoy)	2.6	2.1	1.8	1.8
Real wages (% yoy)	0.7	0.4	0.5	0.9
Unit labour costs (% yoy)	3.0	2.6	1.5	1.9

\* state, provinces, municipalities and social security authorities

Source: Statistics Austria, Thomson Reuters, Raiffeisen RESEARCH



GDP growth rates over the forecast horizon. Because along with exports, import activity is also likely to pick up, against the backdrop of stronger **domestic demand**, which **should advance to become the driving force behind the economic recovery**.

In case of economic sanctions between the EU and **Russia**, which is not our base case, consequences for the Austrian business cycle can be expected. Yet it is important to keep in mind that the trade volume between Austria and Russia is still relatively low. Russia accounts for merely 2.8% (EUR 3.5bn) of total Austrian goods exports (2013), while only 2.4% of Austrian goods imports are coming from Russia (mainly energy/fuel).

Even though capacity utilisation continues to be below average, in the wake of the slack performance seen in recent quarters gross fixed capital formation will probably benefit from the **favourable financing conditions** and the need to move ahead with **replacement investments**. An **upturn in investment activity** is also suggested by industrial confidence, which has been above the long-term average for a few months now.

Also **private consumption is expected to accelerate in the quarters ahead**. Support should come from labour market conditions: whilst the level of employment merely stagnated (in month-on-month terms) for much of 2013, some cautious growth in employment was recently observed again. **Employment growth** should begin to pick up more strongly during the second half of the year at the latest. **Nevertheless, also in 2015 no significant decline in the rate of unemployment (international definition) is expected**, because labour force growth should also continue over the entire forecast horizon, hindering a decline in the unemployment rate. Private consumption should also be bolstered by the development of real wages, because even though wage growth has tapered off in recent months, real wage growth continues to be positive thanks to the falling rates of inflation (in year-on-year terms). What is more, nominal wage increases should be higher again in 2015 (2.7%) after a slight slowdown this year to 2.3%.

**The expected path of inflation should foster positive developments in real wages also in 2014 and 2015.** For example, following a brief rise in December, inflation (yoy) declined again in the following two months. Despite tax hikes, inflation in both 2014 (1.8%) and 2015 (1.8%) is expected to be lower than in 2013 (2.1%).

Financial analyst: Matthias Reith

#### GDP: value added by sector

Change (% yoy, in real terms)	2012	2013	2014e	2015f
Agriculture & forestry	-8.0	-1.4	0.0	0.0
Prod. of goods/mining	1.1	1.1	3.2	4.0
Energy/water supply	9.7	12.7	0.5	4.0
Construction	0.8	0.2	1.5	2.5
Wholesale and retail trade	-1.7	-1.4	0.5	2.2
Transportation	-1.0	-0.6	1.2	2.5
Accom. & restaurant trade	1.6	-2.2	1.0	1.5
Information and communication	-1.5	-2.0	1.0	2.0
Credit and insurance	2.7	0.0	0.5	2.2
Property & business services	1.7	0.7	1.5	2.5
Other economic services	0.8	0.4	2.0	3.0
Public sector	-0.2	0.3	0.2	0.5
Healthcare, social services	2.0	1.4	1.4	1.5
Other services	1.1	1.3	1.7	2.0
Gross domestic product	0.9	0.4	1.5	2.3

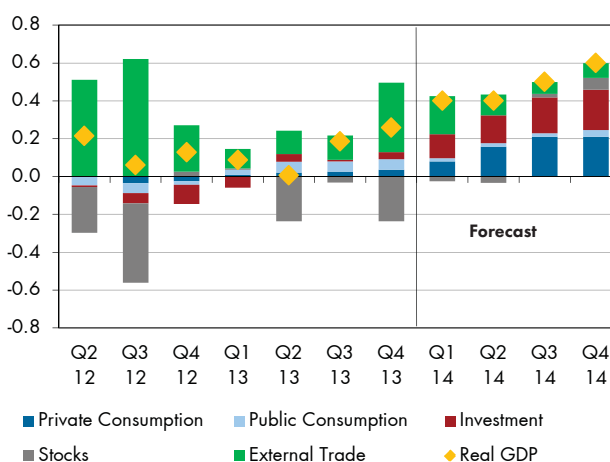
Source: Statistics Austria, Raiffeisen RESEARCH

#### GDP: expenditure composition

Change (% yoy, in real terms)	2012	2013	2014e	2015f
Private consumption	0.5	-0.2	0.8	1.6
Public consumption	0.2	0.1	0.7	0.7
Gross fixed capital formation	1.6	-0.9	2.0	4.1
Equipment	2.1	-3.1	3.3	4.7
Construction	2.5	0.7	1.0	3.6
Exports	1.2	2.8	5.1	6.5
Imports	-0.3	0.6	4.4	6.7
Gross domestic product	0.9	0.4	1.5	2.3

Source: Statistics Austria, Thomson Reuters, Raiffeisen RESEARCH

#### Contributions<sup>1</sup> to real GDP growth (qoq)



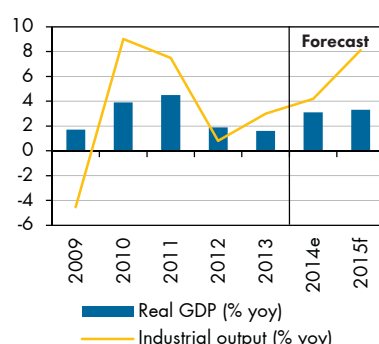
<sup>1</sup> in percentage points

Source: Thomson Reuters, Raiffeisen RESEARCH

## Recovery gains momentum in a non-inflationary environment

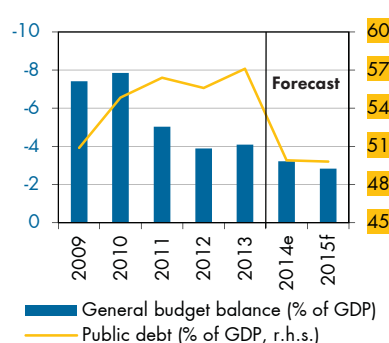
- Internal demand should take up the baton in contributing to GDP growth
- Lack of inflationary pressure encourages MPC to keep interest rates stable at least until end-Q3 2014
- Gradual normalizing of core market yields to drive local currency yields upwards significantly...
- ...but slightly strengthening zloty supports our overall hold recommendation for the POLGB market

### Real GDP (% yoy)



Source: Thomson Reuters, Raiffeisen RESEARCH

### Budget balance and public debt



Source: Thomson Reuters, Raiffeisen RESEARCH

### Economic outlook

The Polish economy continued a firm recovery in Q4 2013, with GDP growth accelerating to 2.7% yoy from 1.9% yoy in Q3. The growth structure seems moderately optimistic as it was generated not only by net export but also by internal demand recovery. Their contributions amounted to 1.5 percentage points and 1.2 percentage points, respectively. The recent **upward dynamics in private consumption** are mainly supported by low inflation, which gives rise to real wage growth and increases households' purchasing power. We expect that this factor should still favour the economy as there is no inflationary pressure and the **CPI index should remain close to 1% yoy** at least until the end of Q3. We expect that it may start to rise more significantly in Q4 as a result of stronger economic activity, improvement on the labour market and the low base effect, and the rate may approach 2% yoy at the end of 2014. The low CPI index and no threat of inflation justifies the MPC decision to **keep interest rates at the current record-low level at least until the end of Q3 2014**. We forecast that first interest rate hikes will take place in Q4 as a result of the improving economic outlook and rising inflation prospects. This stable environment of low interest rates should in turn support further growth in investment activity.

Consequently, we expect that GDP growth will gain momentum in the coming quarters and this is also confirmed by the high PMI readings. On the other hand, as the situation on the labour market is still weak, we maintain our opinion that the **economy should develop at a pace no higher than 3.1% for 2014** as a whole. Moreover, we estimate that the output gap started to narrow in Q4 and we expect this process to continue. As a result, the negative output gap should close in 2015. A risk which recently arose for the economic outlook is the Russian embargo on pork from Polish producers. In the case of **worsening relationships between Russia and Poland, export dynamics may be significantly dampened**.

### Key economic figures and forecasts

	2009	2010	2011	2012	2013	2014e	2015f
Nominal GDP (EUR bn)	311.1	354.7	370.4	381.5	389.0	411.8	450.9
Real GDP (% yoy)	1.7	3.9	4.5	1.9	1.6	3.1	3.3
Industrial output (% yoy)	-4.5	9.0	7.5	0.8	3.0	4.2	8.1
Unemployment rate (avg, %)	11.0	12.1	12.4	12.8	13.6	13.1	12.7
Nominal industrial wages (% yoy)	4.4	3.3	5.0	3.4	2.6	3.3	5.0
Producer prices (avg, % yoy)	3.4	2.1	7.6	3.3	-1.3	2.5	2.6
Consumer prices (avg, % yoy)	3.5	2.6	4.3	3.7	0.9	1.2	2.1
Consumer prices (eop, % yoy)	3.5	3.1	4.6	2.4	0.7	2.0	2.5
General budget balance (% of GDP)*	-7.4	-7.9	-5.0	-3.9	-4.1	-3.2	-2.8
Public debt (% of GDP)*	50.9	54.8	56.4	55.6	57.1	49.9	49.8
Current account balance (% of GDP)	-3.9	-5.1	-4.9	-3.5	-1.3	-2.8	-4.1
Official FX reserves (EUR bn)	55.2	70.0	75.7	82.6	81.0	83.7	89.7
Gross foreign debt (% of GDP)	62.5	66.9	67.5	72.7	71.0	68.7	66.5
EUR/PLN (avg)	4.33	3.99	4.12	4.19	4.19	4.16	4.00
USD/PLN (avg)	3.10	3.01	2.96	3.26	3.15	3.08	3.01

\* with one-off effects from pension funds transfer in 2014/2015  
Source: Thomson Reuters, Raiffeisen RESEARCH

With a better outlook for economic growth, this year should also bring an improvement in the fiscal balance which was additionally supported by pension system reform which **lowered the relation of general government debt to GDP by about 9pp**. Thus we estimate it at the level slightly lower than 50% of GDP.

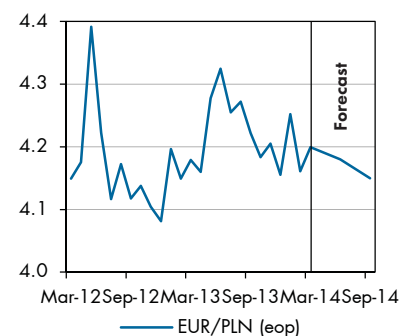
### Financial market outlook

Despite the supportive GDP development, it was mainly external factors that led to the very volatile moves for the zloty during the first quarter 2014. Nevertheless, the benign economic environment should prevail in the coming months, and we project a calming of the external political situation in the second quarter. Meanwhile, the monetary policy council revised its inflation outlook to the downside. This increases the likelihood that the first interest rate hike, initially expected for Q3 2014, will be postponed after the central bank extended its forward guidance of record low rates by one quarter. Despite that, we still expect a slightly stronger zloty versus EUR, but the pace of the appreciation trend is set to slow somewhat compared to our earlier assumptions. However, since we continue to project inflation to be at the upper end of the monetary council's expectation band, we foresee the start of the interest rate tightening cycle already coming in Q4 2014, i.e. in November. Nevertheless, despite these PLN-supportive assumptions it must be stressed that the zloty remains a currency which is susceptible to external shocks. In the case of greater uncertainties both globally and in the CEE region, elevated volatility would be the consequence.

In contrast to our expectations back in December when our previous quarterly strategy was published, the gradual increase in PLN yields was postponed in line with core market yield developments. German Bunds continued to see strong bids in the past few weeks due to flight-to-quality reasons, hindering the structurally justified normalisation of core market and, correspondingly, of POLGB yields. The recent reversal of earlier yield increases on the Polish debt market was additionally supported by the more dovish MP outlook in Poland. Given our assumptions of prolonged tensions surrounding the Ukrainian conflict, the bulk of core market yield increases should come only in H2 2014, leaving our general expectation of cyclically rising core market yields intact. As a result, the Polish LCY yield curve should mirror these moves, while the upward drift in PLN yields should already be supported by domestic drivers such as price developments. Hence, our medium-term bearish view on the market remains intact. Overall, given the combination of a moderately stronger currency and a gradual increase in yields, we maintain our neutral recommendation on the POLGB market over our entire forecast horizon. In line with our FX market assessment, any escalation of the geopolitical situation marks the biggest risk to our forecasts.

Financial analysts: Paweł Radwański, Raiffeisen Polbank, Warsaw; Stephan Imre, RBI Vienna

### Exchange rate development



EUR/PLN: 5y high 4.74, 5y low 3.83  
Source: Bloomberg, Raiffeisen RESEARCH

### Exchange rate forecasts

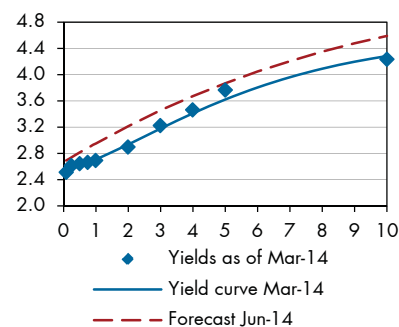
	19-Mar <sup>1</sup>	Jun-14	Sep-14	Dec-14	Mar-15
EUR/PLN	4.20	4.18	4.15	4.10	4.05
Cons.		4.09	4.07	4.04	4.01

	19-Mar <sup>1</sup>	Jun-14	Sep-14	Dec-14	Mar-15
USD/PLN	3.02	3.10	3.19	3.04	3.00
Cons.		3.10	3.12	3.13	3.07

<sup>1</sup> 5:00 p.m. (CET)

Source: Bloomberg, Raiffeisen RESEARCH

### PLN rate and yield curve (%)\*



\* 1m – 12m interest rates; 2y – 10y LCY gov. bond yields  
Source: Bloomberg, Raiffeisen RESEARCH

### Interest rate forecasts

	19-Mar <sup>1</sup>	Jun-14	Sep-14	Dec-14	Mar-15
Key rate	2.50	2.50	2.50	2.75	3.25
Consensus		2.50	2.63	2.88	3.38

1 month <sup>2</sup>	2.41	2.61	2.61	2.86	3.36
3 month <sup>2</sup>	2.51	2.71	2.79	3.16	3.54
Consensus		2.73	2.83	3.11	3.54

6 month <sup>2</sup>	2.54	2.76	2.97	3.35	3.72
12 month <sup>2</sup>	2.59	3.08	3.35	3.75	4.46

<sup>1</sup> 5:00 p.m. (CET) <sup>2</sup> Bid rate

Source: Bloomberg, Raiffeisen RESEARCH

### Yield forecasts

	19-Mar <sup>1</sup>	Jun-14	Sep-14	Dec-14	Mar-15
2y T-bond <sup>2</sup>	2.90	3.3	3.4	3.6	3.7
Cons.		3.2	3.4	3.6	3.8

5y T-bond <sup>2</sup>	3.76	3.9	4.0	4.2	4.2
10y T-bond <sup>2</sup>	4.23	4.6	4.7	4.8	4.9
Cons.		4.7	4.8	4.9	5.1

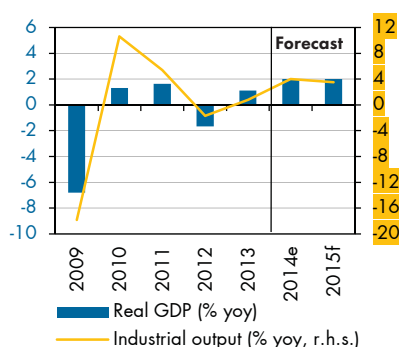
<sup>1</sup> 5:00 p.m. (CET) <sup>2</sup> Ask yield

Source: Bloomberg, Raiffeisen RESEARCH

## Public sector drives growth

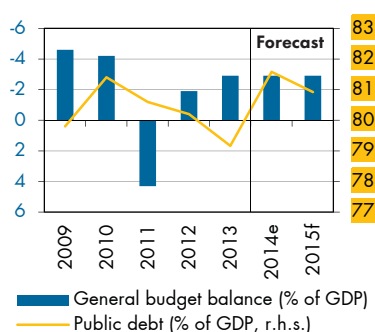
- After 1.1% GDP growth in 2013, we expect 2% growth for 2014
- Inflation at rock-bottom
- Employment reaches 21-year high – mostly due to public works
- Ruling Fidesz likely to be re-elected in the April elections

### Real GDP (% yoy)



Source: Thomson Reuters, Raiffeisen RESEARCH

### Budget balance and public debt



Source: Thomson Reuters, Raiffeisen RESEARCH

### Economic outlook

The year 2013 marked a **turnaround for the Hungarian economy** in various fields indeed. GDP growth came in at 1.1% for the year, investments and construction industry awoke from the doldrums which had lasted for the last 5-6 years and household consumption also picked up towards the end of the period. **Employment reached over 4 million at the end of the year** – we have not seen such a high number since 1992. The bad news is that the bulk of the improvement came from the public sector, while the private sector was characterised by stagnation overall. As far as the outlook is concerned, we expect the **positive trends to be further enhanced in 2014 and project 2% GDP growth**. Most importantly, we forecast the private sector to contribute more to economic growth. Improving demand in major export markets, new capacities in the car industry and the slow recuperation of domestic demand helps the local corporate sector. Its competitive position is enhanced by HUF depreciation (HUF depreciated by 4% in Q1 2014 compared to Q1 2013) as well as the cheap loans available via the central bank's Funding for Growth Scheme. Nevertheless, the **Hungarian growth model is still very much dominated by the public sector**. Apparently, the government's economic policies are centred on the belief that ailing private sector should be either replaced by the state or in some instances boosted by the state (especially concerning the local SME sector).

Large sector taxes on selected industries, new taxes (such as the financial transaction tax) and the available EU funds would allow further growth of state intervention and public investments **without harming the below 3% of GDP budget deficit requirement in 2014**. External balances are set to further improve. The further reduction of FX loan exposure of the corporate and household sector helps to reduce vulnerabilities.

### Key economic figures and forecasts

	2009	2010	2011	2012	2013	2014e	2015f
Nominal GDP (EUR bn)	91.5	96.3	101.3	96.1	97.9	96.4	99.6
Real GDP (% yoy)	-6.8	1.3	1.6	-1.7	1.1	2.0	2.0
Industrial output (% yoy)	-17.8	10.6	5.4	-1.7	0.8	4.0	3.5
Unemployment rate (avg, %)	9.8	11.1	11.0	10.9	10.4	8.0	6.8
Nominal industrial wages (% yoy)	3.8	5.5	6.2	6.2	5.7	4.6	4.5
Producer prices (avg, % yoy)	4.9	4.5	4.3	4.3	0.7	1.7	3.6
Consumer prices (avg, % yoy)	4.2	4.9	3.9	5.7	1.7	1.1	3.2
Consumer prices (eop, % yoy)	5.6	4.7	4.1	5.0	0.4	2.8	3.4
General budget balance (% of GDP)	-4.6	-4.2	4.3	-1.9	-2.9	-2.9	-2.9
Public debt (% of GDP)	79.8	81.4	80.6	80.2	79.2	81.6	80.9
Current account balance (% of GDP)	-0.2	1.1	0.8	1.8	2.8	3.4	4.2
Official FX reserves (EUR bn)	30.0	33.7	37.8	33.9	33.0	33.0	33.0
Gross foreign debt (% of GDP)	149.9	143.5	130.3	131.1	123.6	121.3	114.4
EUR/HUF (avg)	280	275	279	290	298	315	321
USD/HUF (avg)	201	208	201	226	224	233	242

Source: Thomson Reuters, Raiffeisen RESEARCH



Households are seen to benefit from the rock-bottom inflation environment (headline inflation reached 0.0% yoy in January 2014 – we expect 1.3% average inflation for 2014), but only a moderate rise of consumption demand is realistic in light of the ongoing deleveraging.

2014 is an election year. Parliamentary elections are scheduled for April 6. The **governing Fidesz party has good chances to be re-elected**, and opinion poll companies even give Fidesz a fair chance of achieving a qualified 2/3 victory, similar to the 2010 election results. If the base-case scenario comes true (i.e. Fidesz wins the elections), we expect no major change in the economic policy stance of the government.

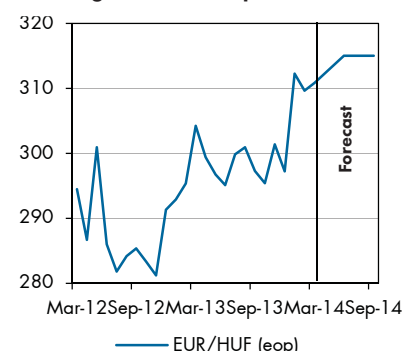
### Financial market outlook

The likely continuation of the rate-cutting cycle together with the ongoing external uncertainty should keep the forint under pressure during the second quarter. We even see a significant risk of short-term overshooting above levels of 320 in April/May. After that, however, we expect some support for the remainder of Q2 from the likely end of the rate-cutting cycle and the calming down of the situation surrounding the Ukrainian conflict with Russia. However, the overall HUF losses witnessed in the past few months should not see a reversal back to EUR/HUF 300. With the central bank as well as the government obviously in favour of a weaker forint, we would expect a continuation of overall HUF depreciation in the next few quarters. For the year-end 2014 this could put us near EUR/HUF 320 and remain there for a longer period of time.

Since mid-Dec 2013, the HGB curve has shifted upwards, with the 3y benchmark bond posting the biggest losses. Until the end of June, by contrast, the long end of the HUF curve should see the most pronounced increases, driven mainly by the rising geopolitical risk premium and the cyclical rise in core market yields. In our view, the HGB market could only outperform our expectations, if the monetary loosening cycle finishes earlier than reflected by our forecasts. First hopes that the MPC could share our view were fed recently, when MPC members indicated that they will rethink the interest rate path as the Ukrainian situation creates an unfavourable environment for the forint. However, price developments – CPI inflation at historical lows – remain the main argument for a further relaxation of monetary conditions. However, despite of the earlier or later end of the rate-cutting cycle we nevertheless expect a bear steepening of the yield curve as the year progresses, although the Hungarian central bank will most likely not follow any interest hike tendencies in the region (e.g. Poland expected to hike in Nov 2014).

Financial analyst: Zoltan Torok, Raiffeisen Bank Zrt., Budapest; Stefan Imre, RBI Vienna

### Exchange rate development



EUR/HUF: 5y high 320.41, 5y low 261.32  
Source: Bloomberg, Raiffeisen RESEARCH

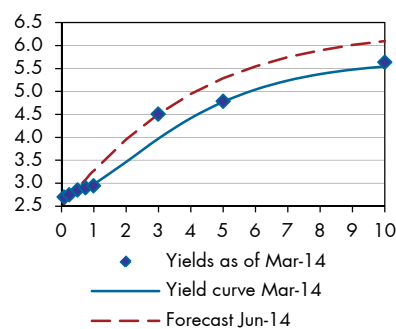
### Exchange rate forecasts

	19-Mar <sup>1</sup>	Jun-14	Sep-14	Dec-14	Mar-15
EUR/HUF	310.83	315.0	315.0	320.0	320.0
Cons.		301.0	299.0	300.0	296.0

USD/HUF	223.39	233.3	242.3	237.0	237.0
Cons.		228.0	229.0	232.0	227.0

<sup>1</sup> 5:00 p.m. (CET)  
Source: Bloomberg, Raiffeisen RESEARCH

### HUF rate and yield curve (%)\*



\* 1m – 12m interest rates; 3y – 10y LCY gov. bond yields  
Source: Bloomberg, Raiffeisen RESEARCH

### Interest rate forecasts

	19-Mar <sup>1</sup>	Jun-14	Sep-14	Dec-14	Mar-15
Key rate	2.70	2.40	2.40	2.40	2.40
Consensus		2.63	2.63	2.75	3.13

1 month <sup>2</sup>	2.70	2.50	2.50	2.60	2.70
3 month <sup>2</sup>	2.75	2.70	2.80	2.90	3.00
Consensus		2.96	2.94	2.92	3.40

6 month <sup>2</sup>	2.85	2.90	2.97	3.10	3.20
12 month <sup>2</sup>	2.94	3.30	3.30	3.50	4.00

<sup>1</sup> 5:00 p.m. (CET) <sup>2</sup> Bid rate  
Source: Bloomberg, Raiffeisen RESEARCH

### Yield forecasts

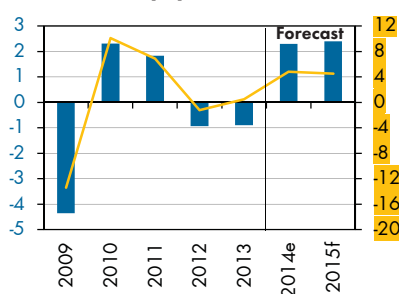
	19-Mar <sup>1</sup>	Jun-14	Sep-14	Dec-14	Mar-15
3y T-bond <sup>2</sup>	3.45	4.2	4.2	4.4	4.8
Cons.		n.v.	n.v.	n.v.	n.v.
5y T-bond <sup>2</sup>	4.78	5.3	5.4	5.6	6.0
10y T-bond <sup>2</sup>	5.63	6.2	6.3	6.6	7.0
Cons.		4.6	4.6	5.4	6.1

<sup>1</sup> 5:00 p.m. (CET) <sup>2</sup> Ask yield  
Source: Bloomberg, Raiffeisen RESEARCH

## Rocket recovery fuelled by one-off effects

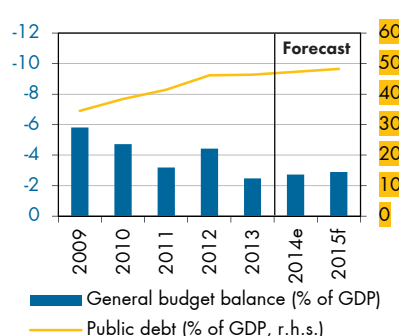
- Continued recovery this year after a technically weaker Q1
- New left-centre government delivers no radical change in recent economic policy
- CNB may exit current FX regime by year-end already
- Expected bond yield gains are limited by low inflation environment and liquidity surplus

Real GDP (% yoy)



Source: Thomson Reuters, Raiffeisen RESEARCH

Budget balance and public debt



Source: Thomson Reuters, Raiffeisen RESEARCH

### Economic outlook

The Czech economy grew by 1.6% qoq in Q4, after mild expansion of 0.3% qoq in Q3. The decline in GDP in 2013 was revised to a smaller number of 0.9%. However, the **rapid growth in Q4 was caused by one-off events**. First was the price increase of imports due to FX intervention (which resulted in a CZK depreciation of more than 6%), and second was the anticipated increase in taxes on tobacco products. Gross value added (without taxes) grew by just 0.6% qoq. The difference between GDP and GVA growth reveals the artificiality of the headline figure. GDP would be rising even without these one-off factors, but far more slowly. The good news is that the **recovery continues which is also evident from the further improvement in monthly indicators** (especially PMI). We forecast a mild decline in GDP at the beginning of this year, as a correction of the one-off acceleration in Q4. The economy will continue to recover thereafter. We project annual growth to reach 2.3% this year. Risks to our forecast are: possibly deeper correction in Q1, and slower growth in the Euro area. As regards the **tense geopolitical situation in Ukraine**, if it affects Czech GDP it will **only do so through the Euro area**, which is dominant destination for Czech exports. The GDP growth in 2015, which we expect to reach 2.4%, will be negatively affected by the expected exit from the current FX regime.

The new **left-centre coalition government has not made any radical changes** in recent economic policy. It aims to make several parametric changes to the tax system (e.g. to introduce a third VAT rate and increase once again exercise tax on tobacco) and increase the effectiveness of public administration (for example by adopting new civil service law and improving the public procurement process). Furthermore, the new cabinet promises to bring the country closer to Euro area entry. So far the statements have been vague on any timing. The **fiscal policy of the new government is expected to be pro-growth oriented** in the coming years.

### Key economic figures and forecasts

	2009	2010	2011	2012	2013	2014e	2015f
Nominal GDP (EUR bn)	142.4	150.0	155.6	153.1	149.5	148.1	160.0
Real GDP (% yoy)	-4.4	2.3	1.8	-0.9	-0.9	2.3	2.4
Industrial output (% yoy)	-13.4	10.1	6.9	-1.2	0.5	4.8	4.5
Unemployment rate (avg, %)	6.2	7.0	6.7	6.8	7.6	7.3	7.2
Nominal industrial wages (% yoy)	3.5	3.8	3.4	3.4	0.9	2.1	3.5
Producer prices (avg, % yoy)	-3.1	1.2	5.6	2.1	0.8	0.4	1.7
Consumer prices (avg, % yoy)	1.0	1.5	1.9	3.3	1.4	1.3	2.0
Consumer prices (eop, % yoy)	1.0	2.3	2.4	2.4	1.4	2.4	1.6
General budget balance (% of GDP)	-5.8	-4.7	-3.2	-4.4	-2.5	-2.7	-2.9
Public debt (% of GDP)	34.5	38.4	41.4	46.2	46.3	47.3	48.3
Current account balance (% of GDP)	-2.4	-3.9	-2.9	-2.4	-1.0	-0.5	-0.1
Official FX reserves (EUR bn)	28.9	31.8	31.1	34.0	40.8	41.0	40.0
Gross foreign debt (% of GDP)	43.5	47.6	49.0	50.5	51.1	49.8	49.3
EUR/CZK (avg)	26.4	25.3	24.6	25.1	26.0	27.1	26.0
USD/CZK (avg)	18.9	19.0	17.7	19.5	19.6	20.1	19.6

Source: Thomson Reuters, Raiffeisen RESEARCH

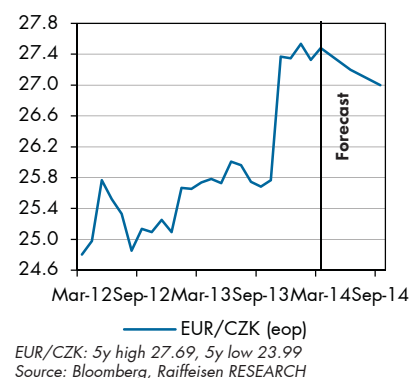
In 2014, the **cyclically-adjusted government deficit is set to widen** after a visible reduction in 2011-2012. The fiscal gap might widen by 0.2 percentage points to 2.7% of GDP this year. And the public debt-to-GDP ratio might exceed 47%, despite solid nominal GDP growth.

### Financial market outlook

As expected, market players have not speculated against the CNB's FX floor of EUR/CZK 27.0. Therefore, EUR/CZK remained around 27.40, without any further outright CNB FX intervention. Although the economy was doing better than expected, inflation has remained subdued at 0.2% yoy. Both actual and anticipated inflation will probably be the key drivers of the EUR/CZK exchange rate this year. We expect that the inflation rate will gradually increase towards 2.0% in Q4 2014, and the CNB's forecast predicts a further rise. By that time market players might already speculate about CZK appreciation in the near future. The CNB might quite easily fight against such speculative pressure, but the question is whether the CNB will be willing to increase FX reserves further when it sees an expanding economy and inflation above the 2.0% target. From this point of view, the CNB might leave the FX floor sooner rather than later. The key question, however, will be inflation. We expect the inflation rate to be around 1% yoy by May 2014. Implicitly, a rate of inflation lower by 100bp compared to the target should postpone the expected abandonment of the FX floor by around 10 months. Estimating the timing of such CNB decisions is obviously difficult. Recently, the CNB governor admitted that he could imagine abandoning the FX floor at the beginning of 2015. At the same time, the CNB is working hard to convince the market that CZK does not need to appreciate much even when the FX floor is abandoned. Sharp currency appreciation would really not be convenient for the CNB as the current EUR/CZK levels around 27.40 provide opportunities for longer-term hedging against future CZK appreciation. The inflation outlook will be crucial for the Czech government bond market as well. We still expect a gradual rise in Czech government bond yields. Although compared to last year, the net borrowing requirements will be higher by around CZK 110 bn, there will probably not be any problem with placement. In fact, net issuance last year was artificially low and is now returning to "normal". The Czech banking sector will probably absorb this quite easily, as the liquidity position of the Czech banking sector was even strengthened by the CNB FX intervention in November 2013. The ministry has already sold CZK 59 bn government bonds in Q1, i.e. already about one third of the CZK bonds the ministry is expected to sell this year. This strategy of "frontloaded issuance" is related to the generally favourable conditions on the market in recent weeks.

Financial analysts: Helena Horská, Michal Brožka, Raiffeisenbank a.s., Prague

### Exchange rate development



### Exchange rate forecasts

	19-Mar <sup>1</sup>	Jun-14	Sep-14	Dec-14	Mar-15
EUR/CZK	27.48	27.20	27.00	26.40	26.20
Cons.		27.20	27.20	27.10	27.00

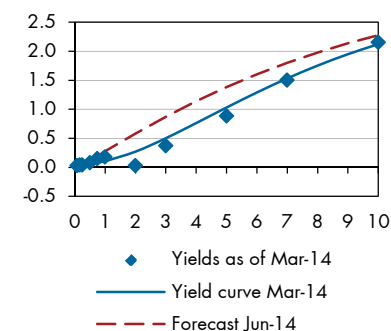
  

	19-Mar <sup>1</sup>	Jun-14	Sep-14	Dec-14	Mar-15
USD/CZK	19.75	20.15	20.77	19.56	19.41
Cons.		20.70	20.80	21.00	20.70

<sup>1</sup> 5:00 p.m. (CET)

Source: Bloomberg, Raiffeisen RESEARCH

### CZK rate and yield curve (%)\*



\* 1m – 12m interest rates; 2y – 10y LCY gov. bond yields

Source: Bloomberg, Raiffeisen RESEARCH

### Interest rate forecasts

	19-Mar <sup>1</sup>	Jun-14	Sep-14	Dec-14	Mar-15
Key rate	0.05	0.05	0.05	0.05	0.25
Consensus		0.05	0.05	0.06	0.06

1 month <sup>2</sup>	0.03	0.05	0.05	0.05	0.20
3 month <sup>2</sup>	0.04	0.10	0.20	0.20	0.35

6 month <sup>2</sup>	0.08	0.20	0.20	0.30	0.50
12 month <sup>2</sup>	0.18	0.20	0.30	0.50	0.70

<sup>1</sup> 5:00 p.m. (CET) <sup>2</sup> Bid rate

Source: Bloomberg, Raiffeisen RESEARCH

### Yield forecasts

	19-Mar <sup>1</sup>	Jun-14	Sep-14	Dec-14	Mar-15
2y T-bond <sup>2</sup>	0.03	0.6	0.8	1.0	1.1
Cons.		0.4	0.5	0.6	0.7

5y T-bond <sup>2</sup>	0.89	1.2	1.4	1.8	2.0
10y T-bond <sup>2</sup>	2.15	2.3	2.5	3.0	3.2
Cons.		2.5	2.6	2.6	2.7

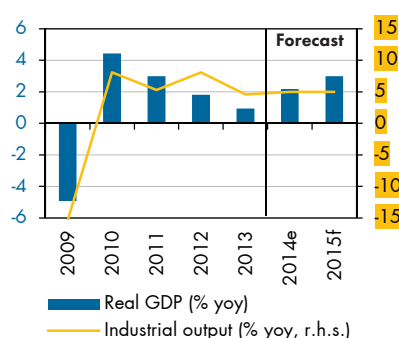
<sup>1</sup> 5:00 p.m. (CET) <sup>2</sup> Ask yield

Source: Bloomberg, Raiffeisen RESEARCH

## Revival of domestic demand

- Price development in negative territory
- Positive surprise in investment growth
- Tax evasion measures successful – government spending increased
- Sustainability of consolidation still in question

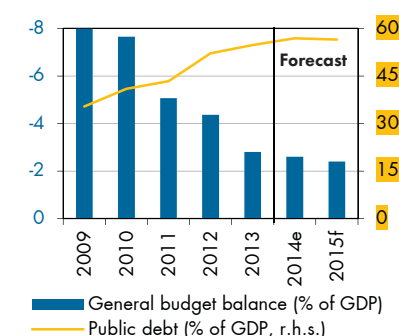
Real GDP (% yoy)



Source: Thomson Reuters, Raiffeisen RESEARCH

The latest set of Q4 2014 GDP data painted an **improving picture of the Slovak economy**. After a long period, the structure of growth was in favour of domestic demand. Another pleasant surprise was the result for investment activity (4%, yoy) at the end of the year. Household and government consumption were also growth supportive. We expect these items to play a key role in the **acceleration of GDP growth in 2014**. Investments in infrastructure should help construction production to rebound as well. After a few years we expect to see this sector in black figures. In February, CPI dipped into deflation territory (-0.1% yoy). We reckon this development to be very short term due to several reasons. First of all, domestic **demand is supported by real wage growth** (1.9%) and this will positively influence demand-driven inflation. Second, the dry weather increases the risk of a poor harvest, which will be gradually transferred into food prices. Accordingly, worries of deflation should only be a topic for a few months. At the end of year, we **expect inflation to be well over 1%**.

Budget balance and public debt



Source: Thomson Reuters, Raiffeisen RESEARCH

Tax revenues benefited from the measures against tax evasion in first two month of 2014. VAT revenues are up by almost 20% yoy for Jan-Feb 2014. In addition, effective from March 2014, additional measures against tax evasion (probably the strongest ones) will be in place. This poses a positive risk to the budget. According to the EU Commission, the deficit should be 2.5% of GDP in 2013. However, without additional effort, the **public deficit may rise to 3.3% of GDP**. We expect that improved tax revenues and a stronger-than-expected economic recovery will help to achieve the government target of 2.6% of GDP.

Financial analyst: Juray Valachy, Tatra banka, a. s., Bratislava

### Key economic figures and forecasts

	2009	2010	2011	2012	2013	2014e	2015f
Nominal GDP (EUR bn)	63.1	65.9	69.0	71.1	72.1	74.4	78.1
Real GDP (% yoy)	-4.9	4.4	3.0	1.8	0.9	2.2	3.0
Industrial output (% yoy)	-15.5	8.1	5.3	8.1	4.6	5.0	5.0
Unemployment rate (avg, %)	12.1	14.4	13.4	13.9	14.2	13.5	13.1
Nominal industrial wages (% yoy)	2.6	5.4	3.6	4.0	3.6	3.5	4.0
Producer prices (avg, % yoy)	-2.5	-2.8	2.6	3.9	-0.1	1.0	3.0
Consumer prices (avg, % yoy)	1.6	1.0	3.9	3.6	1.4	0.7	2.7
Consumer prices (eop, % yoy)	0.5	1.3	4.4	3.2	0.4	1.2	2.7
General budget balance (% of GDP)	-8.0	-7.7	-5.1	-4.4	-2.8	-2.6	-2.4
Public debt (% of GDP)	35.4	41.0	43.4	52.2	54.8	56.9	56.5
Current account balance (% of GDP)	-2.6	-3.7	-2.0	2.3	2.4	2.8	2.6
Gross foreign debt (% of GDP)	72.3	74.5	76.5	71.5	81.6	82.9	83.9
EUR/SKK (avg) <sup>1</sup>	30.13					Euro area membership at EUR/SKK 30.126	

<sup>1</sup> Euro area entry on 1 January 2009

Source: Thomson Reuters, Raiffeisen RESEARCH



## No banking crash – but structural issues remain

- Economy shows first signs of revival
- Recapitalisation of state-owned banks eases long-lasting solvency concerns
- Banking fundamentals continued to deteriorate in 2013
- Most pressing issue is how structural imbalances in Slovenian banking will be resolved

For the first time since 2010, **Slovenia's economy returned to growth** in the fourth quarter of 2013. While the rate for FY 2013 was still negative at -1.1%, Q4 2013 showed growth of 2.1% compared to the previous year's fourth quarter and growth of 1.2% versus the previous quarter. Another good sign was that investment turned positive as well. However, the country still faces many problems, such as high public and corporate indebtedness and a difficult path of fiscal consolidation. **We remain cautious and pencil in a minor decline of 0.5% in GDP in 2014.**

2013 brought a resolution to the most pressing issue of past few years in the banking sector: the system's **recapitalisation and the start of restructuring**. In December 2013, the total cost of capital lacking in the system was made public (EUR 4.8 bn in total), and the largest systemic banks received capital injections from the government (over EUR 3 bn in total). They also transferred sizeable chunks of their non-performing loans (EUR 4.5 bn in total) to the state-run Bank Asset Management Company (BAMC). Although these actions resolved the immediate systemic solvency concerns, the **solution to the deep banking crisis is still far from success**. Banks' aggregate loans and assets remain on a steep downward trend, and the banking sector's net financial result has been negative for a few years in a row. Loan contraction in 2013 alone was 8.5% and amounted to 22% over the past three years. High concentrations in the corporate loan portfolio remains the major weakness of banks' asset mix. Thus, the banks are suffering from lack of revenue-generating opportunities, which erode their capital base, limits access to global market funding, and thus prevents any quick fundamental revival. Therefore, **the question of "how much more might be needed?" remains open**. The country is facing an ECB stress test in 2014, and some additional capital needs cannot be ruled out. The question remains – whether Slovenian government can cope with the problems and successfully restructure the banking sector with its own resources, or EU help is still unavoidable in the future.

*Financial analysts: Andreas Schwabe, CFA, Elena Romanova*

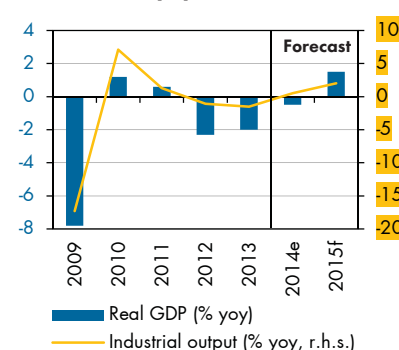
### Key economic figures and forecasts

	2009	2010	2011	2012	2013	2014e	2015f
Nominal GDP (EUR bn)	35.4	35.5	36.2	35.3	35.2	35.6	36.8
Real GDP (% yoy)	-7.8	1.2	0.6	-2.3	-2.0	-0.5	1.5
Industrial output (% yoy)	-17.3	7.1	1.3	-1.1	-1.5	0.5	2.0
Unemployment rate (avg, %)	5.9	7.3	8.2	8.9	10.5	10.5	10.0
Nominal industrial wages (% yoy)	4.6	3.6	2.7	3.7	4.0	3.5	3.5
Producer prices (avg, % yoy)	-1.3	2.1	4.4	0.8	0.2	1.0	2.0
Consumer prices (avg, % yoy)	0.9	1.8	1.8	2.6	1.8	1.8	2.0
Consumer prices (eop, % yoy)	1.8	1.9	2.0	2.7	1.5	2.0	2.0
General budget balance (% of GDP)	-6.3	-5.9	-6.3	-3.8	-7.0	-5.0	-4.0
Public debt (% of GDP)	35.0	38.6	46.9	54.0	65.0	70.0	72.0
Current account balance (% of GDP)	-0.6	-0.1	0.4	3.3	7.1	7.0	4.9
Official FX reserves (EUR bn)	0.7	0.8	0.8	0.7	0.7	0.7	0.7
Gross foreign debt (% of GDP)	113.9	114.7	110.8	115.7	113.6	115.2	115.5
EUR/USD (avg) <sup>1</sup>	1.39	1.33	1.39	1.29	1.33	1.35	1.33

<sup>1</sup> Euro area entry on 1 January 2007

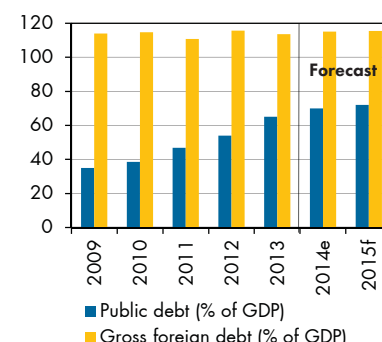
Source: Thomson Reuters, Raiffeisen RESEARCH

Real GDP (% yoy)



Source: Thomson Reuters, Raiffeisen RESEARCH

Public and external debt

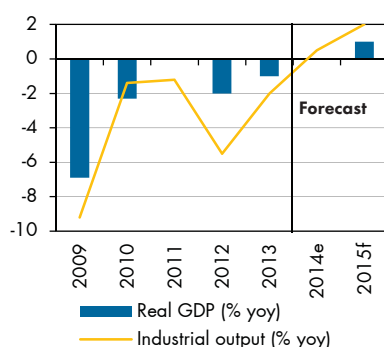


Source: Thomson Reuters, Raiffeisen RESEARCH

## Finally hit rock bottom?

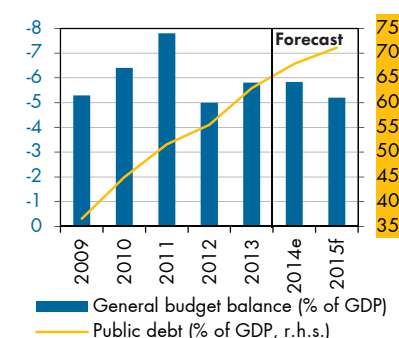
- Concrete structural measures still lacking
- Once more, hopes are pinned on investments
- Slight upward pressures on EUR/HRK continue
- Ample liquidity holds money market interest rates at historically low levels

### Real GDP (% yoy)



Source: Thomson Reuters, Raiffeisen RESEARCH

### Budget balance and public debt



Source: Thomson Reuters, Raiffeisen RESEARCH

### Economic outlook

During the half of a decade of crisis, Croatia has lost 12% of real GDP. Over the years, there has been an awareness of the necessity to implement reforms, particularly in the public sector, and to improve the business and investment climate, but with lacking, lukewarm and inconsistent measures which were more focused on short-term savings. Thus, **weighed down by low competitiveness**, Croatia does not have any chance to recover even this year. Moreover, the **estimated stagnation of economic activity is exposed to downside risks**, primarily fed by fiscal adjustments, the questionable realisation of investment projects, uncertainties surrounding economic developments in major trading partners and recent developments in global risk premia. Once again, investments remain the great hope, but there are reasonable doubts regarding the preparedness degree of (public) projects (financed from the EU funds and other supranational institutions). On the other hand, **private investments are burdened with extraordinary pessimism**, lack of capital and high financing costs. Additionally, the relatively frequent changes in (tax) regulations do not support an improvement in the business climate. In fact, they undermine investor confidence, hamper business activity and directly reduce competitiveness. Prime examples of this are the recent increase in the reduced VAT rate (from 10 to 13%) and health care contributions (by 2pp), which are solely aimed at patching up the state budget. Such fiscal consolidation on the revenue side points to a continuation of existing fiscal policy that avoids any expenditure adjustment, i.e. reforms. The **high budget deficit and unsustainable public debt growth dynamics**, however, require another approach in order to meet the requirements set in the Excessive Deficit Procedure: deficit targets of 4.6% of GDP for 2014, 3.5% of GDP for 2015 and 2.7% of GDP for 2016, consistent with an annual improvement in the structural balance of 0.5% of GDP in 2014, 0.9% of GDP in 2015 and 0.7% of GDP in 2016. Al-

### Key economic figures and forecasts

	2009	2010	2011	2012	2013	2014e	2015f
Nominal GDP (EUR bn)	44.8	44.4	44.4	43.9	44.0	44.4	45.6
Real GDP (% yoy)	-6.9	-2.3	0.0	-2.0	-1.0	0.0	1.0
Industrial output (% yoy)	-9.2	-1.4	-1.2	-5.5	-2.0	0.5	2.0
Unemployment rate (avg, %)	14.9	17.4	18.0	19.1	20.3	21.0	20.6
Nominal industrial wages (% yoy)	0.8	0.0	1.3	1.9	-1.0	0.0	2.0
Producer prices (avg, % yoy)	-0.4	4.3	6.4	7.0	0.5	2.0	2.5
Consumer prices (avg, % yoy)	2.4	1.1	2.3	3.4	2.2	1.6	2.0
Consumer prices (eop, % yoy)	1.9	1.8	2.1	4.7	0.3	2.0	2.0
General budget balance (% of GDP)	-5.3	-6.4	-7.8	-5.0	-5.8	-4.9	-4.6
Public debt (% of GDP)	36.6	44.9	51.6	55.5	66.5	69.2	73.0
Current account balance (% of GDP)	-5.1	-1.1	-0.9	0.1	0.5	0.0	-0.2
Official FX reserves (EUR bn)	10.4	10.7	11.2	11.2	12.9	12.5	12.5
Gross foreign debt (% of GDP)	101.0	104.6	103.0	102.3	104.5	103.6	101.4
EUR/HRK (avg)	7.34	7.29	7.43	7.52	7.57	7.64	7.66
USD/HRK (avg)	5.26	5.49	5.34	5.85	5.70	5.66	5.76

Source: Thomson Reuters, Raiffeisen RESEARCH

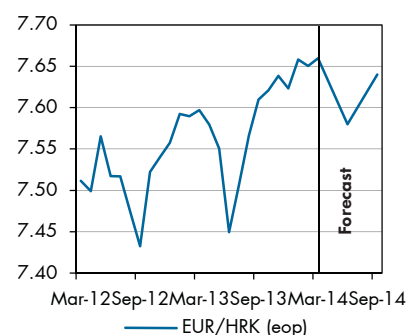
most alone in the crowd of unfavourable expectations, tourism will continue to record positive trends which will also be reflected in the current account balance.

### Financial market outlook

The increase in liquidity levels and low interest rates in the domestic money market in 2013 continued in 2014. Amidst rising liquidity in the financial system and the lack of investment alternatives for domestic institutional investors, **yields on T-bills fell to historical lows**, enabling the government access to exceptionally favourable short-term financing. Yields on T-bills are expected to remain well anchored around the current low levels over our forecast horizon. Domestic government bond issuance in February affirmed the attractiveness of yields, despite the downgrade of Croatia's sovereign rating by S&P to "BB" by the end of January 2014. The MoF successfully tapped the local market for EUR 500 mn in 5y EUR-linked bonds and EUR 650mn in 10y EUR-linked bonds. The total amount of the issue exceeded the planned amount significantly, signalling solid investor demand. Given that the government's refinancing needs (estimated at more than EUR 6 bn in 2014) substantially exceed the abilities of domestic investors, **we expect the government to tap the international market with a new Eurobond**. Therefore, the CNB is expected to continue repurchasing foreign currency from government issues, which will have a positive effect on the increase in liquidity in the domestic money market. Consequently, **downward pressure on interest rates will remain**, although the room for their reduction is much more limited. Although EUR/HRK volatility was relatively low on the back of constant EUR demand, EUR/HRK continued to move towards higher levels, skipping past 7.66 at the end of January. The last time we saw these levels was in early 2004. The commitment to a stable exchange rate remained in place with the CNB withdrawing part of the liquidity from the system (EUR 240.2 mn) via FX interventions, as expected. Similar movements, with **slight upward pressures on the EUR/HRK rate**, are expected to continue. The stability of the exchange rate will largely be influenced by the unchanged situation in the money market. Excess liquidity in the local market and the expected fiscal consolidation path should provide a more comfortable position for the government. Public debt growth is expected to slow down. This is likely to create a new reality where the government intends to refinance its maturing debt on the external market and to use the liquidity surplus to cover its current deficits.

Financial analyst: Elizabeta Sabolek-Resanovic, Raiffeisenbank Austria d.d., Zagreb

### Exchange rate development



### Exchange rate forecasts

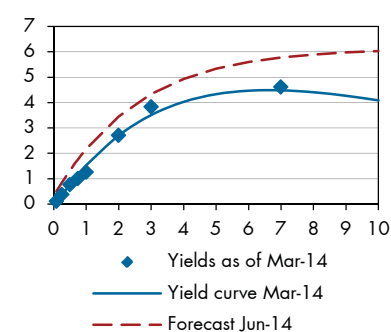
	19-Mar <sup>1</sup>	Jun-14	Sep-14	Dec-14	Mar-15
EUR/HRK	7.66	7.58	7.64	7.68	7.66
Cons.		7.58	7.62	7.63	7.64

	5.50	5.61	5.88	5.69	5.67
USD/HRK					
Cons.		5.75	5.83	5.91	5.86

<sup>1</sup> 5:00 p.m. (CET)

Source: Bloomberg, Raiffeisen RESEARCH

### HRK rate and yield curve (%)\*



\* 1m – 12m interest rates; 2y – 10y LCY gov. bond yields  
Source: Bloomberg, Raiffeisen RESEARCH

### Interest rate forecasts

	19-Mar <sup>1</sup>	Jun-14	Sep-14	Dec-14	Mar-15
Key rate	6.00	6.00	6.00	6.00	6.00
Consensus		6.00	6.00	6.00	6.00
1 month <sup>2</sup>	0.11	0.60	0.80	1.00	1.20
3 month <sup>2</sup>	0.37	0.90	1.10	1.30	1.50
6 month <sup>2</sup>	0.76	1.40	1.60	1.80	2.00
12 month <sup>2</sup>	1.26	1.80	2.00	2.20	2.30

<sup>1</sup> 5:00 p.m. (CET) <sup>2</sup> Bid rate

Source: Bloomberg, Raiffeisen RESEARCH

### Yield forecasts

	19-Mar <sup>1</sup>	Jun-14	Sep-14	Dec-14	Mar-15
2y T-bond <sup>2</sup>	2.70	2.9	3.2	3.5	3.6
Cons.		n.v.	n.v.	n.v.	n.v.
5y T-bond <sup>2</sup>	4.20	4.4	4.5	4.6	4.6
10y T-bond <sup>2</sup>	4.61	5.5	5.5	5.5	5.5
Cons.		n.v.	n.v.	n.v.	n.v.

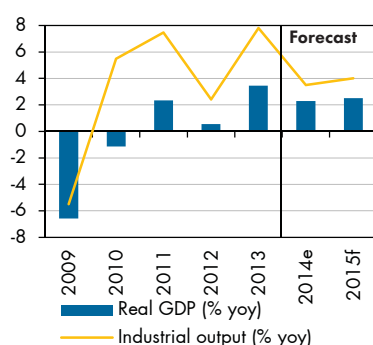
<sup>1</sup> 5:00 p.m. (CET) <sup>2</sup> Ask yield

Source: Bloomberg, Raiffeisen RESEARCH

## New ruling coalition, same constraints

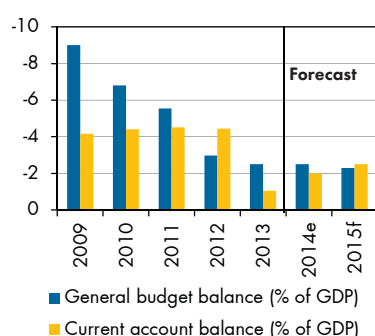
- USL alliance broke down, but major slippages remain unlikely in the near term
- Economic activity to stay on an upward trend, with a rebound in domestic demand as the big bet
- Rate-cutting cycle very likely over, room for consolidation in yields
- Agreement with the IMF remains broadly on track

### Real GDP (% yoy)



Source: Thomson Reuters, Raiffeisen RESEARCH

### Budget and current account balance



Source: Thomson Reuters, Raiffeisen RESEARCH

### Key economic figures and forecasts

	2009	2010	2011	2012	2013	2014e	2015f
Nominal GDP (EUR bn)	118.3	124.4	131.5	131.7	142.8	148.2	159.0
Real GDP (% yoy)	-6.6	-1.1	2.3	0.6	3.5	2.3	2.5
Industrial output (% yoy)	-5.5	5.5	7.5	2.4	7.8	3.5	4.0
Unemployment rate (avg, %)	6.9	7.3	7.4	7.0	7.3	7.2	7.1
Nominal industrial wages (% yoy)	10.0	8.3	6.7	4.6	4.3	4.5	5.5
Producer prices (avg, % yoy)	2.5	4.4	7.1	5.4	2.1	2.3	3.8
Consumer prices (avg, % yoy)	5.6	6.1	5.8	3.3	4.0	2.1	3.3
Consumer prices (eop, % yoy)	4.7	8.0	3.1	5.0	1.6	3.5	3.0
General budget balance (% of GDP)	-9.0	-6.8	-5.5	-3.0	-2.5	-2.5	-2.3
Public debt (% of GDP)	23.6	30.5	34.7	38.0	37.9	38.4	38.5
Current account balance (% of GDP)	-4.2	-4.4	-4.5	-4.4	-1.1	-2.0	-2.5
Official FX reserves (EUR bn)	28.3	32.4	33.2	31.2	32.5	31.5	32.5
Gross foreign debt (% of GDP)	68.7	74.3	75.1	75.7	67.5	65.5	64.1
EUR/RON (avg)	4.24	4.21	4.24	4.46	4.42	4.51	4.48
USD/RON (avg)	3.04	3.17	3.04	3.47	3.33	3.34	3.37

Source: Thomson Reuters, Raiffeisen RESEARCH

### Economic outlook

GDP dynamics in Q4 2013 (5.2% yoy and 1.5% qoq) substantially outpaced both market expectations and ours as well. Growth was driven exclusively by industry and agriculture on the supply side, while the spike in inventories and growth in private consumption were the key drivers of growth on the expenditures side. The large decline in gross fixed capital formation (-5.7% qoq) came as bad news.

We believe that **economic activity remains on an upward trend**. 2014 started on the right foot, as industry, exports to EU countries and retail sales all posted positive performance in January. The factors which boosted GDP dynamics in Q4 2013 – such as very good agricultural output and the spike in inventories – were temporary. The **very good results in Q4 2013** should therefore weigh on GDP dynamics in Q1 2014. In this case, a poor GDP figure in Q1 (i.e. a contraction from Q4) should be no cause for concern. A **revival in domestic demand** (consumption and investment) is our big bet for 2014. Private consumption showed some signs of recovering towards the end of 2013, even though consumer confidence indicators failed to improve. The government once again has **very ambitious plans for investments funded from the national budget and EU funds**. After substantially missing the target last year, progress might be better this year. We foresee real GDP excluding agriculture expanding by 2.6% this year. Faster dynamics cannot be ruled out, especially if Q1 performance beats our expectations.

The political USL ruling alliance broke down following disagreement between its member parties on a governmental reshuffling. The **Social Democratic Party (PSD) set up a new alliance** with the two small parties of USL and with the support of minorities (Hungarian and others) and built a new parliamentary majority. The vote in favour of the new government under PM Ponta amounted to 60.2% of total seats in Parliament. The change in the political colour of the government



increases uncertainty regarding the policies to be implemented, but we think major policy slippages are unlikely in the coming quarters.

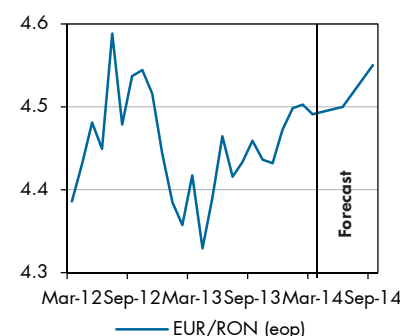
### Financial market outlook

The subdued annual inflation rates (1.1% yoy in Feb) overestimate the speed of the recent disinflation process as this was also spurred by the cut in VAT on bread products (in Sep-2013) and by a decrease in volatile food prices. Starting from this base, consumer price inflation should embark on an upward trend as a result of the enforcement of the special excise on fuels (in April) and as the favourable statistical base effect fades. As of end-September, annual CPI inflation will already land at 3.0-3.5% yoy even when assuming a normal agricultural year. In our view, **the inflation outlook does not offer room for the central bank (NBR) to cut the key rate any further.** However, the NBR has room to adjust the monetary policy stance both in the short run (via active liquidity management) and in the long run (by cutting the minimum reserve requirements ratios). Fluctuations in money market rates are therefore still likely, but the key rate should remain unchanged over our entire forecast horizon at 3.5%, following cuts amounting to a cumulative 175bp since July 2013. However, starting next summer, the higher inflation data should pressure the central bank to tighten its grip on liquidity conditions. Especially the short-end of the RON yield curve (i.e. maturities up to 3y) is sensitive to changes in liquidity conditions as local banks are the key players. At the same time, the **long-end of the yield curve is mainly driven by external developments** as the share of non-resident holdings is sizeable.

The leu proved quite resilient to the latest Emerging Market sell-off at the end of January as well as to the political stalemate during February. One of the reasons for this is that the central bank stepped into the FX market to limit the depreciation pressure on the exchange rate. Although political noise is likely to persist in the period ahead, the new parliamentary majority is here to stay for more time. Therefore, **risks to the exchange rate and RON yields induced by politics are likely to fade in intensity** over the next few quarters. Moreover, a staff-level agreement was reached between the Romanian authorities and the IMF at the beginning of February, while the precautionary SBA remains broadly on track. This is also good news for the RON exchange rate and local currency bonds. Given our expectations of cyclically rising core market yields, especially in the 10y segment, Romania should follow these moves, although to a lesser extent than other CEE bond markets. Mitigating factors in times of mounting market pressure are the liquidity buffer of the Finance Ministry, comfortable FX reserves in tandem with the precautionary IMF SBA as well as moderate gross public funding needs in the course of the year. The other main risk factor to RON markets also comes from the external front, i.e. further development of the Ukrainian crisis.

Financial analysts: Nicolae Covrig, Raiffeisen BANK S.A., Bucharest; Stephan Imre, RBI Vienna

### Exchange rate development



EUR/RON: 5y high 4.64, 5y low 4.06  
Source: Bloomberg, Raiffeisen RESEARCH

### Exchange rate forecasts

	19-Mar <sup>1</sup>	Jun-14	Sep-14	Dec-14	Mar-15
EUR/ RON	4.49	4.50	4.55	4.50	4.45
Cons.		4.45	4.44	4.45	4.34

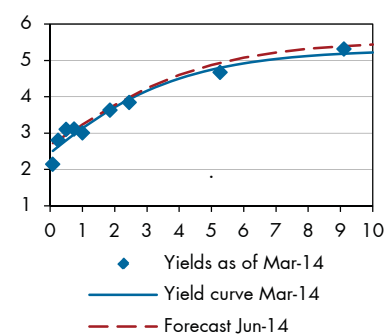
  

USD/ RON	3.23	3.33	3.50	3.33	3.30
Cons.		3.38	3.40	3.44	3.32

<sup>1</sup> 5:00 p.m. (CET)

Source: Bloomberg, Raiffeisen RESEARCH

### RON rate and yield curve (%)\*



\* 1m – 12m interest rates; 2y – 10y LCY gov. bond yields  
Source: Bloomberg, Raiffeisen RESEARCH

### Interest rate forecasts

	19-Mar <sup>1</sup>	Jun-14	Sep-14	Dec-14	Mar-15
Key rate	3.50	3.50	3.50	3.50	3.50
Consensus		3.50	3.50	3.63	3.63

1 month <sup>2</sup>	1.89	2.80	2.85	3.00	3.00
3 month <sup>2</sup>	2.55	2.90	2.95	3.05	3.05
6 month <sup>2</sup>	2.72	2.75	2.95	3.00	3.00
12 month <sup>2</sup>	2.73	3.05	3.10	3.10	3.10

<sup>1</sup> 5:00 p.m. (CET) <sup>2</sup> Bid rate

Source: Bloomberg, Raiffeisen RESEARCH

### Yield forecasts

	19-Mar <sup>1</sup>	Jun-14	Sep-14	Dec-14	Mar-15
2y T-bond <sup>2</sup>	3.63	3.8	4.0	4.2	4.3
Cons.		n.v.	n.v.	n.v.	n.v.

5y T-bond <sup>2</sup>	4.67	4.9	5.0	5.2	5.3
10y T-bond <sup>2</sup>	5.31	5.4	5.6	5.7	5.8
Cons.		n.v.	n.v.	n.v.	n.v.

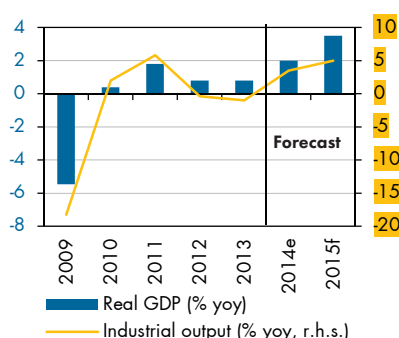
<sup>1</sup> 5:00 p.m. (CET) <sup>2</sup> Ask yield

Source: Bloomberg, Raiffeisen RESEARCH

## Faster growth to come

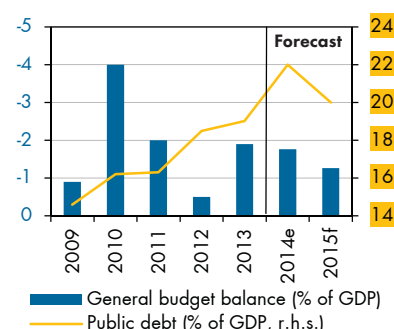
- Exports should keep growing and be the main driver of economic growth
- Household consumption expected to a growth engine in the future
- Deflationary tendencies, as the economy lags behind potential
- Interest rate cuts needed for a faster recovery

### Real GDP (% yoy)



Source: Thomson Reuters, Raiffeisen RESEARCH

### Budget balance and public debt



Source: Thomson Reuters, Raiffeisen RESEARCH

In Q4 2013, GDP grew faster than forecasted, reaching 2.4% yoy (after +1.5% yoy in Q3 2013) and annual GDP growth finally came in at 0.8% in 2013. International demand was again the main growth driver, pushing exports up 11.5% yoy. Otherwise, domestic demand and gross fixed capital formation developed sluggishly. However, **household consumption** grew by 1.8% yoy (above our forecast) and is expected **to be an increasingly strong source of growth** (+1.8% yoy expected in Q1 2014), **along with exports**. Rising household consumption will be borne by modestly improving employment and the expected lower interest rates on deposits. The **more stable political situation in the country should have a positive impact**, not only on investments but also on household consumption. Against the background of the EU recovery, exports will keep growing (6.2% yoy projected in Q1). Meanwhile, an expected increase in domestic demand through household consumption may stimulate rising imports (+5.8% yoy in Q1).

Key obstacles to intensifying investments and domestic demand are the high interest rates on loans in local and foreign currency, as Bulgarian banks remain quite conservative as a result of the international financial crisis. Over the medium term, **we expect a reduction in deposit interest rates**, as they are expensive for banks, which will lead to a reduction in lending rates and a faster recovery by the economy. **Fiscal policy** remained conservative in 2013 (the state budget deficit was below the budget plan) and **will continue to be a guarantee for the financial stability of the country**, as the state budget deficit is projected to stay under the 2% threshold.

Currently, the economy is operating below its potential and this situation will continue in 2014. Therefore, price dynamics reflected atypically low inflation for 2013 (0.9% yoy annual average), and for Q1 it is likely that consumer price inflation will be below 1.6% yoy.

Financial analyst: Emil S. Kalchev, Raiffeisenbank (Bulgaria) Sole-owned Joint Stock Company, Sofia

### Key economic figures and forecasts

	2009	2010	2011	2012	2013	2014e	2015f
Nominal GDP (EUR bn)	34.9	36.1	38.5	39.7	40.5	42.1	44.5
Real GDP (% yoy)	-5.5	0.4	1.8	0.8	0.8	2.0	3.5
Industrial output (% yoy)	-18.3	2.0	5.8	-0.4	-1.0	3.5	5.0
Unemployment rate (avg, %)	6.8	10.2	11.3	12.3	12.9	12.6	12.1
Nominal industrial wages (% yoy)	9.7	10.5	6.6	9.7	4.9	5.1	6.3
Producer prices (avg, % yoy)	-6.2	8.5	9.5	4.4	-1.0	2.4	4.4
Consumer prices (avg, % yoy)	2.8	2.4	4.2	3.0	1.2	2.2	3.5
Consumer prices (eop, % yoy)	0.6	4.5	2.8	4.2	0.5	2.0	3.4
General budget balance (% of GDP)	-0.9	-4.0	-2.0	-0.5	-1.9	-1.8	-1.3
Public debt (% of GDP)	14.6	16.2	16.3	18.5	19.0	22.0	20.0
Current account balance (% of GDP)	-8.9	-1.5	0.1	-1.3	1.5	0.7	-0.5
Official FX reserves (EUR bn)	12.9	13.0	13.3	15.6	14.5	17.2	17.9
Gross foreign debt (% of GDP)	108.3	102.7	94.3	94.9	91.4	89.1	82.4
EUR/BGN (avg)	1.96	1.96	1.96	1.96	1.96	1.96	1.96
USD/BGN (avg)	1.40	1.47	1.41	1.52	1.47	1.45	1.47

Source: Thomson Reuters, wiw, Raiffeisen RESEARCH

# Public sector reforms and economy incentivising go hand in hand

- **Budget revision to follow after the elections**
- **Temporary halt in monetary policy easing will end in H2 2014**
- **Robust FX interventions to slow down after government formation**
- **Many investments in the pipeline, with United Arab Emirates at the forefront**

A slowdown in FIAT exports and frail credit supply will prompt the launch of a subsidy programme by the government so as to prevent a likely economy slowdown. Although the FDIs that were touted during the election campaign might help the economy, flows are not likely to start before Q3 2014. Despite the tight credit conditions, the key rate will remain unchanged (9.5%) for at least one more meeting, due to EUR/RSD fluctuations amidst global financial market instability. Moreover, the **National Bank of Serbia (NBS) continued with strong FX interventions** (EUR 760 mn until the beginning of March), which will continue to be the main action until the formation of the new government. Later, **we expect that the NBS will gradually taper its spending of FX reserves and allow EUR/RSD to depreciate, thus supporting exports**. Inflation will remain in the targeted range (4% +/-1.5pp) during the year, though at a bit higher level compared to 2013, sustained by the base effect and regulated price hikes, and – depending on imports volumes – increases in wheat prices on the global commodity markets. The **new coalition government might be headed by the Serbian Progressive Party (SNS)**, although some new coalition partners may be involved to bring more coherency in respect of the main goals, such as speeding up the reform process and attracting new investments at the same time. The first task of the new government will be the revision of the Budget Law 2014, incorporating the new subsidy programme for corporates, in light of the subdued credit supply, the anticipated slowdown in economic growth and the success of such programmes in 2009-2011. Moreover, there may be **further spending cuts and possible downward corrections in tax revenues**, with the consolidated budget deficit-to-GDP ratio staying at around 7%. Still, we see yields trending upwards in H2 2014 due to tight time line for the reform agenda and implementation risks. On the other hand, the **IMF precautionary deal could be viable in H2 2014** and act as a comfort factor for investors.

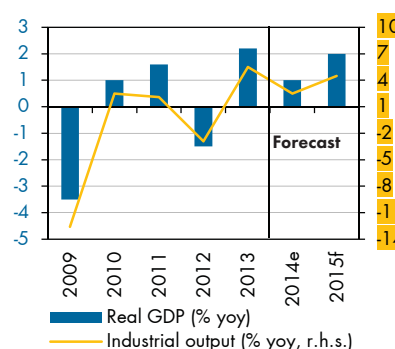
Financial analyst: Ljiljana Grubic, Raiffeisenbank a.d., Belgrade

## Key economic figures and forecasts

	2009	2010	2011	2012	2013	2014e	2015f
Nominal GDP (EUR bn)	29.0	28.0	31.5	29.6	33.0	35.2	37.9
Real GDP (% yoy)	-3.5	1.0	1.6	-1.7	2.2	1.0	2.0
Industrial output (% yoy)	-12.6	2.5	2.1	-2.9	5.5	2.5	4.5
Unemployment rate (avg, %)	16.1	19.2	23.0	26.0	26.0	24.5	23.0
Nominal industrial wages (% yoy)	5.0	10.0	5.0	1.5	1.5	4.0	5.0
Producer prices (avg, % yoy)	5.6	12.7	14.2	8.5	7.0	6.0	6.0
Consumer prices (avg, % yoy)	8.2	6.3	11.3	7.8	7.8	5.5	5.5
Consumer prices (eop, % yoy)	6.6	10.3	7.0	12.2	2.2	5.0	5.0
General budget balance (% of GDP)	-4.5	-4.7	-4.9	-6.4	-4.8	-6.9	-5.9
Public debt (% of GDP)	34.1	43.2	45.8	59.7	60.8	64.1	64.6
Current account balance (% of GDP)	-7.2	-7.4	-9.1	-10.7	-4.8	-5.1	-5.8
Official FX reserves (EUR bn)	10.6	10.0	12.1	10.9	12.1	11.9	12.3
Gross foreign debt (% of GDP)	77.7	84.9	76.7	86.9	78.2	76.2	73.4
EUR/RSD (avg)	93.9	103.0	102.0	113.1	113.2	116.0	119.0
USD/RSD (avg)	67.4	77.6	73.3	88.0	85.3	86.1	89.5

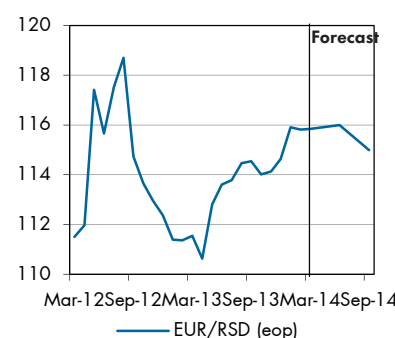
Source: Thomson Reuters, Raiffeisen RESEARCH

## Real GDP (% yoy)



Source: Bloomberg, Raiffeisen RESEARCH

## Exchange rate development



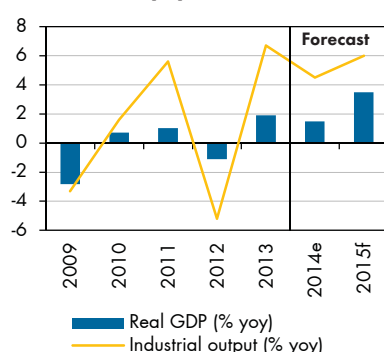
EUR/RSD: 5y high 119.06, 5y low 92.41

Source: Thomson Reuters, Raiffeisen RESEARCH

## Visible signs of the economic recovery

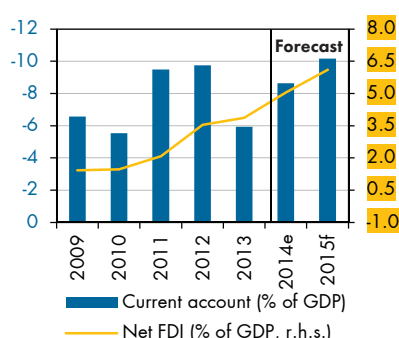
- Economy delivered solid economic growth of 1.9% yoy in real terms in 2013
- Extremely weak domestic demand still a major concern – private consumption on the decline for five straight years
- Economic recovery to continue in 2014, driven by investment cycles in energy and infrastructure, and by export growth
- Stand-By Arrangement still in place, despite latest political wrangling

**Real GDP (% yoy)**



Source: Thomson Reuters, Raiffeisen RESEARCH

**Current account and FDI inflows**



Source: Thomson Reuters, Raiffeisen RESEARCH

The economy experienced a modest recovery in 2013 (1.9% yoy in real terms), mostly driven by the beneficial external environment in the Euro area. The growth rate was only sufficient to bring the unemployment rate down by 50bp to 27.5%, and thus unemployment continues to weigh on the still extremely poor domestic demand which is best mirrored by the decline in private consumption for the last five years in a row. The **first heavyweight indicators for Q1 2014**, which are strongly correlated with GDP, **suggest the economic situation we expected**. Further recovery in the Euro area economy is supporting B&H exports (60% of exports go to Euro area countries), which advanced by 6.3% yoy and was also followed by moderate growth in export-oriented industry (+3.9% yoy) in January 2014. Hence, we estimate that **exports of goods and services and industry** will grow by 5% and 4.5% in 2014, respectively, and thus **once again be one of the major engines behind the anticipated real economic growth** of 1.5% yoy.

The major concern for the outlook in 2014 is mostly related to political situation in the country as general elections are slated for this year. This means that the economic and reform agendas are put aside, and **election campaigns and national rhetoric come into the focus** of the major political players. However, we still believe that the announced infrastructural works (continuation of the Corridor Vc project in both entities) and start of the electro investment cycle (thermo plant Tuzla and Stanari) will be implemented, as these are the "high profile" projects for the election year. Therefore, private and public investments will come to the forefront of the economic recovery, with expected real growth of 9% yoy. Despite the latest political wrangling related to the adoption of several laws which are the preconditions for the successful sixth review of the IMF and **continuation of the Stand-By Arrangement**, political players are close to reaching consensus, meaning that fiscal stability will be preserved in the election year.

Financial analyst: Ivona Zametica, Raiffeisen BANK d.d., Sarajevo

**Key economic figures and forecasts**

	2009	2010	2011	2012	2013	2014e	2015f
Nominal GDP (EUR bn)	12.4	12.7	13.1	13.1	13.5	13.9	14.8
Real GDP (% yoy)	-2.8	0.7	1.0	-1.1	1.9	1.5	3.5
Industrial output (% yoy)	-3.3	1.6	5.6	-5.2	6.7	4.5	6.0
Unemployment rate (avg, %)	24.1	27.2	27.6	28.0	27.5	26.5	24.5
Nominal industrial wages (% yoy)	9.2	2.4	6.8	2.2	-0.5	3.5	4.0
Producer prices (avg, % yoy)	-3.2	0.9	3.7	1.9	-1.8	2.3	2.4
Consumer prices (avg, % yoy)	-0.4	2.1	3.7	2.1	-0.1	2.5	2.5
Consumer prices (eop, % yoy)	0.0	3.1	3.1	1.8	-1.2	2.1	2.0
General budget balance (% of GDP)	-4.4	-2.5	-1.3	-2.0	-1.5	-1.0	-1.0
Public debt (% of GDP)	35.1	38.3	38.9	39.7	41.5	39.6	38.5
Current account balance (% of GDP)	-6.6	-5.5	-9.5	-9.8	-5.9	-8.6	-10.2
Official FX reserves (EUR bn)	3.2	3.3	3.3	3.3	3.6	3.7	4.0
Gross foreign debt (% of GDP)	53.8	57.5	67.0	63.3	62.2	62.0	60.3
EUR/BAM (avg)	1.96	1.96	1.96	1.96	1.96	1.96	1.96
USD/BAM (avg)	1.40	1.47	1.41	1.52	1.47	1.45	1.47

Source: Thomson Reuters, Raiffeisen RESEARCH



## Winds of change

- Agreement signed with IMF for EUR 330 mn to repay arrears to private sector
- Loose monetary policy to continue throughout 2014
- External sector the driving motor of the economy
- EU candidacy status possibly to be granted in June 2014

The Q3 2013 results were shockingly low for the Albanian economy, as the 2.3% yoy contraction of real GDP marked a record low since year 1997. Revision of the national accounts by the new government, the **weak performance of the public sector** during the government change-over period and **continuously slack domestic demand** were the main reasons behind this slump. Even in Q4 the economy is expected to be constrained by the weak performance of the domestic sector. Annual growth for 2013 is expected to be around 1.3%. For 2014, GDP growth might hover around 2%, well below the potential as the increased government debt – which is expected to rocket over 72% from 62% in early 2013 – will constrain public investment.

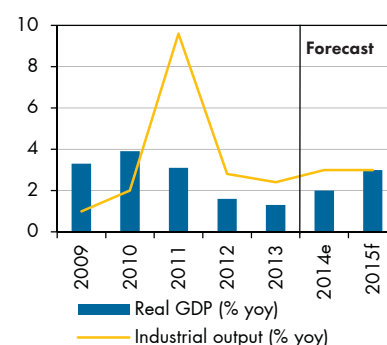
The **IMF agreement for a short-term loan disbursement** of EUR 330.9 mn **will positively influence the liquidity situation** of the private businesses engaged in public investments. Therefore, lending activity is expected to ramp up after Q2 2014, and eventually the banking system NPLs will improve as nearly 25% of the arrears are linked to it.

The Bank of Albania cut the key rate again in late February to 2.75%, and **loose monetary policy is expected to continue** throughout 2014, eventually stimulating the still struggling domestic demand. The inflation rate in January was just 1.7%, below the 2-4% target range, but higher excise taxes for some products should boost the consumer price index to some extent. The hike in excise taxes on some products was offset by a decline in food prices.

**EU candidacy status for Albania is again on the discussion agenda for June.** Key EU countries expect consolidation of the reforms which have already been started, but also importantly the launch of reforms in the judiciary system in order to tackle corruption and organised crime. Although it is expected to be a last minute call, there are good chances that Albania will be granted EU candidate status.

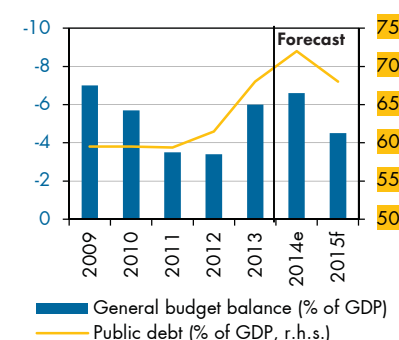
*Financial analyst: Joan Canaj, Raiffeisen Bank Sh.a., Tirana*

**Real GDP (% yoy)**



Source: Thomson Reuters, Raiffeisen RESEARCH

**Budget balance and public debt**



Source: Thomson Reuters, Raiffeisen RESEARCH

### Key economic figures and forecasts

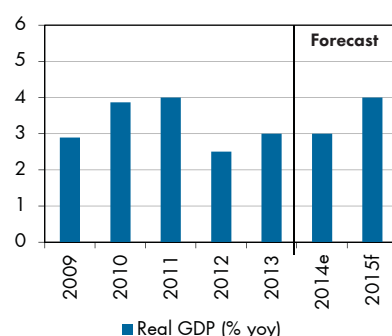
	2009	2010	2011	2012	2013	2014e	2015f
Nominal GDP (EUR bn)	8.8	9.4	9.8	10.1	10.5	11.4	12.0
Real GDP (% yoy)	3.3	3.9	3.1	1.6	1.3	2.0	3.0
Industrial output (% yoy)	1.0	2.0	9.6	2.8	2.4	3.0	3.0
Unemployment rate (avg, %)	13.0	13.5	14.0	13.3	13.5	13.6	13.4
Nominal industrial wages (% yoy)	4.0	8.0	8.0	8.0	8.0	8.0	8.0
Producer prices (avg, % yoy)	5.0	4.0	2.2	1.2	1.0	4.0	5.0
Consumer prices (avg, % yoy)	5.0	4.0	3.5	2.0	1.9	2.3	2.5
Consumer prices (eop, % yoy)	3.5	3.5	1.7	2.4	1.9	2.4	2.4
General budget balance (% of GDP)	-7.0	-5.7	-3.5	-3.4	-6.0	-6.6	-4.5
Public debt (% of GDP)	59.5	59.5	59.4	61.5	68.0	72.0	68.0
Current account balance (% of GDP)	-15.6	-10.3	-11.3	-8.8	-9.1	-9.2	-9.2
Official FX reserves (EUR bn)	1.6	1.9	1.9	1.9	1.9	1.9	1.9
Gross foreign debt (% of GDP)	22.5	23.5	23.6	24.7	26.5	25.9	26.8
EUR/ALL (avg)	132.1	137.8	140.3	139.0	140.3	140.0	140.0
USD/ALL (avg)	94.7	103.9	100.8	108.2	105.6	103.7	105.3

Source: Thomson Reuters, Raiffeisen RESEARCH

## Pushing the reset button

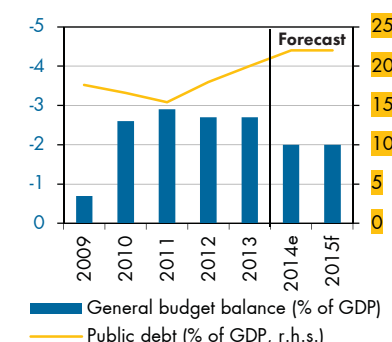
- Consumption remains the economic powerhouse
- Opportunities opening up for business investments
- Salary increase for public employees raises expectations for consumption
- Inflationary shock in sight

Real GDP (% yoy)



Source: Thomson Reuters, Raiffeisen RESEARCH

Budget balance and public debt



Source: Thomson Reuters, Raiffeisen RESEARCH

Solid growth in the real sector and positive external signals have boosted the expectations for an optimistic outlook into the second quarter and beyond. This period will feature some challenges in the labour market and prices, which need to be addressed.

After cooling down in the first quarter, **domestic consumption should pick up pace until mid-year**, mainly powered by expanding consumer credit and enhanced purchasing power thanks to government actions. Current transfers are still high and fill the financing gap.

In the first quarter, the business community has reported stronger-than-average activity, but mainly for the domestic sector, whereas exports still show no significant volatility. Given the expectation that oil prices will remain manageable despite the Ukrainian crisis, and given the bright outlook in the periphery as well as the core EU economies, there are **good grounds for enhanced business activity**. The **financial sector is experiencing a strong downward shift in interest rates on deposits**, and subsequently on loans, both of which will free up capital for investment purposes.

It is now clear that the **parliament might dissolve in late April, giving way for national elections** accompanied by plans for economic and social development. The most prominent among these is the decision of the current government to increase the salaries of the 82,000 public employees by 25% by May of this year. This does not have implications for the budget deficit, which will remain at 2%, but will be financed from the expenses of other budget organisations.

Although public employees only account for about 24% of the current workforce, their salary raise should increase their purchasing power, as well as their credit capacities, but it will also impact the consumer prices significantly, as seen in the last salary increase in 2011, where annual inflation rose by 4 percentage points within two months. However, the currently low inflation environment presents a suitable time to proceed with this move.

Financial analyst: Fisnik Latifi, Raiffeisen Bank Kosovo J.S.C., Pristina

Key economic figures and forecasts

	2009	2010	2011	2012	2013	2014e	2015f
Nominal GDP (EUR bn)	4.1	4.1	4.6	4.7	4.9	5.0	5.2
Real GDP (% yoy)	2.9	3.9	4.0	2.5	3.0	3.0	4.0
Unemployment rate (avg, %)	45.4	45.1	41.4	44.8	30.5	30.5	31.0
Producer prices (avg, % yoy)	3.8	4.7	6.5	0.8	3.5	2.5	2.5
Consumer prices (avg, % yoy)	-2.4	3.5	7.3	2.5	1.8	3.0	2.5
Consumer prices (eop, % yoy)	0.1	6.6	3.6	3.7	0.5	4.0	2.5
General budget balance (% of GDP)	-0.7	-2.6	-2.9	-2.7	-2.7	-2.0	-2.0
Public debt (% of GDP)	17.6	16.6	15.4	18.0	20.0	22.0	22.0
Current account balance (% of GDP)	-9.1	-12.6	-14.4	-8.0	-7.0	-7.7	-7.8
Official FX reserves (EUR bn)	0.6	0.7	0.6	1.2	1.4	1.4	1.5
Gross foreign debt (% of GDP)	16.8	17.1	15.8	14.8	14.4	13.9	13.4
EUR/USD (avg)*	1.39	1.33	1.39	1.29	1.33	1.35	1.33

\* EUR official currency in Kosovo

Source: Thomson Reuters, Raiffeisen RESEARCH

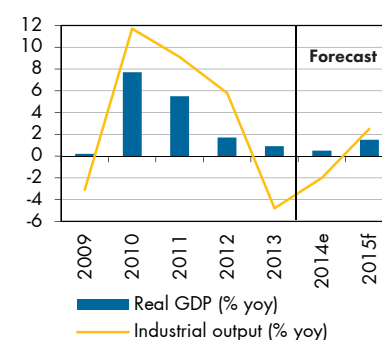
## Disappointing economic performance

- Modest economic growth on the back of private consumption, but the outlook remains bleak
- Negative performance in industrial output is influenced by reduced demand from Russia
- Trade balance deficit to narrow, benefiting from lower incomes
- Gradual BYR depreciation to prevail, no sharp devaluation move around the corner

The start of a new year was rather tough for the Belarusian economy. The first month of 2014 already featured **another 1.1% yoy contraction of GDP**, as even strong domestic demand was not enough to outweigh the negative impact of a decline in industrial output. The most intensive stagnation in the industrial sector is now seen in machinery construction (about 20% yoy), while the amount of inventories is high at 78% of average monthly production. This is mostly attributable to a **15% yoy drop in export performance**, influenced by disappointing economic growth figures in Russia. By the end of this year the situation is expected to become more complicated, as the willingness of households to buy will likely diminish amidst an only modest increase of real incomes. It also should be taken into account that there are **no other visible drivers of growth yet, apart from household consumption**. On a positive note, the lack of further hikes in wages, which were previously not supported by corresponding increases in productivity, has favourable implications for the amount of imports, thus making the expected trade balance deficit more bearable and **leading to the C/A deficit narrowing** from USD 7.3 bn (10.2% of GDP) in 2013 to about USD 2.6 bn (4.0% of GDP). All in all, a slowing growth trend is our base scenario for a mid-term perspective. We now forecast only 0.5% yoy growth in the local economy this year and a slight improvement to 1.5% yoy in 2015. **Depreciation of the Belarusian rouble will be prolonged** at a moderate pace (we expect **BYR to lose another 25% of its value during 2014**). More profound and sharp devaluation is possible, but for the time being not welcomed by the regulator, as households' devaluation expectations are still high and it might also trigger more inflationary pressures.

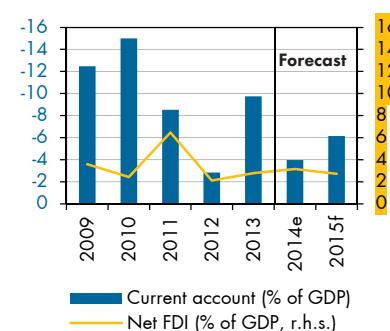
Financial analyst: Mariya Keda, Priorbank Open Joint-Stock Company, Minsk

**Real GDP (% yoy)**



Source: Thomson Reuters, Raiffeisen RESEARCH

**Current account and FDI inflows**



Source: Statistical Committee of the RB, Raiffeisen RESEARCH

### Key economic figures and forecasts

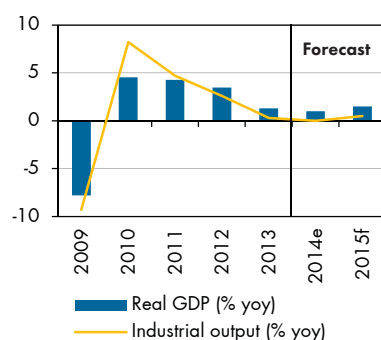
	2009	2010	2011	2012	2013	2014e	2015f
Nominal GDP (EUR bn)	35.3	41.6	43.1	49.6	54.0	47.4	56.3
Real GDP (% yoy)	0.2	7.7	5.5	1.7	0.9	0.5	1.5
Industrial output (% yoy)	-3.1	11.7	9.1	5.8	-4.8	-2.0	2.5
Unemployment rate (avg, %)	0.9	0.7	0.5	0.5	0.5	1.0	1.0
Nominal industrial wages (% yoy)	9.5	25.3	59.2	93.8	40.7	25.0	20.0
Producer prices (avg, % yoy)	13.6	13.6	71.4	76.0	13.6	12.1	12.5
Consumer prices (avg, % yoy)	13.0	7.7	53.2	59.2	18.3	21.0	20.0
Consumer prices (eop, % yoy)	10.1	9.9	108.7	21.8	16.5	25.0	15.0
General budget balance (% of GDP)	-0.7	-2.6	2.1	0.5	0.0	0.0	0.0
Public debt (% of GDP)	22.2	23.3	48.5	31.5	33.0	34.4	34.6
Current account balance (% of GDP)	-12.5	-15.0	-8.5	-2.9	-9.7	-4.0	-6.1
Official FX reserves (EUR bn)	3.4	2.6	4.6	4.4	3.6	3.2	2.5
Gross foreign debt (% of GDP)	43.6	50.9	60.9	51.7	49.0	59.4	54.7
EUR/BYR (avg)	3,894	3,951	6,924	10,718	11,788	14,590	17,197
USD/BYR (avg)	2,793	2,979	4,975	8,337	8,876	10,807	12,930

Source: Thomson Reuters, Raiffeisen RESEARCH

## Preparing for all eventualities

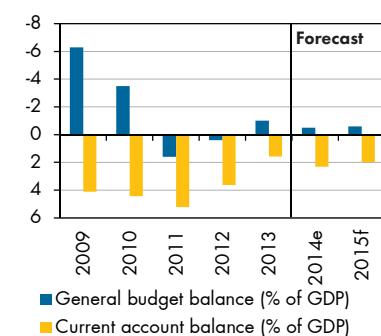
- **Worst deterioration in relations with the West over Ukraine since the end of Cold War**
- **Ukraine situation: main scenario is for moderate sanctions; full-fledged trade and financial sanctions look less likely**
- **GDP forecast for 2014 cut from 1.7% to 1.0%, due to weak economy and current events**
- **In the light of the turmoil with Ukraine temporary RUB depreciation of 5-10%**

### Real GDP (% yoy)



Source: Thomson Reuters, Raiffeisen RESEARCH

### Budget and current account balance



Source: Thomson Reuters, Raiffeisen RESEARCH

### Economic outlook

Russia's external relations with the West (USA and EU) have deteriorated substantially over the **political issues with Ukraine regarding Crimea**. As of late March, no diplomatic solution had yet been found, and the West began to introduce targeted sanctions against Russian individuals. The escalation between Russia and Ukraine into a global stand-off between the West and Russia will definitely have consequences for the Russian economy. Together with weaker-than-expected economic activity during the first months of 2014, the political developments prompted us to **revise our GDP forecast downward from 1.7% to 1.0% in 2014**. The key macro indicators demonstrated disappointing dynamics in January. Industrial production and investment activity stagnated, business sentiment worsened and real wages growth decelerated, creating corresponding risks for retail sales and GDP growth. The main factor which will determine the magnitude of the negative impact of the political conflict is to what extent the West will intervene with **economic sanctions against Russia**. However, whatever the outcome is, the Russian economy will most likely suffer from the deterioration in the investment climate and household sentiment. We also see risks that political uncertainty and turbulence on the financial markets will discourage FDIs and portfolio investments. Moreover, a long period of uncertainty could lead to corporate investment programmes being frozen. Other factors which could suppress investment activity would be the increased cost of local and external borrowing and inflationary risks. The latter could also negatively affect the consumer sector. Having estimated the FX shock pass-through effect, which could add about 0.7 pp to the annual CPI, we also **increased our inflation forecast for 2014 from 5.2% to 5.7%**. While some industries may benefit from the currency depreciation, for consumers the melting purchasing power as a result of RUB depreciation could cause **a significant slowdown in retail sales**. In addition, even without economic

### Key economic figures and forecasts

	2009	2010	2011	2012	2013	2014e	2015f
Nominal GDP (EUR bn)	879.2	1147.1	1342.0	1540.0	1578.0	1431.0	1556.0
Real GDP (% yoy)	-7.8	4.5	4.3	3.4	1.3	1.0	1.5
Industrial output (% yoy)	-9.3	8.2	4.7	2.6	0.3	0.0	0.5
Unemployment rate (avg, %)	8.4	7.5	6.6	5.7	5.8	6.0	6.0
Average gross wages (% yoy)	7.8	12.4	11.5	13.9	10.0	8.0	7.0
Producer prices (avg, % yoy)	13.9	16.7	12.0	5.1	3.7	3.5	3.5
Consumer prices (avg, % yoy)	11.8	6.9	8.5	5.1	6.8	6.1	5.5
Consumer prices (eop, % yoy)	8.8	8.8	6.1	6.6	6.2	5.7	5.6
General budget balance (% of GDP)	-6.3	-3.5	1.6	0.4	-1.0	-0.5	-0.6
Public debt (% of GDP)	8.3	9.3	9.8	10.5	12.0	13.0	14.0
Current account balance (% of GDP)	4.1	4.4	5.2	3.6	1.6	2.3	2.0
Official FX reserves (EUR bn)	291.0	331.0	349.7	369.1	342.9	330.2	337.8
Gross foreign debt (% of GDP)	37.1	31.8	31.1	31.4	34.1	42.3	43.0
EUR/RUB (avg)	43.6	40.3	42.0	39.7	42.2	49.7	49.3
USD/RUB (avg)	31.3	30.4	30.2	30.9	31.8	36.8	37.1
Basket/RUB (avg)	36.9	34.9	35.5	34.8	36.5	42.6	42.6

Source: Thomson Reuters, Raiffeisen RESEARCH



sanctions, the banking sector would be affected by monetary policy tightening (as a response to FX shock), and retail lending may decelerate, creating additional pressure on consumer activity.

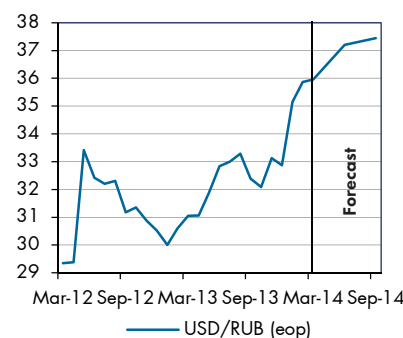
### Financial market outlook

In Q1 2014, **RUB came under serious pressure, losing around 11.7%** against the dual-currency basket and 10.4% against USD ytd. Initially, the RUB depreciation was explained by QE tapering (other EM currencies were also depreciating). Additionally, the CBR took further steps towards shifting to a free-floating regime by 2015, having cancelled its target interventions (USD 60 mn per day previously). Furthermore, MinFin decided to make FX purchases to the Reserve Fund on the open market (RUB 3.5 bn daily). However, at the beginning of March RUB depreciation became more acute due to the **escalation of the situation with Ukraine**. The CBR immediately responded to the panic on the FX market with (1) a temporary hike in the key rate by 1.5 pp to 7%; and (2) a temporary shift in FX policy to manual control, in order to slow down/limit uncontrolled rouble depreciation. The cumulated interventions (which lead to a 5-kopeck shift of the FX band) were increased from USD 350 mn up to USD 1.5 bn. The CBR also demonstrated that it could intervene with huge urgent interventions (>USD 10 bn per day) to limit speculative pressure on RUB. As a result, **speculative attacks became unattractive** due to both high cost of the CBR refinancing and interbank lending. Now the Russian FX market is driven more by political issues rather than economic ones. With the **turmoil around Ukraine to persist** for some while and given the lack of clear positive shift in fundamentals, **we remain short term bearish on RUB**, but would see some appreciation potential from the undervalued levels as soon as the situation with Ukraine calms down.

As we expected, **OFZ yields were on an upward trend in Q1 2014**. At the very beginning of the quarter, selling pressure was mostly due to RUB weakening. Later, however, the escalation of Ukrainian crisis also put serious pressure on Russian government bonds. Selling pressure from non-residents trying to decrease their exposure to Russia and increased REPO rates eventually triggered massive sell-off: yields on 10y OFZ jumped by 150bp to YTM 9.2% year-to-date. According to CBR data, the **position of non-residents in OFZ was cut by USD 1.2 bn in Jan 2014** (the outstanding exposure is USD 24 bn). We do not expect a fast resolution of the Ukraine crisis and the turmoil on the market is unlikely to calm down in Q2 which will **not allow CBR to decrease the key rate to normal levels**. Compared to the CBR's current REPO rates, **OFZs look expensive**. We see a fair yield on 10y OFZ at YTM 10% now, but a sell-off may spur yields higher.

Financial analysts: Denis Poryvay, ZAO Raiffeisenbank, Moscow; Wolfgang Ernst, RBI Vienna

### Exchange rate development



USD/RUB: 5y high 36.63, 5y low 27.28  
Source: Bloomberg, Raiffeisen RESEARCH

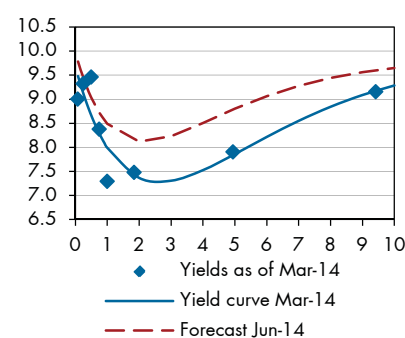
### Exchange rate forecasts

	19-Mar <sup>1</sup>	Jun-14	Sep-14	Dec-14	Mar-15
EUR/RUB	50.05	50.2	48.7	49.0	49.6
Cons.		45.2	45.0	45.6	45.8
USD/RUB	35.96	37.2	37.4	36.3	36.7
Cons.		34.3	34.4	35.2	35.1
RUB basket	42.30	43.0	42.5	42.0	42.5

<sup>1</sup> 5:00 p.m. (CET)

Source: Bloomberg, Raiffeisen RESEARCH

### RUB rate and yield curve (%)\*



\* 1m – 6m interest rates; 1y – 10y LCY gov. bond yields  
Source: Bloomberg, Raiffeisen RESEARCH

### Interest rate forecasts

	19-Mar <sup>1</sup>	Jun-14	Sep-14	Dec-14	Mar-15
Key rate	7.00	7.00	6.00	6.00	6.00
Cons.		n.v.	n.v.	n.v.	n.v.
1 month <sup>2</sup>	9.00	9.20	8.75	8.85	8.85
3 month <sup>2</sup>	9.32	9.75	9.30	9.40	9.40
6 month <sup>2</sup>	9.46	9.80	9.30	9.50	9.50

<sup>1</sup> 5:00 p.m. (CET) <sup>2</sup> Bid rate

Source: Bloomberg, Raiffeisen RESEARCH

### Yield forecasts

	19-Mar <sup>1</sup>	Jun-14	Sep-14	Dec-14	Mar-15
2y T-bond <sup>2</sup>	7.48	8.0	7.3	7.6	7.8
Cons.		n.v.	n.v.	n.v.	n.v.
5y T-bond <sup>2</sup>	7.90	9.0	8.4	8.5	8.8
10y T-bond <sup>2</sup>	9.15	9.5	8.7	8.8	9.0
Cons.		n.v.	n.v.	n.v.	n.v.

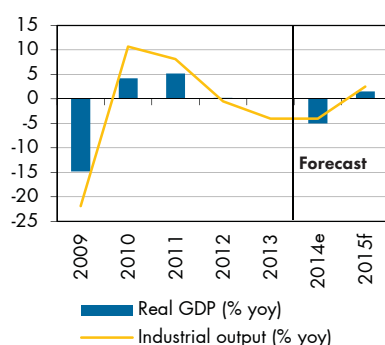
<sup>1</sup> 5:00 p.m. (CET) <sup>2</sup> Ask yield

Source: Bloomberg, Raiffeisen RESEARCH

## Teetering on the edge

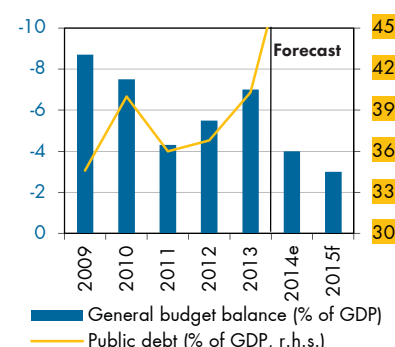
- A massive public uprising swept away President Yanukovich
- Political outlook remains extremely fragile amid domestic tensions and Russian pressure
- Substantial economic adjustment ahead, accommodated by large-scale Western financial support
- Short-term economic outlook is unfavourable with positive developments feasible in the longer run

### Real GDP (% yoy)



Source: State Statistics Committee of Ukraine, Raiffeisen RESEARCH

### Budget balance and public debt



Source: National Bank of Ukraine, Raiffeisen RESEARCH

### Economic outlook

A three-month political crisis in Ukraine, triggered by the decision of the authorities to abandon EU integration and a subsequent brutal crackdown on peaceful protests, resulted in the **ousting of President Victor Yanukovich after more than 100 people died in clashes in downtown Kiev** in mid-February. This led to a complete reboot of the political system – a new majority emerged in the Parliament, and a close ally of former Prime Minister Tymoshenko was appointed as the new Speaker and serves as acting President, until snap presidential elections, scheduled for 25 May. Also, the Rada launched a constitutional reform, which is aimed at shifting the balance of power from the President to the Parliament (basically restoring the system, which existed before 2010, when the President Yanukovich extended his presidential authorities). The new government is headed by Mr Yatsenyuk, one of the political leaders of Euromaidan, and is facing an enormously difficult task of bringing the country back from the brink of bankruptcy and implementing radical economic and structural reforms. The **West welcomed the power change in Kiev** and expressed no doubts in the legitimacy of the new administration. Consequently, a rapprochement quickly followed – an Association Agreement with EU is to be signed soon, while Western powers and international financial organisations are currently putting together a **massive financial help package for Ukraine**, the total size of which might exceed USD 30-35 bn over the next 3-5 years. On the other side, **Russia reacted harshly to the political coup** in Kiev, deemed it unconstitutional and signalled the possibility of military intervention in Ukraine to protect the rights of the ethnic Russian minority.

Moreover, in de facto terms, **Russia has already annexed the autonomous republic of Crimea**. Thus, despite the relatively smooth power transition in Kiev and the high willingness of foreign donors to support Ukraine, the **political outlook remains extremely uncertain** with the full range of scenarios still possible.

### Key economic figures and forecasts

	2009	2010	2011	2012	2013	2014e	2015f
Nominal GDP (EUR bn)	81.7	102.7	117.2	135.6	133.2	103.7	112.9
Real GDP (% yoy)	-14.8	4.2	5.2	0.2	0.0	-5.0	1.5
Industrial output (% yoy)	-21.9	10.7	8.1	-0.5	-4.0	-4.0	2.5
Unemployment rate (avg, %)	8.8	8.1	7.9	7.7	7.5	8.5	8.0
Nominal industrial wages (% yoy)	5.0	21.9	20.9	15.0	8.0	-2.0	0.0
Producer prices (avg, % yoy)	6.6	20.9	19.0	3.6	-0.1	5.5	8.0
Consumer prices (avg, % yoy)	15.9	9.4	8.0	0.6	-0.2	6.0	7.5
Consumer prices (eop, % yoy)	12.3	9.1	4.6	-0.2	0.5	12.0	9.0
General budget balance (% of GDP)	-8.7	-7.5	-4.3	-5.5	-7.0	-4.0	-3.0
Public debt (% of GDP)	34.6	40.0	36.0	36.8	40.3	52.0	53.0
Current account balance (% of GDP)	-1.6	-2.2	-6.3	-8.5	-9.1	-5.9	-4.2
Official FX reserves (EUR bn)	17.8	24.8	23.4	17.2	12.5	13.0	13.9
Gross foreign debt (% of GDP)	88.2	85.2	83.0	74.4	78.9	107.1	106.3
EUR/UAH (avg)	11.2	10.5	11.1	10.4	10.8	14.5	14.6
USD/UAH (avg)	8.0	7.9	8.0	8.1	8.2	10.8	11.0

Source: Thomson Reuters, Raiffeisen RESEARCH

In our baseline case, we do not expect major political fallout and a major escalation in Ukraine-Russia relations, but certain changes to the territorial division and political system of the country are likely.

The political turmoil weighed heavily on the already fragile economy, but GDP bounced back surprisingly in Q4 2013, posting 3.3% yoy increase (after having contracted for five quarters in a row). As a result, GDP growth was flat in 2013 (after a 0.2% yoy increase in 2012). This year **we expect a rather notable contraction in output on the back of the political turbulence**, inevitable policy tightening and substantial deterioration in trade relations with Russia. Hence, we expect the Ukrainian **economy to contract by 3-7% this year**, while consumer price inflation should shoot into the low double digits (10-14% yoy). Sizeable exchange rate adjustment and IMF-induced austerity are to reduce the twin deficits of the country – the C/A deficit is expected to fall to 5-6% of GDP in 2014 (after peaking at 9% last year), while roughly the same adjustment is in the cards for the fiscal accounts. According to our estimates, the general government deficit reached 7-8% of GDP in 2013 and will fall to 4-5% this year.

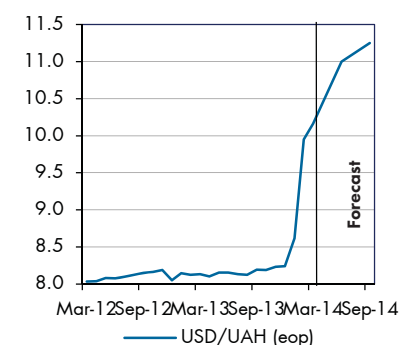
#### Financial market outlook

Ukraine's currency has been one of the main victims of the political crisis so far. The escalation of political turbulences on the back of critically weak external position led to the **forceful breakdown of the peg and prompted the new management of the central bank to introduce a flexible exchange rate regime**. As a result, the hryvnia has lost nearly 15% against USD ytd, while at the peak of volatility the local currency weakened by nearly 30% compared to the beginning of the year. Given our assumption of forthcoming financial assistance, **we would not expect further dramatic UAH weakening in the long term**. However, some overshooting in the short run should not be ruled out amidst continued uncertainty which is likely to persist in the coming weeks. By year-end 2014 we would project USD/UAH to stabilise around 10.50-11.50, which might look broadly in line with the economic fundamentals and broader regional exchange rate trends. Nevertheless, the **tail risks to this scenario remain material**, stemming from domestic policy failures and an escalation of the dispute with Russia.

The escalation of political and economic turmoil triggered **fears of possible public sector debt restructuring** as the state faces repayments of nearly USD 30 bn (including local currency debt) by the end-2015. However, we still consider outright public debt restructuring (possibly supported by the IMF) as a very unlikely scenario as the public debt stock levels remain fairly low in a cross-country perspective (thus, the problem lies mainly in liquidity dimension). **Massive external aid will help alleviate the liquidity problems in the short run**, while LCY debt restructuring brings no benefit at all as the major burden is to be borne by the public sector. However, with the very uncertain political and economic outlook, the chances of Ukraine running into payment difficulties on its external debt are certainly not zero.

Financial analysts: Dmytro Sologub, Raiffeisen Bank Aval Public Joint Stock Company, Kiev;  
Wolfgang Ernst, RBI Vienna

#### Exchange rate development



#### Exchange rate forecasts

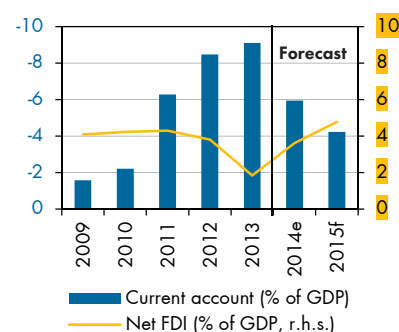
	19-Mar <sup>1</sup>	Jun-14	Sep-14	Dec-14	Mar-15
EUR/UAH	14.14	14.9	14.6	15.5	15.5
Cons.		11.6	11.6	13.1	12.6

USD/UAH	10.16	11.0	11.3	11.5	11.5
Cons.		8.8	8.9	10.1	9.7

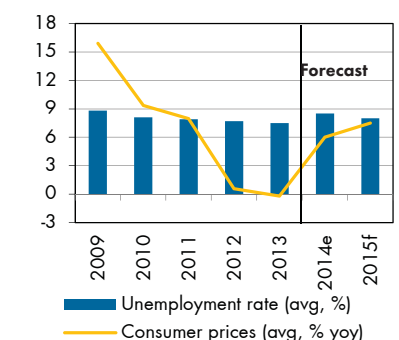
<sup>1</sup> 5:00 p.m. (CET)

Source: Bloomberg, Raiffeisen RESEARCH

#### Current account and FDI inflows



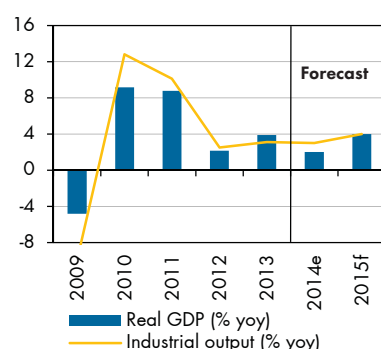
#### Inflation and unemployment



## Economy decelerating again

- Economy to decelerate on monetary tightening and political uncertainties
- Economic rebalancing to proceed, current account deficit to fall
- Following pricing out of election premium, TRY bond market to offer attractive entry opportunities
- Some TRY overshooting still in the cards during the second quarter 2014

Real GDP (% yoy)

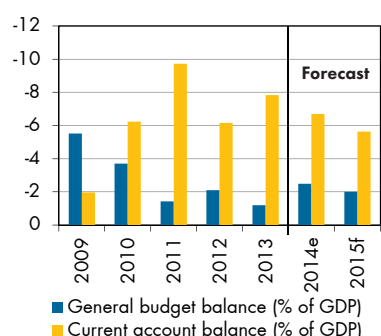


Source: Thomson Reuters, Raiffeisen RESEARCH

### Economic outlook

The full-year result for GDP growth in 2013 has not been published at the time of writing, but the markets and the government expect a figure slightly below 4% yoy, which is better than in the year before. However, towards the end of 2013 and in early 2014, **fears of a deceleration in economic growth have become more acute**. It is mainly the long-standing economic weaknesses such as the large current account deficit and booming bank credit that have made Turkey vulnerable to a deterioration in external conditions. Less ample capital flows to the Emerging Markets and the steps towards normalisation of monetary conditions in the USA and Europe put the **Turkish growth and financing model in danger**. Monetary policy has been already tightened in an abrupt move in February. On top of this, **political turbulences have added to the uncertainties**, as Prime Minister Erdogan is becoming increasingly entangled in corruption charges.

Budget and current account balance



Source: Thomson Reuters, Raiffeisen RESEARCH

We **slash our 2014 growth forecast from 3.5% to 2.0%**, reflecting these fears (we are not alone and market forecasters' consensus estimate has also fallen quickly in recent months). In our opinion, both household demand and investment will be affected and destocking will accelerate again, whilst net exports will become supportive for growth again. This would also imply some **decline in the current account deficit**, given the reduction in imports. Unemployment may inch upwards in 2014. With some pass-through from a weak lira, **inflation rates will likely stay elevated at around 7%**.

### Key economic figures and forecasts

	2009	2010	2011	2012	2013	2014e	2015f
Nominal GDP (EUR bn)	439.5	549.5	554.8	611.8	624.7	586.4	667.8
Real GDP (% yoy)	-4.8	9.2	8.8	2.2	3.9	2.0	4.0
Industrial output (% yoy)	-9.9	12.8	10.1	2.5	3.1	3.0	4.0
Unemployment rate (avg, %)	13.7	11.7	9.6	9.0	9.4	9.8	9.5
Nominal industrial wages (% yoy)	8.1	8.0	8.0	6.0	6.0	6.0	6.0
Producer prices (avg, % yoy)	1.2	8.5	11.1	6.1	4.5	6.0	6.0
Consumer prices (avg, % yoy)	6.2	8.6	6.5	8.9	7.5	7.4	7.3
Consumer prices (eop, % yoy)	6.5	6.4	10.5	6.1	7.4	7.5	7.0
General budget balance (% of GDP)	-5.5	-3.7	-1.4	-2.1	-1.2	-2.5	-2.0
Public debt (% of GDP)	48.9	45.2	42.1	39.8	38.5	38.2	37.3
Current account balance (% of GDP)	-2.0	-6.2	-9.7	-6.2	-7.8	-6.7	-5.6
Official FX reserves (EUR bn)	49.4	60.2	60.3	75.8	80.5	74.1	84.6
Gross foreign debt (% of GDP)	42.8	39.7	42.6	42.0	44.1	51.9	53.2
EUR/TRY (avg)	2.17	2.00	2.34	2.31	2.54	2.94	2.85
USD/TRY (avg)	1.55	1.51	1.68	1.80	1.91	2.18	2.14

Source: Thomson Reuters, wiw, Raiffeisen RESEARCH



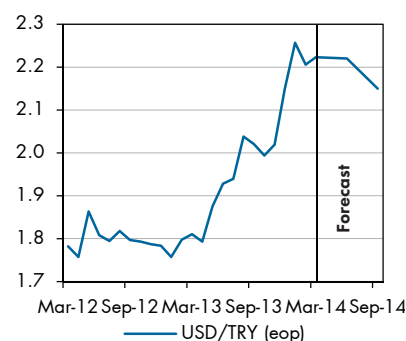
## Financial market outlook

The eruption of the corruption scandals in mid-December continued to undermine the already battered confidence in Turkish financial markets. By the end of January, when the **Turkish central bank (TCMB)** finally bowed to the elevated market pressure and **tightened the interest rate environment considerably**, the currency had already lost another 7% versus USD. In sum, TRY has lost approximately 25% versus USD since the repricing on the emerging financial markets began in May 2013, and was thus one of the top losers in the EM space. Accordingly, the local currency (LCY) yield curve (YC) has shifted substantially upwards since mid-December (which was also the cut-off date for our previous strategy publication), leading to the inversion of the TRY YC. When writing this report, the most liquid 2y bond yield was almost 200bp higher than in mid-December and almost 600bp above the levels seen in April 2013 when the correction of lira debt markets started in line with other overbought EM. In the same timeframes, the 10y yield jumped also considerably, but to a lesser extent than shorter maturities. Even the bolder-than-expected emergency move by the TCMB at the end of January was only able decelerate the ailing of lira markets, since the intensifying geopolitical tensions in Ukraine added to the local political tensions, in tandem with the generally souring EM sentiment which sustained capital outflows from Turkish markets. However, **we do not expect any further tightening of the monetary reigns on our forecast horizon** after end-January's MP adjustment, which amounted to 225bp effectively as the 10% one-week repo is again the new key interest tool and has to be compared to the 7.75% overnight facility (o/n corridor also tightened from 3.5%-7.75% to 8.0-12.0%).

Future capital flows are in any case hard to predict, especially in the case of Turkey where the general business climate, mainly amongst foreign investors, has deteriorated considerably in recent months. Also, **Fed tapering fears are still looming**, although we stick to our assessment that the Fed's line of approach in terms of rescaling its asset purchases is digestible and the risk of a further ailing lira is likely to be defused. **Some overshooting is, however, still in the cards given the possibility of temporary escalations on the local and geopolitical scene.** At the same time, we don't believe that the Turkish lira will reverse the losses it suffered since the tapering signal back in May, but given the expected calming of the Ukrainian crisis and the materialisation of improvements in Turkey's external balances, the local debt market should offer attractive opportunities following the local elections, which took place at the end of March.

Financial analysts: Andreas Schwabe, CFA, Stephan Imre

## Exchange rate development



USD/TRY: 5y high 2.34, 5y low 1.4  
Source: Bloomberg, Raiffeisen RESEARCH

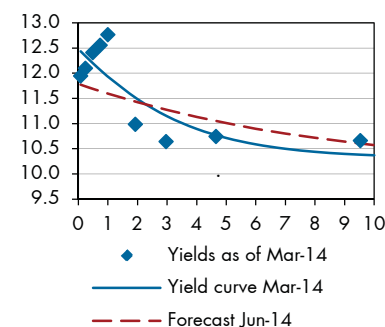
## Exchange rate forecasts

	19-Mar <sup>1</sup>	Jun-14	Sep-14	Dec-14	Mar-15
EUR/TRY	3.09	3.00	2.80	2.84	2.90
Cons.		2.97	2.92	2.87	2.91
USD/TRY	2.22	2.22	2.15	2.10	2.15
Cons.		2.25	2.23	2.22	2.23

<sup>1</sup> 5:00 p.m. (CET)

Source: Bloomberg, Raiffeisen RESEARCH

## TRY rate and yield curve (%)



\* 1m – 12m interest rates; 2y – 10y LCY gov. bond yields  
Source: Bloomberg, Raiffeisen RESEARCH

## Interest rate forecasts

	19-Mar <sup>1</sup>	Jun-14	Sep-14	Dec-14	Mar-15
Key rate	10.00	10.00	10.00	10.00	10.00
Consensus		10.25	10.38	10.25	10.25
1 month <sup>2</sup>	11.65	11.40	11.00	10.50	11.20
3 month <sup>2</sup>	11.80	11.70	11.30	10.90	11.30
6 month <sup>2</sup>	12.11	11.80	11.50	11.10	11.40
12 month <sup>2</sup>	12.45	12.10	12.00	11.60	11.50

<sup>1</sup> 5:00 p.m. (CET) <sup>2</sup> Bid rate

Source: Bloomberg, Raiffeisen RESEARCH

## Yield forecasts

	19-Mar <sup>1</sup>	Jun-14	Sep-14	Dec-14	Mar-15
2y T-bond <sup>2</sup>	10.98	11.0	10.9	10.5	10.5
Cons.		11.05	10.67	10.90	10.25
5y T-bond <sup>2</sup>	10.74	11.2	11.1	10.7	10.4
10y T-bond <sup>2</sup>	10.66	10.6	10.7	10.9	9.9
Cons.		10.60	10.73	11.03	11.19

<sup>1</sup> 5:00 p.m. (CET) <sup>2</sup> Ask yield

Source: Bloomberg, Raiffeisen RESEARCH

## Back in the cold

- Ukraine-Russia political crisis seriously damages the CIS regional outlook
- Primary markets saw record high activity in Q1 and likely to remain active in Q2
- Ukraine crisis and risk of sanctions against Russia dampen the CEE investment outlook
- We change our recommendation on CEE Eurobonds from neutral in Q1 to underweight in Q2

### EMBIG USD value & spreads\*

	19-Mar <sup>1</sup>		Spread values, bp		
	Index	Spread, bp	Q/Q	5y min	5y max
PL (A-)	547	114	-18	107	361
LT (BBB)	156	137	-5	134	493
BG (BBB)	1018	68	0	31	603
RU (BBB)	878	288	89	151	647
TR* (BBB-)	603	290	-5	137	531
RO (BB+)	127	197	4	185	528
HR (BB)	133	274	-22	145	657
HU (BB)	253	258	-13	149	726
RS (BB-)	200	277	-92	277	1006
BY (B-)	133	777	40	525	1706
UA (CCC)	535	1062	297	393	2827

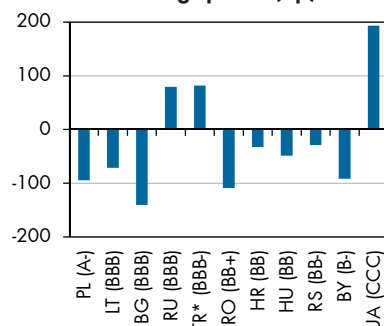
Europe*	948	297	31	171	656
Africa	820	297	-6	183	686
Asia	537	198	-13	133	525
Mid East	442	393	-1	280	756
Latam	579	394	22	285	680
Global	640	322	18	227	647
Inv.grade	491	209	11	135	473
BB	580	306	-5	188	743
B	1008	869	68	406	1395

<sup>1</sup> closing prices 5:00 p.m. (CET)

\* TR - Turkey Fitch rating, Europe - CEE, Q/Q - quarter-on-quarter, 5y - 5-year minimum and maximum

Source: Thomson-Reuters, Raiffeisen RESEARCH

### CEE EMBIG rating spread (bp)\*



\* JPM USD EMBI Global index family, TR - Turkey Fitch rating  
Source: Thomson-Reuters

### Market trends

The unprecedented political crisis in Ukraine and the annexation of Ukraine's Crimean peninsula by Russia following the separatist referendum in March has stirred up a dangerously serious political conflict between Russia, on the one hand, and Ukraine and the West on the other. The resulting volatility amplified CEE market risk and poses the biggest challenge to our originally positive market strategy. **The CEE markets experienced the worst volatility in March, as Crimea tensions directly affected the CEE risk perception. Still, rather surprisingly, the resulting price losses mostly affected the CIS market segment, while CE and SEE demonstrated good stability.** The CEE EMBIG USD price index posted an above-average return, outperforming the broader Composite EMBIG by 1% until mid-February. Nevertheless, escalation of the Ukraine-Russia crisis in early March sent the CEE Eurobond market lower, with the largest negative contributions naturally coming from Ukraine and Russia. As a result, the CEE segment underperformed the Composite price index by 1.5% in Q1. On a positive note, comparing the CEE EMBIG constituencies we note that only CIS countries delivered negative returns, while the positive performance by the rest of CEE helped to offset an otherwise bigger loss. **Another aspect of our strategy which went well was the bet on a weakening correlation between US Treasuries (UST) and EM debt,** which reduced the impact of rising UST yields on Eurobonds, leading to a much slower spread increase for the majority of CEE. Overall, the CEE portion of EMBIG USD including CIS remained virtually flat and excluding CIS the CEE index delivered a 2% gain. Our underweight recommendation on Serbia was loss-making as the spread dropped 92bp on positive political election expectations in the absence of negative economic catalysts. On the other hand, our positive recommendations for Hungary and Romania proved to be correct.

### Primary markets

**Many CEE governments seized the opportunity to issue new debt, taking a full advantage of relatively low yields and strong demand for EM debt,** which prevailed until mid-February. CEE gross issuance in primary Eurobond markets swelled to USD 21 bn or the equivalent of 40% of their 2014 placement plans. Several countries including Poland, Hungary and Slovenia had already pre-funded nearly 70-90% of their 2014 international borrowing needs by mid-Q1. The Ukraine-Russia crisis interrupted primary market activity with no single sovereign placements from CEE seen from mid-February until mid-March. Nevertheless, temporary de-escalation of the crisis propelled sovereign issuance activity, with Hungary and Slovenia returning to the primary markets and Romania also announcing plans for a sovereign bond in H1. **Moreover, as the window of opportunity is likely to narrow in Q3, more CEE sovereigns are expected to offer new bonds in Q2, so we expect a busy issuance schedule ahead.** Meanwhile, in terms of the maturity profile for CEE, May and June are the busiest months with a total USD 2.2 bn of CEE sovereign Eurobonds falling due in May and about USD 3 bn in June.

## Outlook & Strategy

**Going into Q2, we expect market volatility to increase due to a combination of several factors.** First of all, we expect a reversal in the 3-month rolling correlation between UST and EM debt yields, which should approach a positive 0.6-0.8 compared to a negative 0.4. This will increase the negative impact of UST yield increases for EM debt and may subsequently dampen CEE Eurobond performance. The second caveat we have in mind concerns the Ukraine-Russia conflict which involves a higher risk of Western economic sanctions against Russia. Indeed, we believe the market is underestimating the possible implications of this, which might depress Russia's market performance. This may potentially also derail Russia's plans to issue new international bonds as the cost of borrowing for the government may increase in the wake of sanctions. Last but not least, **we expect the CEE rating drift to stabilise only later in 2014 with the outlook for the region changing from negative to stable**, whilst rating upgrade prospects remain slim for most of CEE. Consequently, we see fewer chances to capitalise on fundamental improvements in Q2-Q3. All of the above pushes us to take a moderately negative outlook for CEE in Q2. As a result, **we changed our recommendation on CEE Eurobonds for portfolio investors from neutral in Q1 to slight underweight in Q2.** In particular, we foresee high risks in the CIS region imposing the risk of higher loss. Despite the Ukrainian government being fully committed to honouring its Eurobond debt, **we foresee the Ukraine sovereign risk remaining high due to severe financial limitations** which might dampen Ukraine's payment ability regardless of its strong willingness to pay. **In Russia, we see bond prices still ignoring the possibility of more serious economic sanctions while the CDS-implied rating suggests a strong likelihood of a single-notch downgrade.** Another potential source of concern will be Croatia as anaemic economic growth aggravates fiscal concerns amid the chronic inability of the government to implement consolidation policies. **At the same time, we remain constructive on Hungary and Romania**, due to fundamental improvements and the strong international liquidity position. Regardless of the political volatility in Turkey, we would recommend a tactical overweighting of Turkey vs. Russia, as the latter might pose even greater downside risk.

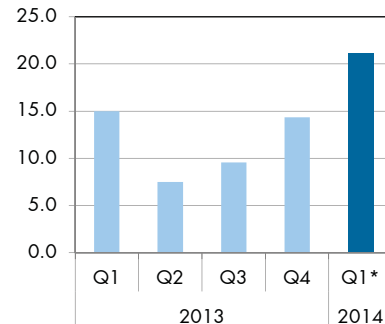
Financial analyst: Gintaras Shlizhyus

## CEE EMBIG vs. UST 10y yields (%)\*



\* JPM EMBI Global index family (yields)  
Source: Thomson-Reuters, Bloomberg, Raiffeisen RESEARCH

## CEE Eurobond issuance timeline \*



\* USD bn, sovereign government Eurobonds only in all currencies, 2014 Q1 - cumulative to-date  
Source: Bloomberg, BondRadar, Raiffeisen RESEARCH

## Benchmark Eurobond forecast and performance

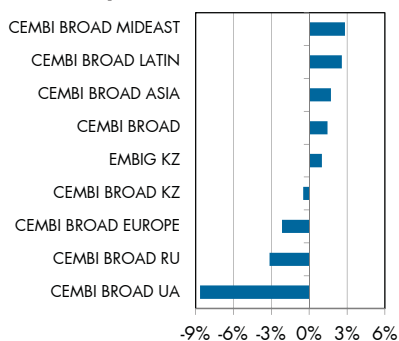
				Spread		Range			Spread		Range			Spread		Range	
		Rating	Dur.	19-Mar	Jun-14	min.	max.	Perf. (%)	Sep-14	min.	max.	Perf. (%)		Dec-14	min.	max.	Perf. (%)
PL 3% due 23	USD	A-	8.0	110	115	105	120	-3.0	135	125	140	-7.0		138	128	142	-8.8
PL 4.5% due 22	EUR	A-	6.9	59	60	59	61	-1.4	69	68	70	-4.1		72	71	72	-7.0
LT 6.625% due 22	USD	BBB	6.4	110	115	106	120	-2.6	135	126	140	-5.1		138	128	142	-6.5
LT 4.85% due 18	EUR	BBB	3.6	139	145	133	151	-0.9	170	158	176	-2.9		174	162	179	-4.5
BG 4.25% due 17	EUR	BBB	3.1	116	125	107	134	-0.9	149	131	158	-2.5		149	132	158	-3.8
RU 4.5% due 22	USD	BBB	6.7	210	220	200	230	-3.0	259	239	269	-6.9		263	243	273	-8.6
TR 3.25% due 23	USD*	BBB-	7.8	258	240	276	222	-1.2	266	302	248	-5.5		276	312	258	-7.8
TR 5.125% due 20	EUR*	BBB-	5.2	306	280	333	254	0.3	307	360	280	-2.6		322	375	296	-5.5
RO 4.375% due 23	USD	BB+	7.8	187	190	184	193	-2.8	220	214	223	-7.5		228	222	231	-9.7
RO 4.875% due 19	EUR	BB+	5.0	254	250	257	246	-0.8	285	293	282	-4.1		300	307	296	-6.8
HR 5.5% due 23	USD	BB	7.0	263	280	245	297	-3.6	332	297	349	-9.3		335	300	352	-10.9
HR 6.5% due 15	EUR	BB	0.8	105	140	70	175	-0.3	181	111	216	-0.6		166	95	201	-0.7
HU 5.375% due 23	USD	BB	7.2	251	230	272	209	-0.9	252	294	231	-4.6		277	319	256	-7.8
HU 3.875% due 20	EUR	BB	5.4	253	230	275	207	0.1	252	297	229	-2.6		277	322	255	-6.1
RS 7.25% due 21	USD	BB-	5.8	247	260	233	273	-2.8	307	280	320	-6.7		311	284	324	-8.1
BY 8.95% due 18	USD	B-	3.2	713	720	706	727	-1.3	709	695	716	-1.6		711	697	718	-2.3
UA 7.5% due 23	USD	CCC	6.1	746	800	692	854	-5.4	662	554	715	1.8		695	588	749	-1.5

<sup>1</sup> closing prices 5:00 p.m. (CET); \* Perf. as cumulative return of gross prices up to forecast horizon, countries sorted by S&P rating, Turkey - Fitch rating  
Source: Bloomberg, S&P, Fitch, Raiffeisen RESEARCH

## Mired in event risk, but short maturities seem attractive

- Weaker economic growth and escalating event risk hit EM credits in Q1
- We suggest moving into Russian short-term BBBs, assuming at least partial de-escalation in the Ukraine-Russian stand-off
- Weaker rouble, higher key rates in Russia and strong market presence in Ukraine – negative for Russian banks in 2014
- Weaker primary market in Q2, due to higher event risk in Ukraine

### Q1 2014 ytd returns

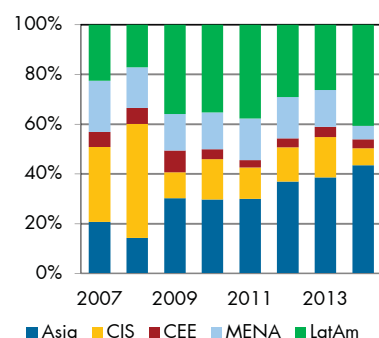


5y average annual return in %: CEMBI UA: 34.3, CEMBI KZ: 16.8, EMBIG KZ: 15.7, CEMBI EUROPE: 15.2, CEMBI RU: 14.6, CEMBI: 11.9, CEMBI LATIN: 11.3, CEMBI ASIA: 10.9, CEMBI MIDEAST: 10.8  
Source: JP Morgan, Raiffeisen RESEARCH

### UST vs. CEMBI RU Index



### EM corporate issuance (%)



From the current perspective, **the escalation of the Ukrainian political crisis and the position of Russia in the conflict are key** for the development of credit spreads in Q2 2014. We think that at least partial de-escalation of the Russian-Ukrainian crisis could spark more buying activity in the oversold Russian credit remit. Although it is not our central scenario, we may witness further intensification of the crisis in Q2 which may decompress credit spreads as event risks remain high. However, from the current perspective, **we do not consider the announced set of sanctions as prohibitive enough to have material impact on the fundamental position of Russian corporate credits.**

Leaving the Russian-Ukrainian stand-off aside, **the political tensions in Ukraine and the country's fragile macroeconomic profile have negative implications for the business risk of some Russian credits – in particular banks.** As of end-2013 according to the National Bank of Ukraine, VEB, Sberbank, Alfa Bank, VTB, Russian Standard and Bank of Moscow held a total of USD 17 bn in total assets in Ukraine. The total exposure of Russian banks in Ukraine according to rating agencies views and the statements of Mr Putin could be as much as USD 30 bn. As concerns the impact of Q1 RUB depreciation on the various sectors of the Russian economy, we think that **chemical companies and the steel sector may profit from the weaker rouble** due to export-driven sales and largely RUB-denominated cost structure. The **impact on oil&gas may be largely neutral** as hard-currency denominated sales are counterbalanced by comparably higher exposure to FX funding. **Banks' profitability will clearly suffer due to the central bank's pre-emptive 150-bp hike in key rates while RUB depreciation could negatively impact some banks' asset quality,** although the NPL impact will be mitigated by the positive effect of a weaker RUB on some borrowers' sales.

As regards valuation, the steepening trend of the Russian BBB curve observable in H2 2013 was reversed as volatility picked up in Q1 2014, and **short maturities suffered more in the subsequent sell-off wave.** If we take a look at BBB-rated Russian credits we can see a clear flattening trend since end-February. The 10-3y spread premium of Russian BBB-rated credits shrank from about 130bp at end-Feb to about 50bp now. That said, we think that **the shorter maturities may become more attractive in the direct aftermath of the crisis if the situation in Ukraine calms down.** We suggest that at least a partial reversal to a steeper credit curve could provide opportunities in the Russian credit remit. We suggest focusing on shorter maturities of better credits and recommend positioning in the oversold Russian oil and gas segment in anticipation of a steeper credit curve as the best strategy for playing the return to normality in Russian-Ukrainian political relations.

Taking a look at the Q1 performance, the global Emerging Markets (EM) corporate credit index returned 1.5% for the quarter-to-date. LatAm and Middle East credits ranked amongst the main contributors to the index's performance, returning 2.7% and 2.8%, respectively. The CIS segment underperformed the index owing to the escalation of the Ukrainian political crisis. Russian and Ukrainian credits lost 3.1% and 8.6% ytd, respectively. The performance of Kazakh high-



yield credits was less impacted by the developments in Ukraine and its Q1 qtd performance was close to zero. On a positive note, Kazakh investment grade credits (EMBIG KZ) delivered a decent 1.0% return.

**Most of the widening was seen in the Russian banking remit and B-rated metals and mining names.** The BBB-rated Russian oil and gas sector proved to be relatively resilient to sell-offs, mostly due to the positive impact of weaker RUB on their nominal sales.

In Kazakhstan, Alliance Bank's restructuring sent spreads wider. Also, Kazkom-mertsbank and BTA Bank bonds were hit by merger talks. Clearly, the 18% ytd depreciation of KZT against USD was a negative factor for the asset quality of Kazakh banks due to their 35-50% FX lending exposure. Halyk Bank bond spreads proved to be quite resilient (+ about 40bp ytd), while ATF Bank's 2017 bond spread even narrowed by 10bp ytd after its sale by UniCredit to a Kazakh owner earlier in 2013. By contrast, Ukrainian credits were hit hardest by the escalation of the political crisis. The Z-spread of Ukrainian steelmaker Metinvest widened by about 830bp while those of DTEK, an integrated utility, surged by about 620bp in Q1 qtd.

**Total return performance of 5-10y CIS credit was somewhat supported by the drop in risk-free rates in Q1.** The UST yield curve edged down ytd in the 5-10y segment by 4-18bp, while yields in the 1-5y segment picked up by up to 10bp. Looking at the primary market, 2014 kicked off with solid activity across the EM markets with the total issued amount for Jan-Feb at USD 94.6 bn, up 4% yoy. However, the **issuance was driven by LatAm and Asia** accounting for 27% and 39% of total issuance, respectively. The CEEMEA region's share decreased by almost 19% in absolute terms to USD 32 bn on the back of significantly lower issuance from the CIS region. The **CIS region's share was sharply down in Jan-Feb 2014** at USD 5 bn vs USD 15 bn seen during first two months of 2013. With sovereign issues missing, financials (58%) and corporates (42%) were the main contributors to overall issuance. Also, market depth was much lower with 6 issuers coming to market in Jan-Feb 2014, compared to 22 a year ago. Taking a look at the country split, Russia continued to drive issuance, accounting for 92% of the CIS total amount. Demand was focused on more stable, well-known names such as Sberbank, Gazprombank, Gazprom and Russian railways which came to the market in February.

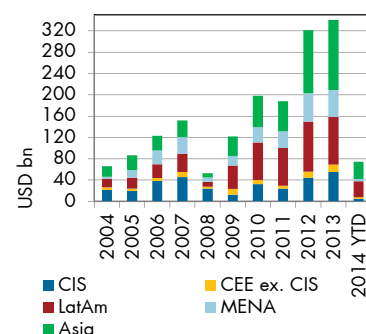
The overall sentiment in the CIS area was additionally impacted by the Russian-Ukrainian stand-off. Several expected deals were postponed until market conditions improve. These included a sub-deal from Tinkoff Credit System bank as well as senior Eurobond from Lukoil.

**The primary market outlook for Q2 is strongly linked to the evolution of the Ukrainian-Russian stand-off. We expect weaker activity in Q2 marked by deal postponements.**

On the secondary market, **we recommend temporarily avoiding Russian banks**, in particular consumer lenders, due to the combination of Ukrainian exposure and a more challenging operating and regulatory environment. Also, in Q2 **we suggest a cautious approach with respect to Ukraine**. On the spread basis, we suggest that **GAZPRU 6.212% due 2016 is well suited for a play on a steeper Russian credit curve** on the way to calmer conditions in the Russian-Ukrainian stand-off. In the BB-rated space, we continue to like Halyk Bank's HSBKKZ 7.25% due 2017, due to a combination of solid fundamentals and attractive valuation.

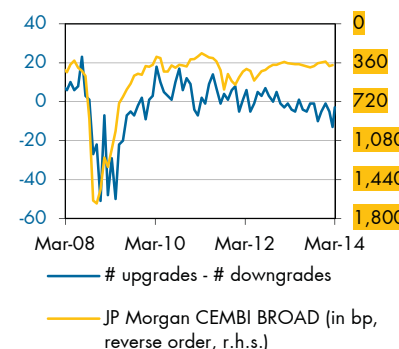
*Financial analysts: Martin Kutny, Lubica Sikova, CFA*

## EM corporate issuance



Source: Bond Radar, Raiffeisen RESEARCH

## Rating drift in Russia



CEMBI BROAD: 5y high: 928 bp; 5y low: 265 bp  
Source: Bloomberg, JP Morgan, Raiffeisen RESEARCH

## Selected CIS Eurobonds

Issuer	ISIN	Maturity	Yield in %
Alfa Bank	XS0544362972	9/25/17	5.7
Alrosa	XS0555493203	11/3/20	6.7
Evraz	XS0618905219	4/27/18	8.8
Gazprom	XS0885733153	2/6/20	5.1
Halyk Bank	XS0298931287	5/3/17	4.8
KazMunay-Gaz	XS0556885753	4/9/21	4.9
VimpelCom	XS0587031096	2/2/21	7.5

Source: Bloomberg, Raiffeisen RESEARCH

## Declining risk aversion as the driving force

- Ukraine crisis also weighing on ATX
- Significant gains in earnings in 2014
- ATX to move higher in Q2

### Value matrix\*

Domestic business activity	2	(2)
Exports	OECD - excl. Eastern Europe	2 (2)
	Eastern Europe	2 (2)
	Asia	2 (2)
Company earnings	2	(2)
Key sectors	2	(2)
Valuation - P/E-ratio	2	(2)
Interest rates / yields	2	(2)
Exchange rates	2	(2)
Foreign equity markets	2	(2)
European liquidity	2	(2)
Technical outlook	2	(3)

1 (4) denotes highly positive (negative) influence on the market. All factors are weighted equally.

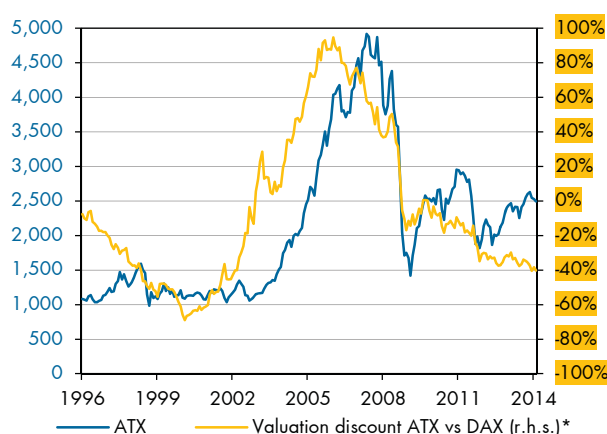
\* expected trend for the next 3 to 6 months

Source: Raiffeisen RESEARCH, Raiffeisen Centrobank

The **development of the Austrian stock market** has been **quite turbulent** in the first few months of this year. Initially, the ATX performed better than the established Western European stock indices for a long time, but then a significant risk premium was priced in due to the mounting geopolitical tensions.

As for **economic performance**, signs are still pointing to a **recovery**. For instance, key leading indicators continue to suggest a rebound in economic activity. Even though this will probably be more subdued than in previous upturns, we expect the high point in economic dynamics to be reached sometime in Q4 2014 / Q1 2015. Along with rising exports thanks to the improvement in external conditions, we also see domestic demand as a key factor behind this acceleration. With the exception of the CIS region, the economic situation in Eastern Europe should continue to improve as 2014 progresses. We expect to see the strongest growth in the Polish economy, and this is supported by the current leading indicators. In terms of monetary policy, we do not see any major impetus for the Austrian equity market during the quarters ahead. Neither the US central bank nor the European Central Bank will spring any major surprises on market participants.

### ATX shows valuation discount



\* Cyclically adjusted price/earnings ratio based on rolling 10 year trailing index earnings  
Source: Thomson Reuters, Raiffeisen RESEARCH

As for **corporate earnings**, there was **hardly any momentum** seen in the **past reporting season**. All in all, the figures which were released did not trigger any euphoria. SBO, Erste Group and Andritz issued profit warnings, and the quarterly reports by voestalpine and Verbund were not very convincing.

The current conflict involving Ukraine also raises the question of how much Russian exposure domestic companies have. By and large, the dependence of most of the firms in the ATX is low. Real estate companies such as Atrium and Warimpex are more strongly involved. For 2014, we estimate Palfinger's share of sales at around 7%.

Since we do not expect to see any further escalation in the situation with Ukraine in our baseline scenario, the increasing pace of global economic activity this year should also allow for **a recovery in earnings**. Ultimately, 2013

### Sector structure ATX

Sector	Company	Weight
Financials	CA Immobilien, conwert, Erste Group, Immofinanz, Raiffeisen Bank International, Vienna Insurance Group	44.5%
Industrials	Andritz, Oesterreichische Post, Strabag, Wienerberger, Zimtobel	18.1%
Energy	OMV, Schoeller-Bleckmann	15.0%
Basic materials	Mayr-Melnhof, Lenzing, RHI, voestalpine	14.5%
Telecom	Telekom Austria	4.5%
Utilities	EVN, Verbund	3.4%

Source: Raiffeisen RESEARCH, Raiffeisen Centrobank, Vienna Stock Exchange

had a negative result in this regard. At the aggregate level, earnings dropped by around 13.3%, with several one-off factors severely impacting the development of earnings at key companies (Erste Group, Vienna Insurance Group, OMV). Due to the significantly lower basis, the **estimated earnings growth of +30.4% for 2014** naturally looks very high at first glance. Thus, in relative terms much stronger performance can be expected for the ATX companies. For instance, consensus is looking for a gain of almost 6.7% for the companies in the DAX, whilst earnings growth for the Euro STOXX 50 companies is projected at around 7.4%. Furthermore, the performance we are forecasting should not obscure the fact that the earnings of Austrian companies will still end up being well below the record-setting level from 2007.

Increasing earnings will also be important in terms of their impact on valuations. Based on our estimates for the aggregate earnings of the companies in the ATX, we project a **P/E ratio of 13.6 for 2014**. The cyclically adjusted PER based on longer-term earnings thus still offers a great deal of leeway on the upside, as it remains far below its historical average and also exhibits a clear discount compared to the DAX.

Summary: In the months to come, the current **geopolitical uncertainties** will frequently impair the performance of the ATX, as this situation bears significant risks for the economy in the Eurozone as well. Nevertheless, we ultimately **do not expect to see further escalation**. Accordingly, in our opinion, sooner or later the focus should shift back to the overall conditions, which look quite positive for equities. Significant factors in this regard include a return to earnings growth, moderate valuations and the continuing lack of investment alternatives offering positive returns in particular. Although some investors will certainly take a more cautious approach due to the Ukraine crisis, we still expect price increases for the **ATX** which will justify a **"Buy" recommendation** for the second quarter.

Financial analyst: Johannes Mattner

#### Fair value of ATX<sup>1</sup> - March 2015

EY-BY <sup>2</sup>	Bond yields (10y)		
	2.50%	3.00%	3.50%
6.00%	2,663	2,515	2,383
5.75%	2,744	2,587	2,447
5.50%	2,830	2,663	2,515
5.25%	2,921	2,744	2,587
5.00%	3,018	2,830	2,663
4.75%	3,122	2,921	2,744
4.50%	3,234	3,018	2,830
4.25%	3,354	3,122	2,921
4.00%	3,483	3,234	3,018
3.75%	3,622	3,354	3,122
3.50%	3,773	3,483	3,234
3.25%	3,937	3,622	3,354
3.00%	4,116	3,773	3,483
2.75%	4,312	3,937	3,622

<sup>1</sup> based on the expected earnings for 2014/2015 (i.e. 226.4 index points)

<sup>2</sup> earnings yield less bond yield

Source: Raiffeisen RESEARCH, Raiffeisen Centrobank

#### Earnings yield\* less bond yield



\* earnings yield = E/P; based on 12-month forward earnings

Source: Thomson Reuters, Raiffeisen RESEARCH, Raiffeisen Centrobank

#### Valuation and forecasts

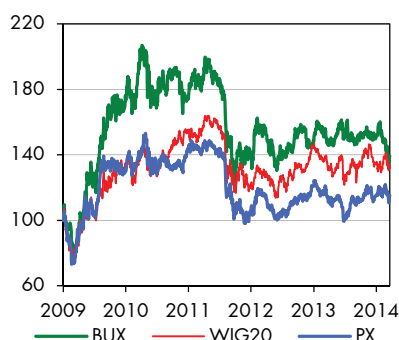
	19-Mar <sup>1</sup>	Jun-14	Sep-14	Dec-14	Mar-15
12-months forward earnings	226.6	193.2	204.4	215.5	226.4
Bond yield forecast	1.87	2.05	2.20	2.60	2.85
<b>Earnings yield less bond yield (EY-BY)</b>	<b>7.25</b>	<b>5.50</b>	<b>6.00</b>	<b>5.25</b>	<b>5.75</b>
ATX-forecast based on EY-BY		2559	2492	2745	2632
<b>ATX-forecast</b>	<b>2,483.7</b>	<b>2,600</b>	<b>2,500</b>	<b>2,700</b>	<b>2,660</b>
Expected price change		4.7%	0.7%	8.7%	7.1%
Range		2100-2700	2200-2800	2300-2900	2200-2800
P/E based on 12-month forward earnings	11.0	13.5	12.2	12.5	11.8

<sup>1</sup> 11:59 p.m. (CET); Source: Raiffeisen RESEARCH, Raiffeisen Centrobank

## Ukraine conflict casts a shadow over economic recovery

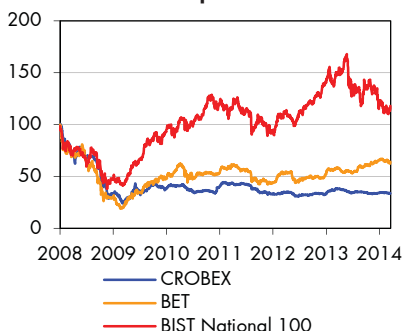
- Geopolitical conflict over Ukraine at the centre of attention
- Escalation between the Western industrialised countries and Russia is not anticipated
- Pace of economic recovery varies across regions
- Local topics play a subordinated role for now

### CE core indices



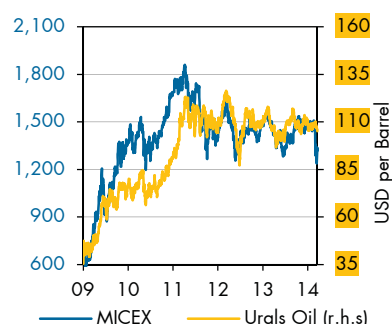
Source: Thomson Reuters, Raiffeisen RESEARCH

### SEE indices in comparison



Source: Bloomberg, Raiffeisen RESEARCH

### MICEX vs Oil



Source: Thomson Reuters, Raiffeisen RESEARCH

Equity markets in the CEE region were unable to decouple from the Ukraine crisis triggered by Russia, and as a result the gains for the indices seen so far in the year were neutralised or reversed. The outcome of the referendum in Crimea was expected and has thus not led to any change in the previous assessment of the situation. The key issue continues to be the manner in which the threats being traded by the Western industrialised countries and Russia materialise and if there will be further escalation. This will depend mostly on Russia's future strategy with regard to eastern Ukraine. In our baseline scenario, we do not expect any actual escalation, but we do expect to see the situation remain tense. Nor is it likely that a quick solution will be found and waves of uncertainty could hit the capital markets at any time again. Considering the fact that the capital markets' reaction to any escalation will likely be quite negative, we have decided to take this into account to a certain degree in our forecasts, and consequently the risk premiums which have built up so far are only priced out to a limited degree.

The **Russian stock market** is currently dominated by the development of the Crimean crisis, which poses a risk to both the economy of Russia (sanctions) and the stability of the local financial market. Due to the very international nature of the exchange in Moscow (non-residents hold 70% of equities), the volatility of financial flows is particularly high. The negative development has also been exacerbated by the depreciation trend for the rouble (-8.9% since the beginning of the year). Even without the Ukraine crisis, conditions for stock investments in Russia are not all that great. The slowing pace of economic activity (2014e GDP: +1.0%) is weighing on corporate earnings (2014e: +3.7%), along with the recent hike in the key rate to 7%. On the other hand, the market is supported by the extremely attractive valuation (P/E ratio 2014e: 4.7), which was lower than this in only nine months during the last 11 years. By way of comparison, the MSCI Emerging Markets Index is currently trading at a P/E ratio of 11.4. In light of the political tensions, volatility should remain high in the coming weeks, even though we believe that quite a bit has already been discounted in the current prices. **HOLD.**

**Poland's WIG 20** stock market index was also hit by the effects of the Crimean crisis and is also trading in the red now, with a loss of 1.7% since the beginning

### Value matrix stock markets

	PL		HU		CZ		RU		RO		HR		TR	
Politics	2	(2)	4	(4)	2	(2)	4	(2)	3	(2)	2	(2)	4	(3)
Interest rate trends	3	(3)	2	(2)	1	(1)	3	(2)	1	(1)	2	(2)	4	(3)
Earnings outlook	3	(3)	4	(1)	1	(1)	3	(4)	1	(1)	4	(4)	2	(2)
Key sectors	3	(3)	3	(2)	2	(2)	4	(4)	2	(2)	3	(3)	2	(2)
Valuation (P/E)	3	(3)	2	(2)	3	(2)	1	(1)	2	(1)	4	(4)	2	(2)
Liquidity	1	(1)	3	(3)	3	(3)	2	(2)	3	(3)	4	(4)	2	(1)
Technicals	2	(3)	3	(3)	2	(3)	2	(1)	2	(1)	3	(2)	2	(4)

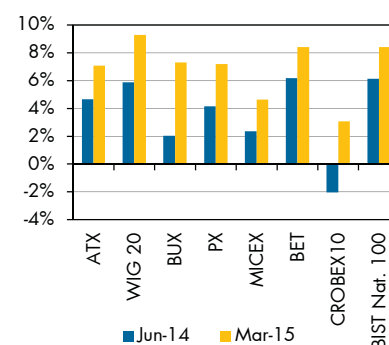
1 (4) denotes highly positive (negative) influence on the market. All factors are weighted equally. Assessment refers to a 3-month period.

Source: Raiffeisen RESEARCH

of the year. We continue to expect further improvement in Polish economic performance, and this has prompted us to boost our GDP forecast again from 2.9% to 3.1%. Aggregate earnings growth for the index amount to a modest 2%, leading to a P/E ratio of 13.2, which is already higher than Western European levels. For Polish pension funds, due to the high ratio of local equities, we expect to see diversification into foreign equities and corporate bonds, which will probably cause these funds to be net sellers of Polish stocks. At the same time, we do not expect an abrupt sell-off, since the government has targeted an equity ratio of at least 75% for 2014. However, this negative assumption should be more than offset by rising inflows for equity investments, due to the low levels of interest rates and the improving macro-economic data. **BUY.**

In the **Czech Republic**, the leading **PX** index also conceded its gains from the start of the year, but is counted amongst the more stable markets in Eastern Europe with a flat performance of 0% for this year. During the year, companies on this market should profit from the weaker koruna and from the economic upturn in the Eurozone (destination for around half of Czech exports), and this should also provide the impetus for a strong upswing in the Czech economy (2014e GDP: +2.3%). The key rate should stay at its current record low level of 0.05% for the rest of the year and will be no cause for concern. Compared to yields on 10-year government bonds (2.2%), the equities on the Prague exchange are cer-

#### Expected index performance



Source: Raiffeisen RESEARCH

#### Indices in performance comparison

	2005	2006	2007	2008	2009	2010	2011	2012	2013	19-Mar <sup>1</sup>
ATX	50.8%	21.7%	1.1%	-61.2%	42.5%	16.4%	-34.9%	26.9%	6.1%	-2.5%
BUX	41.0%	19.5%	5.6%	-53.3%	73.4%	0.5%	-20.4%	7.1%	2.2%	-8.1%
WIG 20	35.4%	23.7%	5.2%	-48.2%	33.5%	14.9%	-21.9%	20.4%	-7.0%	-1.7%
PX	42.7%	7.9%	14.2%	-52.7%	30.2%	9.6%	-25.6%	14.0%	-4.8%	0.0%
MICEX	84.3%	67.5%	11.5%	-67.2%	121.1%	23.2%	-16.9%	5.2%	2.0%	-12.3%
BET	50.9%	22.2%	22.1%	-70.5%	61.7%	12.3%	-17.7%	18.7%	26.1%	-3.4%
CROBEX	26.4%	62.2%	63.2%	-67.1%	16.4%	5.3%	-17.6%	0.0%	3.1%	-1.7%
BIST Nat. 100	n.a.	-1.7%	42.0%	-51.6%	96.6%	24.9%	-22.3%	52.6%	-13.3%	-3.4%
CECE Composite Index	44.7%	14.7%	10.5%	-53.7%	40.5%	15.7%	-29.1%	25.7%	-9.6%	-2.9%
DAX	27.1%	22.0%	22.3%	-40.4%	23.8%	16.1%	-14.7%	29.1%	25.5%	-2.9%
Euro STOXX 50	21.3%	15.1%	6.8%	-44.4%	21.1%	-5.8%	-17.1%	13.8%	17.9%	-1.0%
S&P 500	3.0%	13.6%	3.5%	-38.5%	23.5%	12.8%	0.0%	13.4%	29.6%	0.7%
MSCI World	13.7%	13.5%	2.8%	-40.1%	22.8%	7.8%	-7.6%	13.1%	26.3%	-0.6%

In local currency

<sup>1</sup> 11:59 p.m. (CET)

Source: Bloomberg, Thomson Reuters, Raiffeisen RESEARCH

#### Stock market indicators

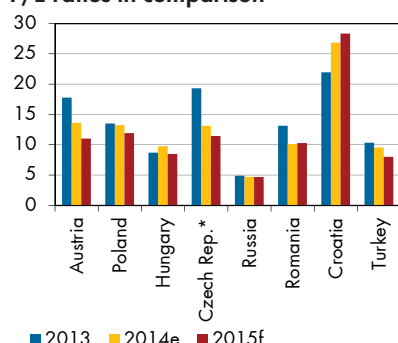
	Long-term growth	Earnings growth			Price/earnings ratio			Dividend yield
		13	14e	15f	13	14e	15f	
ATX	5.5%	-13.3%	30.4%	24.2%	17.8	13.6	11.0	3.0%
WIG 20	3.6%	-24.8%	2.0%	10.7%	13.5	13.2	11.9	4.7%
BUX	4.2%	-1.8%	-11.1%	15.1%	8.7	9.8	8.5	3.4%
PX*	6.8%	-21.1%	46.8%	14.9%	19.3	13.2	11.4	4.4%
MICEX	4.1%	-3.8%	3.7%	0.4%	4.9	4.7	4.7	5.4%
BET	6.7%	11.7%	30.2%	-1.9%	13.2	10.1	10.3	5.9%
CROBEX10	3.2%	1.3%	-18.3%	-5.2%	22.0	26.9	28.4	3.3%
BIST Nat. 100	7.7%	-7.6%	8.2%	19.0%	10.3	9.5	8.0	2.8%

<sup>1</sup> Czech Rep. (PX): excl. Tatry Mountain Resorts

Source: Thomson Reuters, IBES, Bloomberg, Raiffeisen RESEARCH

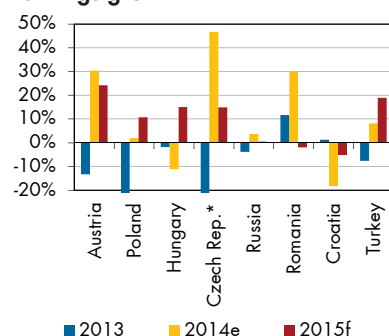


## P/E ratios in comparison



\* Czech Rep. (PX): excl. Tatry Mountain Resorts  
Source: Thomson Reuters, IBES, Bloomberg, Raiffeisen RESEARCH

## Earnings growth



\* Czech Rep. (PX): excl. Tatry Mountain Resorts  
Source: Thomson Reuters, IBES, Bloomberg, Raiffeisen RESEARCH

tainly an interesting alternative for return-oriented investors (2014e PX dividend yield: 4.4%). **BUY.**

The conflict between Ukraine and Russia triggered massive pressure on the **Hungarian** stock market index **BUX**, which has now lost 8.1% since the start of the year. The main reasons for this are the index heavyweights OTP Bank (as Russia and Ukraine accounted for 37.2% of net interest income in 2013) and the pharmaceuticals company Gedeon Richter (Russia and Ukraine accounted for 34.5% of total sales in 2013), along with the problems with the Croatian MOL subsidiary INA (dispute with the Croatian government). The economic situation in Hungary appears to still be improving, which has moved us to raise our previous 2014e GDP forecast from 1.5% to 2.0%. According to the current opinion polls, Viktor Orban is clearly ahead for the upcoming general elections on 6 April. While 2014e aggregate earnings had previously been estimated at 18.1%, the forecast has now turned around and is pointing to -11.1%. This results in an anticipated P/E ratio of 9.8 for 2014. Furthermore, taken together Gedeon Richter and OTP Bank have an index weighting of almost 55%, and thus we have to take into account more intense impacts in the event of escalation in the Ukraine crisis. **HOLD.**

The **stock market in Istanbul** has suffered greatly in recent months. A corruption scandal which led to a government crisis, steep depreciation for the local currency which led to a massive rate hike and the general malaise affecting the Emerging Markets resulted in the **BIST National 100** losing 3.4% in the last three months. Whilst the local elections at the end of March and the presidential elections in August may cause some tensions, the prospects of more moderate politics and a return of investor confidence are grounds for cautious optimism. In light of Turkey's strong dependence on foreign capital, the pressure on the political elite may be enough for them to change their management style. A very realistic scenario is that AKP will do well in the local elections (according to polls they are ahead), which would mean Erdogan staying in politics. His subsequent possible election as President would provide him with immunity and thus enable his party to take a more moderate approach without losing face. With a P/E ratio of 9.5 following the price declines in recent months, the BIST index is looking quite attractive again from a valuation perspective. **BUY.**

## Index estimates

	19-Mar <sup>1</sup>	Jun-14	Sep-14	Dec-14	Mar-15	Recommendation
<b>ATX</b>	2484	2600	2500	2700	2660	<b>BUY</b>
Performance		4.7%	0.6%	8.7%	7.1%	
Range		2100-2700	2200-2800	2300-2900	2200-2800	
<b>WIG 20</b>	2361	2500	2400	2600	2580	<b>BUY</b>
Performance		5.9%	1.7%	10.1%	9.3%	
Range		2100-2700	2100-2700	2300-2800	2300-2800	
<b>BUX</b>	17053	17400	17100	18600	18300	<b>HOLD</b>
Performance		2.0%	0.3%	9.1%	7.3%	
Range		15000-19000	15000-19000	16000-20000	16000-20000	
<b>PX</b>	989	1030	1020	1080	1060	<b>BUY</b>
Performance		4.1%	3.1%	9.2%	7.2%	
Range		900-1050	950-1050	980-1150	980-1150	

In local currency

<sup>1</sup> 11:59 p.m. (CET)

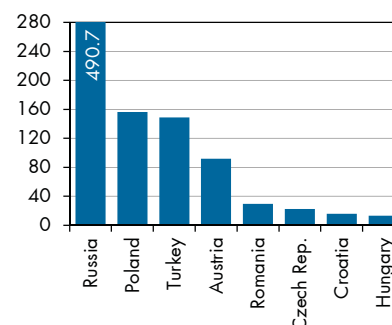
Source: Thomson Reuters, Raiffeisen RESEARCH

The crisis in Ukraine has also cast a shadow over the **Romanian stock market**. Regardless of this, both macro-economic and fundamental data point to positive development for the Romanian stock index **BET**. Fundamental conditions are good for the exchange in Bucharest, thanks to record low interest rates (3.5%), weak inflationary pressure and the positive economic environment (2014e GDP: +2.3%), along with the government's commitment to the agreement with the IMF. Above and beyond this, two state-owned companies will be listed on the stock market this year, which could also provide additional momentum for the Bucharest exchange. An IPO by the state-owned electricity utility Electrica is set to go forward, which should bring the state revenues of more EUR 400 mn. MSCI's proposal to revise the Frontier Markets Index is another positive aspect. According to the proposed change, the index weighting of the securities represented (OMV Petrom, Banca Transilvania, BRD-GSG and Romgaz) would increase from a total of 1.5% to 2.7%. Fundamentally speaking, the P/E ratio of 10.1 (2014e) for Romanian stocks looks attractive and with a dividend yield of 5.9% (2014e aggregate for the BET) this market is interesting for return-oriented investors. **BUY**.

Since the beginning of the year, the **Croatian CROBEX10** index has suffered a relatively modest decline of around 1.5%. Nevertheless, this is no reason to be happy and we expect sub-average performance by the exchange in Zagreb this year. The economy is stagnating (2014e GDP: 0.0%) and the Croatian government is under heavy pressure to cut spending. The recession lasting since 2009 has depressed Croatia's GDP per capita to about one half the EU average. Private consumption is weak, unemployment is high and the lack of competitiveness makes business difficult for Croatian companies. Consequently, we expect declining corporate earnings in 2014 for the CROBEX10 securities (2014e: -18.3%). This will be accompanied by a reduction in the high valuation for this market (2014e P/E ratio: 26.9). All in all, we thus expect negative performance for the Croatian stock market. **SELL**.

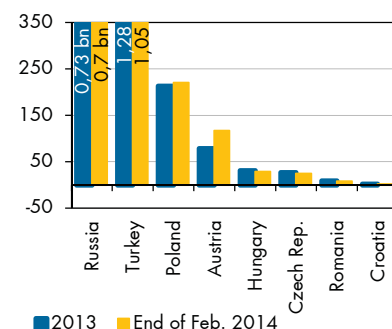
Financial analysts: Aaron Alber, Andreas Schiller

#### Market capitalisation overview



In EUR bn; end of February 2014  
Source: FESE, WFE, BSE, ZSE, Raiffeisen RESEARCH

#### Avg. daily turnover (EUR mn)



Source: FESE, WFE, BSE, ZSE, Raiffeisen RESEARCH

#### Index estimates

	19-Mar <sup>1</sup>	Jun-14	Sep-14	Dec-14	Mar-15	Recommendation
<b>MICEX</b>	1319	1350	1330	1400	1380	<b>HOLD</b>
Performance		2.4%	0.8%	6.1%	4.6%	
Range		1100-1400	1250-1400	1300-1500	1300-1500	
<b>BET</b>	6272	6660	6550	6850	6800	<b>BUY</b>
Performance		6.2%	4.4%	9.2%	8.4%	
Range		5700-6800	6000-6800	6400-7200	6400-7200	
<b>CROBEX10</b>	980	960	940	1000	1010	<b>SELL</b>
Performance		-2.0%	-4.1%	2.0%	3.1%	
Range		880-1050	860-1050	900-1100	900-1100	
<b>BIST Nat. 100</b>	65487	69500	68000	72000	71000	<b>BUY</b>
Performance		6.1%	3.8%	9.9%	8.4%	
Range		60000-73000	65000-73000	70000-80000	70000-80000	

In local currency

<sup>1</sup> 11:59 p.m. (CET)

Source: Thomson Reuters, Raiffeisen RESEARCH

## Increased risk as a little chance

### ATX



RIC: .ATX, 2008 – 2014: High = 4,4549.23, Low = 1,379.86, 19.03.2014, 11:47 a.m. CET  
Source: Thomson Reuters, Raiffeisen RESEARCH

### ATX

Last: 2,452.70

Expectedly 2,200 has gotten hit and the rising-support line proven firm once again. Thus some rebound could be due, i.e. towards 2,550 – 2,650. A rise beyond the trend's high 2,730.25 would indicate one towards 2,800, but the evolving Wedge-pattern is hinting on a retracement to in below of 2,350, which would indicate a plunge towards 2,200 – 2,170. First bearish signal would be 2,400 -> 2,370.

Sell 2,350 -> 2,170 – 1,995

Buy 2,510 -> 2,730 – 2,800...

### BIST 100



RIC: .XU100, 2008 – 2014: High = 93,398.33, Low = 20,912.19, 19.03.2014, 11:15 a.m. CET  
Source: Thomson Reuters, Raiffeisen RESEARCH

### BIST 100

Last: 65,261.35

At least it's remarkable, that the rising-support line at 55,000 hasn't been hit by now plus that a Morning Star pattern seemingly is evolving. The latter would mark a bullish reversal once 68,840 would have gotten crossed. This would indicate a further advance towards 75,300 – 80,000. A move beyond the moving average and 66,155 would be understood as a first hint on optimism.

Buy 66,480 -> 68,840 – 75,000

Sell 59,990 -> 55,000 – 54,420

### BUX



RIC: .BUX, 2008 – 2014: High = 26,242.90, Low = 9,337.99, 19.03.2014, 00:44 p.m. CET  
Source: Thomson Reuters, Raiffeisen RESEARCH

### BUX

Last: 19,954.64

With the rectangular pattern (yellow lines) recently bearishly honoured with 17,530 -> 16,000 and in consideration of this so-called Measured Move (marks I – III on the build) the resulting targets would actually be 14,300 and 12,000. With regard to these truly bearish indications the current rebound can only be taken for serious once it stretches to in beyond of 18,150.

Short 15,980 -> 14,780 – 14,300

Buy 18,150 -> 19,740 – 21,000

## CROBEX 10

Last: 984.58

The neutral pattern, the Rectangle, had just recently been left to downside making it a bearish continuation pattern, but considering the current rebound's pattern a bearish whipsaw followed by a rally would gain on likelihood once in beyond of 999. Until this happens, another sell-signal at 973 would not be off the table, just like a retracement towards 955 – 900 thereafter.

Buy 997 -> 1,050 – 1,100

Stop 970 -> 955 - 900

## CROBEX



RIC: .CRBEX, 2008 – 2014: High = 1,286.13, Low = 874.68, 19.03.2014, 01:20 p.m. CET

Source: Thomson Reuters, Raiffeisen RESEARCH

## MICEX

Last: 1,320.50

This sideways-trend – as of range 1,240 – 1,550 in effect since 2011 has withheld this recent testing-out, but as this other triangular pattern (see red lines on build) has just been bearishly confirmed at 1,300 indicating a draw-back to 1,100 and 1,000, the current rebound, that's actually been forming another Triangle, fails to make a bullish impression.

Sell 1,170 -> 1,000 - 935

Stop 1,375 -> 1,460

## MICEX



RIC: .MCX, 2008 – 2014: High = 1,970.46, Low = 493.62, 19.03.2014, 01:55 p.m. CET

Source: Thomson Reuters, Raiffeisen RESEARCH

## WIG 20

Last: 2,374.37

The Rectangle, vulgo neutral trend (yellow lines), has been intact since 2011. Three times it almost had been left behind already. The current consolidation pattern hints on another re-testing of its upper barrier 2,615, but in this case it should even hit 2,930 consequently. Another drop to in below of 2,200 would signal the opposite: a major decline towards not only 2,010 but even 1,850.

Buy 2,450 -> 2,620 – 2,800

Sell 2,200 -> 2,010 – 1,850

## WIG 20



RIC: .WIG20, 2008 – 2014: High = 3,491.01, Low = 1,470.85, 19.03.2014, 03:43 p.m. CET

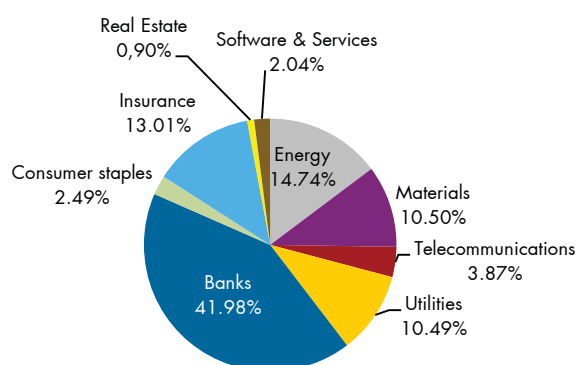
Source: Thomson Reuters, Raiffeisen RESEARCH

Financial analyst: Robert Schittler

## Sector weightings in comparison

### Sector weightings Poland, WIG 20

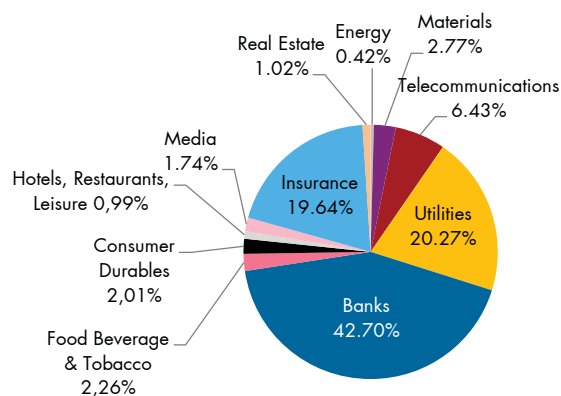
Dom. market cap.: EUR 156,4 bn (Source: FESE; 28-Feb-14)



Source: Thomson Reuters, Raiffeisen RESEARCH

### Sector weightings Czech Republic, PX<sup>1</sup>

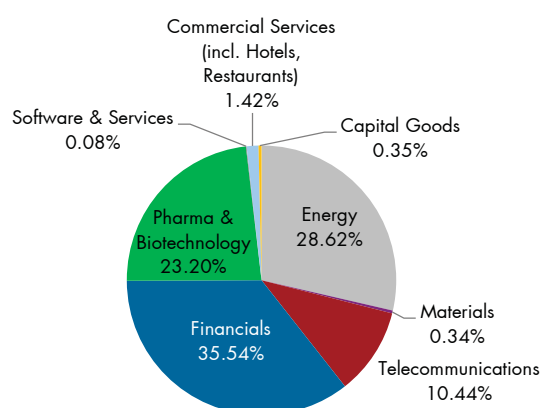
Dom. market cap.: EUR 22,7 bn (Source: FESE; 28-Feb-14)



<sup>1</sup> excl. Tatry mountain resorts  
Source: Thomson Reuters, Raiffeisen RESEARCH

### Sector weightings Hungary, BUX

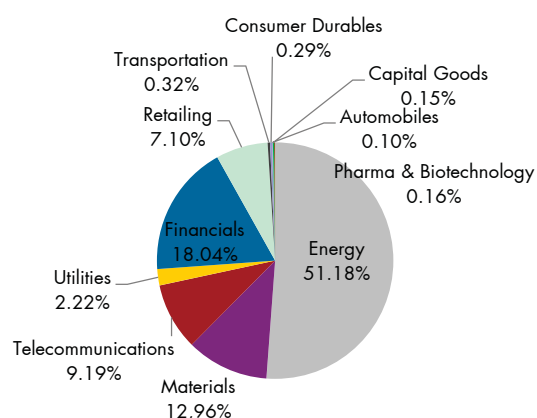
Dom. market cap.: EUR 13,2 bn (Source: FESE; 28-Feb-14)



Source: Thomson Reuters, Raiffeisen RESEARCH

### Sector weightings Russia, MICEX

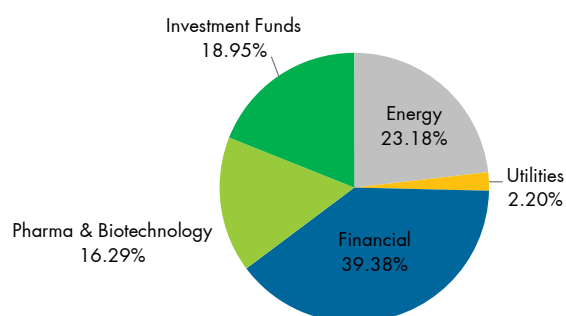
Dom. market cap.: EUR 490,7 bn (Source: WFE; 28-Feb-14)



Source: Thomson Reuters, Raiffeisen RESEARCH

### Sector weightings Romania, BET

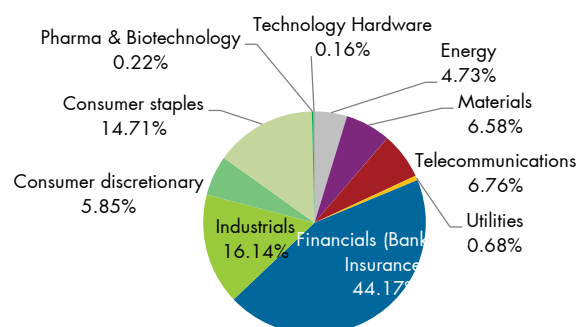
Dom. market cap.: EUR 29,5 bn (Source: BSE; 28-Feb-14)



Source: Bloomberg, Raiffeisen RESEARCH

### Sector weightings Turkey, ISE 100

Dom. market cap.: EUR 148,8 bn (Source: FESE; 28-Feb-14)



Source: Thomson Reuters, Raiffeisen RESEARCH



## Financials: A lot priced-in, but tough environment ahead

- We expect external factors (RU/UA, AQRs) to dominate sentiment in the banking landscape
- Watch out for delivery of PL banks in Q1 14 on elevated earnings forecasts
- Our short-term picks: BHW, PEO (div. yield), Erste and OTP (a lot priced-in)

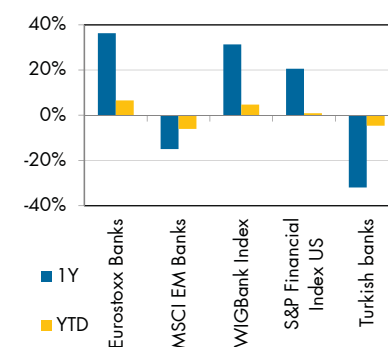
As a final solution does not appear in sight, current turmoil in Russia/Ukraine will likely remain a dominant factor for all CEE banking names, depending in addition also on the pace of possible EU/US sanctions against Russia. We still hint on the potential risks from the precautionary actions from banks regarding the ECB's AQR as demonstrated by some of them in Q4 (UniCredit, Erste) by lifting NPL coverage ratios and/or via further goodwill/tax assets impairments. Our macro base-case scenario foresees gradually incoming positive news-flow in PL, CZ and RO, which should accompany the meanwhile long-awaited revival of corporate/SME loan demand in CE3. We believe that the market should get more visibility of the Hungarian regulatory environment post the April elections.

YTD Polish banks, thanks to the strong year opening, still are the outperformers (+11% vs. EM banks, +9% vs. Turkish banks), but the recent neighbourhood tensions have calmed down the macro recovery euphoria having in mind already elevated 2014 earnings forecasts. Nevertheless, Q1 14 results should not bring any nasty surprise but are not seen as an upward trigger either: NIM revival, weaker F&CI, flattish to higher opex and slightly lower CoR. Given the external uncertainties for the coming months we would suggest looking at more defensive banks in Poland (Pekao, Handlowy), with additional spice from a 5-7% dividend yield. Our more risky recovery plays, PKO and ALR, remain on BUY list and being higher-beta stocks, they might recover in the case of easing tensions.

Outside Poland, after the recent correction we would bet on a rebound at Erste (no RU/UA presence, RO recovery in sight and weak 2014 outlook largely priced-in) as well as OTP (attractive valuation, and recovery in HU while RU/UA exposure to large extent diggested). Following the huge loss in Q4 13 caused by an upward adjustment of NPL coverage we turned more bullish on BRD's mid-term earnings recovery and would therefore prefer the stock over TLV.

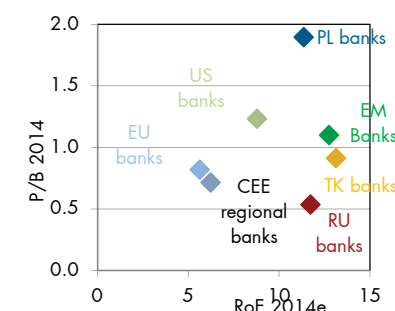
Financial analysts: Jovan Sikimic, Stefan Maxian

Performance (%)



Source: Bloomberg

P/B - RoE regression



Source: Bloomberg

### Sector comparison\*

Company	Recommendation	Target price	PER		P/BV		DY	
			2014e	2015e	2014e	2015e	2014e	2015e
Erste Group	Buy	EUR 27.50	14.4	10.8	0.9	0.8	1.6%	2.7%
Komercni Banka	Hold	CZK 4,800	13.8	12.9	1.8	1.7	5.0%	5.5%
OTP**	UR	UR	8.1	7.0	0.7	0.6	3.8%	4.2%
PKO BP	Buy	PLN 49.60	14.2	12.6	1.8	1.7	3.2%	3.6%
BZ WBK	Hold	PLN 428.0	17.8	15.8	2.5	2.3	2.8%	3.2%
Getin Noble Bank	Sell	UR	19.5	14.8	1.4	1.3	0.0%	0.0%
Bank Pekao SA	Hold	PLN 186.0	16.5	15.1	2.0	1.9	4.5%	5.0%
mBank	Sell	PLN 444.0	17.7	16.6	2.0	1.9	2.8%	3.0%
Bank Millennium	Hold	PLN 9.27	16.3	14.5	1.9	1.7	3.1%	3.4%
Alior Bank	UR	UR	18.1	13.4	2.3	1.9	0.0%	1.9%
Bank Handlowy	Buy	PLN 123.0	15.7	13.8	1.9	1.9	4.8%	5.4%
BRD-GSG	Buy	RON 10.80	8.3	6.5	1.0	0.9	4.6%	6.2%
Banca Transilvania	Reduce	RON 1.45	10.9	10.4	1.1	1.0	0.0%	2.4%
Komercijalna	UR	UR	7.7	7.1	0.4	0.4	0.3%	0.3%
Aik Banka	UR	UR	4.8	4.2	0.3	0.2	0.0%	0.0%
RBI	NC	NC	12.9	7.4	0.6	0.6	3.9%	4.8%

UR = under revision, NC = not covered

\* recommendation and target price refer to a 12 month horizon; \*\* estimates under revision

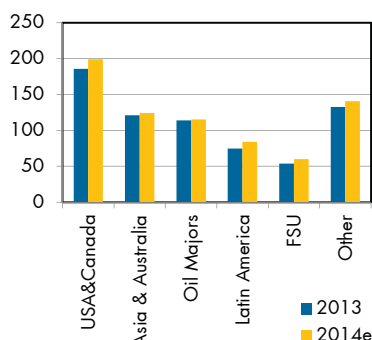
Source: Raiffeisen Centrobank estimates

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Supervisory authority: Financial Market Authority FMA, Otto-Wagner-Platz 5, A-1090 Vienna.

## Oil & Gas: Lower E&P spending by IOCs supportive for oil price

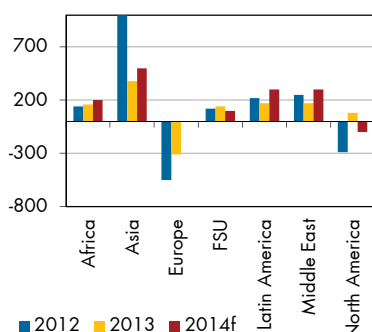
- Global E&P spending to grow by 6% in 2014e, driven by NOCs
- IOCs to stay focused on efficiency and returns and spend less on expansion
- We favour Novatek and LUKoil in the CIS and OMV/OMV Petrom in CEE

Global E&P spending (USD bn)



Source: Global 2014 E&P Spending Outlook by Barclays

World Total Oil Demand growth\*



\*kboepd (1,000 barrels of oil equivalent per day)  
Source: IEA Oil Market Report February 2014

European oils are underperforming downstream players in 2014 despite a still challenging environment faced by refiners. Stagnating oil prices, budget overruns in the development of complex projects and missing output from risky regions have made investors turn less bullish on international oil companies (IOCs). A new wave of shareholder activism made IOCs rethink their strategy by focusing on efficiency improvements and returns, rather than reserve accumulation and development of costly projects. At the same time, national oil companies (NOCs) are expected to further expand their reserves. Market surveys show that global spending on exploration and production (E&P) should grow by 6% in 2014e, driven by NOCs. It seems that the resource-hungry NOCs are willing to take advantage of upstream portfolio restructuring by IOCs and buy additional oil fields to fulfil ambitious strategic agendas. The question then is how will the oil price develop. Currently, the market plays the "no-oil-price-growth" scenario, betting on a further increase of production in North America. While we agree with such a scenario, we expect higher oil prices in the longer term. The underinvestment of IOCs could be one of the reasons. Higher costs for finding and development, but also producing oil should also drive prices longer-term (new production usually comes at higher costs). At the same time, we see little support for European refiners. With crude not allowed to be exported from the USA and Russian refiners undergoing massive modernisation, it is hard to believe that even by closing some of the loss-making refineries, the European market could become more balanced and be able to offset the negative impact of product inflows from lower-cost countries in the medium term.

We continue to favour upstream players. We believe that OMV and OMV Petrom stand to benefit from an improved production profile and stable output, as well as the liberalisation of gas prices in Romania. LUKoil is attractive due to share buy-backs and increasing output, while Novatek should demonstrate the highest increase in EBITDA among Russian oils.

Financial analyst: Oleg Galbur

Sector comparison\*

Company	Recommendation	Target price	PER		EV/EBITDA		P/CE	
			2014e	2015e	2014e	2015e	2014e	2015e
OMV	Buy	EUR 39.50	9.4	8.4	3.9	3.7	2.5	2.6
OMV Petrom	Buy	RON 0.55	4.8	5.5	2.7	2.7	2.9	3.0
MOL	Hold	HUF 14,000	7.4	6.9	4.7	4.3	2.9	2.4
PKN	Hold	PLN 42.00	92.1	11.0	8.8	5.7	7.7	6.2
Lotos	Hold	PLN 40.50	5.4	5.4	5.3	5.2	3.5	2.7
Gazprom	Hold	RUB 145.0	2.3	2.4	1.7	1.5	1.5	1.6
Novatek	Buy	RUB 493.0	9.3	8.8	6.0	5.4	9.1	8.7
LUKoil	Buy	UR	4.6	4.5	2.7	2.7	2.8	2.8
Rosneft	Hold	UR	8.1	5.6	4.8	3.5	4.2	3.4
Tatneft	Reduce	UR	5.6	5.3	4.2	3.9	4.3	4.1

UR = under revision

\* recommendation and target price refer to a 12 month horizon

Source: Raiffeisen Centrobank estimates

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## Utilities: High valuation but no growth

- Outlooks for 2014e for the most part negative
- Sector valuation unusually high
- BUY recommendations: CEZ, E.On Russia, Enel OGK-5

Utilities outperformed the broad market overall in Q1. Earnings expectations are still subdued, while the valuation levels have increased (which is partly also attributable to investors' lower risk appetite and the high share of regulated business). After a slump of the Polish market in December, Polish utilities were among the outperformers as well. In spite of the eventual "backloading" (postponement of the allocation) of 900 mn CO<sub>2</sub> emission allowances and the subsequent rise in certificate prices to above EUR 7/t, electricity prices in CEE have decreased further, dampened also by lower coal prices and the strong euro. It was therefore not surprising that the results outlooks of the large electricity producers (Verbund, CEZ) could be considered muted, to say the least. Not much is given away also elsewhere: the new legislation on renewable energies and green electricity certificates in Poland is still not completed, which gives rise to considerable uncertainty in connection with earnings estimates. EVN – being a predominantly regulated company – could promise more stability if it were not for the uncertainties regarding its business in South-Eastern Europe and Russia. The regulated companies in Romania are a silver lining: in our opinion, they should manage to achieve better cost control and hence better results, which is likely to translate into high dividend yields. Russian names have come under pressure in March, when political tensions around Ukraine appeared. We note that even good results ahead of consensus estimates (e.g. InterRAO once again reported better than expected EBITDA and bottom line) are not a sufficient driver for Russian utilities at the moment. Nonetheless, we see several interesting points that could potentially lead to a more justified regulation in the sector. For example, the government has started to discuss potential capacity decommissioning and de-regulation of capacity prices.

We do not anticipate any major changes in the fundamental picture at present, not least because the politicians are still very reluctant to take a decision. Our BUY recommendations are CEZ, Transelectrica as well as the Russian utilities E.ON Russia and Enel OGK-5.

### Sector comparison\*

Financial analyst: Teresa Schinwald, Fedor Kornachev

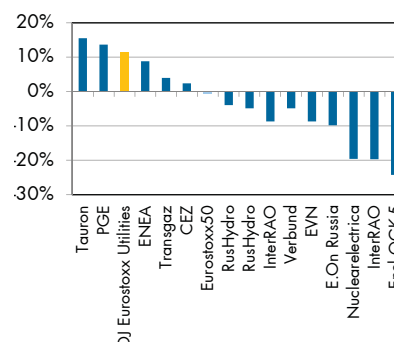
Company	Recommendation	Target price	PER		EV/EBITDA		DY	
			2014e	2015f	2014e	2015f	2014e	2015f
CEZ	Buy	CZK 630.0	9.9	10.7	6.1	6.3	5.9%	5.5%
Enea	Hold	PLN 15.30	9.6	10.5	4.8	5.6	3.1%	2.8%
Enel OGK-5	Buy	RUB 1.23	4.4	4.3	2.8	2.8	9.2%	9.3%
E.ON Russia	Buy	RUB 3.34	8.5	5.6	4.1	2.7	7.0%	10.8%
EVN	Hold	EUR 11.70	10.5	11.6	3.7	3.4	4.0%	4.0%
Federal Grid Company	Reduce	RUB 0.09	2.6	2.7	2.9	3.0	9.8%	9.3%
InterRAO	Hold	RUB 0.011	5.5	5.1	2.4	1.8	4.6%	4.9%
PGE	Hold	PLN 18.80	10.5	11.2	4.5	4.8	4.8%	4.5%
RusHydro	Hold	RUB 0.62	6.8	5.0	4.1	3.6	3.7%	5.0%
Tauron	Hold	PLN 5.30	9.9	10.0	5.2	5.6	2.8%	3.3%
Transelectrica	Buy	RON 20.50	6.1	6.4	3.3	3.4	13.6%	10.6%
Transgaz	Hold	RON 202.0	5.9	5.8	3.3	3.2	8.8%	9.0%
Verbund	Hold	EUR 15.20	25.4	18.3	10.2	8.8	2.0%	2.8%

\* recommendation and target price refer to a 12 month horizon

Source: Raiffeisen Centrobank estimates

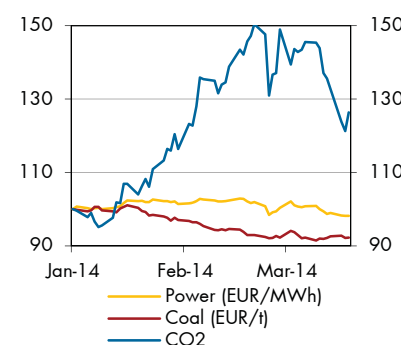
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Supervisory authority: Financial Market Authority FMA, Otto-Wagner-Platz 5, A-1090 Vienna.

### PL outperforms following a weak Dec



Source: Bloomberg

### Power does not react on CO<sub>2</sub> strength

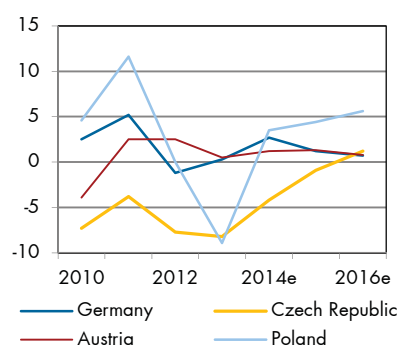


Source: Bloomberg

## Construction: Light at the end of the tunnel

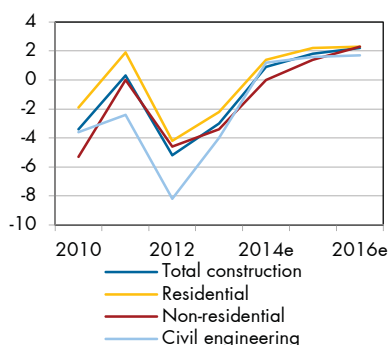
- Recovery of European constructions sector under way
- The outlook for the Austrian, German and Polish seems to have improved
- Our current sector favourite is Porr

**Total construction market growth\***



\* % yoy  
Source: Euroconstruct

**European market growth (% yoy)**



Source: Euroconstruct

Throughout 2013, the European construction industry suffered from the heavy pressure from imbalances in the real estate markets and restrictions in public budgets. According to data from Euroconstruct, overall construction volumes declined by 3%. For 2014, however, demand is expected to recover and fuel growth in the European construction industry to a moderate 0.9%. While residential production is supported by the low interest rate environment, non-residential construction activity should finally bottom-out in 2014, helped by improving GDP development. The Austrian construction market is expected to expand 1.2% fuelled primarily by residential construction and civil engineering. The outlook for the German construction market seems quite strong for 2014, projecting growth of 2.7%. The drivers should be the residential sector as well as civil engineering, for which a similar pattern applies.

The contraction of the Polish construction sector has been pronounced in the last two years due to slowing GDP growth, falling road infrastructure spending as well as a massive oversupply of unsold flats. Nonetheless, we expect some stabilisation this year and an acceleration of construction activities from 2015e on.

Within the sector our preferred pick is PORR as the investment case features several interesting angles. As of YE 13 the company had a record order backlog. The management has implemented a comprehensive cost-cutting programme until 2015e. Combined with stricter risk and working capital controlling the company's return profile should improve. Moreover, we regard the disposal of non-core real estate assets as a major trigger to substantially reduce the financial leverage and pay back expensive means of financing. Lastly, the management has been vocal that it mulls plans for a capital increase which would not only further lift the balance sheet quality but would clearly improve the share's currently meagre liquidity. We continue to rate STRABAG a HOLD due to a lack of catalysts. Wienerberger is rated HOLD as the share price already discounts a strong recovery of the European market.

Financial analyst: Markus Remis

### Sector comparison\*

Company	Recommendation	Target price	PER		EV/EBITDA		DY	
			2014e	2015e	2014e	2015e	2014e	2015e
STRABAG SE	Hold	EUR 20.50	13.6	11.3	3.4	2.3	2.2%	2.7%
PORR	Buy	EUR 48.00	12.9	8.9	6.6	4.3	2.2%	3.2%
Wienerberger	Hold	EUR 14.00	99.9	27.3	8.5	7.3	1.1%	1.5%
Budimex	Hold	PLN 145.0	20.2	18.9	9.4	8.5	3.5%	3.7%
Zumtobel	Hold	EUR 18.00	18.7	12.5	7.0	5.6	1.7%	2.8%

\* recommendation and target price refer to a 12 month horizon  
Source: Raiffeisen Centrobank estimates

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Supervisory authority: Financial Market Authority FMA, Otto-Wagner-Platz 5, A-1090 Vienna.

# OMV: Weak Q4 results should be exception rather than the rule

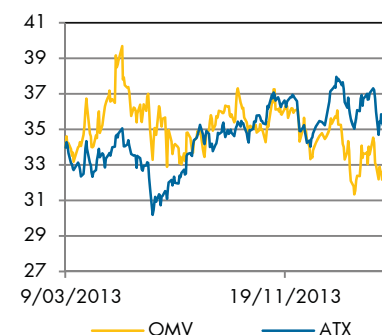
- **Current share price: EUR 32.25<sup>1</sup>**
- **Target price: EUR 39.50**
- **Market capitalisation: EUR 10,518 mn**

After a stellar performance in 2013, OMV's share price has come under pressure, triggered by uncertainties regarding upstream operations in Libya, the market's expectation of weak 4Q results as well as concerns about execution risks related to high-impact upstream projects such as Rosebank (UK). The recently reported trading statement reconfirmed our expectations of weak 4Q results. Despite a bunch of negative developments across all segments, we believe that weak fourth quarter figures should be an exception rather than the rule. Production from Norway should partially offset the volatile contribution from Libya, while the on-going gas market liberalisation in Romania should support Petrom's upstream results. With more crude coming from stable regions, OMV should also diminish its dependency on volatile output from high-risk regions, making its earnings more predictable. With the upstream segment's contribution to EBITDA expected to reach 80% in a few years (from 76% in 2012), OMV's earnings should become more resilient to challenging market conditions faced by other segments.

After completion of its divestment program in the downstream segment we do not expect any more significant one-offs such as those that burdened OMV's bottom line in the past. We believe that the market should be less concerned about execution risks of high-impact projects. While the statement of Chevron (field operator), which said that Rosebank is not one of its top priorities, should not be ignored, we believe that through its previous involvement in the project and 50% participation, OMV has a strong negotiating power to find the right solution. Therefore, we continue to rely on OMV's guidance for the E&P projects' development and, based on our DCF-derived valuation, rate OMV a BUY with a 12m TP of EUR 39.5.

Financial analyst: Oleg Galbur

## OMV



Source: Bloomberg

## Income statement & balance sheet (IFRS)

in EUR mn	2013	2014e	2015f	2016f
<b>Income Statement</b>				
Consolidated sales	42,415	39,867	43,348	44,789
EBITDA	4,891	4,907	5,391	6,241
EBIT	2,717	2,647	2,971	3,693
EBT	2,290	2,398	2,736	3,468
Net profit b.m.	1,729	1,679	1,779	2,150
Net profit a.m.	1,162	1,119	1,254	1,616
<b>Balance sheet</b>				
Total assets	31,786	33,081	34,880	36,598
Shareholders' equity	14,545	13,367	14,230	15,438
Goodwill	1,137	1,137	1,137	1,137
NIBD	4,190	4,674	5,047	5,025

Source: OMV, Raiffeisen Centrobank estimates

## Key ratios

in EUR mn	2013	2014e	2015f	2016f
EPS	3.56	3.43	3.85	4.95
PER	9.1	9.4	8.4	6.5
Operating CF per share	12.60	12.86	12.39	14.21
Price cash flow	2.6	2.5	2.6	2.3
Book value per share	44.6	40.98	43.63	47.33
Price book value	0.7	0.8	0.7	0.7
Dividend yield	3.9%	3.7%	3.9%	4.5%
ROE	8.0%	8.6%	9.1%	10.9%
ROCE	7.7%	9.0%	8.8%	9.8%
EV/EBITDA	3.0	3.9	3.7	3.2

Source: OMV, Raiffeisen Centrobank estimates

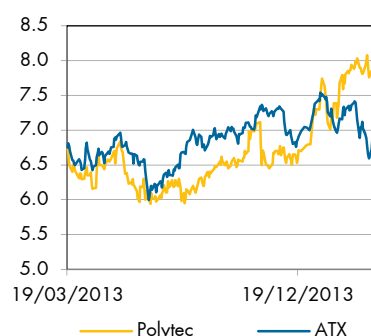
<sup>1</sup> the indicated price is the last price as available at 6.30 a.m. (CET) on 20 March 2014



## Polytec: Improved fundamental picture

- Current share price: EUR 7.76<sup>1</sup>
- Target price: EUR 9.50
- Market capitalisation: EUR 171 mn

### Polytec



Having been burdened by declining European passenger car and truck markets in recent years, we are upbeat that Polytec will be able to capitalise on improved fundamentals of its end-markets. While non-European car markets should display higher growth rates, industry intelligence nevertheless suggests that also Polytec's primary market Europe should show a positive momentum, whilst the truck market should at least stabilise. These assumptions, coupled with an improved situation of its home appliances business (Miele), bode well for Polytec. The non-recurrence of some burdening effects together with operational leverage should thus translate into appealing earnings growth. Further upside could stem from M&A and the potential penetration of the Chinese market. The solid balance sheet determined by a (presumably rising) net cash position provides decent financial leeway. Trading at considerable discounts vs. the peers (which can only be partially explained by lower profitability and share liquidity constraints), we think the stock offers compelling value. European car registrations have endured a 6-year-long streak of yoy declines and are now slightly more than 20% below the 2007 peak. How-

ever, momentum turned over the course of 2013 and expectations call for moderate growth in 2014 and a further acceleration in 2015. Forecasts for the European truck market are somewhat less optimistic, mainly on account of demand having been brought forward ahead of the introduction of tighter emission regulations in 2014. Nevertheless, truck OEMs assume a stable development for the full year.

Our 2013e estimates are fully in line with the management targets. We look for sales of EUR 472 mn and EBIT of EUR 19.5 mn, which should translate into EPS of EUR 0.63. Despite the expectation of just stable revenues in 2014e we expect nearly 30% higher EBIT and EPS of EUR 25.1 mn and EUR 0.82, respectively. For 2015e we assume a revival of top line momentum to EUR 506 mn and another decent earnings hike with EBIT reaching EUR 29 mn (margin 5.7% vs. 4.1% in 2013e) and EPS of EUR 0.95.

Financial analyst: Markus Remis

### Income statement & balance sheet (IFRS)

in EUR mn	2012	2013e	2014f	2015f
<b>Income Statement</b>				
Consolidated sales	482	472	473	506
EBITDA	42	35	41	45
EBIT	28	20	25	29
EBT	27	19	24	28
Net profit b.m.	22	15	19	22
Net profit a.m.	22	14	18	21
<b>Balance sheet</b>				
Total assets	260	270	265	279
Shareholders' equity	128	134	148	163
Goodwill	19	19	19	19
NIBD	-15	-10	-17	-22

Source: Polytec, Raiffeisen Centrobank estimates

### Key ratios

	2012	2013e	2014f	2015f
EPS	0.97	0.63	0.82	0.95
PER	6.0	10.8	9.5	8.2
Operating CF per share	0.71	1.15	1.47	1.39
Price cash flow	8.3	5.9	5.3	5.6
Book value per share	5.82	6.11	6.72	7.42
Price book value	1.0	1.1	1.2	1.0
Dividend yield	6.0%	2.9%	3.2%	3.9%
ROE	17.8%	10.5%	12.7%	13.4%
ROCE	14.3%	9.0%	11.3%	12.6%
EV/EBITDA	2.9	4.2	3.9	3.4

Source: Polytec, Raiffeisen Centrobank estimates

<sup>1</sup> the indicated price is the last price as available at 6.30 a.m. (CET) on 20 March 2014

# Netia: Strong cash generation, M&A story still convincing

- **Current share price: PLN 4.97<sup>1</sup>**
- **Target price: PLN 5.90**
- **Market capitalisation: EUR 412 mn**

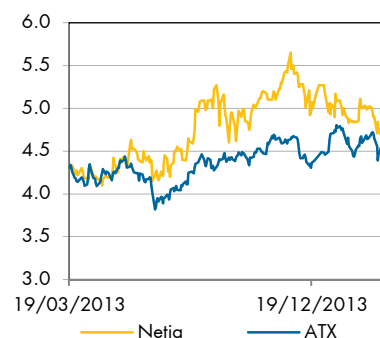
We stick to our story of Netia as a safe dividend play (over 8% yield, without major risk to dividend payments in the current and the following year) and a cheap acquisition target (EV/EBITDA of below 4.0x, high cash flow yield and potential interest of Polish cable-TV operators, private equity funds or Deutsche Telekom). We slightly adjust our TP from PLN 6.0 to PLN 5.9 but confirm a BUY recommendation. We expect that Netia will be able to reduce its net debt by PLN 95 mn in 2014e (PLN 0.27 per share) on top of the DPS of PLN 0.42 to be paid out from 2013 profits. Compared with the expected dividend we therefore see a significant cushion thanks to the group's cash generation.

Adjusted capex is expected to drop to PLN 200 mn as guided by the company (additionally one-off integration capex of PLN 14 mn should be incurred). Excluding regulated revenues and investments in the regulated network the ratio of capex to own-network sales amounts to approx. 19%, a sufficient spending to keep the network upgraded. We assume that Netia may increase investments to PLN 250 mn next year, but this would still suffice for a dividend pay-out of PLN 0.42 from 2014e profit and a small reduction in net debt. While there are certainly technical difficulties regarding the integration of CA-TV player with a telecommunications network we still see a chance that, e.g., Multimedia or Vectra may decide to bid for Netia (or its retail part) in order to look for sales synergies.

We assume a small growth in data revenues to PLN 742 mn in 2016e (3-year CAGR of 1%), a decline in voice sales to PLN 572 mn (3-year CAGR of -12%) and expansion of pay-TV revenues to PLN 95 mn (3-year CAGR of 27%). We see a risk in falling voice APRU of own-network clients, which may have a continuously negative impact on EBITDA in the following years. On the other hand, due to expected improvement in macroeconomic conditions we reckon that Netia may benefit from its strong position in the more cyclical B2B segment.

Financial analyst: Dominik Niszczyński

**Netia:**



Source: Bloomberg

**Income statement & balance sheet (IFRS)**

in PLN mn	2013	2014e	2015f	2016f
<b>Income Statement</b>				
Consolidated sales	1,876	1,738	1,680	1,637
EBITDA	533	496	472	448
EBIT	93	69	98	114
EBT	46	48	83	102
Net profit b.m.	46	34	62	83
Net profit a.m.	46	34	62	83
<b>Balance sheet</b>				
Total assets	2,938	2,741	2,570	2,482
Shareholders' equity	2,205	2,092	2,008	1,945
Goodwill	281	281	281	281
NIBD	291	195	150	115

Source: Netia, Raiffeisen Centrobank estimates

**Key ratios**

	2013	2014e	2015f	2016f
EPS	0.13	0.10	0.18	0.24
PER	39.6	51.1	27.9	20.9
Operating CF per share	1.65	1.33	1.27	1.20
Price cash flow	3.2	3.7	3.9	4.2
Book value per share	6.34	6.01	5.77	5.59
Price book value	0.8	0.8	0.9	0.9
Dividend yield	8.0%	8.5%	8.5%	8.5%
ROE	2.1%	1.6%	3.0%	4.2%
ROCE	2.5%	2.0%	3.2%	4.3%
EV/EBITDA	4.0	3.9	4.0	4.1

Source: Netia, Raiffeisen Centrobank estimates

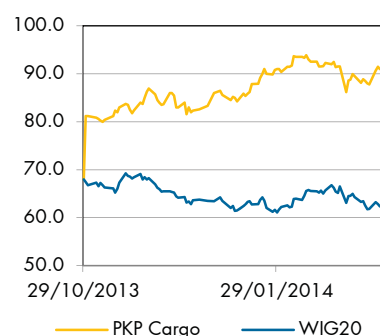
<sup>1</sup> the indicated price is the last price as available at 6.30 a.m. (CET) on 20 March 2014

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## PKP Cargo: Decent Exposure to a rebounding macro

- Current share price: PLN 91.00<sup>1</sup>
- Target price: PLN 103.0
- Market capitalisation: EUR 978 mn

### PKP Cargo



PKP Cargo established in 2001, is the leading and incumbent rail cargo company in Poland (with a market share amounting to approx. 50% on tons of cargo transported and an approx. 60% on rail freight turnover. Poland is the second largest rail freight market in the EU after Germany. The company's product range consists of rail transport, forwarding, intermodal services, terminals, rolling stock services as well as rail siding services. The company does not own or manage railway tracks.

We believe the company offers a very decent exposure to quickly rebounding Polish economy via its rail cargo transportation services additionally emphasised with a high operating and low financial (net cash) leverages. We believe a reviving industrial production should positively impact coal consumption via higher electricity needs, with coal constituting the majority of goods transported by PKP Cargo. Furthermore, the company offers a very decent construction exposure without the

risks carried by construction companies by means of transporting aggregate utilized in infrastructure erection. We also see some top line growth coming from dynamically increasing intermodal transportation as well as an international transportation (up to date, the company has been growing its operations in the neighbouring countries of Germany, the Czech Republic and Slovakia and has expanded to Austria, Belgium, Hungary and the Netherlands).

PKP Cargo has undergone a major restructuring exercise resulting in a transformation of an overemployed and overcapitalized state-owned entity into a slim and profitable organization. Nonetheless, we foresee further margins expansion coming from fuel savings (modernization of locomotives), falling electricity prices, decreasing rolling stock, and employment as well as recently cut infrastructure access fees. And last but not least, PKP Cargo does not have to invest in the infrastructure modernization (the state does) and hence we project the company to be FCF positive going forward.

Financial analyst: Bartłomiej Kubicki

### Income statement & balance sheet (IFRS)

in PLN mn	2012	2013	2014e	2015f
<b>Income Statement</b>				
Consolidated sales	5,159	4,797	4,687	4,863
EBITDA	767	499	805	892
EBIT	344	110	396	467
EBT	353	89	400	472
Net profit b.m.	267	65	308	368
Net profit a.m.	268	74	306	366
<b>Balance sheet</b>				
Total assets	5,624	5,744	6,027	6,119
Shareholders' equity	3,143	3,447	3,592	3,805
Goodwill	3	3	3	3
NIBD	-20	-271	-392	-470

Source: PKP Cargo, Raiffeisen Centrobank estimates

### Key ratios

	2012	2013	2014e	2015f
EPS	6.18	1.71	6.82	8.16
PER	n.v.	53.0	13.3	11.2
Operating CF per share	18.02	16.17	16.07	18.22
Price cash flow	n.v.	5.6	5.7	5.0
Book value per share	72.51	80.97	79.95	84.68
Price book value	n.v.	1.1	1.1	1.1
Dividend yield	n.v.	1.0%	3.8%	4.5%
ROE	8.8%	2.2%	8.9%	9.9%
ROCE	7.7%	1.8%	7.8%	8.9%
EV/EBITDA	n.v.	7.2	4.6	4.1

Source: PKP Cargo, Raiffeisen Centrobank estimates

<sup>1</sup> the indicated price is the last price as available at 6.30 a.m. (CET) on 20 March 2014

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## Enel OGG-5: Discounts on multiples and yields

- **Current share price: RUB 0.849<sup>1</sup>**
- **Target price: RUB 1.23**
- **Market capitalisation: EUR 598 mn**

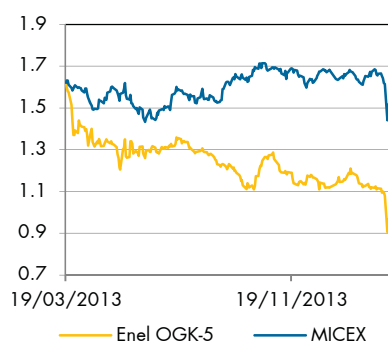
We currently expect the EBITDA margin to deteriorate slightly, but it should still stay above 20%, and the net margin to improve in 2015e-2018e. We believe that the predictable and stable flow from CSA-contracted capacities combined with potential capex optimisation as well as the healthy dark spreads of Reftinskaya guarantee that the company should generate stable positive free cash flow and distribute it in the form of dividends, which is one of the key reasons why we turn more bullish. We notice that potential one-off positive effects on the 2014e bottom line could result in a 9.2% dividend yield next year under the same 40% payout assumption. Moreover, we do not rule out that Enel OGG-5 might afterwards lift its payout to a more generous 50% guided by its parent Enel for 2015e. We currently model a 39% growth in EPS. We believe that the main drivers could be the lower income tax (as in FY 13 the company had a one-off effect from deferred taxes) and the potential receipt of an insurance payment related to an accident at Sredneuralskaya CCGT (we expect a ~RUB 0.5 bn positive effect before taxation).

We have updated our valuation of Enel OGG-5. After the recent stock dive the current dividend yield reaches 6.6% and we see the 2014e dividend yield at 9.2%. We believe that an attractive dividend yield is what Enel OGG-5 really lacked to be a strong value case and therefore upgrade our recommendation to BUY even despite a ~15% drop in the target price, mainly driven by higher risk-free rates that we currently incorporate into our models.

We consider the recent share price underperformance as excessive and cannot see enough rationale behind Enel OGG-5 looking weaker than other names in power generation. We therefore upgrade the stock to a BUY and expect the situation to reverse. There is a significant discount to peers that has only widened recently.

*Financial analyst: Fedor Kornachev*

**Enel OGG-5**



**Income statement & balance sheet (IFRS)**

in RUB mn	2013	2014e	2015f	2016f
<b>Income Statement</b>				
Consolidated sales	69,723	72,518	74,186	78,101
EBITDA	16,036	16,095	16,492	17,102
EBIT	9,852	9,862	10,107	10,546
EBT	6,686	8,570	8,683	9,072
Net profit b.m.	4,939	6,856	6,946	7,258
Net profit a.m.	4,954	6,871	6,961	7,273
<b>Balance sheet</b>				
Total assets	132,600	135,319	135,576	138,164
Shareholders' equity	78,126	83,016	87,228	91,717
Goodwill	0	0	0	0
NIBD	19,322	15,582	16,052	13,073

Source: Enel OGG-5, Raiffeisen Centrobank estimates

**Key ratios**

	2013	2014e	2015f	2016f
EPS	0.14	0.19	0.20	0.21
PER	8.0	4.4	4.3	4.1
Operating CF per share	0.50	0.36	0.37	0.39
Price cash flow	2.2	2.3	2.3	2.2
Book value per share	2.21	2.35	2.47	2.59
Price book value	0.5	0.4	0.3	0.3
Dividend yield	5.0%	9.2%	9.3%	9.7%
ROE	6.5%	8.5%	8.2%	8.1%
ROCE	6.3%	7.9%	7.7%	7.7%
EV/EBITDA	3.7	2.8	2.8	2.5

Source: Enel OGG-5, Raiffeisen Centrobank estimates

<sup>1</sup> the indicated price is the last price as available at 6.30 a.m. (CET) on 20 March 2014

## RBI Risk Indicator

### Performance since 2009\*

	Mean return. annualized	Max drawdown	Sharpe ratio**	Volatility
RBI Risk Indicator strategy	12.2%	-10.1%	1.065	11.5%
Benchmark***	7.5%	-17.5%	0.779	9.4%

### Yearly performance\*

	2009	2010	2011	2012	2013	2014 ytd
RBI Risk Indicator strategy	27.3%	13.5%	-0.6%	13.9%	15.7%	-1.4%
Benchmark***	14.6%	8.4%	0.0%	7.1%	9.0%	1.1%

\* All performance measures based on signals generated using end of week closing prices and restructuring on the following Monday. \*\*risk free rate = 0 %; \*\*\*composed from MSCI World and JPM Global Bonds  
Source: Thomson Reuters, Raiffeisen RESEARCH

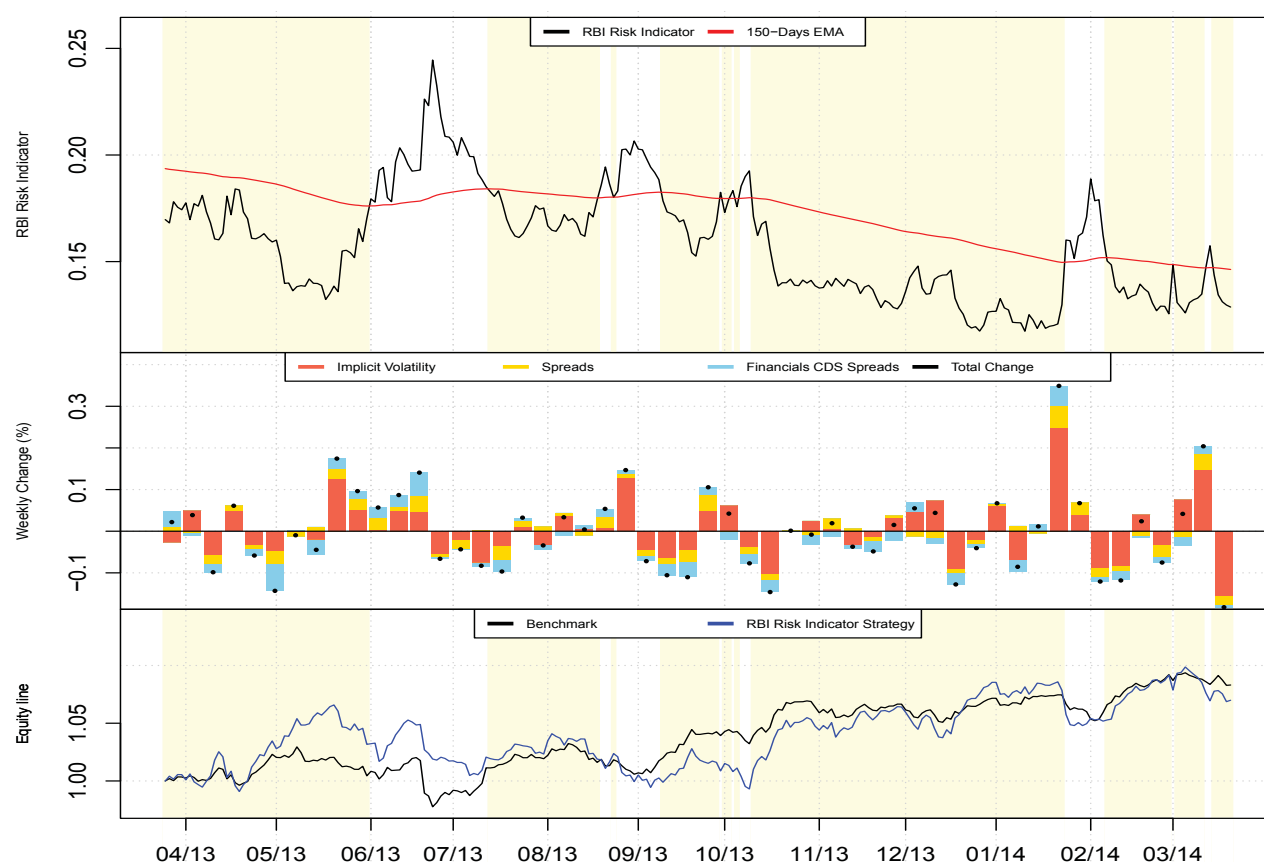
### Description

The **RBI Risk Indicator** is a quantitative indicator that serves primarily as a short-term decision support instrument for high-risk investments.

The timing-rule goes as follows: An index sinking below the 150-day moving average (i.e. in the case of a falling level of risk aversion) equals a buy-signal for shares. The opposite case should be interpreted as a sell-signal. Generally speaking, high RBI Risk Indicator values imply a very low risk appetite and high risk premiums.

Please refer to the special publication 'New Edition of the RBI Risk Indicator', published on 8 April 2013, for a detailed description.

### RBI Risk Indicator



Source: Thomson Reuters, Raiffeisen RESEARCH

### Beta to MSCI World and MSCI EM

**Beta:** Measures the sensitivity of an equity index to changes of a factor (MSCI World and MSCI EM)

Beta > 1: The equity index shows larger swings than the factor.

**Up-Beta:** Up-beta > 1: The equity index rises more than the factor in positive periods.

**Down-Beta:** Down-beta > 1: The equity index decreases more than the factor in negative periods.

#### Beta to MSCI World

	Beta	Up-Beta	Down-Beta	Up-Down
EM Europe	0.94	1.06	1.15	-0.09
Czech Rep.	0.43	0.28	0.86	-0.58
Poland	0.72	0.82	0.76	0.06
Russia	1.06	1.28	1.13	0.15
Hungary	0.77	0.67	1.17	-0.50

Betas to MSCI World; weekly returns of the last 2 years  
Source: Thomson Reuters, Raiffeisen RESEARCH

#### Beta to MSCI EM

	Beta	Up-Beta	Down-Beta	Up-Down
EM Europe	1.07	1.27	0.98	0.29
Czech Republic	0.57	0.33	0.81	-0.49
Poland	0.82	0.96	0.58	0.38
Russia	1.18	1.37	0.95	0.42
Hungary	0.62	0.59	1.30	-0.72

Betas to MSCI EM; weekly returns of the last 2 years  
Source: Thomson Reuters, Raiffeisen RESEARCH



## **Risk notifications and explanations**

### **Warnings**

- Figures on performance refer to the past. Past performance is not a reliable indicator of the future results and development of a financial instrument, a financial index or a securities service. This is particularly true in cases when the financial instrument, financial index or securities service has been offered for less than 12 months. In particular, this very short comparison period is not a reliable indicator for future results.
- Performance is reduced by commissions, fees and other charges, which depend on the individual circumstances of the investor.
- The return on an investment can rise or fall due to exchange rate fluctuations.
- Forecasts of future performance are based purely on estimates and assumptions. Actual future performance may deviate from the forecast. Consequently, forecasts are not a reliable indicator for the future results and development of a financial instrument, a financial index or a securities service.

*A description of the concepts and methods which are used in the preparation of financial analyses can be found at: [www.raiffeisenresearch.at/conceptsandmethods](http://www.raiffeisenresearch.at/conceptsandmethods)*

*Detailed information on sensitivity analyses (procedure for checking the stability of the assumptions made in this document) can be found at: [www.raiffeisenresearch.at/sensitivityanalysis](http://www.raiffeisenresearch.at/sensitivityanalysis)*

## Bonds

### MARKET STRATEGY\*

	Eurobonds		LCY Bonds			FX
	EUR	USD	2y	5y	10y	-
Bulgaria	Hold	-	-	-	-	-
Croatia	Sell	Sell	-	-	-	Hold
Czech Republic	Hold	Hold	Hold	Hold	Hold	Buy
Hungary	Buy	Hold	Hold	Hold	Sell	Sell
Poland	Hold	Hold	Hold	Hold	Sell	Buy
Romania	Hold	Hold	Hold	Hold	Hold	Hold
Russia	-	Hold	Buy	Buy	Hold	Sell
Serbia	-	Hold	-	-	-	Hold
Slovakia	-	-	-	-	-	-
Slovenia	-	-	-	-	-	-
Turkey	Buy	Buy	Buy	Hold	Buy	Hold
Ukraine	Sell	Sell	-	-	-	Sell

\*based on absolute expected performance:

- LCY bond: absolute performance in LCY

- Eurobonds: based on expected spread change

RU, TR, UA FX recommendations against USD, others against EUR

horizon: end 2nd quarter 2014

Source: Raiffeisen RESEARCH

## Corporate Credits

### Recommendations history (12M)

Start of coverage	17/04/2008	
	Date of recommendation	Recommendation
HSBKKZ 7.25% due 2017	14/03/2013	Sell
HSBKKZ 7.25% due 2017	20/09/2013	Hold
HSBKKZ 7.25% due 2017	18/11/2013	Buy

Start of coverage	17/04/2008	
	Date of recommendation	Recommendation
GAZPRU 6.212% due 2016	12/04/2013	Buy
GAZPRU 6.212% due 2016	31/01/2014	Buy

### Breakdown of all recommendations (last 3M)

Buy	50%
Hold	18%
Sell	32%

## Equities, asset allocation

### Equities: Historical recommendations

Datum	MICEX	WIG 20	PX	BUX	BET	CROBEX 10	BIST 100	ATX
21/03/2013	Hold	Buy	Buy	Buy	Buy	Buy	Buy	Buy
15/05/2013	I	I	I	I	Buy	I	I	I
20/06/2013	Sell	Sell	Sell	Sell	Sell	Sell	Buy	Hold
13/08/2013	I	I	I	I	I	I	I	Sell
17/09/2013	Buy	Buy	Buy	Buy	Buy	Buy	Buy	Buy
19/12/2013	Hold	Buy	Buy	Buy	Buy	Sell	Hold	Buy

### Equities

Financial instruments/ Company	Date of the first publication
MICEX	21/12/2009
WIG 20	01/06/1994
PX	01/06/1994
BUX	01/06/1994
BET	19/12/2006
CROBEX 10	31/07/2009
BIST 100	25/06/2012
ATX	01/04/1993

### Distribution of recommendations of the past three months

Recommendation	Base: all analysed equity indices
Buy	66%
Hold	28%
Sell	6%

## Equities

### OMV

Start coverage: 01.02.2002

#### Recommendation history

Date	Rating	Target Price	Prev. day's close	Upside
12.02.2014	Buy	39.5	33.06	19.50%
26.11.2013	Hold	40	36.1	10.80%
13.11.2013	Buy	42.8	36	18.90%
22.08.2013	Buy	42.4	33.45	26.80%
27.05.2013	Hold	39.2	37.48	4.60%
13.03.2013	Hold	35.9	34.4	4.40%
23.11.2012	Buy	31.6	27.32	15.70%
07.08.2012	Buy	33.5	26.2	27.90%
16.05.2012	Buy	30	22.33	34.30%
03.04.2012	Buy	33.5	26.69	25.50%

#### Coverage universe recommendation overview

	buy	hold	reduce	sell	suspended	UR
Universe	41	60	11	4	16	8
Universe %	29%	43%	8%	3%	11%	6%
Investment banking services	14	16	1	0	3	1
Investment banking services %	40%	46%	3%	0%	9%	3%

Source: Raiffeisen Centrobank

### Polytec

Start coverage: 11.04.2011

#### Recommendation history

Date	Rating	Target Price	Prev. day's close	Upside
30.01.2014	Buy	9.5	7.17	32.40%
31.07.2013	Hold	7.5	6.3	19.00%
11.02.2013	Buy	8.5	6.6	28.80%
16.10.2012	Buy	8.5	5.7	49.10%
06.08.2012	Buy	10	5.44	83.90%
28.03.2012	Buy	10.5	7.2	45.90%

#### Coverage universe recommendation overview

	buy	hold	reduce	sell	suspended	UR
Universe	41	60	11	4	16	8
Universe %	29%	43%	8%	3%	11%	6%
Investment banking services	14	16	1	0	3	1
Investment banking services %	40%	46%	3%	0%	9%	3%
Investment banking services %	40%	46%	3%	0%	9%	3%

Source: Raiffeisen Centrobank

## Equities

### Netia

Start coverage: 02.02.2011

#### Recommendation history

Date	Rating	Target Price	Prev. day's close	Upside
17.03.2014	Buy	5.9	4.85	21.60%
12.11.2013	Buy	6	5.1	17.60%
26.08.2013	Hold	5.45	5.09	7.10%
27.05.2013	Buy	5	4.34	15.20%
27.02.2013	Buy	5	4.25	17.60%
20.12.2012	Hold	5.7	5.06	12.60%
27.08.2012	Hold	6.7	6.02	11.30%
23.05.2012	Buy	6.6	5.52	19.60%
27.03.2012	Hold	7.1	6.3	12.70%

#### Coverage universe recommendation overview

	buy	hold	reduce	sell	suspended	UR
Universe	41	60	11	4	16	8
Universe %	29%	43%	8%	3%	11%	6%
Investment banking services	14	16	1	0	3	1
Investment banking services %	40%	46%	3%	0%	9%	3%

Source: Raiffeisen Centrobank

### PKP Cargo

Start coverage: 17.01.2014

#### Recommendation history

Date	Rating	Target Price	Prev. day's close	Upside
17.01.2014	Buy	103	86.2	19.50%

#### Coverage universe recommendation overview

	buy	hold	reduce	sell	suspended	UR
Universe	41	60	11	4	16	8
Universe %	29%	43%	8%	3%	11%	6%
Investment banking services	14	16	1	0	3	1
Investment banking services %	40%	46%	3%	0%	9%	3%

Source: Raiffeisen Centrobank

### Enel OGK-5

Start coverage: 02.07.2012

#### Recommendation history

Date	Rating	Target Price	Prev. day's close	Upside
28.10.2013	Hold	1.48	1.27	16.40%
10.04.2013	Buy	2.02	1.39	45.10%
07.03.2013	Buy	2.28	1.63	39.90%
12.02.2013	Buy	2.28	1.69	35.10%
02.07.2012	Hold	1.84	1.67	10.40%

#### Coverage universe recommendation overview

	buy	hold	reduce	sell	suspended	UR
Universe	41	60	11	4	16	8
Universe %	29%	43%	8%	3%	11%	6%
Investment banking services	14	16	1	0	3	1
Investment banking services %	40%	46%	3%	0%	9%	3%

Source: Raiffeisen Centrobank



## Technical analysis

### Technical analysis: Historical recommendations

Datum	ATX	BELEX 15	BUX	CROBEX 10	MICEX	PX	WIG 20
12/03/2014	BEARISH		NEUTRAL	NEUTRAL	BEARISH	BEARISH	BEARISH
06/03/2014				BULLISH			BULLISH
27/02/2014	BEARISH			NEUTRAL			BEARISH
20/02/2014	NEUTRAL	NEUTRAL		BEARISH	NEUTRAL		
12/02/2014	BULLISH	BULLISH			BULLISH	NEUTRAL	BULLISH
30/01/2014	BEARISH	BEARISH	BEARISH		BEARISH	BEARISH	
18/12/2013			NEUTRAL				
06/12/2013			BULLISH				
29/11/2013		BULLISH				BEARISH	
13/11/2013	NEUTRAL	BEARISH	BULLISH	BULLISH	NEUTRAL	BEARISH	

### Technical analysis

Financial instruments/ Company	Date of the first publication
ATX	15/04/1995
BELEX 15	01/10/1996
BUX	01/10/1996
CROBEX	18/11/2009
MICEX	02/09/2013
PX	15/03/2002
WIG 20	01/10/1996
<b>Distribution of recommendations of the past three months</b>	
Recommendation	Base: all analysed equity indices
Bullish	29%
Neutral	29%
Bearish	43%

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