ERSTE GROUP

Press release

5 July 2011

CEE Equity markets battle lack of momentum although outlook is moderate

- **Markets appear extremely sentiment driven because of Greek story impact**
- **Liquidity remains a major issue although CEE8 markets posted increasing in turnover of 9% m/m**
- **Economic growth is still intact in Europe, however, slowing down**

Erste Group analysts in their bi-annual report on CEE Equities see that markets appear extremely sentiment driven due to the political and economic turmoil in Greece. In line with this view, liquidity remains a major issue especially when looking at global fund flows and active allocations.

The current ZEW-Erste sentiment indicator[1] nevertheless showed a positive note on liquidity when survey participants were asked, 'what is their outlook for liquidity in the region?' Sixty-two per cent of respondents expected increasing liquidity for regional equity markets. Furthermore, over eighty per cent of survey participants expected to see regional markets attracting better liquidity for regional markets, when compared to Eurozone equity markets. We have to note that these views focus more on the long term and this majority does narrow when comparing the region against world equity markets.

Henning Esskuchen, Co-Head of CEE Equity Research Erste Group, and author of the report explains, "*Another concern weighing on equity markets in general, is sentiment reflecting the growth outlook. Our view on spreads between 12M rate of change for the OECD CLI[2] and the corresponding 12M performances for the respective indices confirms that equity markets are far from euphorically pricing in any outlook, but rather reflect the view of moderating growth rates. Hence, the main trouble for equity markets remains a lack of momentum."*

Regarding fundamentals, consensus figures still put the region on very fair terms. Even if growth expectations were going down, valuations did so too, leaving markets attractive.

Esskuchen continues, "*Key conclusion for an outlook on 3Q is that market-pressing issues, such as the debt woes in Greece, etc., and its consequent somewhat positive news recently, will provide some short-term momentum to equity markets. This move should also be supported by having already reached pretty depressed levels during 2Q, which might be the base for a little rally. However, when combining still dry fund flows and with the consensus outlook expressing its view on further moderating growth via earnings revision rates turning/remaining negative, we do not expect any miracles in 3Q*."

Country allocation

Size is the most dominant item influencing the recommendations given by our quantitative model, which comes as no surprise when looking at fund flows. Also, valuations are contributing strongly for most markets. *"However, valuations will not be a strong argument as long as liquidity does not help to lift these treasures. In general, we would still not expect the third quarter to see a significant breakthrough for equity markets. With some positive news from Greece and also the US, the best we should see is a recovery from depressed levels, which were reached during 2Q. "*

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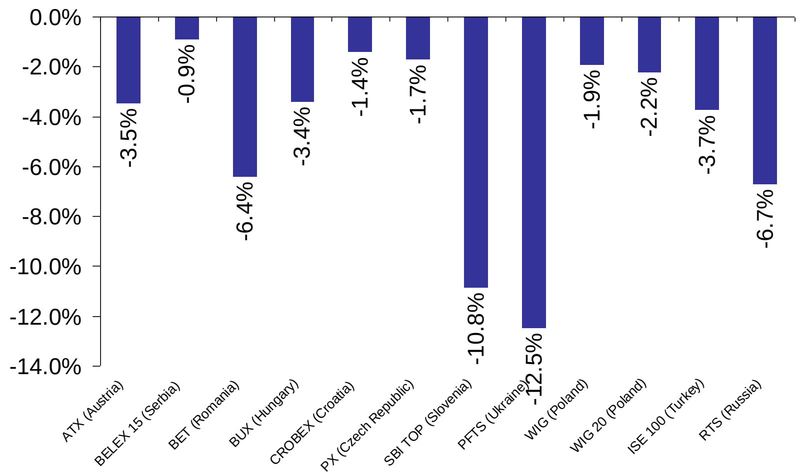
[1] The ZEW-Erste Group Bank Economic Sentiment Indicator for Central and Eastern Europe including Turkey (CEE) is calculated as the balance of positive and negative expectations for the economic development on a six-month time horizon.

[2] The OECD composite leading indicator (CLI) is designed to provide early signals of turning points (peaks and troughs) between expansions and slowdowns of economic activity. The OECD compiles CLIs for 29 member countries.

Performance overview 2Q 2011 (in LC)



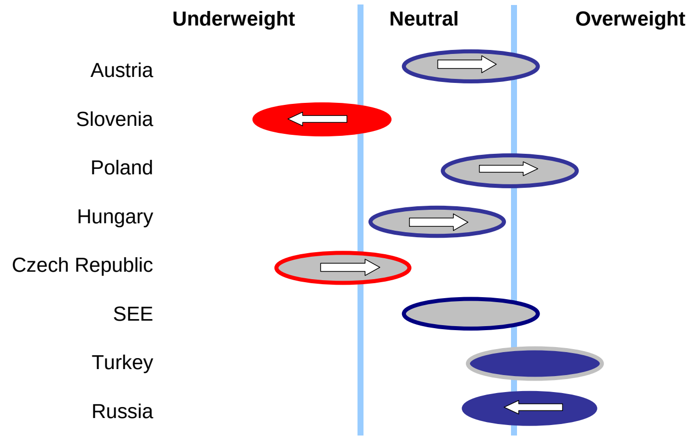
2Q 2011 = 3month performance, closing price 01.07.2011; Source: Factset Partners, Erste

- **Austria –.sound neutral**. Given the significant declines in turnover on the Vienna Stock Exchange during this year (accumulated y/y -23%, based on FESE data), size represents the strongest downside, as far as single components of the quant model. Hopes here are that we might see some movement in capital gains tax and that the expected overall increase in liquidity (see ZEW section, special question – page 31) will also leave its positive marks in Austria. What has also been holding back the market is the dominant position of financials – which might see some continued impetus, based on the latest move in Greece and as the large OMV (one of our top picks) has not been a star performer so far. However, the latest news from Greece might provide some momentum for financials, lasting at least for a while. As soon as liquidity overall makes a move to the positive, we would expect to see gains in Austrian value plays. Awaiting this, we place the market at a comfortable neutral to overweight.
- **Czech Republic – neutral to underweight**. Size is given as the main argument against the Czech market. The second is valuation. We would not fully subscribe to this, when looking at forward P/Es and implied valuations. Hence, relative to other markets, we leave the Czech Republic at a neutral to underweight position, slightly improving the harsh view of our quant model
- **Hungary –.neutral.** A forward P/E of 8.9 speaks clearly as far as valuation is concerned. Revision rates are quite moderate and growth rates based on the consensus are quite reasonable at 13-15% in EUR. Hence, we veto the quant model outcome which sees Hungary more or less balanced between size (negative) and profitability (positive), and call Hungary a neutral. We would still see the biggest risks in government action and liquidity.
- **Southeastern Europe –. neutral to overweight.** Southeastern Europe is one of the few markets receiving positive votes from our model. Valuation is among the main arguments and, relative to growth, the picture indeed looks attractive, mostly for Romania. Also, valuations for Croatia came down, but are still among the highest in the region – as is the growth outlook. However, liquidity remains the main issue for these frontier markets, being the biggest reason for caution. With a stressed speculative element, we rate these markets neutral to overweight, confirming the model outcome.
- **Poland –. neutral to overweight.** The model is quite undecided on Poland, with the strongest contribution coming from valuations (negative). Being valued higher than Austria and the Czech Republic, it certainly still has the advantage of liquidity and fresh issues coming to the market.
- **Russia –. moderate overweight**. Russia never seemed to be very responsive to valuation, as performance has been more a reflection of the oil price. With the oil price seeing some positive momentum again these days, making up what it lost after interventions via strategic reserves, this might translate into a positive outlook for

the Russian market. Also, the latest cautiously positive news from the US might help as far as the global growth outlook is concerned. Watching these developments carefully, we rate the market a slight overweight, but probably not as positive as the quant model would suggest.

- **Turkey –. moderate overweight.** Turkey remains a delicate case. While seen positively by the model, the economy's growth comes at a high price – its C/A deficit. Concerns on economic expectations, inflation and interest rates are strongly reflected in the latest ZEW sentiment survey. Consequently, expectations on stock market performance are among the lowest in the survey.
- **Slovenia – underweight.** We confirm the model outcome for Slovenia and maintain our rather cautious view. Valuation is the main argument for the market, while size is indicated as the main issue against it. Within the current environment, we tend to weight the latter higher in the case of Slovenia.

Country allocation proposal



Source: Erste Group Research

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