CEE BANKING: THE NEW “NORMAL”

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CEE Banking study 2012: main findings

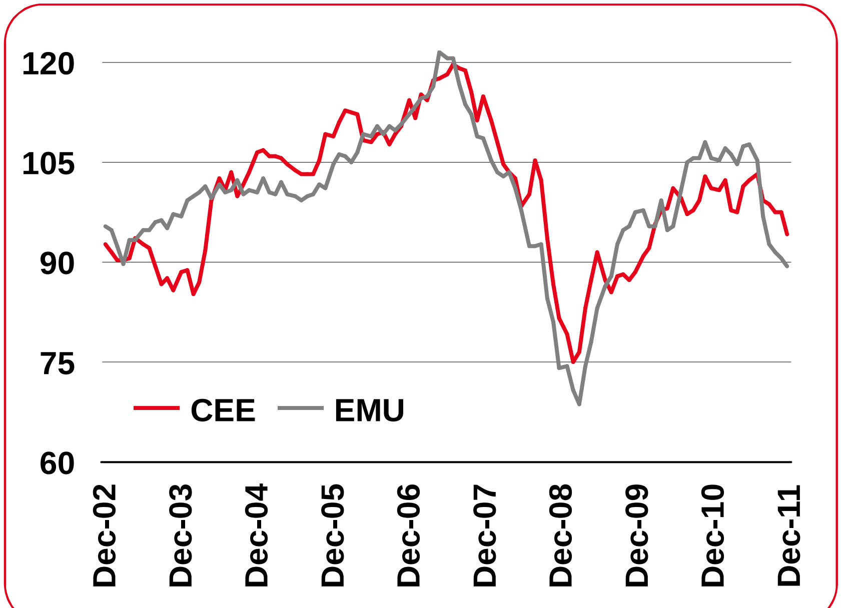
- The long-term outlook for regional convergence remains intact, but economic growth will likely be structurally lower on average and growth differentials within the region (much) wider than in the past.
- We still see potential for the CEE banking sector to generate above-EU average growth in banking volumes and profitability, as the penetration gap still exists, but there remain large divergences among segments and countries.
- In the new environment, a more balanced funding structure should clearly prevail, particularly in countries featuring high funding gaps.
- 2012 should remain a challenging year for CEE banking, with regulatory changes and European debt crisis as main risk factors. Western European banks' deleveraging remains however a manageable drag although some countries are more exposed than others.

Agenda

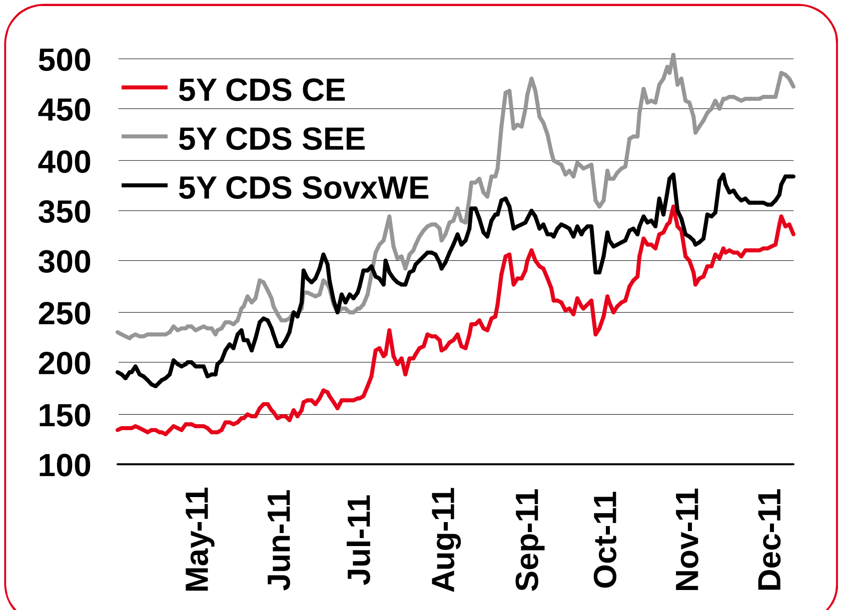
- **CEE Macro: testing times**
- CEE Banking: the new ‘normal’

Eurozone woes increase the CEE risk, although the region shows good resilience

Consumer confidence indicator (1)



Sovereign credit risk premia

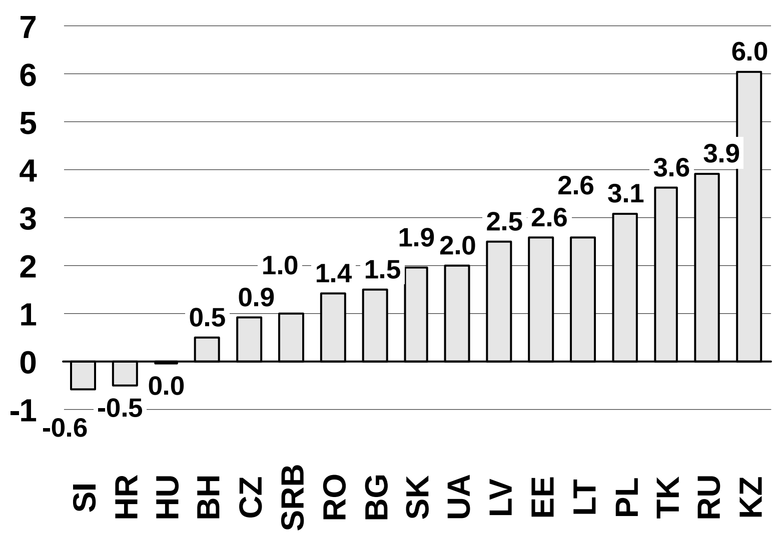


- CEE is not in the eye of the storm …
- … but financial woes in EMU have led to a widening of risk premia also for CEE countries
- Confidence indicators point to a slowdown, but less alarming than in 2008

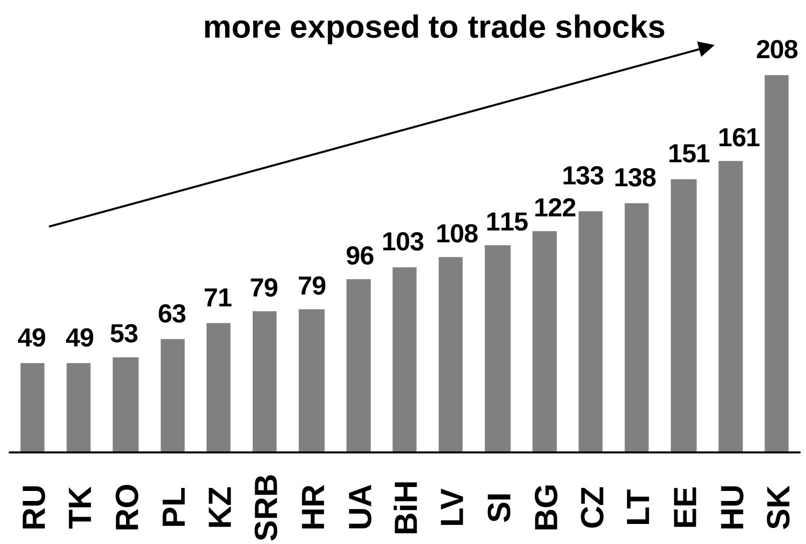
(1) CEE including only EU member states
SOURCE: UniCredit CEE Strategic Analysis, Bloomberg, EU Commission

Differentiation of growth performance also likely to persist in 2012

2012 GDP growth (real % yoy)



Trade[1] (% of GDP, 2010)



- Some countries remain more exposed through the trade channel to external shocks
- SEE and some CE economies should experience greater moderation in headline figures
- Poland, Russia, Kazakhstan and Turkey ought to show a better performance

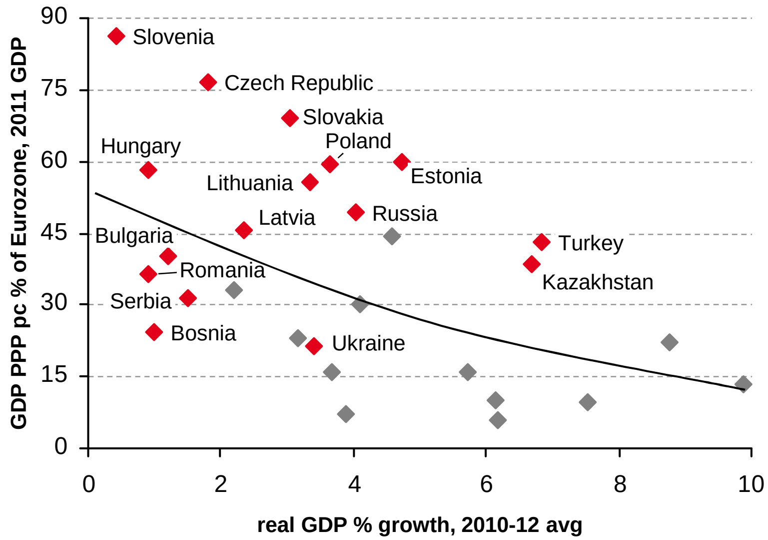
[1] Trade: Export + Import

SOURCE: UniCredit Research, Yapi Kredi Research, World Bank

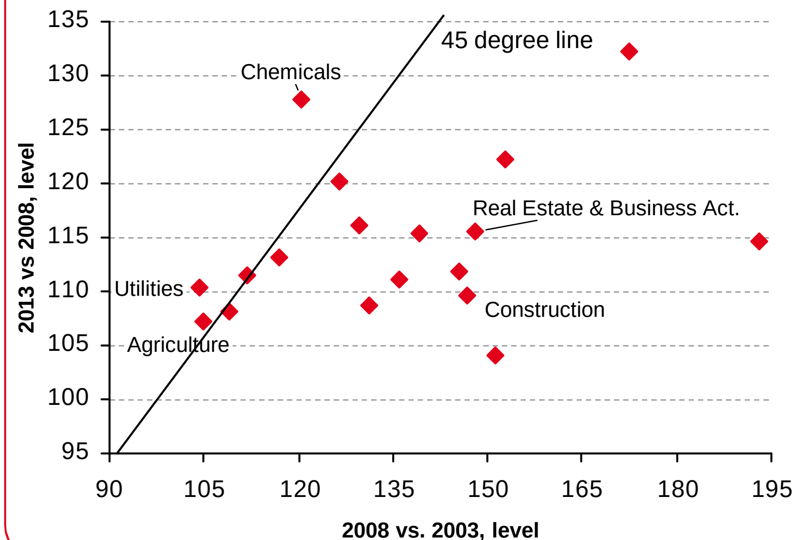
Convergence, but not at breakneck speed and driven by tradable sectors

Catch-up potential remains in place, but pace should be differentiated

Mid-term growth potential [1]



Value added by sector [2]



- **Decent catch-up potential underpinned by improving productivity and convergence of income levels is expected over the medium term**
- **Long-term vision for regional convergence remains in place but should be pursued through broader economic diversification and increasing role of tradable sectors**

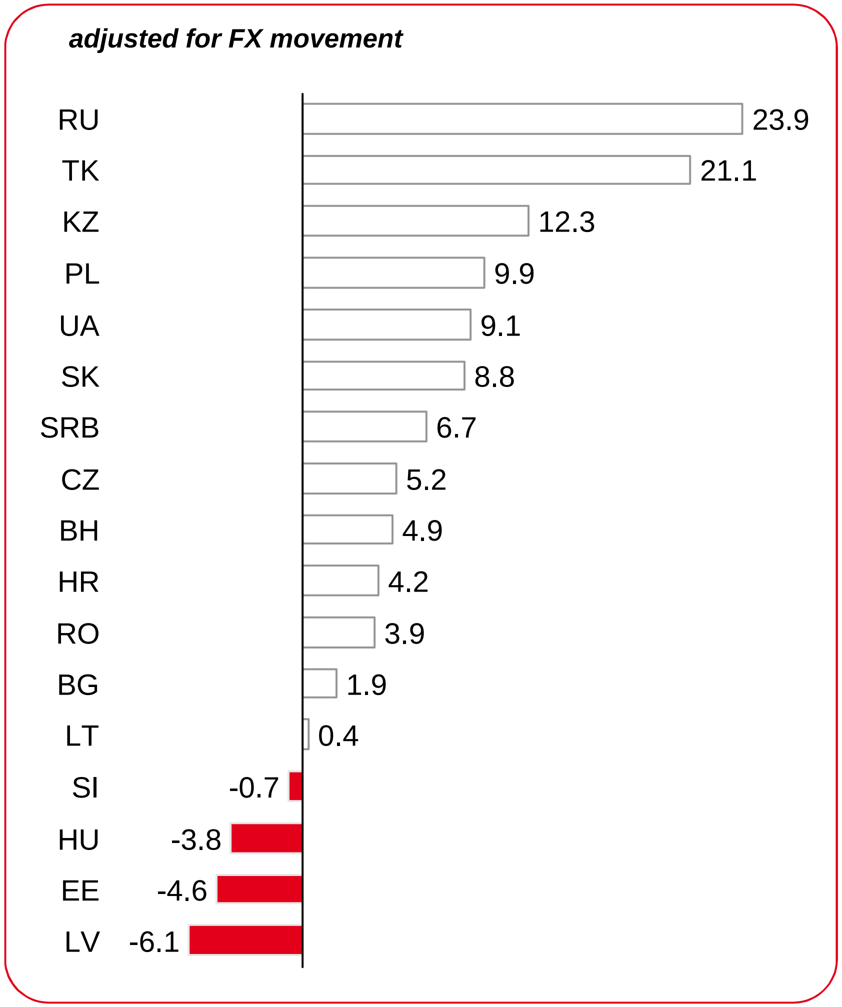
[1] Countries in grey refer to other emerging economies in CEE and Central Asia.
[2] CEE aggregate including CZ, BG, HU, PL, RO, RU, SK, UA and TK
SOURCE: IMF WEO, Global Insight, UniCredit CEE Strategic Analysis

Agenda

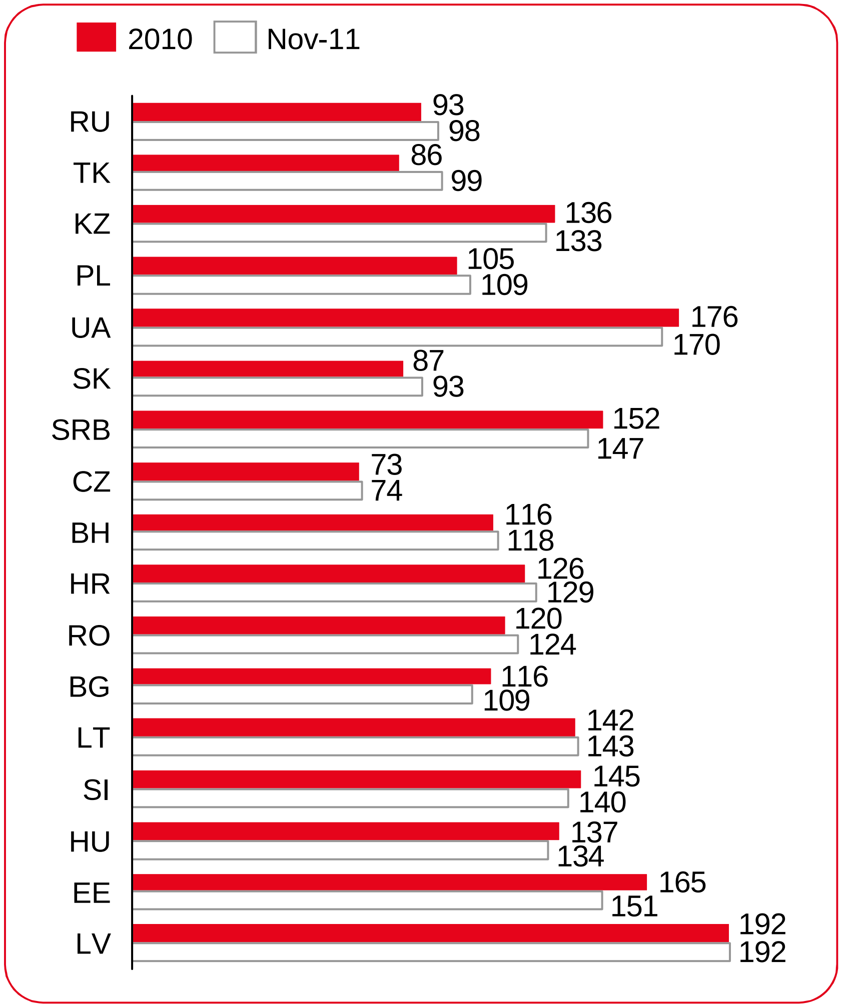
- CEE Macro: testing times
- **CEE Banking: the new ‘normal’**

Lending activity restarted in most of CEE. Russia and Turkey emerge as clear outperformers

Total Loans, YTD % growth (Nov-2011)



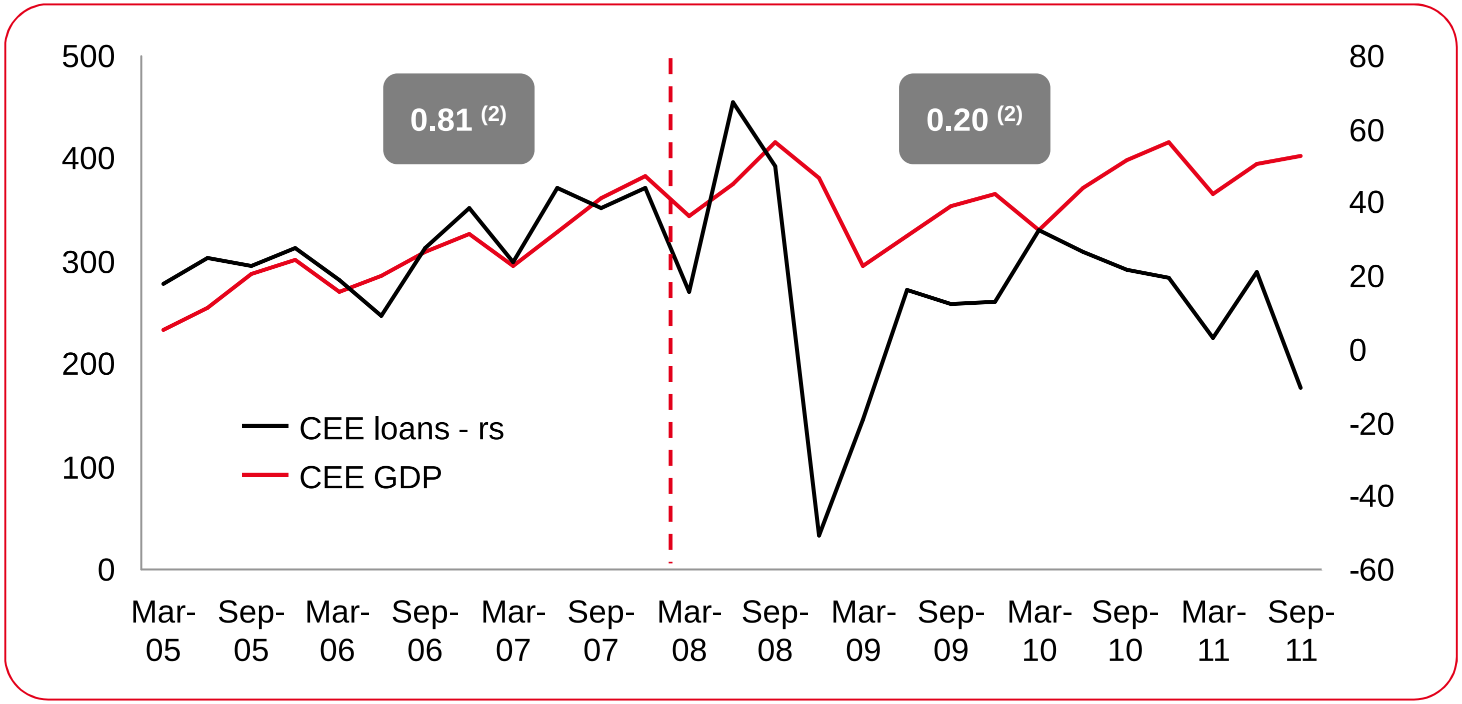
Loan-to-deposits ratio, %



SOURCE: UniCredit CEE Strategic Analysis

Rising evidence of decoupling between credit growth and the economic cycle

CEE-12 lending activity and economic growth (delta volumes in EUR bn) (1)

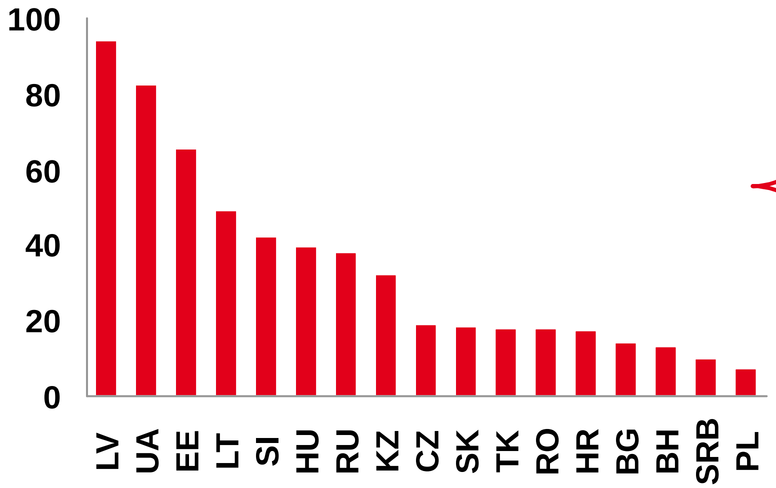


- **Creditless recoveries are not a rare event. One out of four recoveries in output occurs without a pick-up in lending activity**
- **Weaknesses in credit growth appear to be the result of both demand and supply factors**

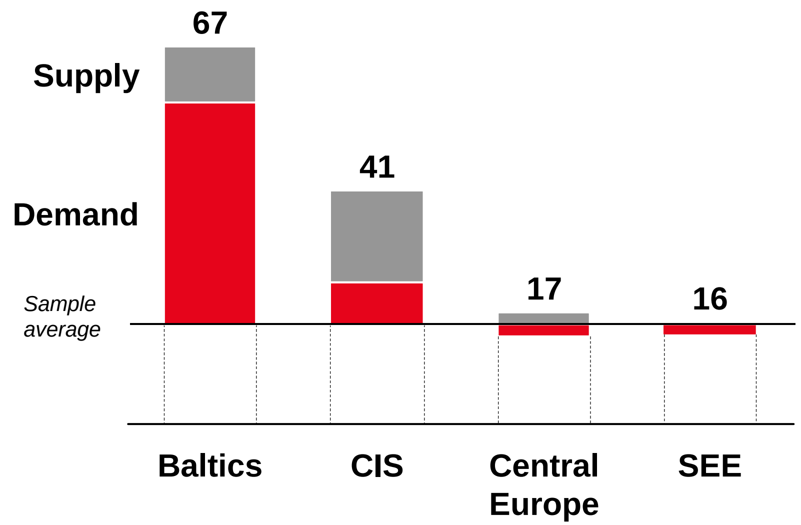
(1) CEE-12 includes EU members + Croatia and Turkey
(2) Correlation between lending and economic growth
SOURCE: UniCredit CEE Strategic Analysis

How far could lending fall short?

Estimated prob of a creditless recovery



Contributions to estimated prob by sub-regions



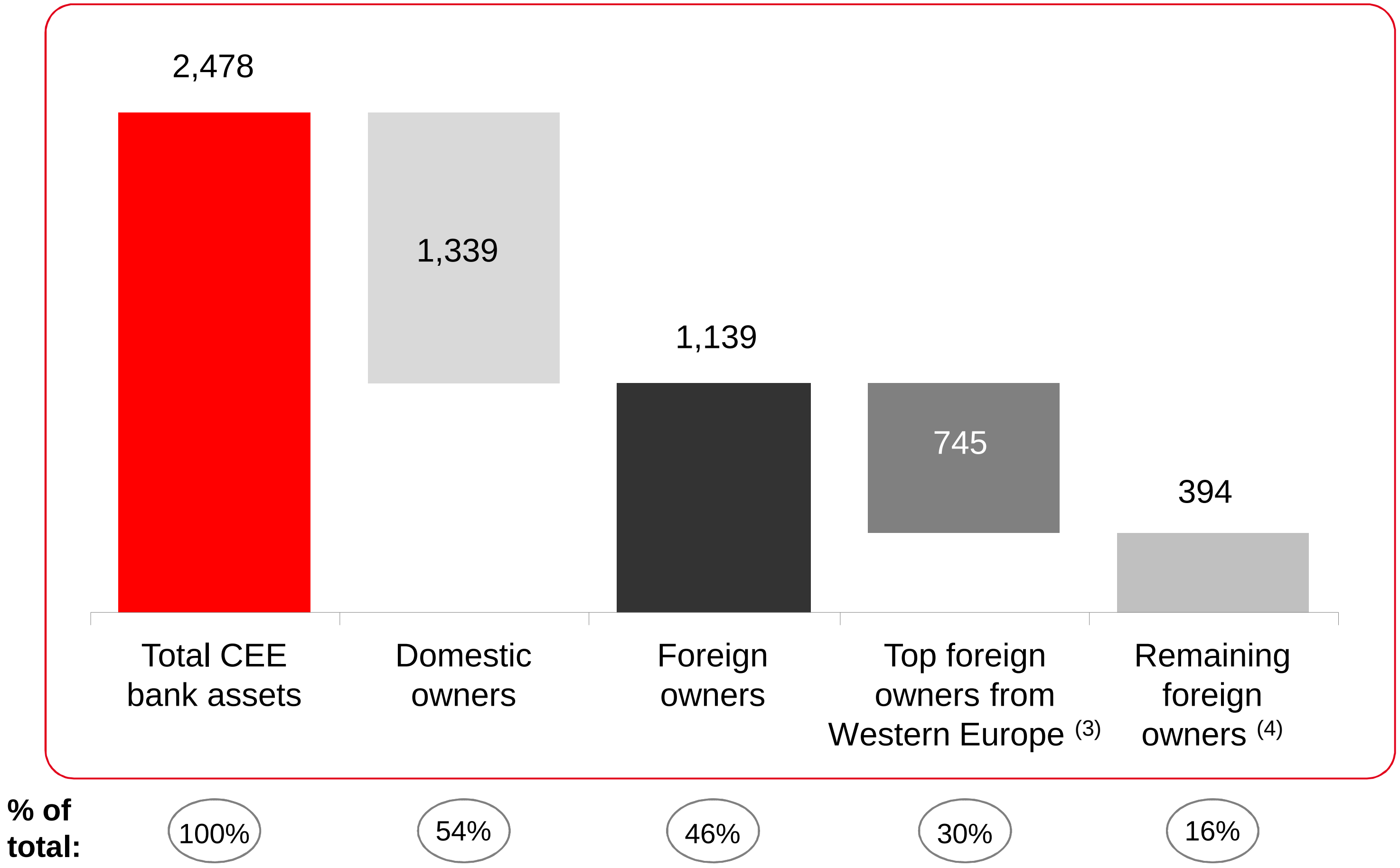
Probabilities of creditless recoveries during the next years remain largely heterogeneous within CEE

- Demand factors contribute to increase probability of creditless recovery by 56pps in Latvia, 41pps in Estonia, 33pps in Ukraine, 27bps in Lithuania and 9pps in Slovenia
- Supply factors become crucial in countries hit by large banking shocks and/or experiencing a significant deleveraging process (increasing probability of a creditless recovery by about 28pps in Latvia and Ukraine and 15pps in Kazakhstan and Slovenia)

SOURCE: UniCredit CEE Strategic Analysis

Top foreign owners from Western Europe account for 30% of CEE (1) banking assets

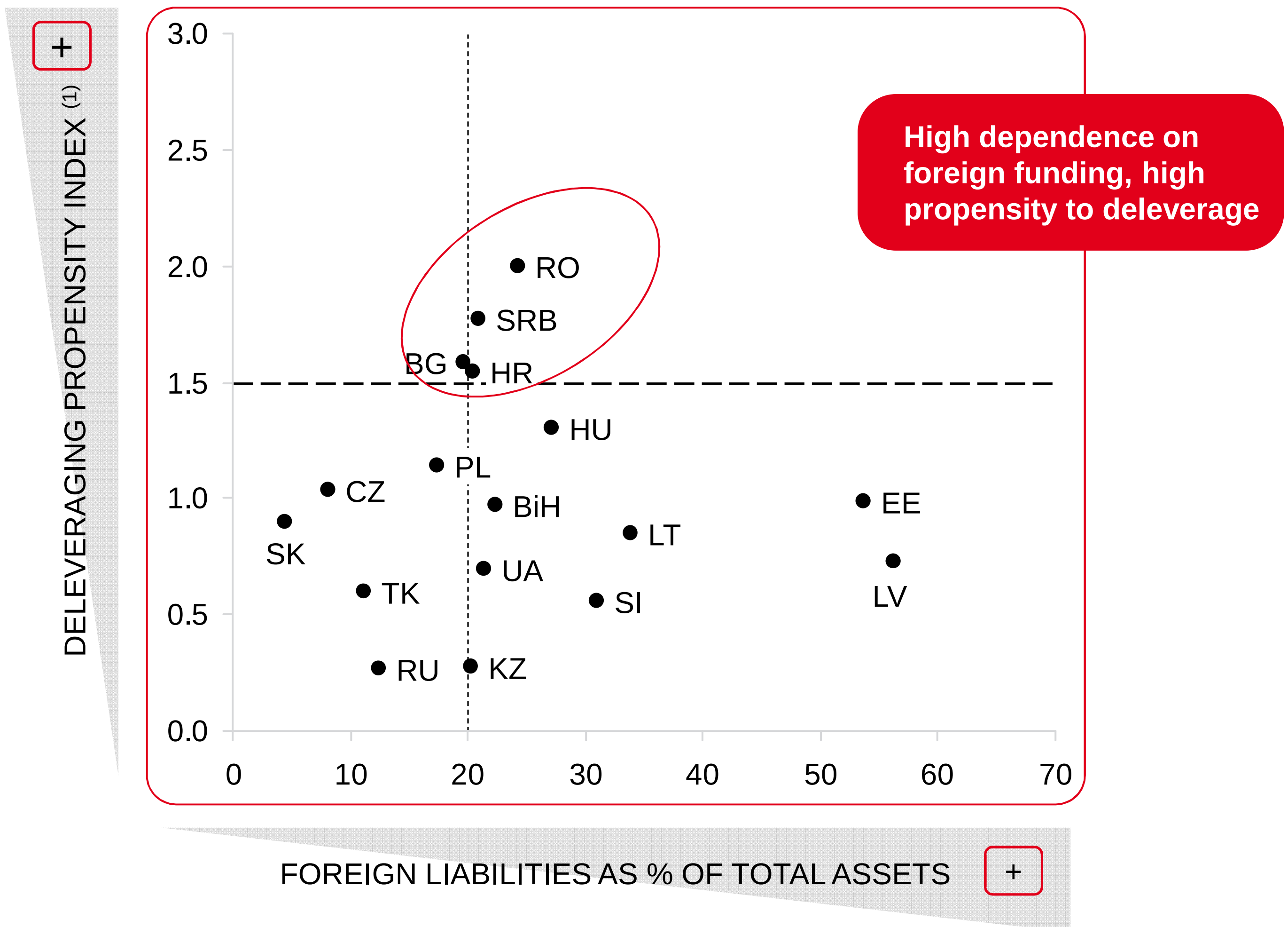
Bank assets (2) in CEE (EUR bn, end of 2010)



(1) EU10 member states + Bosnia & Herzegovina, Croatia, Kazakhstan, Russia, Serbia, Turkey and Ukraine
(2) Split between domestic and foreign owners is based on the main shareholder (sometimes less than 50% stake)
(3) Top CEE players from Western Europe + some other WE players with strong presence in specific CEE countries
(4) Remaining WE players (with negligible share in CEE) + other foreign players (e.g. from US)
SOURCE: UniCredit CEE Strategic Analysis

EMU banks' deleveraging: country risk scores remain rather low

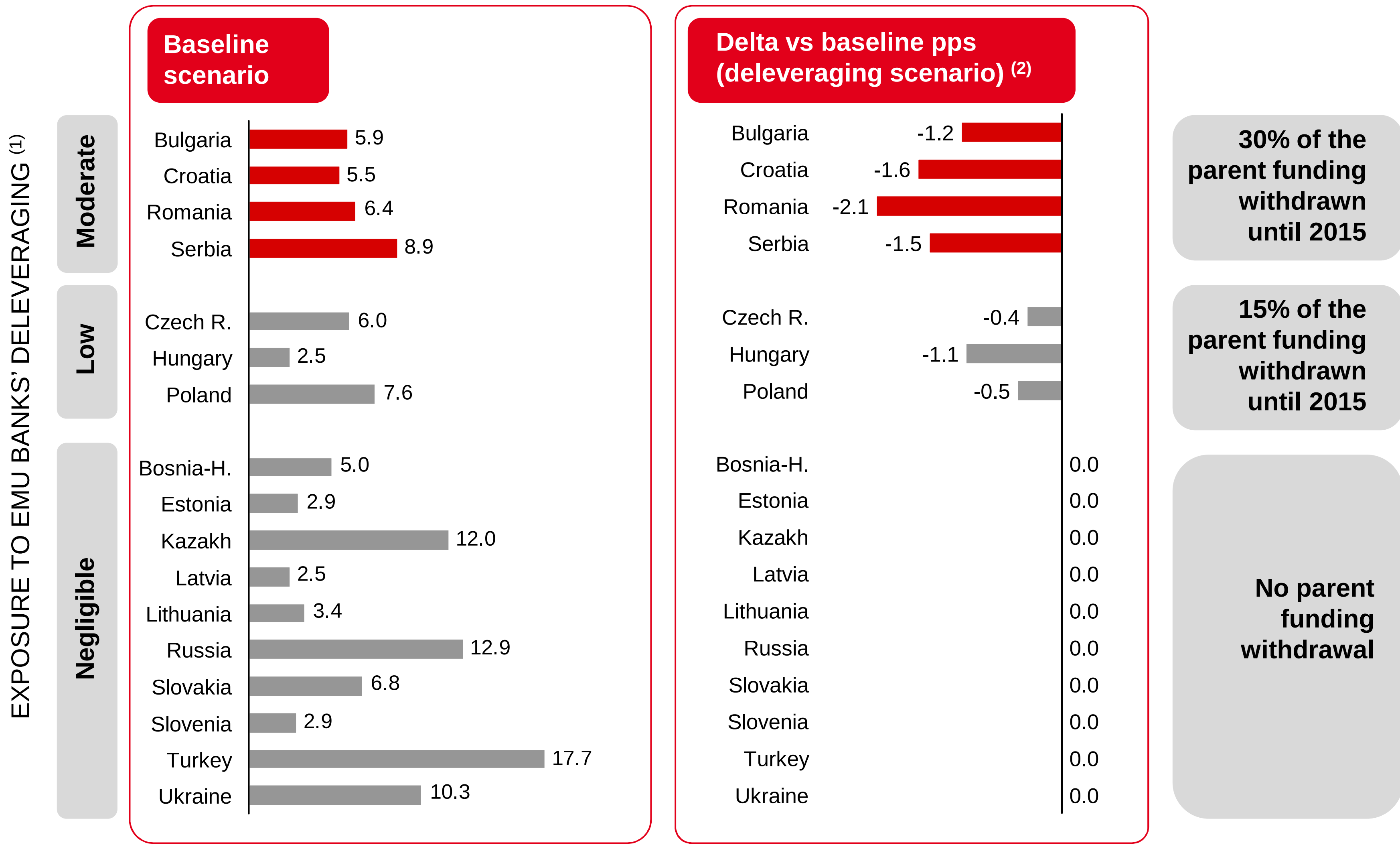
Western European banking deleveraging risk index for CEE countries



[(1)] The index is a weighted (with a share in a country's total bank assets) average of bank owners' ranks. The ranks vary from 0 (no risk) to 5 (high risk). 0 = domestic owners; 1 = non-WE foreign owners and WE owners with small (<5%) potential need to deleverage or CEE subsidiary fully self-funded; 2 = WE owners with potential need to deleverage by 5-10%; 3 = WE owners with potential need to deleverage by 10-15%; 4 = WE owners with potential need to deleverage by 15-20%; 5 = WE owners with potential need to deleverage by more than 20%.

The overall impact of potential Western European banks deleveraging on lending activity ought to remain limited

2011-2015 total loans growth (% LC CAGR)



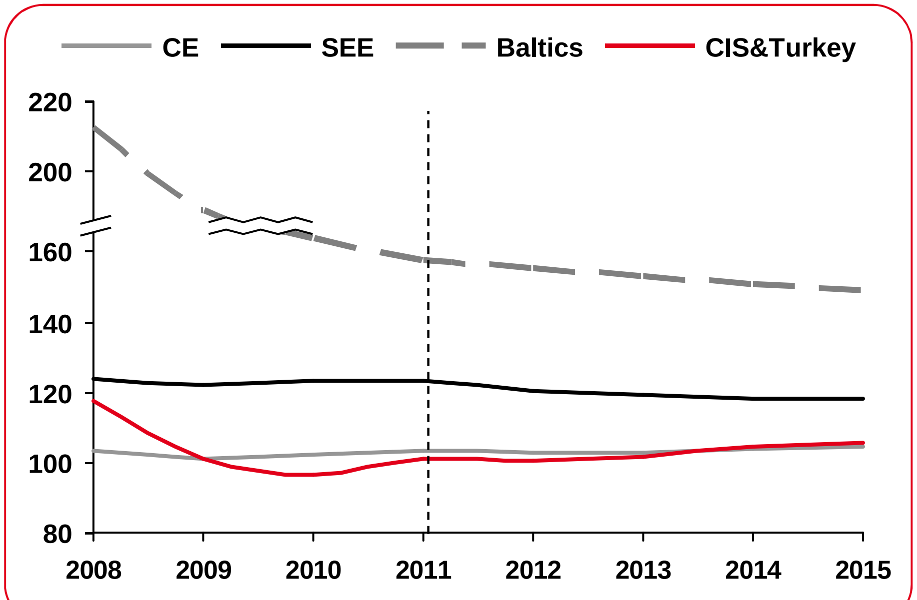
[1] Moderate" exposure - countries with the mid-term deleveraging propensity index above 1.5. "Low" exposure – countries with the mid-term deleveraging propensity index between 1 and 1.5; "none" exposure – countries with the mid-term deleveraging propensity index below 1.0

[2] Under the deleveraging scenario, forecasts incorporate only the direct impact of parent bank problems due to capital shortages

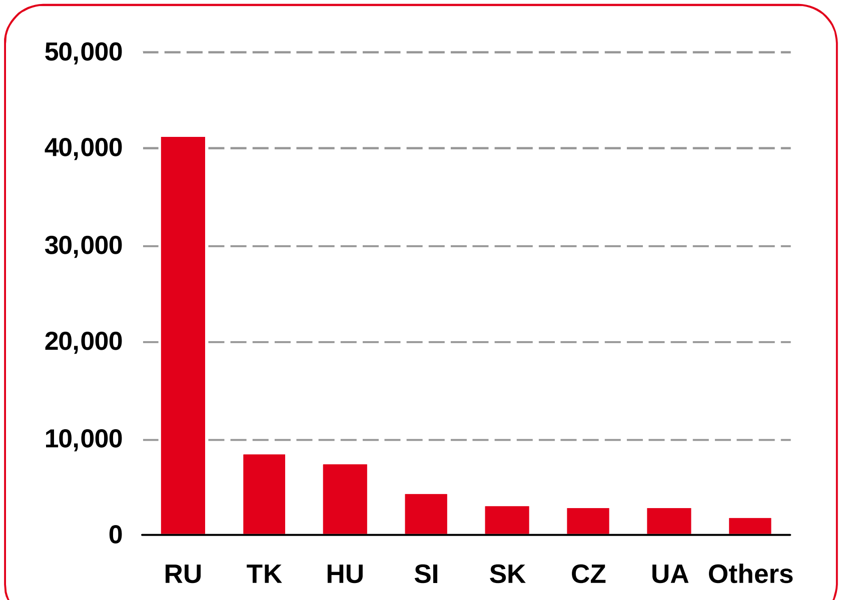
SOURCE: UniCredit CEE Strategic Analysis

Under the new normal, a more balanced funding structure should prevail. A further effort to boost the domestic debt market remains crucial to foster lending activity in the region

Loan-to-deposits ratio, %



Bond issuance in CEE (2008-11, € mn) [1]

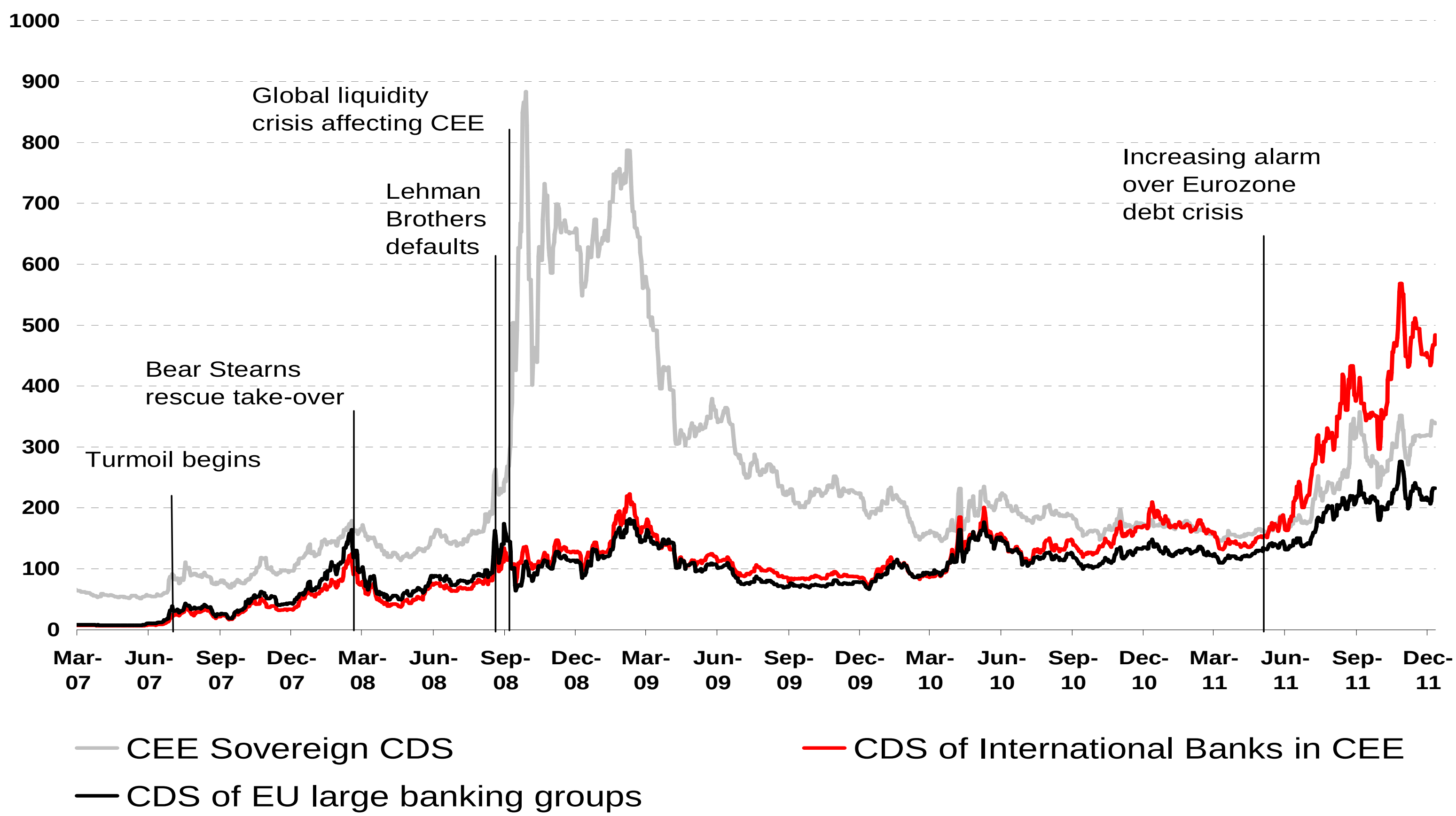


- **We foresee deposits and other local funding as likely increasing their significance in banks' total liabilities with a further contraction in the share of external liabilities**
- **Given the short-term nature of deposits, the development of local currency long-term funding remains crucial**

[1] Figures for 2011 refer to YTD issuance until Oct 2011 and include covered bonds, guaranteed bonds, senior unsecured and subordinated
SOURCE: UniCredit CEE Strategic Analysis, Bloomberg

Cost of funding remains a key variable to monitor

Global banking and CEE regional risks [1] (5Y CDS, bp)

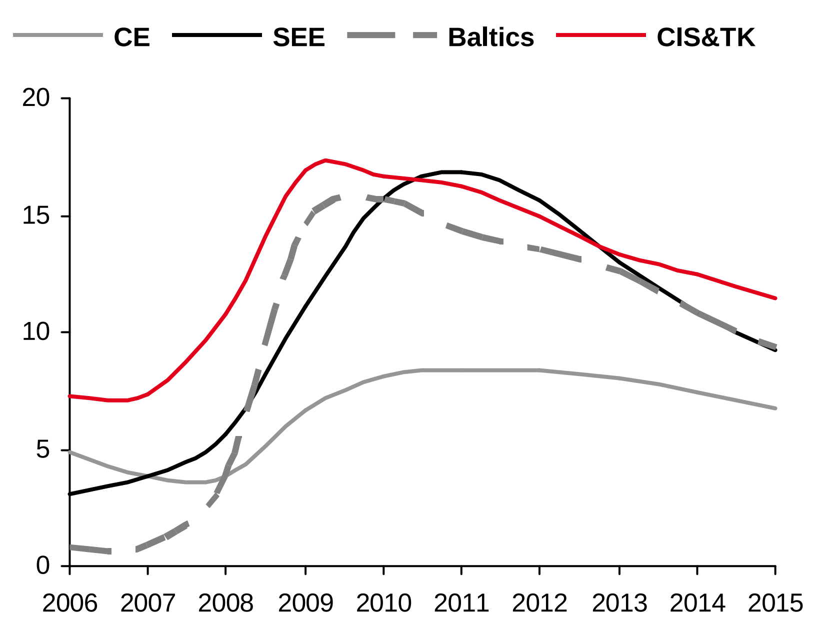


[1] International banks in CEE include UCG, ERSTE, KBC, SOCGEN and INTESA; EU large banking groups include BARCLAYS, RBS, HSBC, BBVA, DB

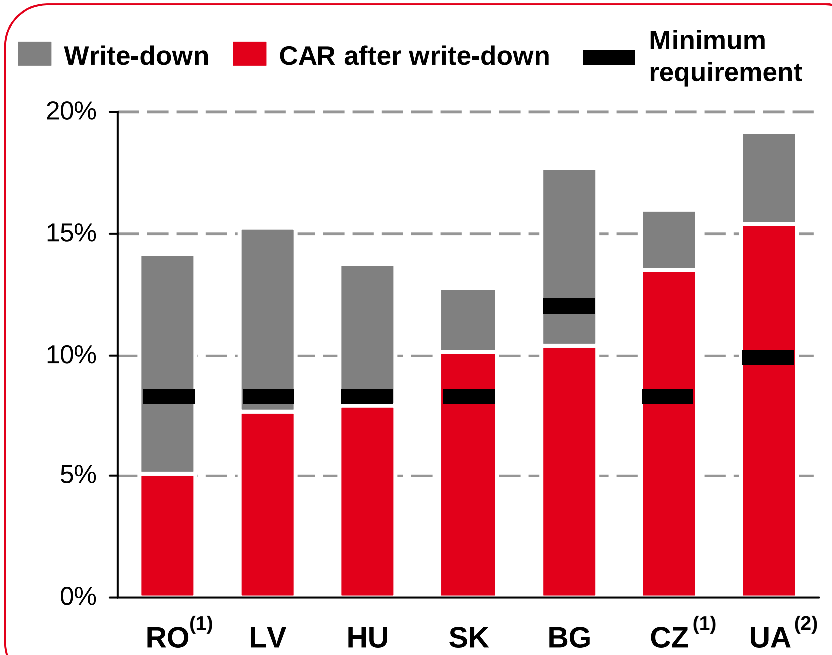
SOURCE: UniCredit CEE Strategic Analysis

In some countries, credit quality problems might reoccur

NPL ratio by sub-regions (% of gross loans)



Effect of NPL write-down on CEE banks' CAR



- NPLs should further normalize although with mixed trend across countries
- Despite good capital adequacy ratios in the region, still high NPLs represent a potential source of risk
- Fast NPL resolution would be desirable but can prove to be harmful for banks' financial stability

(1) For Romania and Czech Republic informally required target 10%

(2) For Ukraine, simulation based on official NPL statistics; using unofficial estimates on the NPL ratio, the impact would be more severe with CAR turning negative

SOURCE: Local Central Banks, UniCredit CEE Strategic Analysis