SEE BANKING INDUSTRY OUT OF THE CRISIS

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Bank of Greece, The Global Financial Crisis and SEE: lessons for macroeconomic policy and financial stability
Athens, May 14th 2010

EXECUTIVE SUMMARY

- The recovery is gradually starting in the whole CEE region with SEE lagging behind. Economic convergence promise holds, with a rebalanced economic model and average long term growth expected at 4.4% in SEE vs the pre-crisis 6.0%. The Greek crisis confirms the end of cheap cost of country risk
- SEE banking resilient, even in the years of the crisis, although return to business needs time and a rebalancing:
  - We are still in the middle of a demand driven credit crunch
  - Credit quality gradually stabilizing, with peak in NPL in H2 2010
  - Long term profitability holds, with a multi-equilibrium scenario
- All stakeholders committed to find strategies for re-igniting growth - demand rather than supply of credit should be the driver out of the crisis. In a scenario of strict fiscal control and high country risk, countries have to find a way to stimulate demand
  - EU Funds full utilization is a must, which has the potential to contribute in the range of 0.8pps to 2.0pps to annual growth (in nominal terms)
  - Strategies for increasing competitiveness and quality of the operating environment have to remain a priority, to compensate other long term weaknesses (first of all ageing of population)

AGENDA

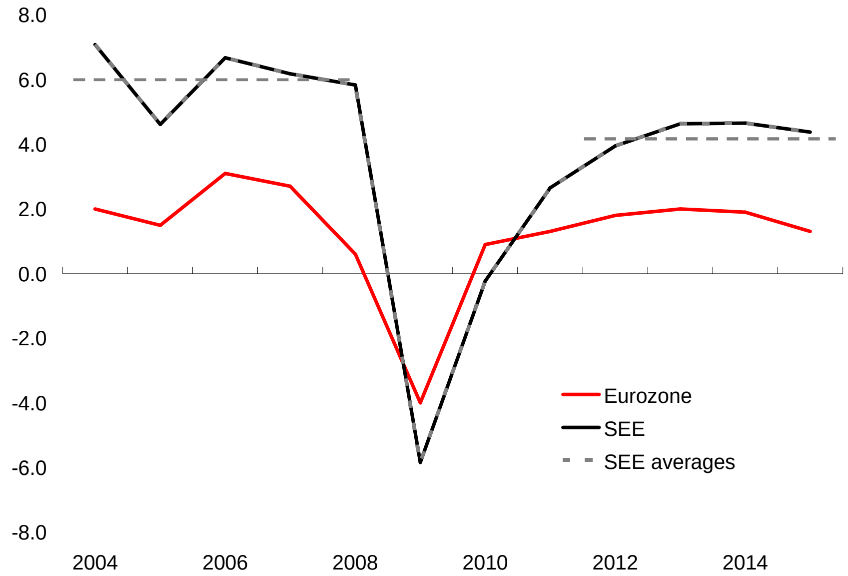
- **CONVERGENCE CONTINUES, WITH A REBALANCED MODEL**
- SEE BANKING HOLDS AS AN OPPORTUNITY
- HOW TO RE-START
- CONCLUSIONS

RECOVERY IS UNDERWAY - OUT OF THE CRISIS, THE GROWTH MODEL HOLDS BUT LONG TERM GROWTH WILL REMAIN BELOW PRE-CRISIS

Real GDP growth
(% yoy growth)

	2009	2010F	2011F
Poland	1.7	2.6	2.7
Hungary	-6.3	-0.1	2.8
Czech Rep.	-4.2	1.6	2.4
Slovakia	-4.7	3.1	3.8
Slovenia	-7.8	0.6	1.5
Lithuania	-15.0	-3.0	3.0
Latvia	-18.0	-2.5	5.5
Estonia	-14.1	-1.3	3.4
Bulgaria	-5.0	-1.0	2.2
Romania	-7.1	0.4	3.5
Croatia	-5.8	-1.0	1.3
Bosnia-H.	-3.5	-1.0	0.8
Serbia	-3.0	-0.5	2.2
Turkey	-4.7	4.5	4.5
Ukraine	-15.1	3.0	4.0
Russia	-7.9	3.4	5.0
Kazakhstan	1.2	3.5	5.0
CEE-17	**-5.7**	**2.8**	**4.1**

Long term economic trends SEE vs Eurozone
(GDP yoy growth %)



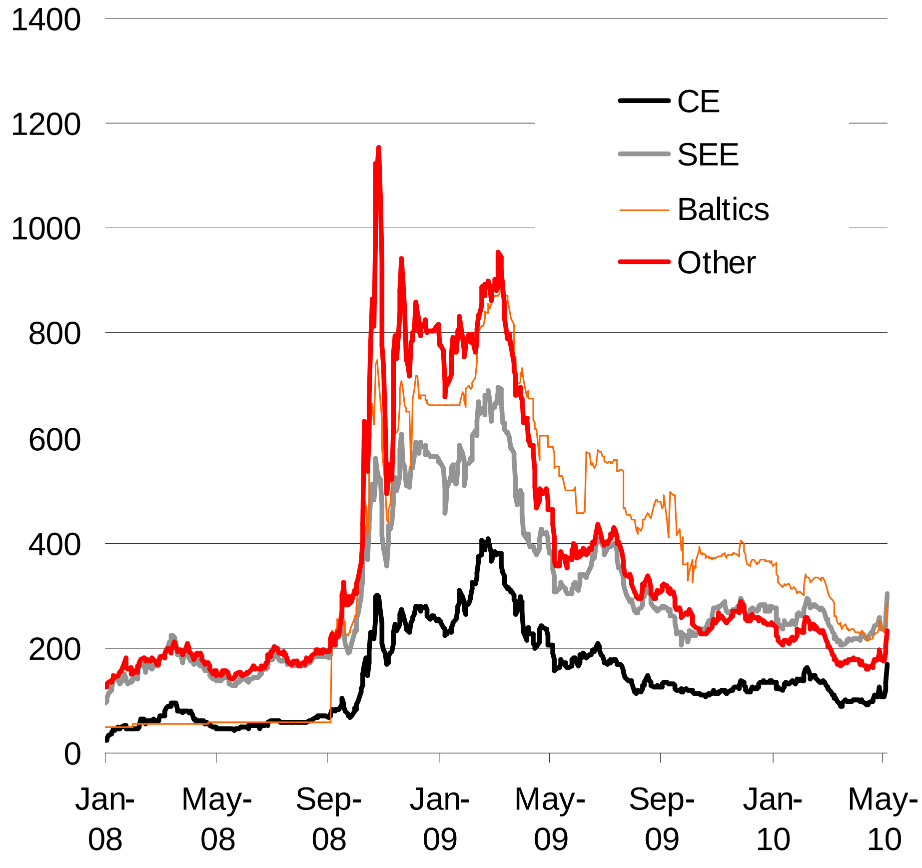
Drivers of convergence hold but are weaker than in the past

- Competitiveness (but uncertain world outlook and East competition)
- Capital inflows (but higher cost of country risk)
- Convergence in standards of living (but households sector delays recovery)
- EU Funds and infrastructural projects

SOURCE: UniCredit Group CEE Strategic Analysis, UniCredit Research

END OF CHEAP FUNDING – COST OF COUNTRY RISK REMAINS HIGHER THAN PRE-CRISIS AND VOLATILE, WITH "EURO BONUS" TODAY SUBSTANTIALLY LOWER THAN IN THE PAST

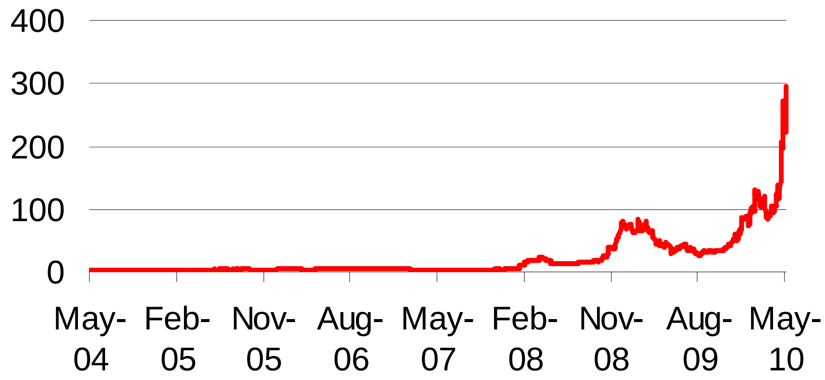
Country risk by CEE sub-regions
(CDS spreads by CEE sub-regions 5Y USD, bps)[1]



Euro convergence process

	Joined ERM II Date	Criteria fulfilled No.(2)	Euro Adoption (first possible date)
Estonia	Jun-04	3	2011-12
Lithuania	Jun-04	2	2014
Poland	-	1	2015
Latvia	Apr-05	2	2014
Czech Rep.	-	3	2015
Bulgaria	-	2	2014
Romania	-	1	2015
Croatia	-	1	2018
Hungary	-	0	2014

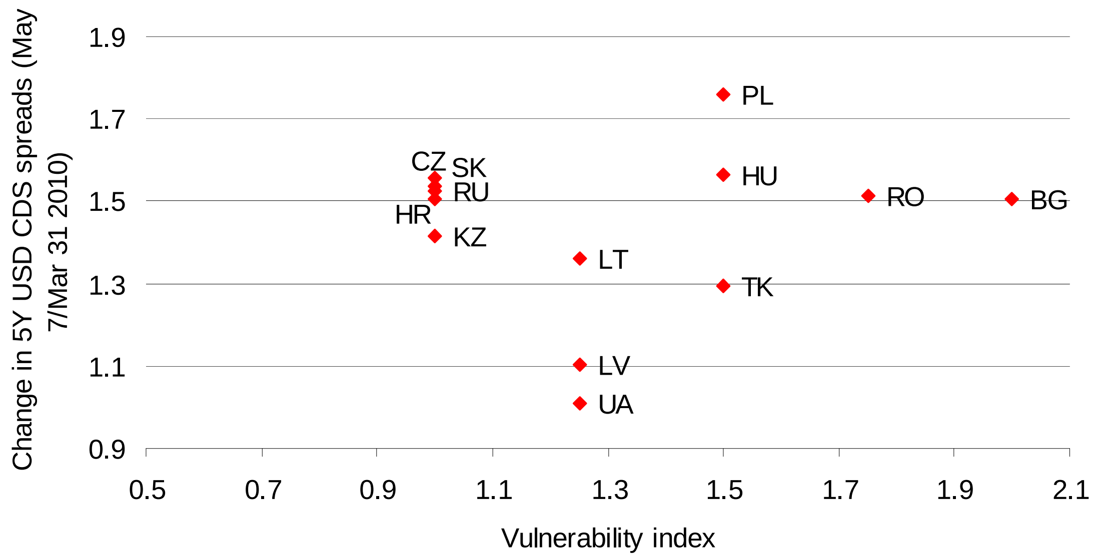
Euro not any more homogeneous in terms of risk[2]
(Volatility in EMU cost of country risk - standard deviation of 5Y USD CDS spreads)



(1) CE: HU, CZ, PL, SK; SEE: RO, BG, HR, SRB; Other: RU, TK, UA, KZ; (2) Incl. France, Germany, Greece, Italy and Portugal (from Jan 2009 also Slovakia); (2) Criteria: i) CPI no more than 1.5 percentage points higher than the average of the three best performing ; ii) Bond yields not higher than the avg of best 3 EMU members +1% point; iii) Public debt/GDP not over 60%; iv) Budget deficit not over 3% of GDP; v) FX stability (+/-15%) and in ERM-II. SOURCE: UniCredit Group CEE Strategic Analysis, UniCredit Research, Bloomberg

VULNERABILITY TO GREECE AND EURO CRISIS MORE THROUGH THE INDIRECT CHANNELS THAN DIRECT ONES

CDS spreads and level of vulnerability[1]



Indirect channels	Level of vulnerability	Most influenced	Direct channels	Level of vulnerability	Most influenced
Public Debt/ Fiscal Budget	High	PL, HU, RO, Baltics	Banking	Medium	BG, RO, SRB, TK
			Trade and FDI	Low	BG
			Portfolio investment	Low	HU, TK, PL

(1) Index (3=highest level of vulnerability) calculated considering average countries' vulnerabilities through banking sector channel, trade and FDI, portfolio investment and public finances
SOURCE: UniCredit CEE Strategic Analysis, Bloomberg

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THE IMPACT OF THE CRISIS HAS BEEN FELT, BUT ON THE OVERALL THE SEE BANKING SECTOR HAS REMAINED RESILIENT

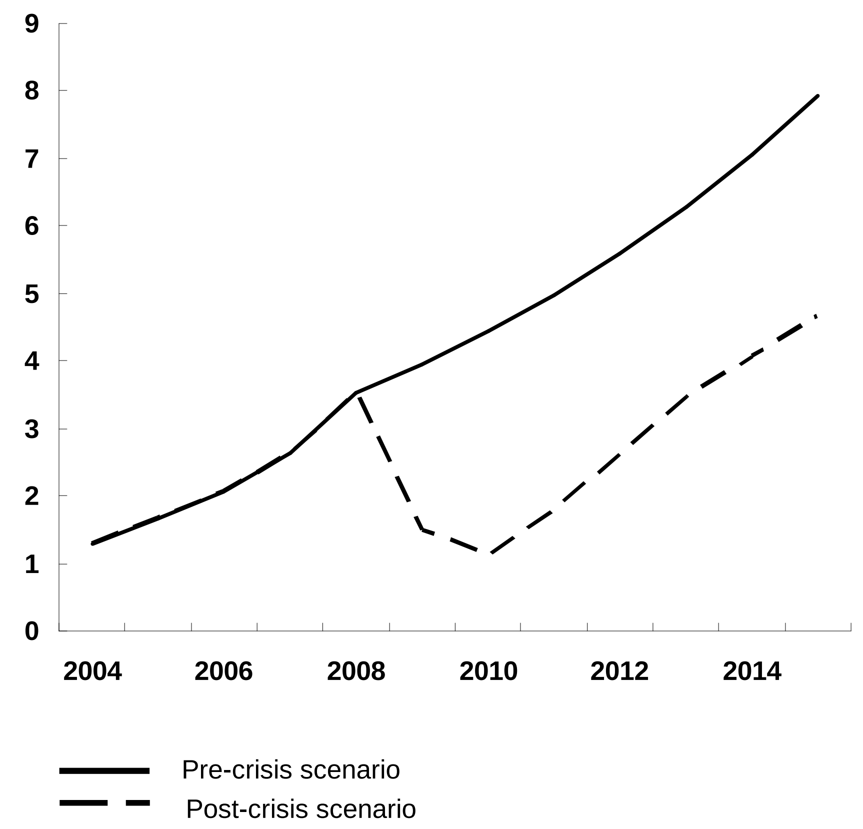
- **Liquidity crisis**
  - Avg SEE funding cost up from 35bps end 2006 to 278bps in Dec 2009 (peaking at almost 700bps in March 2009)
- **Credit quality problems**
  - 2009 NPLs ratio x3.1 relative to end of 2007 (x16 in the Baltics, x5 in CIS[1], while lower in CE)
- **Business and credit crunch**
  - Credit crunch, with average sub-regional growth in total loan volumes at 2.0% yoy in 2009 (2008: 21% yoy)
  - Loan-to-deposits ratio down to 122% in 2009 from 124% the year before
- **Never an issue of capital**
  - CAR well above minimum requirement all over the region (from x1.3 the minimum regulatory requirement in HR and BH to x2.1 in SRB)
- **Profitability**
  - ROA down from 1.5% in 2007 to 0.7% in 2009

(1) Excluding Russia

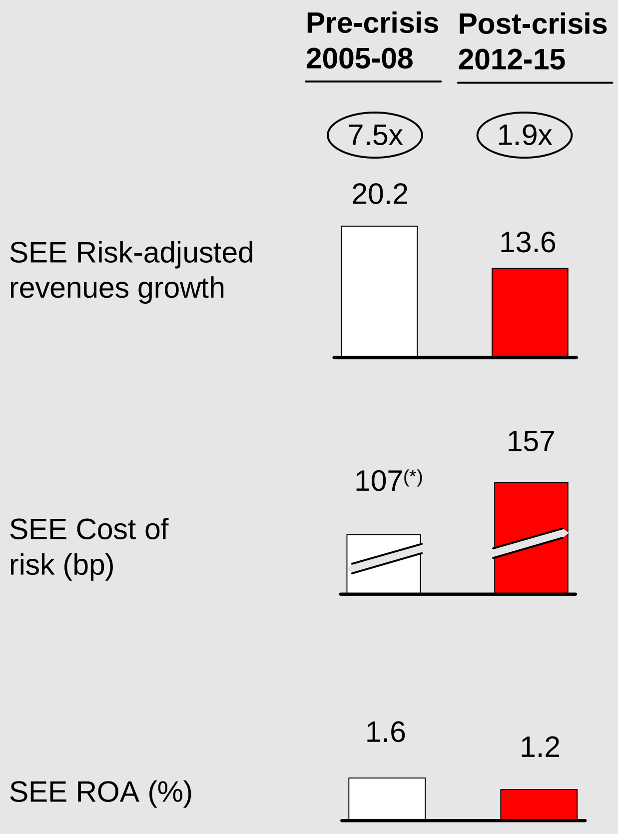
OUT OF THE CRISIS, THE SEE REGION IS EXPECTED TO RECOVER TOWARDS A LOWER GROWTH RATE PATH, ALTHOUGH MANTAINING A SIGNIFICANT ADVANTAGE VS WESTERN EUROPE

SEE expected to recover towards a lower growth path…

SEE total banking system profits - bn euro



… yet maintaining a significant advantage vs. Western Europe



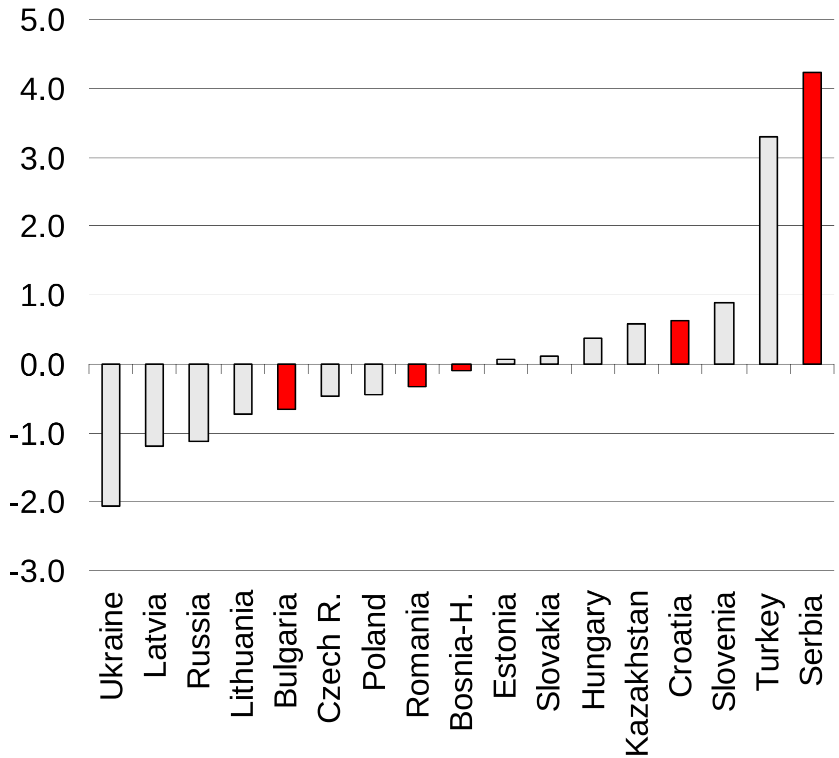
(*) 2005-2007

SOURCE: UniCredit Group CEE Strategic Analysis

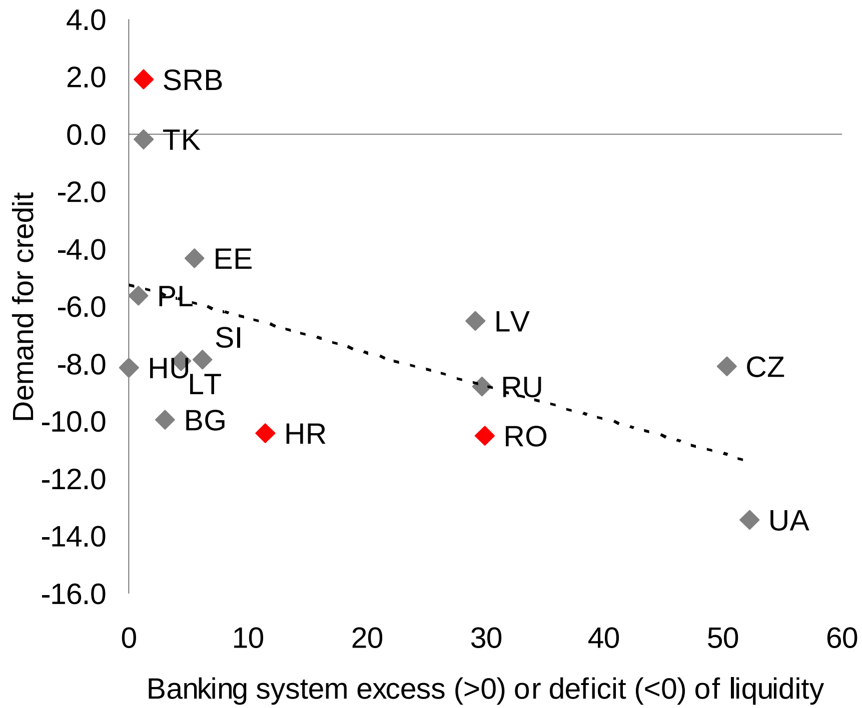
x SEE vs WE

CREDIT CRUNCH – A MATTER OF LACK OF DEMAND, IN THE CONTEXT OF OVER-LIQUIDITY

Credit crunch visible…
(Total loans - YTD change Feb 2010, adjusted for FX movements)



…Low demand rather than liquidity the driver
(Banking sector liquidity and demand for credit - Feb 2010)[1]

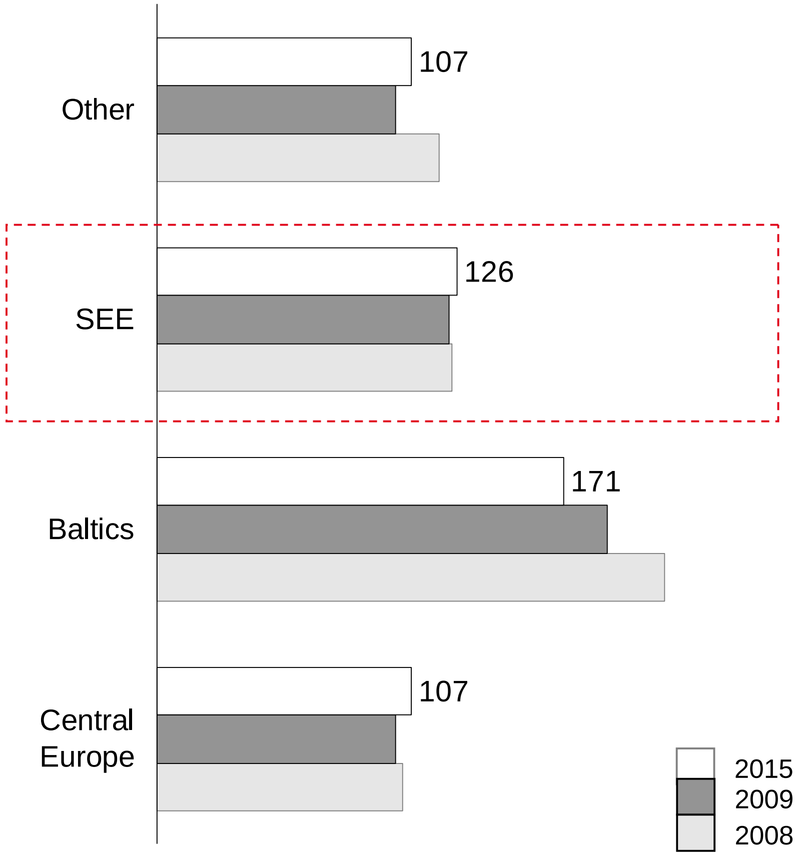


(1) BANKING SYSTEM LIQUIDITY: a value of the index equal to 100 means highest level of excess liquidity in the region; the index is obtained considering average excess reserves of commercial banks with the CB (as a share of MRR) and change in the difference b/w local interbank and reference rates (compared to end of 2009). DEMAND FOR CREDIT: value based on average change in IP, Retail sales and Economic confidence indicator between Feb 2010 and Dec 2009. SOURCE: UniCredit Group CEE Strategic Analysis, Eurostat

THE GROWTH MODEL CONTINUES TO BE BASED ON EXTERNAL FUNDING

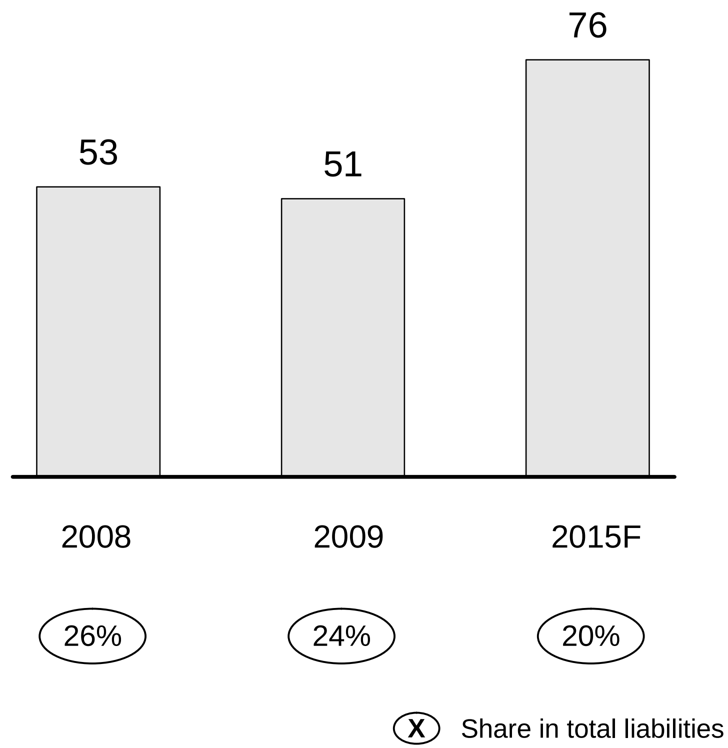
A more balanced banking model

CEE Banks loan-to-deposits ratio, %[1]



Banks access to external funding remains crucial

SEE Banks External liabilities (bn € and % in total)



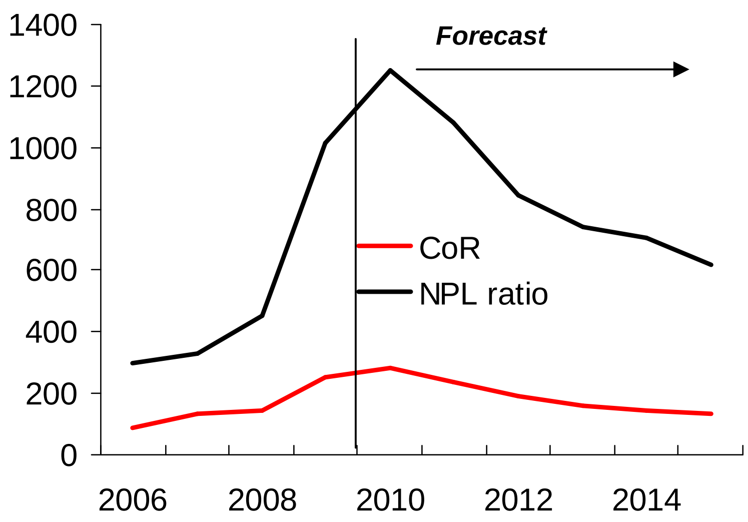
(1) Central Europe: HU, CZ, PL, SI, SK; SEE: RO, BG, HR, SRB, BH; Other: RU, TK, UKR, KZ

SOURCE: UniCredit Group CEE Strategic Analysis

COST OF RISK CONVERGING, BUT REMAINING ABOVE THE PRE-CRISIS LEVELS

SEE Cost of Risk (provisions[1] % Ø gross loans) and NPL[2]

In basis points



Year of the peak in Cost of Risk:

2009: SRB

2010: HR,BG,RO,BH

Year of the peak in NPL ratio:

2010: SRB, HR, BG, RO, BH

Cost of Risk (provisions[1] % Ø gross loans)

%	2008	2009	2010F	2011F
Poland	1.0%	1.8%	1.7%	1.6%
Hungary	0.9%	2.4%	2.1%	1.7%
Czech R.	0.9%	1.5%	1.6%	1.1%
Slovakia	1.1%	1.3%	1.2%	0.8%
Slovenia	0.8%	1.5%	1.5%	1.3%
Bulgaria	0.8%	2.0%	2.9%	2.0%
Romania	2.3%	3.7%	3.7%	3.2%
Croatia	0.5%	1.4%	1.4%	1.3%
Bosnia-H.	1.8%	2.3%	3.0%	2.4%
Serbia	10.6%	8.5%	7.4%	6.8%

Non-performing loans (% of gross loans)[3]

%	2008	2009	2010F	2011F
Poland	4.2%	7.0%	8.9%	8.0%
Hungary	4.5%	8.5%	8.8%	8.3%
Czech R.	3.3%	5.4%	7.3%	6.9%
Slovakia	3.2%	5.5%	6.7%	6.2%
Slovenia	2.9%	5.5%	6.0%	5.8%
Bulgaria	3.2%	6.2%	10.0%	9.6%
Romania	6.3%	14.7%	17.0%	13.5%
Croatia	3.2%	7.5%	9.0%	8.5%
Bosnia-H.	2.6%	5.3%	5.8%	4.9%
Serbia	5.3%	12.5%	15.5%	14.7%

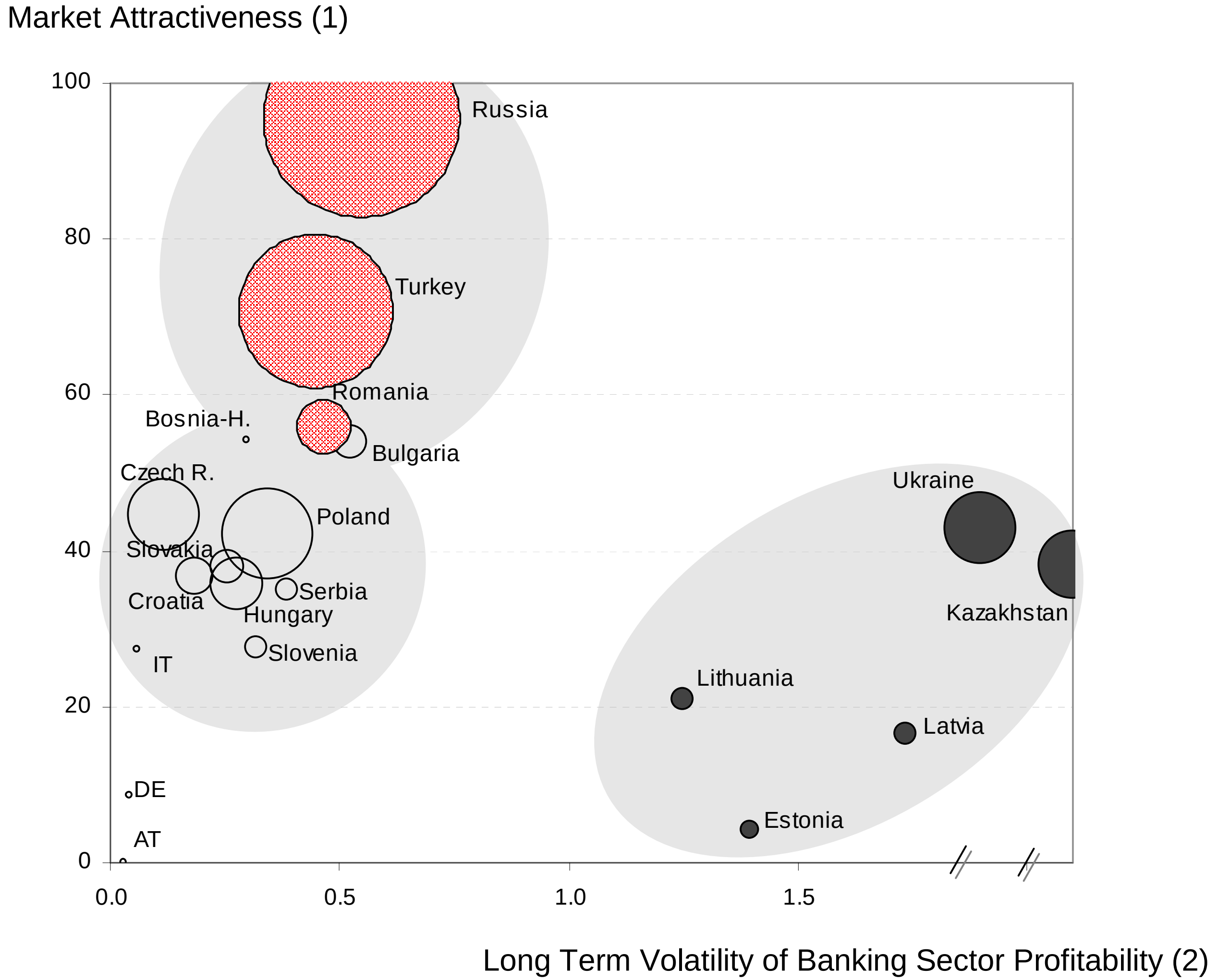
(1) General + specific provisions; (2) SEE (excl. SRB); (3) Substandard, doubtful and loss

SOURCE: UniCredit Group CEE Strategic Analysis

PROFITABILITY HOLDS, WITH A MULTI EQUILIBRIUM SCENARIO

Banking system Net Profit (bn €, 2015F)

Long term market attractiveness, risk and size of CEE Profit pool



(1) Market Attractiveness is an index ranked between 0 (low attractiveness) and 100 (high attractiveness). It is obtained by considering growth potential (50% weight) and profitability (50% weight). Growth potential is measured in terms of volumes growth, while profitability in terms of ROA.
(2) Long Term Volatility of Banking Sector Profitability means the standard deviation of banking system ROA.
SOURCE: UniCredit Group CEE Strategic Analysis

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HOW TO RE-START THE ECONOMIC ACTIVITY

- Demand rather than supply of credit should be the driver out of the crisis. In a scenario of strict fiscal control and high country risk, countries have to find a way to stimulate demand

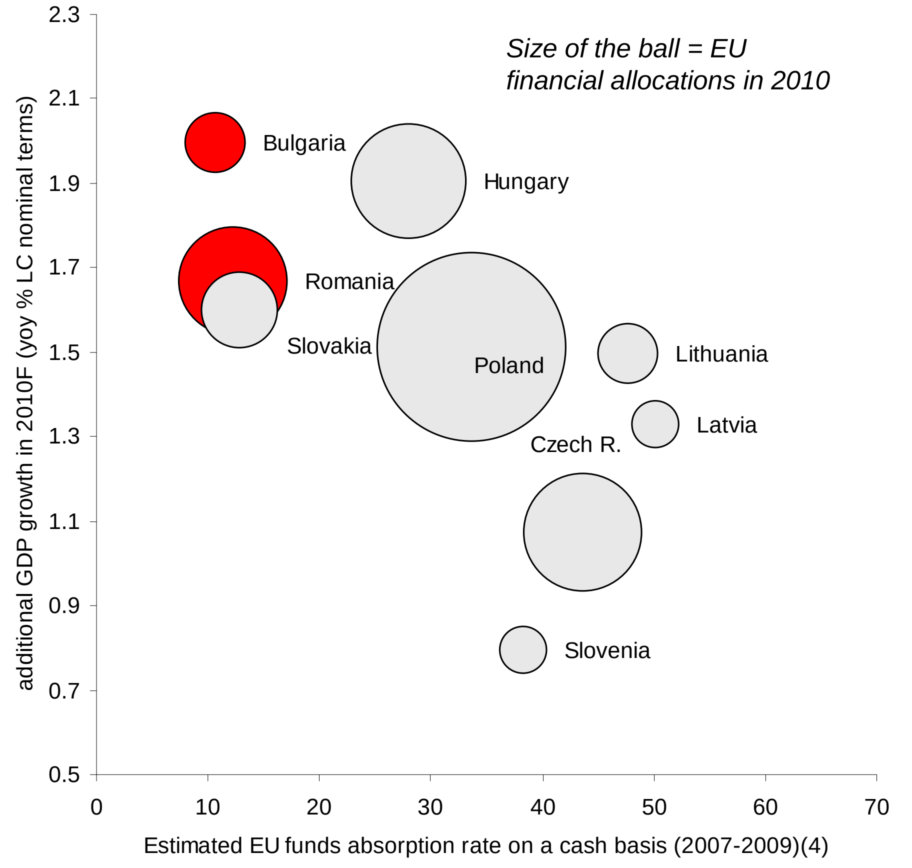
  1. EU Funds full utilization is a must, which has the potential to contribute in the range of 0.8pp to 2.0pps of annual growth (in nominal terms)
  2. Strategies for increasing competitiveness and quality of the operating environment have to remain a priority, to compensate other long term weaknesses (first of all ageing of population)

1. SHORT TERM BOOST TO THE ECONOMY VIA IMPROVED ABSORPTION OF EU FUNDS

EU funds (current prices)

Structural Funds	EU Financial Allocations 2007-2013 (€ bn)*
Bulgaria	**6.7**
Romania	**19.7**
Hungary	24.9
Poland	67.9(2)
Czech Rep.	31.0(1)(2)
Slovakia	11.7(2)
Lithuania	6.6
Estonia	3.5
Latvia	4.5
Slovenia	4.2
Total	**180.6**
Pre-Accession Assistance (IPA)	**EU Financial Allocations 2007-2012 (€ bn)**
Croatia	**0.9**
Bosnia	**0.6**
Serbia	**1.2**
Turkey	3.9
Total	**6.6**

Simulated impact of full absorption of EU funds on nominal GDP growth (2010F)[3]

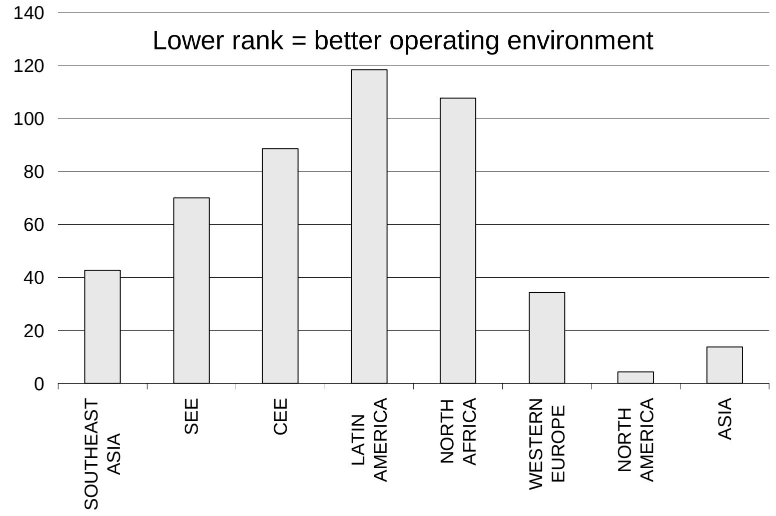


(*) Excluding funds for Rural Development and fisheries; (1) Including co-financing from local budget; (2) Incl. recently approved extra funds of EUR 633mn for PL, EUR 237mn for CZ and EUR 138mn for SK; (3) Based on short term government investment multipliers; interest rates are held constant at baseline value in all simulations; (4) Funds paid out % of EU funding 2007-2009 (March 2010 – SI as of Dec 2009, HU Oct 2009)

SOURCE: UniCredit Group CEE Strategic Analysis, OECD, European Commission

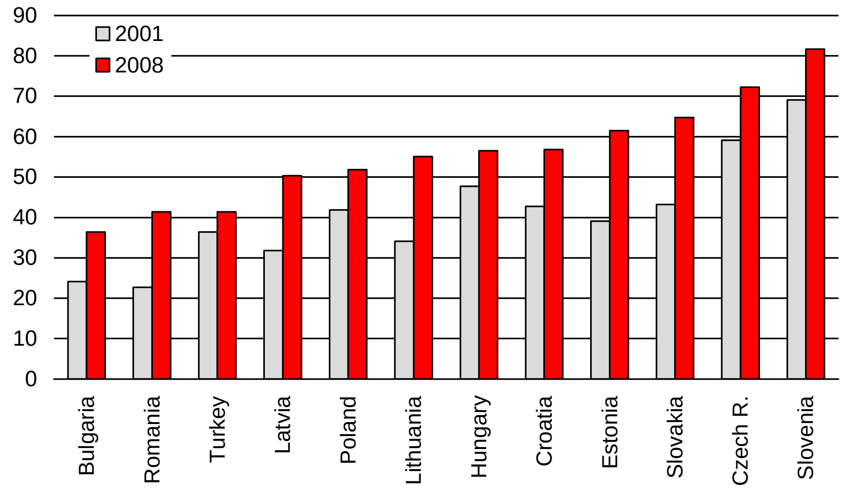
2. STRATEGIES FOR IMPROVING GENERAL COMPETITIVINESS AND QUALITY OF OPERATING ENVIRONMENT REMAIN CRUCIAL

Ease of doing business (2009)

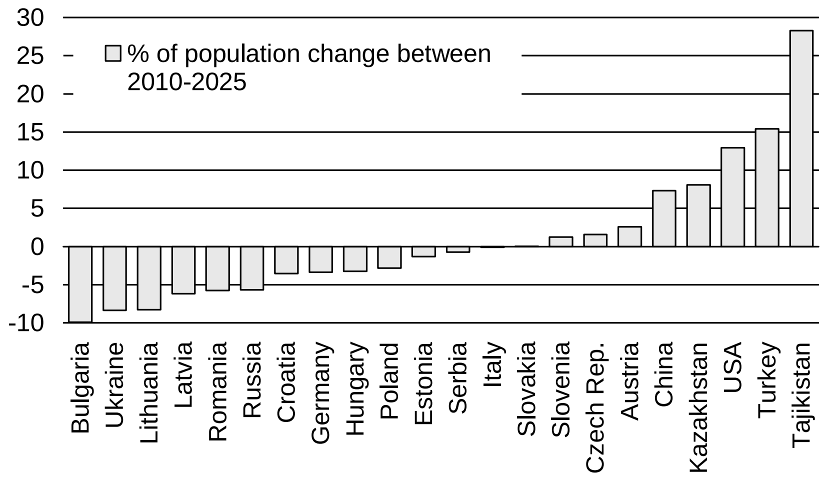


- **Room for improving the operating environment,** when compared to Asia and South Asia
- **Cost competitiveness holds but squeezing**
- **Worsening of the demographic trends in the region represent a risk to monitor** (only exception Turkey and Kazakhstan)

Compensation per employee, EU15=100



Demographic trends



SOURCE: UniCredit Group CEE Strategic Analysis, Eurostat, World Bank, UN

3. REGULATORY DEVELOPEMENTS TO BE CLOSELY MONITORED

Regulatory Initiatives	Impact on SEE banking
Capital Base	■ Generally prudent minimum capital adequacy standards and banks well above the minimum ■ No real need for further generalized strengthening, which might further delay lending recovery
Basle III	■ Strong impact from the implementation of long-term ratio for liquidity standard given the structural lack of long term funding, particularly in local currency ■ If implemented, banking and economic growth might be constrained
FX lending regulation	■ No fix ban of FX lending, but development of constructive solutions to strengthen local currency markets, based on country specificities ■ Without proper means for long term local funding for SEE banks, strict regulation might put a constraint to banking and economic growth

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CONCLUSIONS

- SEE convergence continues, with a rebalanced economic model. The Greek crisis confirms however the end of cheap cost of country risk and represents a source of vulnerability
- SEE banking holds as an opportunity, but a rebalancing of the banking model is needed
- Suggestions and strategies for re-igniting growth in the region:
  - EU Funds full utilization is a must, which has the potential to contribute in the range of 0.8pps to 2.0pps to annual growth (in nominal terms)
  - Strategies for increasing competitiveness and quality of the operating environment have to remain a priority