

Economic and Capital Market Outlook for 2009:

Important to keep economic motor running and stabilize consumer confidence

- **GDP to shrink in euro zone by - 0.4%, inflation expected to drop to 1.5%**
- **ECB to lower key lending rate to record level of 1.75% in 1HY 2009**
- **A year of sluggish economic growth ahead for US**
- **Average CEE growth higher than euro zone**
- **Bond market benefiting from the crisis (especially government bonds); middle 2009 to bring appetite for riskier investment classes (corporate bonds)**

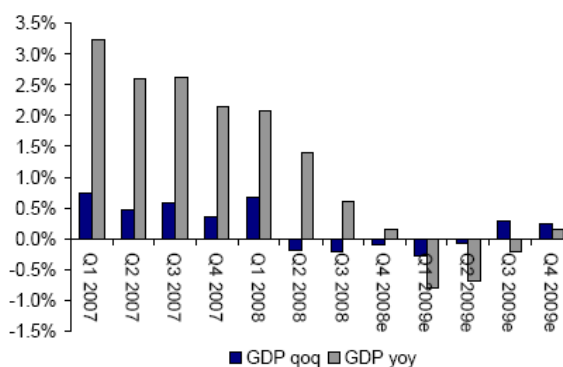
When the financial market crisis reached its climax in mid-September, this put such a damper on the global economy that massive support measures had to be taken by governments to rescue the situation. *"Many different actions were initiated in an attempt to solve the global crisis,"* said Rainer Singer, the expert for bond and currency markets at Erste Group at the press conference. *"Bailout plans for the economy and the banking sector were initiated not only as an attempt to stabilize the financial markets, but also to counteract the economic downwards spiral in an early stage. It is important to keep the economic motor running and to stabilize consumer confidence. Not only have investors become more risk averse, but consumers and businesses as well. High risk premiums are expected to prevail on the money market for some time to come,"* added Rainer Singer.

"The bond market is benefiting from the crisis and especially government bonds are considered safe havens," stated Gudrun Egger, the interest rate and bond expert at Erste Group. The experts of Erste Bank continue to recommend short maturities for the coming months. Around the middle of next year, government bonds might correct slightly, thus potentially increasing the appeal of riskier investment classes (corporate bonds).

Euro zone: Key lending rate expected to reach record of 1.75%

The growth cycle in the **euro zone** has entered into a contraction phase due to high inflation and the related decline in demand. The contraction of the economy was accelerated by the exacerbating financial market crisis as of mid-September. The depth of the recession and how long it will last are unclear. Therefore, consumers are exercising more restraint in spending and companies in key industries are responding by cutting back production and postponing investment plans. The analysts of Erste Group expect GDP to shrink in the euro zone in 2009 by -0.4%. The economic downswing, sinking commodity prices and base effects are expected to push inflation down to 1.5% next year. This would give the ECB more room for lowering the key lending rate in the first half of 2009 to the record level of

Eurozone GDP estimates (%)



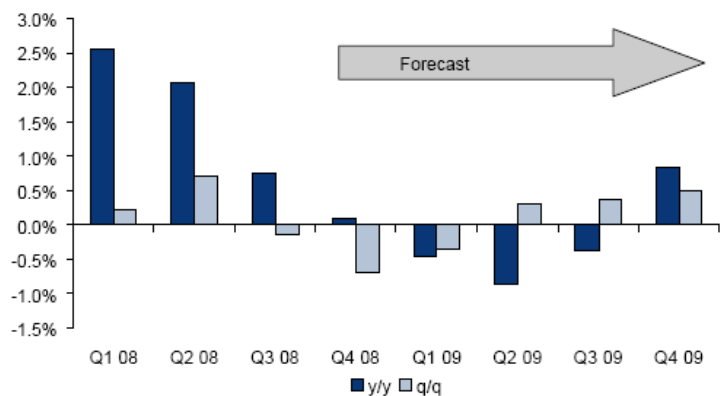
Source: Erste Group Research

around 1.75%, which would push down money market rates as well. Government bonds might initially rise even further due to the risk aversion of investors. With the end of the interest rate cutting cycle and more issues of government bonds, yields are expected to rise again slightly as of mid-2009.

USA: A year of sluggish economic growth lies ahead for the US

The downturn of the **US economy** is in full swing. What is unclear is how much of the downswing is a direct reaction to the financial market crisis and how steep the downslide will be that was triggered by the spending restraint of consumers over the past few months. How long will the downwards spiral feeding on worsening employment data and shrinking demand last? This also entails the question of whether the diverse rescue

GDP forecast



Source: Erste Group Research, Bloomberg

packages and economic stimulation plans of historic dimensions will be effective. According to the cautious estimates of the team of analysts, the trust of the real economy in the financial sector should gradually be restored. What is uncertain is if this will also apply the other way around, i.e., how will lending develop. The degree of the insecurity is particularly high this time, but the analysts believe that even though the US economy is in for a very weak year, in the end, it will stabilize. One factor over which there is no doubt even now is that the budget deficit of the public sector will widen enormously, with all of the entailing risks for financing costs.

CEE: Average CEE growth expected to be higher than euro zone average

The CEE region is also expected to face a weak economic year. Undoubtedly, exports to the most important export market - Euroland – will shrink. Moreover, a cyclical downswing after years of very robust growth is due. “Nonetheless, the competitive advantages and the still large potential for catching up in these economies point to an average growth level above that of the euro zone, albeit with the situation varying widely from country to country,” said Rainer Singer at the press conference. The current valuation of currencies and bonds reflects the insecurity caused by the financial market crisis and is too low if measured by the fundamental data. The capital markets of the CEE region therefore stand to benefit significantly from the stabilization of the global environment. Additional support for bond markets will come from falling inflation rates and lower key lending rates.

The **EUR corporate bond market** is marked by constant insecurity. The reason is the phase of economic contraction characterized by falling interest rates, sinking corporate earnings and a deterioration of credit quality. “After the economic low in the euro zone, we expect moderately rising corporate earnings, gradual debt reduction and a stabilizing trend in credit quality in the second half of 2009,” stated Elena Statelov. Risk premiums are expected to be volatile at a high level with prospects of narrowing spreads only as of the second half of the year 2009. Investors will have the opportunity to buy

into high returns, especially in the form of attractively priced new issues. However, the selection of the securities and also a fundamental credit analysis are of enormous importance in this context. The defensive sectors have meanwhile become expensive, but due to the generation of stable cash flows, the experts continue to have a preference for telecoms, utilities and non-cyclical consumer securities.

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