Central & Eastern European Strategy

1st quarter 2015

Between geopolitics, ECB and Fed

- Decent growth in CE and Romania
- Leeway for additional monetary easing
- Russia and Ukraine in recession
- CE shares and indices as top picks

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Central & Eastern European Strategy

Explanation:
e ... estimate (current year)
f ... forecast
p ... preliminary figures
n.v. ... no value

Abbreviations

Currencies and Countries

ALL	Albanian lek
BAM	Bosnian marka
BGN	Bulgarian lev
BYR	Belarusian roubel
CZK	Czech koruna
EKK	Estonian kroon
HUF	Hungarian forint
HRK	Croatian kuna
LTL	Lithuanian litas
LVL	Latvian lats
PLN	Polish zloty
RON	Romanian leu
RSD	Serbian dinar
RUB	Russian rouble
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
ECB	European Central Bank
FCY	Foreign Currency
FDI	Foreign Direct Investments
FX	Foreign Exchange
FY	Full year
GB	Government bond
GDP	Gross Domestic Product
HCPI	Harmonized Consumer Price Index
LCY	Local Currency
mmav	month moving average
mom	month on month
MP	Monetary policy
MPC	Monetary policy council
O/N	overnight rate
pp	percentage points
PMI	Purchasing Manager Index
PPI	Producer Price Index
QE	Quantitativ easing
qoq	quarter on quarter
qtd	quarter to date
REPO	Repurchase agreement
T/B	Trade Balance
ULC	Unit Labour Costs
UST	US Treasury bond
YC	yield curve
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

Fixed income indices

EMBIG	JP Morgan Emerging Markets Bond Index Global
CEMBI	JP Morgan Corporate Emerging Markets Bond Index

Equity related

DY	Dividend yield
EBIT	Earnings before interest and taxes
EBITDA	earnings before interest, taxes, depreciation, and amortization
EBT	earnings before taxes
EPS	earnings per share
EG	Earnings growth
LTG	Long term (earnings) growth
NIBD	Net interest bearing debt
P/B	Price book ratio
P/E ratio	Price earnings ratio
RoE	Return on equity
ROCE	Return on capital employed
RS	Recommendation suspended
UR	Under Revision

Euro area (EA)	*Austria, Belgium, Cyprus, Estonia, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Malta, Netherlands, Portugal, Slovenia, Slovakia, Spain*
CE	*Central European countries - Poland, Hungary, Czech Republic, Slovakia, Slovenia*
SEE	*South East European countries - Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Kosovo, Romania, Serbia*
CIS	*European CIS (Commonwealth of Independent States) countries - Russia, Ukraine, Belarus*
CEE	*Central and Eastern Europe (CE + SEE + CIS)*

Please note the risk notifications and explanations at the end of this document

Resilience in Central Europe, recession in Russia

- **No end in sight to the Russia-Ukraine conflict in 2015**
- **Sanctions and oil price drop exacerbate the downward trend in Russia**
- **Central Europe shows impressive resistance to slack growth in Russia and the euro area**

There is no significant decrease in the tensions between Russia and Ukraine. Consequently, there is a high likelihood that the EU and US sanctions imposed on Russia will be extended past the middle of 2015. In particular, the impacts of state-owned companies being cut off from the USD and EUR financial markets are being felt, as well as the effects on the exchange rate of the rouble. The Russian government is making efforts to escape the downward spiral of falling private investment, missing foreign investment, and falling real incomes by pushing ahead with infrastructure projects and public sector investment. But in our view, this will only be able to slow the downward slide and will not be able to prevent recession. In Ukraine itself, the slump is massive and may only start to ease somewhat during the course of 2015, because the structure of the regions and economy will have to be completely overhauled in order to be competitive for exports to the EU in the future. Fortunately, economic conditions in Central Europe are looking very robust. Burgeoning domestic demand in Poland, the Czech Republic and Hungary is helping to shield growth in these economies to a great degree from the anemic conditions on the euro area. This also applies to Romania, whereas most of the SEE countries such as Serbia and Croatia continue to experience stagnation. We have also further downgraded our GDP estimate for Austria. With expectations of a slow revival in private investments and exports, the projection for GDP growth in 2015 is just 0.7%. At around 1.2%, inflation in Austria is set to remain well higher than the euro area average. Consequently, consumer price inflation in parts of Eastern Europe will be lower than in Austria. A mild increase is expected during the year.

Impact on monetary policy and exchange rates

The extremely low inflation and the ECB's ultra-expansive monetary policy pave the way for low key rates and money market rates to remain in place. In Poland, Hungary and Romania, we believe that there may even be some leeway for further cuts. By contrast, Russia will have to shore up the weakening rouble with further rate hikes. We expect to see the period of depreciation continue during the first half of 2015. The Ukrainian hryvnia (UAH) will probably carry on to depreciate, in similar patterns like 2014. On the other hand, the major CE currencies should remain relatively steady versus the euro and thus weaken versus USD.

Impact on the bond and equity markets

Government bond markets in Eastern Europe profited from the impressive descent in yields in the euro area. As a result, 10-year yields in Poland, Hungary and Romania have dropped to all-time lows. Thanks to the ECB's policies, bond yields have been camped near their lows. In Russia, by contrast, bond yields are in double-digit territory, to offer compensation for the ongoing currency weakness.

The equity markets in Eastern Europe still have some remaining potential to catch up to the established markets. We take a positive view of most equity markets for the first quarter, in light of the upbeat economic prospects. Turkey, Romania and Poland will lead the way in terms of stock price performance, with Croatia bringing up the rear.

Financial analyst: Peter Brezinschek

CEE: Market strategy*

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

** based on absolute expected performance:*
LCY bond: absolute performance in LCY
Eurobonds: based on expected spread change
RU, TR, UA, BY FX recomm. against USD, others against EUR
Previous recomm. (as of September 2014) in brackets
Recomm. horizon: **end 1th quarter 2015**
B: buy; H: hold; S: sell
Source: RBI/Raiffeisen RESEARCH

Recommendations[1] - stock markets

Indices	
Buy	ATX, BET, WIG 30, BUX, PX, BIST Nat. 100
Hold	MICEX, CROBEX 10
Sell	-

Equities

Andritz
Current share price: EUR 45.26
Target price: EUR 52.00
UNIQA
Current share price: EUR 8.27[2]
Target price: EUR 10.00
MOL
Current share price: HUF 12,180[2]
Target price: HUF 13,800
PKP Cargo
Current share price: PLN 81.99[2]
Target price: PLN 90.00
OTP
Current share price: HUF 4,080[2]
Target price: HUF 4,550

Recommendations[1] – debt markets

Corporate bonds	
Buy	Halyk 7.25% due 2017

[1] horizon: **end 1st quarter 2015**
[2] the indicated price is the last price as available at 6.30 a.m. (CET) on 9 December 2014
Source: RBI/Raiffeisen RESEARCH

Real GDP (% yoy)

Countries	2013	2014e	Consensus	2015f	Consensus	2016f	Consensus
Poland	1.7	3.3	3.1	3.5	3.2	3.0	3.6
Hungary	1.5	3.2	3.2	2.3	2.4	2.3	2.3
Czech Rep.	-0.7	2.6	2.4	2.4	2.5	3.0	2.8
Slovakia	1.4	2.5	2.3	2.5	2.6	3.0	3.0
Slovenia	-1.1	2.5	1.8	2.0	1.5	2.0	1.7
CE	**1.0**	**3.0**	2.8	**2.9**	2.8	**2.9**	3.1
Croatia	-0.9	-0.8	-0.7	0.0	0.3	1.0	1.3
Bulgaria	0.9	1.4	1.5	1.2	1.9	2.1	2.3
Romania	3.5	2.5	2.1	2.7	2.8	3.0	3.1
Serbia	2.5	-2.0	-0.9	0.0	1.3	2.5	2.9
Bosnia a. H.	2.5	0.5	0.4	2.5	2.2	3.0	3.0
Albania	0.4	2.0	1.4	3.0	2.3	4.5	3.0
Kosovo	3.0	3.0	n.a.	3.5	n.a.	3.5	n.a.
SEE	**2.2**	**1.2**	1.1	**1.8**	2.1	**2.6**	2.7
Russia	1.3	0.5	0.3	-1.5	-0.2	2.0	1.3
Ukraine	0.0	-7.0	-7.4	-4.5	-1.8	0.5	2.4
Belarus	0.9	0.5	1.1	0.0	1.8	1.0	2.5
CIS	**1.2**	**-0.1**	-0.3	**-1.7**	-0.3	**1.9**	1.4
Turkey	4.1	3.5	3.0	3.5	3.4	3.5	3.8
Austria	**0.2**	**0.3**	0.8	**0.7**	1.2	**1.8**	1.8
Germany	0.2	1.5	1.4	1.6	1.4	2.2	1.8
Euro area	**-0.4**	**0.8**	0.8	**1.2**	1.1	**1.9**	1.5
USA	**2.2**	**2.2**	2.2	**3.2**	3.0	**3.2**	3.0

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

Consumer prices (avg, % yoy)

Countries	2013	2014e	2015f	2016f
Poland	0.9	0.0	0.6	1.8
Hungary	1.7	-0.2	1.0	3.0
Czech Rep.	1.4	0.4	1.0	2.2
Slovakia	1.4	-0.1	0.5	2.0
Slovenia	1.8	0.3	0.8	1.5
CE	**1.2**	**0.1**	**0.7**	**2.0**
Croatia	2.2	0.0	1.2	1.5
Bulgaria	0.9	-1.2	1.9	3.2
Romania	4.0	1.1	1.4	2.4
Serbia	7.8	2.1	3.3	4.3
Bosnia a. H.	-0.1	-0.9	1.5	2.5
Albania	1.9	1.8	2.5	2.8
Kosovo	1.8	0.6	2.5	3.0
SEE	**3.4**	**0.6**	**1.7**	**2.6**
Russia	6.8	7.6	9.4	7.0
Ukraine	-0.2	12.1	24.7	12.0
Belarus	18.3	19.0	18.0	15.0
CIS	**6.6**	**8.3**	**10.8**	**7.6**
Turkey	7.5	9.0	7.0	6.9
Austria	**2.1**	**1.5**	**1.2**	**1.5**
Germany	1.6	1.0	1.5	2.2
Euro area	**1.4**	**0.5**	**0.6**	**1.2**
USA	**1.5**	**1.7**	**1.4**	**2.5**

Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

Current account balance (% of GDP)

Countries	2013	2014e	2015f	2016f
Poland	-0.3	-0.3	-0.3	-0.4
Hungary	4.1	3.9	3.9	3.8
Czech Rep.	-1.4	0.0	-0.1	0.0
Slovakia	2.1	2.1	2.0	1.9
Slovenia	6.5	6.3	4.9	4.7
CE	**0.6**	**0.9**	**0.7**	**0.6**
Croatia	0.9	0.5	0.4	0.7
Bulgaria	1.9	0.3	-0.5	-0.8
Romania	-0.8	-0.9	-1.5	-2.0
Serbia	-6.5	-6.3	-6.9	-7.9
Bosnia a. H.	-6.0	-9.6	-8.5	-7.4
Albania	-10.4	-10.2	-10.5	-9.9
Kosovo	-7.0	-7.6	-7.5	-6.5
SEE	**-1.5**	**-2.0**	**-2.4**	**-2.7**
Russia	1.6	3.4	3.7	2.5
Ukraine	-9.0	-3.3	-3.7	-4.3
Belarus	-10.2	-5.4	-5.9	-7.5
CIS	**0.4**	**2.7**	**2.7**	**1.7**
Turkey	-7.9	-5.2	-4.2	-4.9
Austria	**1.0**	**0.1**	**-0.5**	**-0.5**
Germany	6.7	7.0	6.5	6.0
Euro area	**2.0**	**2.3**	**2.4**	**2.2**
USA	**-2.3**	**-2.6**	**-2.9**	**-2.9**

Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

General budget balance (% of GDP)

Countries	2013	2014e	2015f	2016f
Poland	-4.3	-3.2	-2.7	-2.0
Hungary	-2.3	-2.9	-2.8	-2.8
Czech Rep.	-1.3	-1.5	-2.1	-1.8
Slovakia	-2.6	-2.9	-2.3	-1.4
Slovenia	-14.7	-5.0	-4.0	-3.0
CE	**-3.7**	**-2.9**	**-2.6**	**-2.1**
Croatia	-5.2	-6.0	-5.1	-4.4
Bulgaria	-1.9	-3.6	-2.0	-1.9
Romania	-2.2	-2.0	-2.3	-2.3
Serbia	-4.8	-8.0	-6.0	-5.5
Bosnia a. H.	-2.2	-3.8	-2.5	-2.0
Albania	-6.0	-6.6	-4.5	-3.5
Kosovo	-2.7	-2.0	-2.0	-2.0
SEE	**-3.1**	**-3.7**	**-3.2**	**-2.9**
Russia	-1.0	-0.8	-0.6	-0.2
Ukraine	-6.5	-11.0	-7.0	-5.5
Belarus	0.2	0.0	0.0	0.0
CIS	**-1.4**	**-1.6**	**-1.1**	**-0.6**
Turkey	-1.2	-2.0	-2.0	-2.0
Austria	**-1.5**	**-2.6**	**-2.2**	**-1.5**
Germany	0.1	0.2	0.0	0.2
Euro area	**-2.9**	**-2.6**	**-2.4**	**-2.1**
USA	**-4.1**	**-2.9**	**-2.6**	**-2.9**

Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

Public debt (% of GDP)

Countries	2013	2014e	2015f	2016f
Poland	57.0	49.4	50.0	48.4
Hungary	77.2	77.8	77.7	76.8
Czech Rep.	45.7	44.7	43.9	43.4
Slovakia	54.6	54.9	54.7	53.4
Slovenia	73.0	80.0	82.0	81.0
CE	**57.9**	**54.1**	**54.3**	**53.1**
Croatia	75.7	82.0	86.9	90.0
Bulgaria	19.0	28.8	24.0	22.0
Romania	37.9	38.2	38.8	39.0
Serbia	63.0	70.8	76.4	78.5
Bosnia a. H.	41.5	45.0	44.6	42.5
Albania	68.0	72.0	70.0	69.0
Kosovo	20.0	22.0	22.0	22.0
SEE	**44.7**	**48.3**	**49.2**	**49.6**
Russia	11.3	11.5	12.0	13.5
Ukraine	40.3	70.0	82.0	87.0
Belarus	32.5	33.0	34.0	35.0
CIS	**14.2**	**16.6**	**18.0**	**19.8**
Turkey	39.8	35.8	35.0	34.0
Austria	**81.2**	**87.2**	**87.1**	**85.2**
Germany	76.9	74.5	72.4	69.6
Euro area	**90.9**	**92.1**	**92.5**	**91.6**
USA	**100.5**	**103.5**	**102.5**	**101.3**

Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

Gross foreign debt (% of GDP)

Countries	2013	2014e	2015f	2016f
Poland	69.9	68.6	68.6	66.4
Hungary	118.5	109.4	95.7	87.2
Czech Rep.	51.5	51.6	51.0	50.1
Slovakia	81.1	97.4	101.9	99.0
Slovenia	113.3	112.3	112.5	112.2
CE	**75.6**	**75.3**	**73.8**	**70.9**
Croatia	104.8	106.8	106.9	105.3
Bulgaria	93.5	100.2	96.2	93.8
Romania	67.8	63.5	62.8	61.8
Serbia	80.8	83.9	86.8	85.8
Bosnia a. H.	62.5	66.4	63.6	58.3
Albania	28.2	28.5	29.3	30.8
Kosovo	14.4	13.7	12.9	12.1
SEE	**75.9**	**75.0**	**74.0**	**72.3**
Russia	33.6	34.7	47.0	37.2
Ukraine	77.0	109.1	147.2	146.1
Belarus	52.7	52.9	53.0	56.3
CIS	**37.5**	**39.9**	**53.8**	**44.4**
Turkey	45.3	55.8	53.5	48.2
Austria	**n.v.**	**n.v.**	**n.v.**	**n.v.**
Germany	n.v.	n.v.	n.v.	n.v.
Euro area	**n.v.**	**n.v.**	**n.v.**	**n.v.**
USA	**n.v.**	**n.v.**	**n.v.**	**n.v.**

Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

Exchange rate EUR/LCY (avg)

Countries	2013	2014e	2015f	2016f
Poland	4.20	4.17	4.13	3.97
Hungary	297	309	313	322
Czech Rep.	26.0	27.5	27.4	26.9
Slovakia	euro	euro	euro	euro
Slovenia	euro	euro	euro	euro
Croatia	7.58	7.64	7.65	7.66
Bulgaria	1.96	1.96	1.96	1.96
Romania	4.42	4.44	4.43	4.40
Serbia	113	117	123	126
Bosnia a. H.	1.96	1.96	1.96	1.96
Albania	140	140	140	140
Kosovo	euro	euro	euro	euro
Russia	42.3	50.5	66.6	62.9
Ukraine	10.8	15.9	19.6	20.8
Belarus	11,828	13,591	13,842	17,136
Turkey	2.53	2.91	2.67	2.74
Austria	**euro**	**euro**	**euro**	**euro**
Germany	euro	euro	euro	euro
USA	**1.33**	**1.33**	**1.17**	**1.19**

Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

Ratings[1]

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	BBB-	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-	Baa2	BBB
Ukraine	CCC	Caa3	CCC
Belarus	B-	B3	not rated
Turkey	BB+	Baa3	BBB-
Austria	**AA+**	**Aaa**	**AAA**
Germany	AAA	Aaa	AAA

[1] *for FCY, long-term debt*
Source: Bloomberg, RBI/Raiffeisen RESEARCH

Please note the risk notifications and explanations at the end of this document

Exchange rate forecast

Countries	8-Dec[1]	Mar-15	Jun-15	Dec-15
vs EUR				
Poland	4.16	4.15	4.15	4.05
Hungary	306.02	310.0	315.0	320.0
Czech Rep.	27.59	27.5	27.4	27.2
Croatia	7.67	7.66	7.59	7.70
Romania	4.44	4.40	4.45	4.40
Serbia	121.73	123.0	122.0	126.0
Albania	140.45	141.0	139.5	140.0
vs USD				
Russia	53.8	58.3	58.5	54.1
Ukraine	15.58	16.00	17.00	17.50
Belarus	10845	11400	11800	12800
Turkey	2.27	2.28	2.25	2.30
EUR/USD	1.23	1.20	1.17	1.12

[1] 5:00 p.m. (CET)
Source: Bloomberg, RBI/Raiffeisen RESEARCH

Key interest rate forecast

Countries	8-Dec[1]	Mar-15	Jun-15	Dec-15
Poland	2.00	1.75	1.75	1.75
Hungary	2.10	1.80	1.80	1.80
Czech R.	0.05	0.05	0.05	0.05
Romania	2.75	2.25	2.25	2.25
Russia	9.50	11.00	11.00	9.00
Turkey	8.25	7.75	7.75	7.75
Euro area	0.05	0.05	0.05	0.05
USA	0.25	0.50	1.00	2.00

[1] 5:00 p.m. (CET)
Source: Bloomberg, RBI/Raiffeisen RESEARCH

3m money market rate forecast

Countries	8-Dec[1]	Mar-15	Jun-15	Dec-15
Poland	1.86	1.95	1.95	1.97
Hungary	2.10	1.84	1.84	1.88
Czech R.	0.04	0.10	0.10	0.10
Croatia	1.09	0.90	0.95	1.20
Romania	1.17	1.10	1.30	1.70
Russia	13.49	12.20	12.40	10.60
Turkey	9.25	8.40	8.55	9.05
Euro area	0.08	0.05	0.05	0.05
USA	0.24	0.60	1.10	2.10

[1] 5:00 p.m. (CET)
Source: Bloomberg, RBI/Raiffeisen RESEARCH

2y LCY yield forecast

Countries	8-Dec[1]	Mar-15	Jun-15	Dec-15
Poland	1.89	1.9	2.0	2.5
Hungary*	2.57	2.3	2.3	2.5
Czech R.	0.16	0.1	0.1	0.2
Croatia	2.60	2.5	2.6	2.8
Romania	1.75	1.7	1.9	2.2
Russia	11.63	11.5	11.5	9.7
Turkey	7.74	7.3	7.8	8.0
Austria	-0.02	-0.1	-0.1	-0.1
Germany	-0.04	-0.1	-0.1	-0.1
USA	0.63	0.8	1.2	1.4

[1] 5:00 p.m. (CET); * 3y LCY yields
Source: Bloomberg, RBI/Raiffeisen RESEARCH

5y LCY yield forecast

Countries	8-Dec[1]	Mar-15	Jun-15	Dec-15
Poland	2.19	2.1	2.3	2.7
Hungary	3.00	2.7	2.8	3.1
Czech R.	0.22	0.2	0.2	0.6
Croatia	3.34	3.4	3.5	3.6
Romania	2.54	2.6	2.7	3.1
Russia	12.41	11.7	11.8	10.0
Turkey	7.96	7.6	8.3	8.7
Austria	0.12	0.2	0.2	0.4
Germany	0.10	0.1	0.2	0.3
USA	1.66	2.3	2.7	2.9

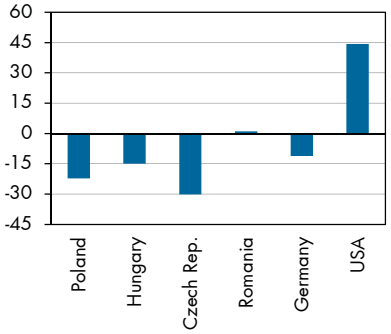
[1] 5:00 p.m. (CET)
Source: Bloomberg, RBI/Raiffeisen RESEARCH

10y LCY yield forecast

Countries	8-Dec[1]	Mar-15	Jun-15	Dec-15
Poland	2.59	2.4	2.5	2.9
Hungary	3.55	3.4	3.5	3.9
Czech R.	0.90	0.6	0.7	1.1
Croatia	3.40	3.4	3.6	3.7
Romania	3.59	3.6	3.7	4.1
Russia	12.49	12.5	12.1	10.8
Turkey	8.01	7.7	8.5	9.1
Austria	0.83	0.7	0.8	1.1
Germany	0.71	0.6	0.7	1.0
USA	2.26	2.7	3.2	3.4

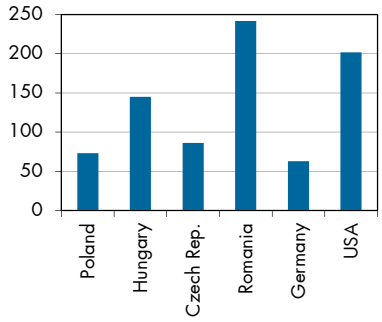
[1] 5:00 p.m. (CET)
Source: Bloomberg, RBI/Raiffeisen RESEARCH

Expected yield change



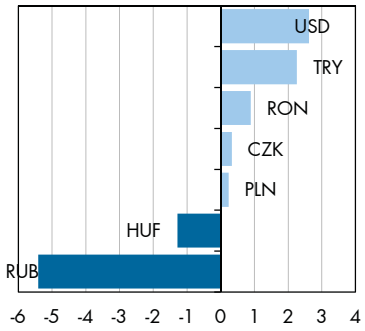
bp-change of 10y gov. bond yield in next 3 months
Source: Bloomberg, RBI/Raiffeisen RESEARCH

Yield structure



bp-spread between 10y and 3m maturity
Source: Bloomberg, RBI/Raiffeisen RESEARCH

LCY changes vs EUR (% qoq)[1]



[1] forecasts for 31/03/2015 in comparison to 08/12/2014
Source: Bloomberg

Stock market indicators

	Earnings growth		Price/earnings ratio	
	14e	15f	14e	15f
ATX	-15.0%	57.3%	18.9	12.0
WIG 20	1.1%	5.2%	14.7	14.0
BUX	-32.8%	26.6%	13.3	10.5
PX*	30.6%	2.3%	13.8	13.5
MICEX	-5.8%	0.8%	4.5	4.4
BET**	-4.8%	17.4%	19.3	16.4
CROBEX10	-24.4%	0.4%	31.0	30.6
BIST Nat. 100	2.9%	15.7%	12.2	10.5

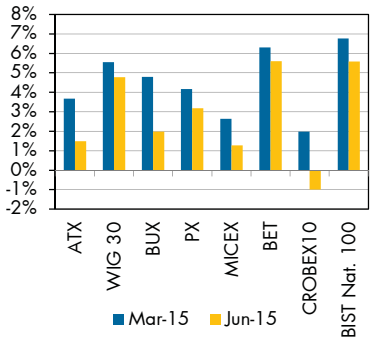
* Czech Rep. (PX): excl. New World Resources and Erste Group
** Romania (BET) excl. Fondul Proprietatea
Source: Thomson Reuters, IBES, Bloomberg, RBI/Raiffeisen RESEARCH

Stock market forecasts

	Index estimates			
	8-Dec[1]	Mar-15	Jun-15	Dec-15
ATX	2,286	2,370	2,320	2,450
WIG 30	2,615	2,760	2,740	2,870
BUX	17,748	18,600	18,100	19,500
PX	1,008	1,050	1,040	1,100
MICEX	1,481	1,520	1,500	1,630
BET	7,008	7,450	7,400	7,900
CROBEX10	1,010	1,030	1,000	1,080
BIST Nat. 100	85,240	91,000	90,000	96,000

[1] 11:59 p.m. (CET)
in local currency
Source: Bloomberg, RBI/Raiffeisen RESEARCH

Expected index performance



Source: RBI/Raiffeisen RESEARCH

Disappointing performance in 2014

- **High volatility in the CEE region**
- **Rouble exposed to intense depreciation pressure**
- **Successful weightings in the equity and bond segments in Q4**

Sum of last quarter[1]

RBI portfolio (in EUR)	-3.96%
Benchmark (in EUR)	-4.15%
RBI outperformance (in EUR)	0.18%
by weighting of equities vs bonds	-0.16%
regional equity weightings	0.16%
weighting of EB vs LCY bonds	0.00%
country weightings of LCY bonds	0.19%
country weightings of EB EUR	0.00%
country weightings of EB USD	0.00%
joint effects / duration	0.00%

1 15 Sep 2014 - 8 Dec 2014
EB...Eurobonds
Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

Period 1: 15 Sep 2014 - 28 Oct 2014

RBI portfolio (in EUR)	-2.43%
Benchmark (in EUR)	-2.19%
RBI outperformance (in EUR)	-0.24%
by weighting of equities vs bonds	-0.23%
regional equity weightings	0.00%
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, RBI/Raiffeisen RESEARCH

Period 2: 28 Oct 2014 - 28 Nov 2014

RBI portfolio (in EUR)	0.23%
Benchmark (in EUR)	0.10%
RBI outperformance (in EUR)	0.13%
by weighting of equities vs bonds	0.00%
regional equity weightings	0.01%
weighting of EB vs LCY bonds	0.00%
country weightings of LCY bonds	0.11%
country weightings of EB EUR	0.00%
country weightings of EB USD	0.00%
joint effects / duration	0.00%

EB...Eurobonds
Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

Period 3: 28 Nov 2014 - 8 Dec 2014

RBI portfolio (in EUR)	-1.76%
Benchmark (in EUR)	-2.06%
RBI outperformance (in EUR)	0.29%
by weighting of equities vs bonds	0.07%
regional equity weightings	0.15%
weighting of EB vs LCY bonds	0.00%
country weightings of LCY bonds	0.08%
country weightings of EB EUR	0.00%
country weightings of EB USD	0.00%
joint effects / duration	0.00%

EB...Eurobonds
Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

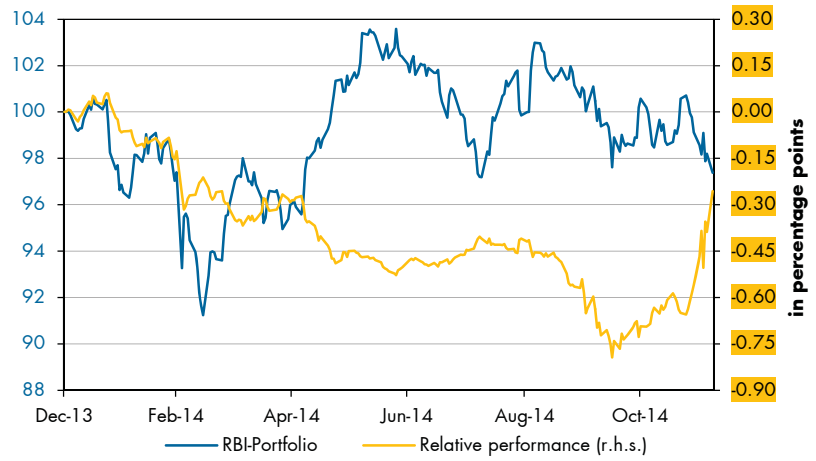
Despite the tense geopolitical situation, **outperformance of 18bp versus the benchmark** was achieved for this quarter. With an eye to the latest monetary policy easing in the euro area, bonds were underweighted in favour of equities during the first period of Q4. Due to the elevated uncertainty on the equity markets, however, this weighting led to underperformance of 24bp. After shifting to a neutral positioning in the 2nd period, bonds were overweighted during the 3rd period (7bp in outperformance). Summing up: an underperformance of 26bp was achieved for the overall portfolio from the beginning of the year till 8th December 2014.

In the **equity segment**, outperformance amounted to 16bp in Q4. In periods 1 and 2, the overweighting of the Czech Republic, Poland and Romania which was financed from Croatia generated a positive result. In period 3, Russia was underweighted in favour of the Czech Republic. Due to the intense depreciation pressure on the rouble from the Ukraine crisis and the sharp decline in the price of oil, this weighting in particular was able to generate significant outperformance, due to the exchange rate developments.

In the **LCY bond segment**, the rouble depreciation was the driving factor behind the cumulative quarterly outperformance of 19bp. The overweighting of Romania and Poland at the expense of the Czech Republic had a neutral effect.

Financial analyst: Veronika Lammer

Performance 2014



Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

CEE portfolio

	2012	2013	Year to date
Benchmark	21.90%	-2.54%	-2.36%
Portfolio	21.07%	-2.41%	-2.62%
Relative Performance	-0.83%	0.12%	-0.26%

Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

Neutral positioning between equities and bonds

- **Russia is a dominant factor due to the high share in the equity benchmark**
- **CE and Romania look interesting both for equities and bonds**
- **Expansive monetary policy should result a slow rise in capital inflows**

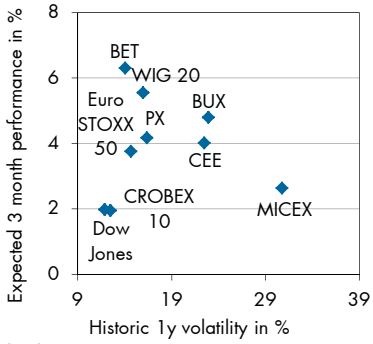
We recommend a **neutral weighting between equities and bonds** for the first quarter. One of the main reasons for this is that Russia has by far the highest market capitalisation in the equities portfolio, and consequently further depreciation of the rouble will have a negative impact on the anticipated performance of the equities segment. Despite the underweighting of the Russian market, this effect offsets the otherwise positive outlook for the stock markets in the Czech Republic, Poland, Hungary and Romania.

Another argument for a balanced weighting is that international capital inflows may initially focus on the CEE bond markets and stronger inflows into the equity markets may only be seen with a delay. Against the backdrop of extremely expansive monetary policy in the euro area in Q1 and low spreads on corporate bonds and Eurobonds, the **hunt for yields** will intensify even more. However, the tensions between the West and Russia may prove to be an obstacle and actually lead to outflows of capital. As a result, we leave the weighting of LCY bonds versus Eurobonds neutral.

Looking at the volatility measures for investments in equities and bonds in the CEE region, one can see that there has recently been a different development compared to the previous quarter. While volatility of the performance in euro for equities rose to 15.5%, it dropped for bonds to 4.3%.

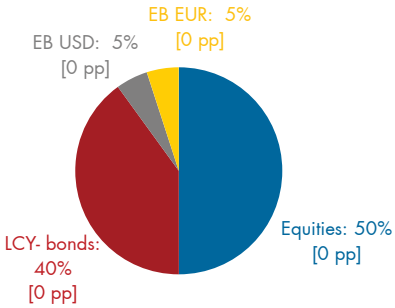
Financial analyst: Veronika Lammer

Risk-return (%)



In local currency
Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

CEE portfolio weightings Q1 2015



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

Historical volatility & performance (%)

	Equities[1]						Bonds					
	Volatility[2]		Performance ytd		Performance 5Y yoy[3]		Volatility[2]		Performance ytd		Performance 5Y yoy[3]	
Countries	EUR	LCY	EUR	LCY	EUR	LCY	EUR	LCY	EUR	LCY	EUR	LCY
Czech Republic	18.0	17.8	11.1	12.0	-4.9	-3.6	2.7	1.3	8.2	9.1	5.2	6.6
Hungary	19.9	18.0	-11.3	-8.5	-9.4	-7.4	6.5	3.0	8.8	12.2	7.7	10.1
Poland	12.7	11.5	2.3	2.4	1.1	1.2	4.3	3.1	9.8	9.8	7.8	7.9
Romania	11.2	10.7	5.6	5.0	6.6	7.6	2.0	0.4	2.2	1.7	3.1	4.1
Russia	30.6	19.3	-32.2	-10.7	-5.3	0.0	28.6	8.5	-39.5	-11.9	-3.4	4.2
Turkey	21.9	18.4	33.5	25.8	5.8	10.7	10.9	6.2	23.9	16.7	4.8	9.7
Croatia	11.5	11.4	-4.6	-3.9	-5.3	-4.3	2.9	2.9	10.3	10.3	7.0	7.0
CEE	15.5	-	-2.4	-			4.3	-	6.6	-		

[1] MSCI indices
[2] Three months volatility annualised
[3] Five-year annual return
LCY…local currency
Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

Turkish government bonds entice with high yields

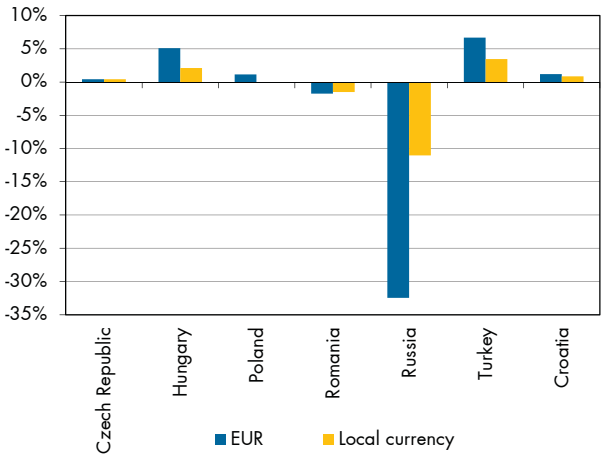
- **Russian rouble vulnerable to more depreciation**
- **Falling inflation supportive for CE and Romanian local currency bonds**
- **CE currencies stable**

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	20.0%	20.0%	0.0%
Hungary	20.0%	20.0%	0.0%
Poland	45.0%	45.0%	0.0%
Romania	5.0%	5.0%	0.0%
Russia	3.0%	5.0%	-2.0%
Turkey	7.0%	5.0%	2.0%
Croatia	0.0%	0.0%	0.0%

Source: RBI/Raiffeisen RESEARCH

Historical relative performance*



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

Within the bond portfolio, we recommend **overweighting TRY bonds** by 2 percentage points. Aside from Russian government bonds, these securities offer the highest yields. Furthermore, our expectations of a cut in interest rate suggest possible additional price gains, and currency developments should also make a positive contribution. As long as there is no threat of negative surprises in the sense of stronger-than-anticipated rate hikes by the Fed, the hunt for yields from the euro area should support the performance of LCY Turkish government bonds.

We use **RUB government bonds as a source of financing**, underweighting these instruments by 2 percentage points. Despite the very high level of yields, expectations of more RUB depreciation on the one hand and falling prices on the bond market on the other point to significant underperformance compared to the other bond markets in the portfolio.

We take a neutral stance on the other bond markets relative to each other. The projected performance differences are too small to make bets on these markets. We forecast slow appreciation for the traditional financing currency, the Czech koruna. Furthermore, the yield advantage in Poland, Hungary and Romania has shrivelled up quite a bit already. We expect positive performance for all of these markets in Q1. The only exception is Croatia, which is not part of our benchmark.

Financial analyst: Veronika Lammer

Expected bond market performance (%)

	3m		6m		9m		12m	
Countries	**EUR**	**LCY**	**EUR**	**LCY**	**EUR**	**LCY**	**EUR**	**LCY**
Czech Republic	3.8	3.4	3.7	2.9	2.7	1.5	1.7	0.2
Hungary	1.0	2.4	-0.3	2.8	-0.7	2.4	-2.7	2.0
Poland	2.9	2.7	2.4	2.2	2.9	1.5	3.3	0.7
Romania	3.0	2.0	2.1	2.3	1.6	1.9	2.7	1.8
Russia	0.7	4.7	7.5	9.3	17.9	13.4	33.4	21.2
Turkey	6.8	4.4	7.5	1.4	7.4	1.0	10.0	1.9
Croatia	1.9	1.8	3.5	2.3	4.2	3.8	4.9	4.9

Not annualised; 10y treasury bond, LCY…local currency
Source: RBI/Raiffeisen RESEARCH

Czech Republic, Poland and Romania as possible buys

- **Positive underlying trends, amidst more expansive monetary policy in CE and Romania**
- **Robust growth rates bolstering stock markets in CE and Romania**
- **Russia still an underperformer in EUR terms**

Within the equities portfolio, we overweight the Czech Republic, Poland and Romania by one percentage point each, financing this with a 2-percentage point underweighting of Russia and a 1-percentage point underweighting of Croatia. On the one hand, this **reflects** the anticipated **performance figures in EUR** terms, and on the other it mirrors **the risk which is also present** in the markets. We maintain a neutral stance on Hungary. On the one hand some of main players on the stock market have strong business ties with Russia on the other hand economic growth should be able to keep up with the other CE countries.

In our view, the equity markets in the **Czech Republic, Poland and Romania** stand to profit from the supportive monetary policy in their own respective economies as well as in the euro area. For all three of these countries, the decline in the price of oil helps to reduce costs and boost spending power. All three also show healthy growth figures, and we expect stable to somewhat stronger exchange rates versus the euro. On the downside, valuations are already high to some degree and earnings expectations are modest.

While **Russian stocks** are profiting from their nature as a tangible asset during a period of massive RUB depreciation, this is no incentive for EUR-based investors. The decision to underweight this market is driven by prospects of a recession and exchange rate losses. **Croatia** is struggling with a variety of problems, such as a stubborn recessionary environment, rising debt and the exceptionally high valuation of the stock market.

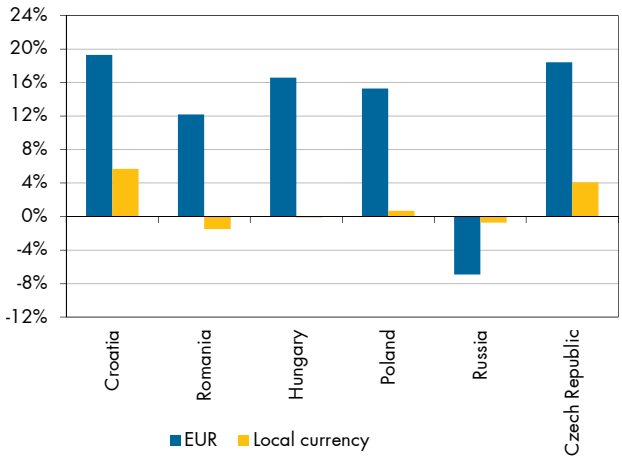
Financial analyst: Veronika Lammer

Portfolio weightings: stocks

	Portfolio	Benchmark	Difference
Czech Republic	16.0%	15.0%	1.0%
Hungary	12.0%	12.0%	0.0%
Poland	26.0%	25.0%	1.0%
Romania	6.0%	5.0%	1.0%
Russia	38.0%	40.0%	-2.0%
Croatia	2.0%	3.0%	-1.0%

Source: RBI/Raiffeisen RESEARCH

Historical relative performance*



** to MSCI CEE, since 3 months*
Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

Expected stock market performance (%)

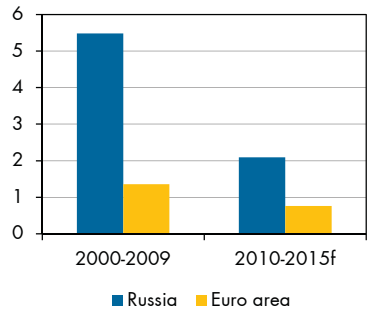
	3m		6m		9m		12m	
Countries	**EUR**	**LCY**	**EUR**	**LCY**	**EUR**	**LCY**	**EUR**	**LCY**
Czech Republic	4.6	4.2	4.0	3.2	6.4	5.2	10.8	9.1
Hungary	3.5	4.8	-0.9	2.0	2.4	5.4	5.1	9.9
Poland	5.8	5.5	5.1	4.8	7.5	5.9	12.8	9.8
Romania	7.3	6.3	5.4	5.6	8.2	8.4	13.8	12.7
Russia	-2.9	2.6	-2.2	1.3	7.1	4.7	20.2	10.1
Croatia	2.1	2.0	0.1	-1.0	2.3	2.0	6.5	6.9

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

Russia and the West: Alienation continues

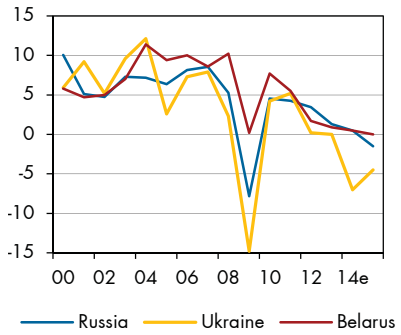
- **Sanctions to stay longer given hardened positions both in Russia and the West**
- **Recession, and possibly more financial market/rating pressure ahead in Russia; uphill battle for stabilisation in Ukraine**
- **Isolationist tendencies and import substitution to shift long term Russian growth further down**
- **Economic stagnation might increase willingness of Russia to compromise in the long run**

Real GDP (% yoy)



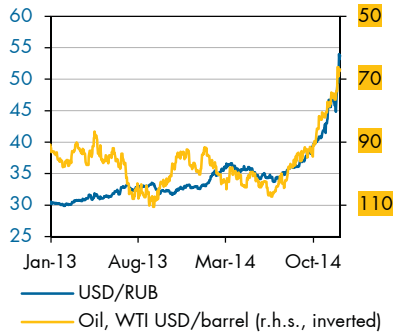
Source: National sources, Eurostat, RBI/Raiffeisen RESEARCH

Real GDP (% yoy)



Source: National sources, RBI/Raiffeisen RESEARCH

Oil and RUB united in the fall



USD/RUB: 5y high 54.5, 5y low 27.3
Oil, WTI USD/barrel: 5y high 112.1, 5y low 65.5
Source: Bloomberg, RBI/Raiffeisen RESEARCH

The broad based EU economic sanctions against Russia were imposed given the Russian willingness to act despite warnings as well as the **Russian harsh policy stance**. The State of the Union speech of Mr. Putin on 4th December did definitely not provide any elements for a de-escalation scenario. Over the last few months the Russian policy stance remains clearly driven by geopolitics and not economic rationality. From an economic policy perspective it seems that hardliners are having a stronger influence on Russian policymaking than more market-oriented actors. This conclusion can be derived from the circumstance that current policies might lead to a sustained exclusion of Russia from Western investment and capital flows.

From a purely economic point of view the EU (and US) sectoral sanctions against Russia do make sense. Economically speaking they are imposed by economic and financial giants on an economic "satellite". Therefore, it comes as no surprise that **Western economic sanctions against Russia** are already **having a noticeable impact**. Moreover, given the coincident fall in oil prices in Q4 and the adjunct fall of the RUB by a third, the sanctions' short-term impact might be even stronger than anticipated. However, given the dominance of geopolitics, we do think that political isolation and economic sanction pressure will not yield any near-term success; rather on the contrary it makes prolonged confrontation – at least frozen at the current level – between the West/EU and Russia a more likely scenario. Moreover, we do not see a fair chance that the situation on the ground in Ukraine will improve substantially, i.e. parts of the regions of Donetsk and Lugansk are likely to remain outside the control of the government in Kiev. The frozen conflict on the ground in Ukraine is likely to go hand in hand with no progress in the relations between Russia and the West. Such a scenario is definitely a challenge to the prevailing baseline scenario among a lot of economic actors, both in Russia and abroad. A lot of business plans are still based on de-escalation over the next 6-9 months. The main question is, if Europeans let sanctions automatically expire after the built-in one year term or if EU leaders are capable of forming a consensus to prolong them at least partially and for a limited period of time in summer 2015 – if needed. While opposition to prolong sanctions by a couple of EU countries and lobbying by European businesses invested in Russia can be taken for granted, **we see the possibility that Europeans will compromise on a (partial) continuation of existing sanctions** in place – again for another specific period of time and to be reviewed every quarter – if there is no visible improvement in the geopolitical situation until spring 2015.

Key economic implications

As a swift de-escalation becomes increasingly unlikely economic challenges are significantly on the rise in Ukraine, Russia and possibly some other neighbouring countries as well. A scenario of prevailing tensions between Russia and West definitely makes the task of **stabilizing the Ukrainian economy** an even more **challenging uphill battle.** Firstly, such a scenario implies that the new government in Kiev has to commit substantial (military and managerial) resources to the conflict in the eastern parts of the country. Secondly, ongoing confrontation between Russia

and the West implies that economic retaliation of Russia against Ukraine remains in place. Such a scenario does not support the idea that de facto the EU and Russia should cooperate to stabilise the Ukrainian economy.

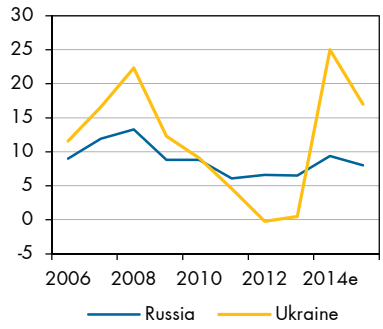
For the **Russian economy** the **outlook** also **becomes more challenging** if Western economic sanctions are continuing well into 2015 (and possibly even beyond). As things stand we expect recession in 2015 and economic and financial downside risks would be definitely on the rise in case the current situation will not be resolved in 2015. Firstly, we are more sceptical about the prospects of diversifying away from the strong West/EU economic relations from a short-term perspective. Secondly, we are also cautious with regards to outlook for private sector capital flows. The current situation of the Russian economy is not a good argument for repatriation of foreign (offshoring) capital back to Russia and to make large scale investments in the Russian economy. Refinancing on external markets will remain an issue. Therefore, a prolongation of the current situation could also lead to a significant reserve drain (FX reserves and fiscal reserves), that may ultimately result in more pressure on financial markets (e.g. sovereign downgrades in 2015 that may induce additional sell-off pressure). Thirdly, the longer the current situation continues the higher the medium-term impact on the Russian economy. Increasing protectionism, that got a boost from the recent escalation but was already on the rise in recent years (e.g. as seen in import restrictions via taxes or technical standards), is likely to impair the longer term outlook for the Russian economy significantly. Historical **experience with large-scale import-substitution strategies** in Latin America and Asia (in the 1960/1970ies) has clearly shown that such a politically motivated cut-off from international markets and competition **can lead to long-term stagnation**.

From a policymaking perspective it has to be taken into account that the economic situation in Russia is likely to remain challenging in the year to come anyways. Given current economic projections (by and large factoring in that economic sanctions will not be very long-lasting) post-crisis GDP growth in Russia (2010-2016) will only reach some 20% of pre-crisis levels (2000-2009). Such a setting is comparable to the disappointingly weak post-crisis economic growth performance of the euro area, that also induced significant (economic) policy challenges (e.g. stagnation or reduction of incomes, increasing unemployment, increasing calls for public investments, mounting political legitimacy deficits). A scenario of significantly rising (economic) policymaking challenges in Russia is highly relevant for companies operating locally, but may ultimately also be the trigger for a higher Russian willingness to compromise.

The challenging sketched regional economic outlook may also impact on some **countries neighbouring Russia**, mostly **Belarus** and **Kazakhstan**. The looming recession in Russia is likely to impact the export performance of the Belarusian and Kazak economy. Therefore, for Belarus we also see the danger of a recession in 2015. Given the increasing challenges in the Russian economy, the willingness and ability to provide subsidies to Belarus may also decrease going forward. Moreover, remittances from workers in Russia are also to decrease substantially. This holds also true for the Central Asian economies like Kazakhstan, which may take an additional hit from low commodity prices. Most importantly significant devaluation of the Russian RUB and Ukrainian UAH are indirectly also increasing the devaluation pressure on other currencies like the BYR or KZT. On a positive note a lot of other **major CE/SEE economies** and markets (like Poland, Hungary, Romania) were **less impacted by geopolitical tensions given limited direct economic ties** with the Russian economy.

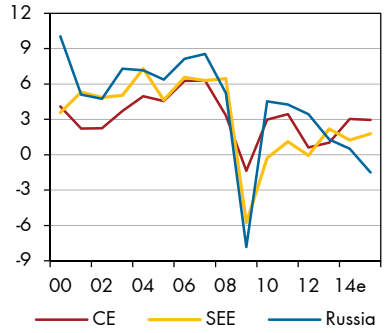
Financial analysts: Gunter Deuber, Andreas Schwabe, CFA, RBI Vienna

CPI (% yoy, eop)



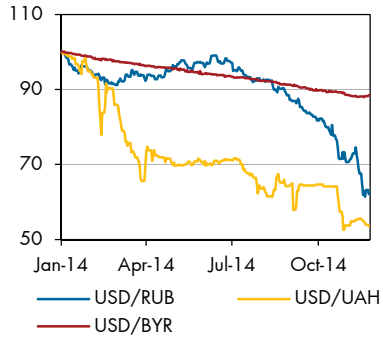
Source: National sources, RBI/Raiffeisen RESEARCH

Real GDP (% yoy)



Source: National sources, RBI/Raiffeisen RESEARCH

CIS exchange rates in comparison*

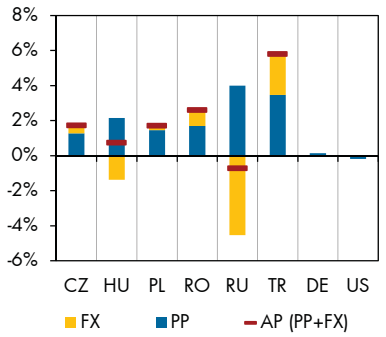


** Indexed chart: January 2014 = 100*
Source: Bloomberg, RBI/Raiffeisen RESEARCH

ECB and local easing to support debt markets

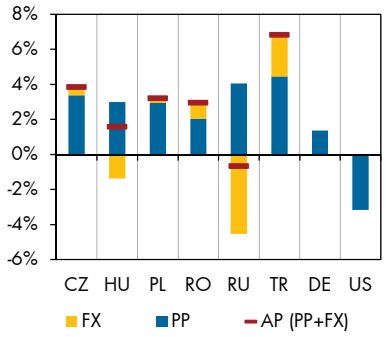
- **Turkey regional outperformer in Q4 2014 with some room left for further gains on a short-term horizon**
- **In anticipation of more easing by the ECB and local central banks, constructive view on most CEE LCY debt markets**
- **Biggest question, however, to what extent ECB QE can cushion negative spillovers from US MP tightening**
- **Russia is our single sell recommendation, whilst OFZ market can regain attractiveness in case of RUB stabilisation**

Expected perf. 2y LCY bond -> Mar-15



Hungary: 3y, not 2y maturity
FX: Currency performance (chg LCY/EUR)
PP: Bond price performance (price chg + carry)
AP: Absolute performance (PP + FX)
DE, US: Only price performance (PP)
Source: Bloomberg, RBI/Raiffeisen RESEARCH

Expected perf. 10y LCY bond -> Mar-15



FX: Currency performance (chg LCY/EUR)
PP: Bond price performance (price chg + carry)
AP: Absolute performance (PP + FX)
DE, US: Only price performance (PP)
Source: Bloomberg, RBI/Raiffeisen RESEARCH

Market strategy (horizon: Mar-15)*

	LCY Bonds	
	2y	10y
CZ	H (H)	B (H)
HU	H (H)	H (H)
PL	B (B)	B (B)
RO	B (B)	H (B)
RU	S (B)	S (H)
TR	B (B)	B (H)

** based on absolute expected performance in LCY between 09 Dec 2014 and 31 Mar 2015*
Previous recomm. (as of September 2014) in brackets
B: buy; H: hold; S: sell
Source: RBI/Raiffeisen RESEARCH

Since our last Strategy Update (CEE Debt Market Strategy released 10 Nov. 2014) Turkey outperformed regional peers, whilst Hungarian and Polish local currency debt markets also managed to extend year-to-date gains. With longer tenors outperforming shorter ones a bull flattening of the yield curves was the result in these countries. The revived optimism towards Turkey's economic fundamentals triggered a sentiment shift of international yield hunters towards the country. Turkey is one of the biggest beneficiaries from the ailing oil price that eases the pressure on its external balance and domestic prices. The latter, in turn, **widens the room for the Turkish central bank to manoeuvre**. Hence, we expect a moderate downwards adjustment of the policy rate in Q1 2015 and pencilled-in 50bp cuts under the assumption that the long-awaited disinflation dynamics show-up eventually in numbers. Elsewhere, **rate cutting speculations in Poland moderated somewhat** following the MPC's on-hold-decision in November, but market pricing and we are still for one last 25bp cut in Q1 2015. At the same time it became more and more likely that **Hungarian rate setters will opt for a Poland-style downward adjustment** of the base rate in Q1 2015 (Polish MPC resumed rate cuts following a more than one-year-pause and slashed the base rate by 50bp in October). Whilst on the domestic scene lower than expected price dynamics in tandem with sign of economic weaknesses (both in the euro area and locally) widen the room for local central banks to ease monetary conditions further, the expected government bond purchasing programme of the ECB in H1 2015 lends additional support from the external front.

Apart from local factors, hence, the significantly increasing likelihood that we will see large-scale QE in the euro area (EA) continues to **support a positive outlook for most local debt markets in CE** and SEE: Firstly, a compression of EA yields (most likely lasting much longer than just for Q1 2015) is likely to support lower yield levels locally (e.g. Poland or Czech Republic). Secondly, from a relative value perspective, downward trending EA yields is likely to add to the "search for yield pressure" and channel portfolio flows also to markets like Hungary, Romania, Croatia and possibly Serbia and Turkey. To what extent large-scale euro area QE can cushion the expected **negative spillovers from US policy rate hikes** remains thereby the biggest question. Basically we would not overrate the favorable impact as large-scale QE in the euro area are already largely priced in CEE LCY markets. That said any negative surprise on the QE front could lead to a sell-off on European debt markets, including core CE/SEE markets. As witnessed in earlier periods of market stress high-beta-countries like Hungary or Turkey should be the most vulnerable to external shocks again. Should RUB depreciation, finally, come to a halt in H2 2015 as reflected by our current forecasts, the Russian **OFZ market should offer the most value** in the CEE debt market space. With OFZ yields currently continuing to head from one record-high to another in line with the stubborn RUB depreciation trend, the turning point remains unpredictable as the unquantifiable factor in the investment equation remain geopolitics. On a short-term horizon, we therefore recommend selling OFZs.

Financial analysts: Stephan Imre, Gunter Deuber, RBI Vienna

Rouble under pressure – depreciation to continue in Q1 2015

- **Russian rouble hit hard by plunging oil price**
- **Volatility in CE region still at historical lows, but expected to increase as monetary policy diverges**
- **CIS currencies to remain under pressure in Q1 2015**
- **Most potential seen for TRY and PLN against EUR for 2015**

The significant, persistent depreciation of the rouble throughout basically the entire fourth quarter 2014 surprised us. Not only did the cease-fire agreement in eastern Ukraine not contribute to the desired positive effect, the oil price also witnessed a severe, unexpected decline, thereby destroying any hopes of even a short technical rebound by the rouble. This was accompanied by the central bank's strategy to let the **rouble float freely in November** on the vain hopes that speculation against the rouble would thus be reduced. Given these developments, our speculation for at least a short-term technical rebound proved too optimistic.

In our view, the current market environment holds only **limited potential for the CE and SEE exchange rates in Q1 2015**. Volatility in the CE exchange rates remains at historically low levels and should only slowly increase as soon as the monetary policy between the US and the euro area diverges, bringing an end to the ultra-loose monetary policy at least in the USA. Despite support for CE currencies coming from our expectation of quantitative easing in the euro area our projections for PLN, HUF and CZK during Q1 remain tame, with a low-volatility sideways movement expected. For the SEE region, the Romanian leu has the best appreciation potential against the euro, but in our view this does not justify a buy recommendation. The Serbian dinar is expected to continue its weakening trend against the euro as seen since mid of 2014.

In contrast to the CE region, **volatility in the CIS region is high and should remain elevated**. We project the depreciation trend to persist for Ukraine's hryvnia, most likely with one-off depreciation episodes in 2015 as seen in 2014. On the other hand, the Russian rouble should continue to see more gradual movements with the unsupportive environment (low oil price, sanctions, recession) forcing RUB weaker against both EUR and USD. We thus see the strongest pressure on the rouble in Q1 2015. Only in H2 2015 should we see potential for a recovery from the oversold levels, with support coming from a slowly rising oil price and the hopes that some euro area sanctions may be lifted. At the same time, it is difficult, if not impossible, to predict where the depreciation could end for the rouble as the RUB has experienced substantial speculative selling pressure. Support could come from an intervention decision by the CBR, and threats to our scenario include the low oil price or further escalation in Donbass.

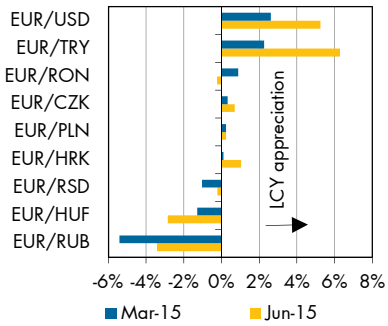
For Q1 2015 the only **buying opportunity we see is the Turkish lira against EUR.** Stable GDP growth, a moderate and stabilising current account deficit, falling inflation and most of all the EUR/USD projections indicate appreciation potential for the lira versus the euro of about 2% on a quarterly basis.

Whereas we have a sell recommendation on all CEE currencies against USD for Q1 given our significant USD appreciation projection, we underweight HUF, RUB, UAH and the Serbian dinar against EUR as well for the first quarter 2015.

Taking a **one-year perspective (to end-2015), we see the most potential for TRY and PLN against EUR**. Despite our expectations of calmer conditions for RUB in H2 2015 and subsequent appreciation from somewhat oversold levels, we remain cautious for 2015 regarding the rouble as there are currently too many factors of uncertainty attached. There may be more clarity in this regard in the first half 2015.

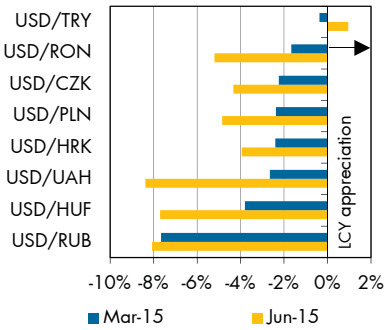
Financial analyst: Wolfgang Ernst, CEFA, RBI Vienna

Projections LCY vs EUR



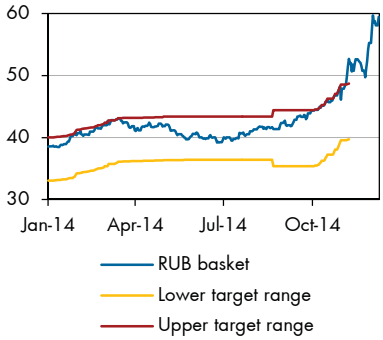
Source: Bloomberg, RBI/Raiffeisen RESEARCH

Projections LCY vs USD



Source: Bloomberg, RBI/Raiffeisen RESEARCH

End to the RUB managed float

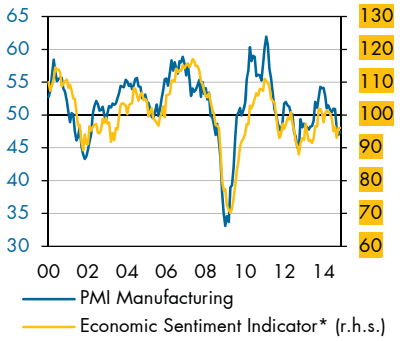


5y high 59.17, 5y low 32.89
Source: Bloomberg, RBI/Raiffeisen RESEARCH

Business cycle is lacking impetus

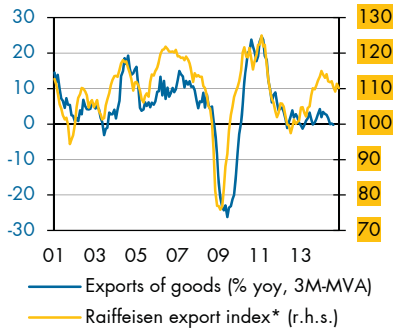
- **Steady slowdown in business cycle dynamics over the course of 2014**
- **Short-term outlook also subdued**
- **Slow recovery borne by domestic demand expected for 2015**
- **Real wage growth supported by falling inflation due to oil prices**

Leading indicators still weak



** European Commission*
Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

Exports are lagging behind



** trade weighted leading indicators of Austria´s most important export destinations*
Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

Economic activity in Austria decelerated more and more over the course of 2014, reaching the tentative low point in the third quarter. Between July and September, real GDP contracted by 0.3% compared to the previous quarter. This negative development in Q3 was mainly due to gross fixed capital formation, and within this category due to both equipment and construction investment. Net exports also had a negative impact on GDP growth which was already the case in the second quarter. Falling imports were outpaced by even stronger declines in exports. On the other hand, both private and public consumption made positive contributions to growth.

Despite the disappointing developments, the **short-term outlook is also subdued**. Although the manufacturing PMI stabilised in November, the reading of 47.4 is not only clearly below the 50 points mark but also falls short of the figures being registered in the other core countries in the euro area. The EU Commission's economic sentiment indicator for Austria does not paint a much brighter picture: with a figure of 96.1 for November, this index remains well below the long-term average of 100 points. Yet no further decline is expected for the fourth quarter as GDP is projected to stagnate (in qoq term), and **the pace of economic activity should gradually accelerate in 2015, thanks to domestic demand**. That said, on the whole this rebound will be more subdued than in previous periods of economic recovery. In this scenario, real GDP is expected to grow by 0.3% in 2014, by 0.7% in 2015 and by 1.8% in 2016.

The positive trend in private consumption seen during the third quarter should continue in a weaker form during the winter half year (Q4 2014 and Q1 2015), as the stable employment situation should provide support for private consumption, despite the mild increase in the rate of unemployment (international definition) next year, due to the ongoing increase in labour supply. Finally, the anticipated

Key economic figures and forecasts

	2013	2014e	2015f	2016f
Real GDP (% yoy)	0.2	0.3	0.7	1.8
Private consumption (% yoy)	-0.1	0.4	1.0	1.9
Gross fixed capital formation (% yoy)	-1.5	0.9	-0.5	3.7
Nominal exports (% yoy)	3.5	1.4	2.0	5.3
Nominal imports (% yoy)	1.8	2.7	2.5	5.0
Trade balance (goods and services, EUR bn)	11.5	9.6	8.9	9.7
Current account balance (EUR bn)	3.3	0.3	-1.7	-1.7
General budget balance (EUR bn)*	-4.8	-8.5	-7.4	-5.2
General budget balance (% of GDP)*	-1.5	-2.6	-2.2	-1.5
Unemployment rate (avg, %, EU definition)	4.9	5.0	5.3	5.2
Consumer prices (avg, % yoy)	2.1	1.5	1.2	1.5
Real wages (% yoy)	0.4	0.8	0.9	1.0
Unit labour costs (% yoy)	2.6	2.6	1.6	1.4

** state, provinces, municipalities and social security authorities*
Source: Statistics Austria, Thomson Reuters, RBI/Raiffeisen RESEARCH

acceleration in economic activity should be reflected in further employment gains from H2 2015 onwards. Support is also expected to come from real wages. It is assumed that despite the somewhat lower increases in nominal wages in 2015 real wages will increase by nearly 1% and thus by slightly more than in 2014, as lower oil prices exert downward pressure on inflation and thus act like an "advanced tax reform". But also the (planned) actual tax reform should provide some tailwind, although the economic effect of this will depend on the actual extent and the specific measures involved. All in all, the aforementioned factors mean that **private consumption will play the main role in the anticipated economic recovery**.

Due to a one-off effect, gross fixed capital formation jumped strongly at the start of year, after which a slowdown in investment activity was recorded in the second and third quarter, also owing to developments in construction investment. Although industrial confidence is only slightly below the long-term average, no immediate pick-up in equipment investment is expected, in particular since such a development is contradicted by further declines in capacity utilisation and negative trends in incoming orders. Consequently, **further declining investment activity should come as no surprise in the winter half year**. A moderate revival in gross fixed capital formation is only expected to occur after that, but this should then strengthen to become a major support for the economic recovery.

By contrast, **net exports are not projected to make a significant contribution to GDP growth** over the entire forecast horizon. Although it is likely that Austrian exports will accelerate against the backdrop of improving external conditions, import growth is expected to match this pace, owing to the projected upturn in domestic demand. Furthermore, it has been seen for some time now that export performance has been lower than indicated by business cycle dynamics in Austria´s most important trading partners.

With an **inflation rate** (HICP) of 1.4% yoy in October, price increases in Austria remain near the top of the field in the EU. Although a small decline from 1.5% in 2014 to 1.2% is projected for the coming year due to oil price developments, this will still mean that inflation in Austria is considerably higher than the rate for the euro area as a whole.

Financial analyst: Matthias Reith, CIIA

GDP: Value added by sector

Change (% yoy, in real terms)	2013	2014e	2015f	2016f
Agriculture & forestry	-3.5	8.0	0.0	0.0
Prod. of goods/mining	0.6	-0.3	0.6	3.0
Energy/water supply	6.8	0.5	0.9	1.5
Construction	0.4	1.5	1.5	1.9
Wholesale and retail trade	-1.6	-0.7	0.6	2.0
Transportation	-0.7	-0.5	0.7	1.5
Accom. & restaurant trade	0.7	0.2	0.8	1.6
Information and communication	-1.6	-4.0	1.0	2.5
Credit and insurance	-0.4	0.2	0.5	1.1
Property & business services	3.0	0.5	1.0	2.0
Other economic services	0.7	0.6	1.0	3.3
Public sector	0.0	-0.2	0.2	0.5
Healthcare, social services	0.5	2.0	1.0	1.5
Other services	-0.2	1.3	1.4	2.0
Gross domestic product	0.2	0.3	0.7	1.8

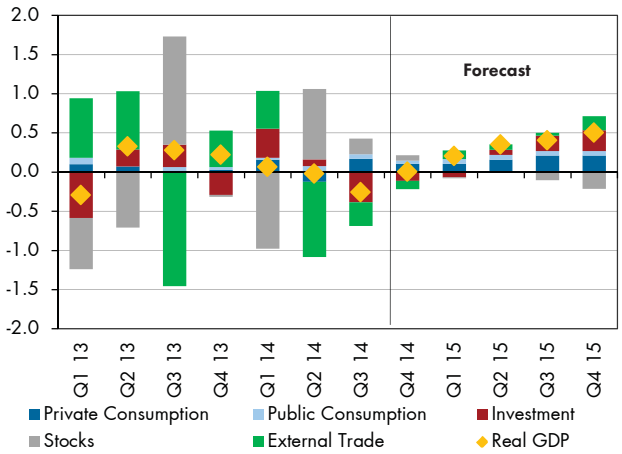
Source: Statistics Austria, RBI/Raiffeisen RESEARCH

GDP: Expenditure composition

Change (% yoy, in real terms)	2013	2014e	2015f	2016f
Private consumption	-0.1	0.4	1.0	1.9
Public consumption	0.7	0.9	1.1	1.2
Gross fixed capital formation	-1.5	0.9	-0.5	3.7
Equipment	-1.5	1.1	-1.0	5.0
Construction	-2.2	0.7	0.0	2.6
Exports	1.4	-0.1	0.8	3.7
Imports	-0.3	1.1	1.3	3.5
Gross domestic product	0.2	0.3	0.7	1.8

Source: Statistics Austria, Thomson Reuters, RBI/Raiffeisen RESEARCH

Contributions* to real GDP growth (qoq)

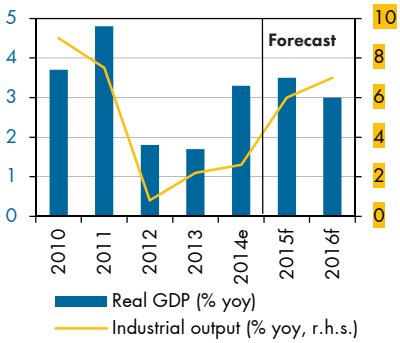


** in percentage points*
Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

Strong internal demand exposed to external risks

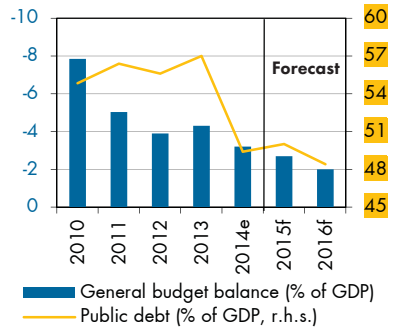
- **Growth engine shifted to internal demand, 2015 with robust investment activity**
- **Politics as a source of increasing uncertainty**
- **Zloty driven by rate cut speculations**
- **Monetary Policy Council members show high discrepancy in their assessment on monetary policy**

Real GDP (% yoy)



Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

Budget balance and public debt



Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

Economic outlook

Poland did surprisingly well in 2014, as far as the business cycle was concerned, with the **growth engine switching fully over to internal demand**. The negative contribution of net exports results both from the weaker condition of the German economy and from the rapidly falling trade with Russia and Ukraine. As strong internal demand supports imports, even the expected rebound in the European economy will not be sufficient to reverse the negative contribution of net exports in 2015. Strong internal demand is being fostered by private consumption and surprisingly robust investments, which have grown by almost 10% yoy so far. As the current slowdown in exports combined with uncertainty in the East weighs on sentiment among consumers and enterprises, we expect the moderate slowdown which started in Q3 to continue in Q4 and result in GDP growth falling slightly below 3%. As Q1 results might be hampered by high base effects, the economic rebound should start no sooner than Q2. Our optimistic forecast of 3.5% GDP growth in 2015 is strongly based on investment activity, which should be supported by new inflows of EU funds, strong activity by local governments, high capacity utilisation and the comfortable financial situation among private enterprises. Although inflation is expected to return to the positive domain in Q1/Q2 2015, **real income growth should not decline below 3% yoy.**

Nevertheless, **risks to the Polish economy remain concentrated to the downside**. Apart from external risks from Russia-Ukraine and the risks related to euro area growth, an internal source of uncertainty is the political scene and the two elections planned for 2015 (presidential in spring and parliamentary in autumn). The latest polls and results of municipal elections show similar support for the leading Civic Platform and the main opposition party Law and Justice. This **creates a political risk of no clear winner in the elections** and problems creating a stable majority in the new parliament.

Financial analyst: Marta Petka-Zagajewska, Raiffeisen Polbank, Warsaw

Key economic figures and forecasts

	2010	2011	2012	2013	2014e	2015f	2016f
Nominal GDP (EUR bn)	354.8	370.9	381.6	396.2	413.8	437.4	475.8
Real GDP (% yoy)	3.7	4.8	1.8	1.7	3.3	3.5	3.0
Industrial output (% yoy)	9.0	7.5	0.8	2.2	2.6	6.0	7.0
Unemployment rate (avg, %)	12.1	12.4	12.8	13.5	12.3	11.0	10.5
Nominal industrial wages (% yoy)	3.3	5.0	3.4	2.9	3.5	4.8	6.0
Producer prices (avg, % yoy)	2.1	7.6	3.3	-1.3	-1.3	1.2	2.0
Consumer prices (avg, % yoy)	2.6	4.3	3.7	0.9	0.0	0.6	1.8
Consumer prices (eop, % yoy)	3.1	4.6	2.4	0.7	-0.5	1.6	2.0
General budget balance (% of GDP)	-7.9	-5.0	-3.9	-4.3	-3.2	-2.7	-2.0
Public debt (% of GDP)	54.8	56.4	55.6	57.0	49.4	50.0	48.4
Current account balance (% of GDP)	-5.1	-4.8	-3.5	-0.3	-0.3	-0.3	-0.4
Official FX reserves (EUR bn)	70.0	75.7	82.6	77.1	77.5	80.0	78.0
Gross foreign debt (% of GDP)	66.9	67.4	72.7	69.9	68.6	68.6	66.4
EUR/PLN (avg)	3.99	4.12	4.18	4.20	4.17	4.13	3.97
USD/PLN (avg)	3.01	2.96	3.25	3.16	3.14	3.53	3.34

Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

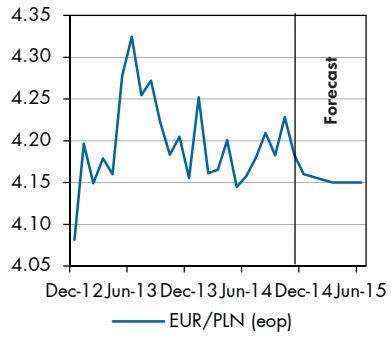
Financial market outlook

The Polish zloty remained fairly stable with low volatility in the last quarter of 2014, as the mild movements were mostly driven by interest rate speculations in Poland. The external newsflow had remarkably limited effects on PLN, despite the developments in CIS and the fact that in the past the zloty was always regarded a proxy for CEE risk. For Q1 2015, rate cut expectations will continue to be a major factor. With our current projection of the rate-cutting cycle ending soon, the zloty should witness some support thereafter. But until this is announced, we are likely to witness some short-term volatility in the zloty that should drive EUR/PLN in the 4.15-4.20 range. Until the end of the first quarter, however, we think that the rate-cutting speculations will have vanished and we therefore see PLN tending more towards 4.15 to the euro. Despite the rather sideways movement during the first half of 2015, we currently see some **potential for the second half of 2015**. Robust economic development and even some initial speculation about an end to the low interest rate environment should support PLN. Risks to our projections take the form of external developments, especially the geopolitical conflict between Russia and the West.

In recent months, the LCY government bond market maintained strong upward momentum which was favoured both by external and internal factors. The long end of the yield curve (YC) followed core market developments, experiencing a rally on expectations of an extension of QE in the euro area. As a result, 10y yields dived to the new record low below 2.4%. At the same time, short-end yields were depressed by the interest rate cut delivered by the Polish MP Council in October. Rising concerns regarding deflation and the economic outlook encouraged the MPC to cut the main rate by 50bp. As the Council left the door open for further cuts, market appetite for more easing drove 2y yields below 1.7%. However, Council members' opinions vary strongly with regard to the appropriate monetary policy path. In November, the Council surprisingly left interest rates unchanged, which cooled market expectations for cuts and triggered a retreat of 2y yields close to 2%. Thus, the YC flattened significantly and the 10-2y spread narrowed from 100bp to about 60bp in mid-November. Looking ahead, we assume that the **Council may decide on another 25bp cut in Q1 2015**, but one should note that the decision will be highly dependent on incoming monthly indicators. The recent surge in the PMI and favourable GDP data decreased the likelihood of such a move. All in all, we expect that although the room for further gains on the short papers exists, it is limited. Meanwhile, as long as hopes for more easing by the ECB remain in place, we are still moderately bullish on long papers. Thus, YC flattening may continue.

Financial analysts: Michał Burek, Raiffeisen Polbank, Warsaw
Wolfgang Ernst, RBI Vienna

Exchange rate development



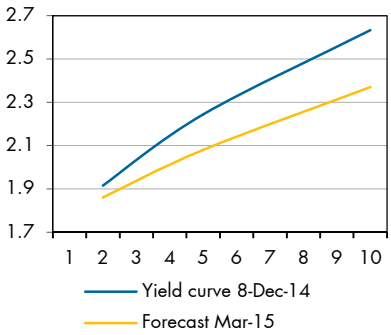
EUR/PLN: 5y high 4.57, 5y low 3.83
Source: Bloomberg, RBI/Raiffeisen RESEARCH

Exchange rate forecasts

	8-Dec[1]	Mar-15	Jun-15	Sep-15	Dec-15
EUR/PLN	4.16	4.15	4.15	4.10	4.05
Cons.		*4.20*	*4.15*	*4.15*	*4.10*
USD/PLN	3.38	3.46	3.55	3.57	3.62
Cons.		*3.43*	*3.47*	*3.50*	*3.50*

[1] 5:00 p.m. (CET)
Source: Bloomberg, RBI/Raiffeisen RESEARCH

PLN yield curve (%)*



** 2y – 10y LCY government bond yields*
Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

Interest rate forecasts

	8-Dec[1]	Mar-15	Jun-15	Sep-15	Dec-15
Key rate	2.00	1.75	1.75	1.75	1.75
Consensus		*1.90*	*1.85*	*1.90*	*1.90*
1 month[2]	1.88	1.85	1.85	1.85	1.85
3 month[2]	1.86	1.95	1.95	1.95	1.97
Consensus		*1.97*	*1.98*	*2.02*	*2.05*
6 month[2]	1.85	2.10	2.10	2.11	2.25

[1] 5:00 p.m. (CET) [2] Bid rate
Source: Bloomberg, RBI/Raiffeisen RESEARCH

Yield forecasts

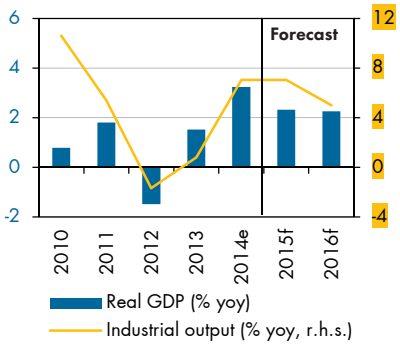
	8-Dec[1]	Mar-15	Jun-15	Sep-15	Dec-15
2y T-bond[2]	1.89	1.9	2.0	2.2	2.5
Consensus		*1.9*	*2.0*	*2.1*	*2.2*
5y T-bond[2]	2.19	2.1	2.3	2.5	2.7
10y T-bond[2]	2.59	2.4	2.5	2.7	2.9
Consensus		*2.7*	*2.8*	*2.9*	*3.1*

[1] 5:00 p.m. (CET) [2] Ask yield
Source: Bloomberg, RBI/Raiffeisen RESEARCH

Private sector improving, but not enough to sustain growth

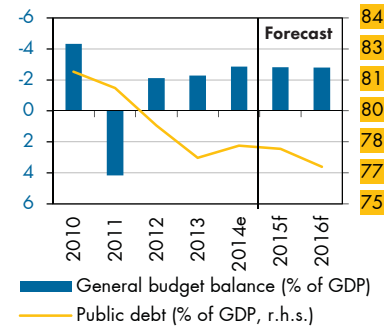
- **GDP growth surprises on the upside with over 3% in 2014**
- **Emphasis is shifting from public to private sector in growth generation**
- **Forint projected to see continued moderate depreciation throughout 2015**
- **Additional interest rate cuts to come in early 2015**

Real GDP (% yoy)



Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

Budget balance and public debt



Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

Economic outlook

Hungary registered 3.6% yoy GDP growth in the Q1-Q3 period. Industry contributes almost half of the growth, and there is a strong rise in construction as well, while services and agriculture are also performing well. **Industrial output is driven by the upswing in the automotive industry** (+24% yoy increase in Q1-Q3 2014), due to new capacities coming into operation. The share of the auto industry within the economy has been increasing continuously in recent years.

The **construction industry is another hot-spot**, with almost 17.8% growth yoy (in Q1-Q3). This is due to a large extent to public sector investment projects which are typically strongly co-financed by EU funds. We expect gradually decreasing construction output growth.

Domestic consumption contracted by a cumulated 10% in the 2007-2012 period, but stabilised in 2013 and shows initial signs of a promising increase in 2014 with 1.6% yoy growth in Q1-Q3. **Gross fixed capital formation is another driver of growth** with a 16.5% jump in the same period. Due to the hefty investment activity and the improvement in domestic consumption, the contribution of net exports to growth became weaker compared to previous periods when it was the only contributor on the positive side. Hungary's export growth remained fairly healthy, most notably due to the new capacities in manufacturing.

The **unemployment rate dropped 7.1% in October 2014**, down from close to 10% a year before. There are almost 200,000 more people registered as having a job. This improvement stems from the extended public work programmes, but the capability of the private sector to create jobs is improving.

As far as the outlook is concerned, domestic consumption is likely to grow by over 1% in the coming year, the current outstanding increase of gross fixed capital formation is set to decelerate, and export growth of 4-5% is still realistic. Thus, we forecast 2.3% GDP growth for 2015.

Financial analyst: Zoltán Török, Raiffeisen Bank Zrt., Budapest

Key economic figures and forecasts

	2010	2011	2012	2013	2014e	2015f	2016f
Nominal GDP (EUR bn)	97.8	100.3	98.7	100.5	102.4	105.5	109.1
Real GDP (% yoy)	0.8	1.8	-1.5	1.5	3.2	2.3	2.3
Industrial output (% yoy)	10.6	5.4	-1.7	0.8	7.0	7.0	5.0
Unemployment rate (avg, %)	11.1	11.0	10.9	10.4	7.9	7.2	6.6
Nominal industrial wages (% yoy)	5.5	6.2	-0.7	4.6	4.3	4.0	5.0
Producer prices (avg, % yoy)	4.5	4.3	4.3	0.7	-0.5	0.0	3.0
Consumer prices (avg, % yoy)	4.9	3.9	5.7	1.7	-0.2	1.0	3.0
Consumer prices (eop, % yoy)	4.7	4.1	5.0	0.4	-0.4	2.5	3.2
General budget balance (% of GDP)	-4.3	4.2	-2.1	-2.3	-2.9	-2.8	-2.8
Public debt (% of GDP)	81.4	80.6	78.8	77.2	77.8	77.7	76.8
Current account balance (% of GDP)	1.1	0.8	1.9	4.1	3.9	3.9	3.8
Official FX reserves (EUR bn)	33.7	37.8	33.9	33.0	30.0	28.0	26.0
Gross foreign debt (% of GDP)	143.7	134.9	128.9	118.5	109.4	95.7	87.2
EUR/HUF (avg)	275.4	279.4	289.2	296.8	308.6	313.3	321.9
USD/HUF (avg)	207.6	200.7	225.0	223.5	232.0	267.8	270.5

Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

Financial market outlook

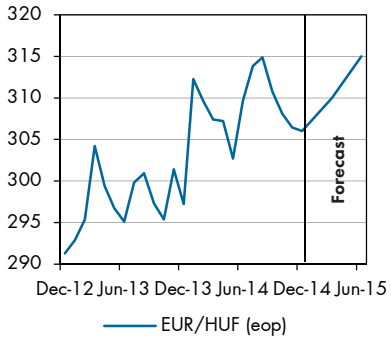
The Hungarian economy has an improving risk profile with continuously decreasing level of external debt, a stabilising and slowly decreasing public debt-to-GDP ratio, persistently large surpluses in the external balances, a low fiscal deficit policy of the government and a positive economic activity with more than 3% GDP growth in 2014. This is partially reflected by the relatively tight trading range of between EUR/HUF 304 and 316 and the fact that the forint managed to appreciate slightly in Q4 2014. This is not against the desire of policymakers who prefer a relatively strong HUF at the very end of the year, given the still fairly large share of FX-denominated debt in public debt and the requirement to decrease the debt-to-GDP ratio a little bit every year. Nevertheless, **we maintain our slightly negative outlook for the forint in 2015**. While a stable forint was needed to achieve the budget and debt goals at the end of 2014, in 2015 the government could be more eager for HUF depreciation. On the one hand, this would increase competitiveness of the economy that is already estimated to witness a slowdown in growth in 2015. On the other hand, the government may be keen on having a weaker HUF in Q1 already, for the sake of making the conversion of FX mortgages look more favourable for those concerned (approximately half a million households). As the conversion rate is already fixed at EUR/HUF 309 (the market rate on 7 Nov), a stronger HUF in early 2015 would undermine the government's aim of giving substantial help, thereby costing voter support instead of gaining it as planned. For the remainder of 2015 we would likewise expect the HUF weakening trend of the past years to persist against the euro.

2014 was characterised by the disappearance of inflation, driven by external factors (low imported inflation, falling energy prices, etc.) and internal factors (i.e. massive household utility price cuts ahead of the elections). Inflation is running in negative territory even in the yearly average, compared to a 3% inflation target. Given the stronger quantitative easing measures by the European Central Bank and the serious downward revisions of 2015 inflation expectations plus the policy need for making HUF assets less attractive, there is **increasing pressure to cut the key rate further.** We expect another 30bp rate cuts to come in H1 2015.

As far as the LCY bond market is concerned, the expected rate cut and the improving risk profile would argue for further decreasing yield levels along the curve, while the expected slow increase in core market yields would rather point to an opposite movement. In our view, this dichotomy may characterise the coming quarters: in the short run the first argument should mostly drive the market, while the second may become more important later on.

Financial analysts: Zoltán Török, Raiffeisen Bank Zrt., Budapest
Stephan Imre, RBI Vienna

Exchange rate development



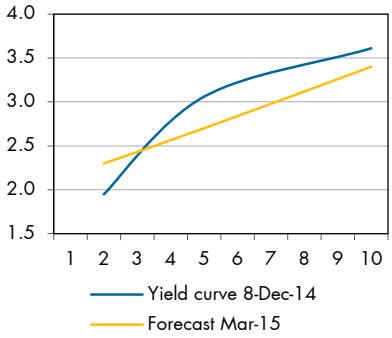
EUR/HUF: 5y high 320.41, 5y low 261.23
Source: Bloomberg, RBI/Raiffeisen RESEARCH

Exchange rate forecasts

	8-Dec[1]	Mar-15	Jun-15	Sep-15	Dec-15
EUR/HUF	306.02	310.0	315.0	315.0	320.0
Cons.		*309.00*	*309.00*	*305.00*	*309.00*
USD/HUF	248.50	258.3	269.2	273.9	285.7
Cons.		*252.00*	*257.00*	*258.50*	*260.00*

[1] 5:00 p.m. (CET)
Source: Bloomberg, RBI/Raiffeisen RESEARCH

HUF yield curve (%)*



** 2y – 10y LCY government bond yields*
Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

Interest rate forecasts

	8-Dec[1]	Mar-15	Jun-15	Sep-15	Dec-15
Key rate	2.10	1.80	1.80	1.80	1.80
Consensus		*2.10*	*2.10*	*2.15*	*2.45*
1 month[2]	2.10	1.83	1.83	1.84	1.87
3 month[2]	2.10	1.84	1.84	1.85	1.88
Consensus		*2.20*	*2.33*	*2.40*	*2.54*
6 month[2]	2.13	1.86	1.86	1.87	1.89

[1] 5:00 p.m. (CET) [2] Bid rate
Source: Bloomberg, RBI/Raiffeisen RESEARCH

Yield forecasts

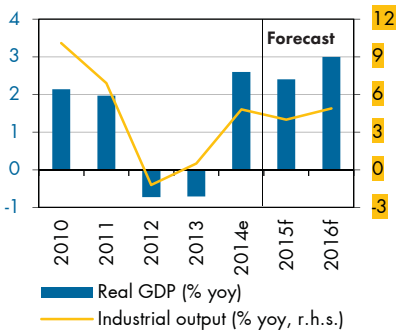
	8-Dec[1]	Mar-15	Jun-15	Sep-15	Dec-15
3y T-bond[2]	2.57	2.3	2.3	2.4	2.5
Consensus		*n.v.*	*n.v.*	*n.v.*	*n.v.*
5y T-bond[2]	3.00	2.7	2.8	3.0	3.1
10y T-bond[2]	3.55	3.4	3.5	3.7	3.9
Consensus		*3.8*	*3.9*	*3.7*	*4.1*

[1] 5:00 p.m. (CET) [2] Ask yield
Source: Bloomberg, RBI/Raiffeisen RESEARCH

Recovery continues, but remains fragile

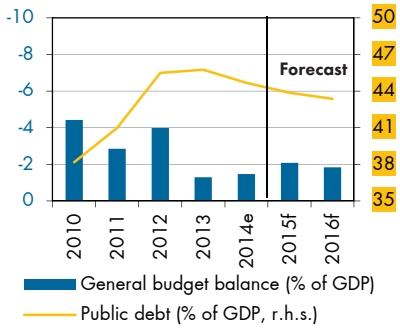
- **Recovery continues at slower pace, fiscal expansion mainly targeting consumption**
- **CPI inflation – sluggish return towards the target**
- **EUR/CZK to stay above 27.0 until Q3 2016**
- **Key interest rate unchanged at 0.05% until Q4 2016**

Real GDP (% yoy)



Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

Budget balance and public debt



Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

Economic outlook

The Czech economy continued recovering in Q3 as it grew at a rate of 0.4% qoq. This represented a mild acceleration from +0.2% qoq in Q2. As regards the structure of GDP, **household consumption expanded by 0.3% in Q3 and was thus outpaced by the decline in government consumption**. Gross fixed investment continued growing. Exports declined due to the worse external environment, but imports declined as well. Leading indicators suggest a mild acceleration of growth for Q4.

Next year, the **economy will benefit from the expansive fiscal policy and the continuing FX commitment by Czech National Bank (CNB)** (EUR/CZK above 27.0). Fiscal expansion will be targeted especially towards consumption as wages in public sector will be raised by 3.5% (for some professions even more). This growth in nominal wages coupled with expected low inflation next year will stimulate real household consumption in our view. The government will also try to stimulate investment in infrastructure, but it is an open question as to how many new roads will be actually built. This fiscal support justifies our forecast of 2.4% GDP growth next year. The main risk to our forecast is that external environment will be a drag on the economy.

The Czech government plans a budget deficit of CZK 100 bn next year. We think this sum will translate into a **deficit of 2.1% of GDP** (general government budget); up from the current year's forecast of 1.5% of GDP. We think this kind of fiscal expansion is temporary acceptable (the deficit will stay clearly below the threshold of 3% of GDP), but in the medium and long term the government should have the ambition to lower the structural deficit. Consumer price inflation accelerated mildly to 0.7% yoy in October from the cyclical low of 0.0% yoy in June. Given the expected low price of oil next year, CPI inflation will only accelerate slowly, driven mostly by domestic demand. **Inflation is expected to stand at 1.8% yoy at the end of next year** and the 2% inflation target will likely be reached in early 2016.

Financial analyst: Vaclav France, Raiffeisenbank a.s., Prague

Key economic figures and forecasts

	2010	2011	2012	2013	2014e	2015f	2016f
Nominal GDP (EUR bn)	156.2	163.5	161.0	157.3	153.1	159.0	169.5
Real GDP (% yoy)	2.1	2.0	-0.7	-0.7	2.6	2.4	3.0
Industrial output (% yoy)	10.1	6.9	-1.2	0.5	4.8	4.0	4.9
Unemployment rate (avg, %)	7.0	6.7	6.8	7.7	7.7	7.2	6.9
Nominal industrial wages (% yoy)	3.8	3.5	3.2	1.0	2.7	4.1	5.8
Producer prices (avg, % yoy)	1.2	5.6	2.1	0.8	-0.6	0.5	1.8
Consumer prices (avg, % yoy)	1.5	1.9	3.3	1.4	0.4	1.0	2.2
Consumer prices (eop, % yoy)	2.3	2.4	2.4	1.4	0.3	1.8	2.0
General budget balance (% of GDP)	-4.4	-2.9	-4.0	-1.3	-1.5	-2.1	-1.8
Public debt (% of GDP)	38.2	41.0	45.5	45.7	44.7	43.9	43.4
Current account balance (% of GDP)	-3.7	-2.6	-1.3	-1.4	0.02.	-0.07	0.02
Official FX reserves (EUR bn)	31.8	31.1	34.0	40.8	43.8	44.0	43.2
Gross foreign debt (% of GDP)	45.7	45.0	48.4	51.5	51.6	51.0	50.1
EUR/CZK (avg)	25.28	24.59	25.14	25.98	27.52	27.40	26.88
USD/CZK (avg)	19.06	17.66	19.55	19.56	20.69	23.42	22.59

Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

Financial market outlook

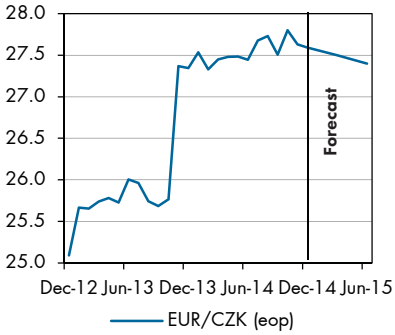
The FX intervention regime of the CNB, which keeps EUR/CZK above 27.0, remains in place. The conflict in Ukraine had no further impact on CZK and the EUR/CZK rate remained close to 27.60. With the oil price declining and economic weakness in the euro area, the outlook for inflation has been lowered. We now expect that inflation will not pass the 2% mark sooner than Q1 2016. With this shift we postpone **our expectation for exiting the current FX regime to Q3 2016**. Inflation should be above 2% by that time and with the expected economic acceleration it should stay close to that level. As mentioned, economic growth has been solid for several quarters, and according to leading indicators and the expected government policy growth will probably outpace the rates recorded in the euro area in the years to come. That is the key mid/long-term argument for our expectation that CZK will appreciate vis-á-vis EUR, unless the inflation differential does not fully substitute it. This we do not expect. However, for the next 1-2 years the inflation outlook remains the key variable for the CZK rate forecast, as 2% inflation is the key target of the CNB. For 2015 we only expect a marginally stronger CZK i.e. still above EUR/CZK 27.0.

The CNB has mentioned many times that when there is a need to tighten monetary policy the first step will be currency appreciation, i.e. exiting the intervention regime. Only after that will it start thinking about raising interest rates. Taking into account that the ECB will probably not increase the key rate before 2017, we also postpone our expectation for a key rate hike by the Czech central bank by one quarter to Q4 2016.

Although fiscal policy will become expansionary in 2015, the **financing position of the Czech government will remain very favourable** as the economy is growing faster than expected and the Ministry of Finance will also continue drawing on the cash reserves which will bring net emissions in CZGBs close to nothing (CZK 10-20 bn). Therefore, the supply side of the equation will hardly be a trigger for rising bond yields in 2015. The government bond yield spread of the Czech 10y bond over the German benchmark will probably stay close to current levels around, i.e. 0bp + -10bp. The key question for the coming months will be the behaviour of the ECB and consequently bond yields in the euro area. A government bond purchase programme within the euro area would keep Czech government bond yields down as well. For Q1, we stick to our neutral recommendation for CZGBs.

Financial analysts: Michal Brožka, Raiffeisenbank a.s., Prague
Stephan Imre, RBI Vienna

Exchange rate development



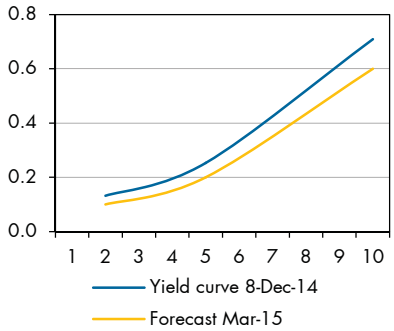
EUR/CZK: 5y high 27.93, 5y low 23.99
Source: Bloomberg, RBI/Raiffeisen RESEARCH

Exchange rate forecasts

	8-Dec[1]	Mar-15	Jun-15	Sep-15	Dec-15
EUR/CZK	27.59	27.50	27.40	27.30	27.20
Cons.		*27.55*	*27.50*	*27.45*	*27.25*
USD/CZK	22.41	22.92	23.42	23.74	24.29
Cons.		*22.50*	*23.00*	*22.92*	*23.48*

[1] 5:00 p.m. (CET)
Source: Bloomberg, RBI/Raiffeisen RESEARCH

CZK yield curve (%)*



** 2y – 10y LCY government bond yields*
Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

Interest rate forecasts

	8-Dec[1]	Mar-15	Jun-15	Sep-15	Dec-15
Key rate	0.05	0.05	0.05	0.05	0.05
Consensus		*0.05*	*0.05*	*0.05*	*0.05*
1 month[2]	0.03	0.05	0.05	0.05	0.05
3 month[2]	0.04	0.10	0.10	0.10	0.10
Consensus		*0.35*	*0.35*	*0.35*	*0.37*
6 month[2]	0.07	0.10	0.10	0.15	0.15

[1] 5:00 p.m. (CET) [2] Bid rate
Source: Bloomberg, RBI/Raiffeisen RESEARCH

Yield forecasts

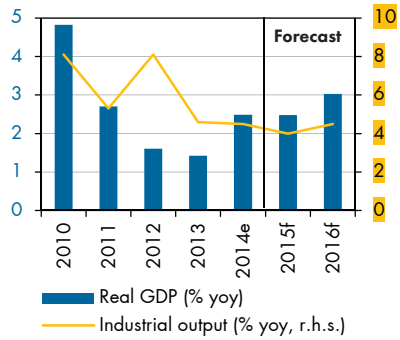
	8-Dec[1]	Mar-15	Jun-15	Sep-15	Dec-15
2y T-bond[2]	0.16	0.1	0.1	0.1	0.2
Consensus		*0.2*	*0.3*	*0.3*	*0.3*
5y T-bond[2]	0.22	0.2	0.2	0.4	0.6
10y T-bond[2]	0.90	0.6	0.7	0.9	1.1
Consensus		*1.1*	*1.2*	*1.2*	*1.3*

[1] 5:00 p.m. (CET) [2] Ask yield
Source: Bloomberg, RBI/Raiffeisen RESEARCH

Balanced and stable growth continues

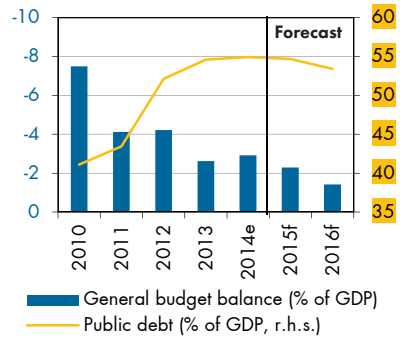
- **Stable qoq dynamics with improved employment**
- **Price developments help households boost real consumption**
- **Fiscal deficit under control**
- **ESA-transition pushs public debt-to-GDP ratio below 55% of GDP**

Real GDP (% yoy)



Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

Budget balance and public debt



Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

GDP growth reached 2.4% yoy in Q3 2014. The economy showed a surprisingly stable quarterly rate of +0.6% qoq in Q3 2014 and in the last four quarters as well. Available monthly data (wages and retail sales) confirm that private consumption still has good momentum. Industry has lost a bit of steam, with a 2.7% yoy increase in production in Q3 2014. Investment activity should continue in the final quarter of 2014 as well. Therefore, the **structure of growth remains balanced**. Total employment is increasing in line with GDP. In Q3 2014, employment went up by 1.4% yoy which is a rather high number given that GDP growth is just 2.4%. Barring any massive escalation of the Russia-Ukraine conflict, we expect stable quarterly dynamics with some small negative risks in Q4 2014. **Headline annual GDP growth should stay close to 2.5% in Q4 2014 and for the rest of 2015** as well. Inflation is currently at the "zero" level from January 2014, and we do not expect any increase in the inflation rate sooner than in summer 2015. The decrease in energy prices (gas, electricity and motor fuels) and stagnating food prices will be the most important factors behind the benign price level in 2015 as well. Average inflation should be only 0.5% in 2015.

The **fiscal development in 2014 was a step back from the otherwise solid performance** from 2010-2013. In 2014, Slovakia should have a budget deficit of 2.9% of GDP which is higher than in 2013 (2.6% of GDP). In 2015, the government should get back on track towards a balanced structural deficit. The estimated deficit should drop to 2.3% of GDP. The government plans further deficit reduction in the election year of 2016, but the credibility of this goal is questionable. Government debt should remain below 55% of GDP in 2014 and in the years after.

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

Key economic figures and forecasts*

	2010	2011	2012	2013	2014e	2015f	2016f
Nominal GDP (EUR bn)	67.2	70.2	72.2	73.6	75.2	77.1	81.1
Real GDP (% yoy)	4.8	2.7	1.6	1.4	2.5	2.5	3.0
Industrial output (% yoy)	8.1	5.3	8.1	4.6	4.5	4.0	4.5
Unemployment rate (avg, %)	14.4	13.4	13.9	14.2	13.3	12.7	12.1
Nominal industrial wages (% yoy)	5.4	3.6	4.0	3.6	4.6	3.5	4.0
Producer prices (avg, % yoy)	-2.8	2.6	3.9	-0.1	-3.5	0.5	2.0
Consumer prices (avg, % yoy)	1.0	3.9	3.6	1.4	-0.1	0.5	2.0
Consumer prices (eop, % yoy)	1.3	4.4	3.2	0.4	0.1	1.0	2.5
General budget balance (% of GDP)	-7.5	-4.1	-4.2	-2.6	-2.9	-2.3	-1.4
Public debt (% of GDP)	41.1	43.4	52.1	54.6	54.9	54.7	53.4
Current account balance (% of GDP)	-3.6	-3.7	2.2	2.1	2.1	2.0	1.9
Gross foreign debt (% of GDP)	73.1	75.2	70.5	81.1	97.4	101.9	99.0

** euro area entry on 1 January 2009*
Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

Back to business after years of pain

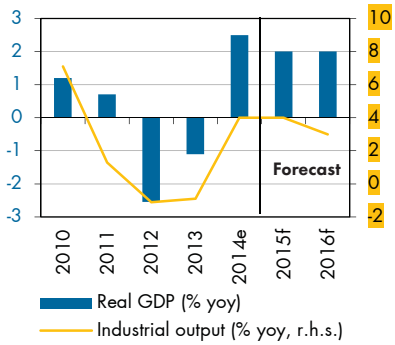
- **Strong Q3 growth, internal and external demand balanced**
- **Inflation close to zero, to inch up to 0-1% in 2015, with downside risks**
- **Budget deficit back to normal levels after banking sector costs**
- **Banking sector restructuring supports recovery in the real economy**

Although we already improved the growth projection for this year to 1.5% three months ago, we were probably still too modest with our forecast. With a growth rate of 3.2%, the **Slovenian economy showed strong growth in Q3 2014** – with a positive result for the 4th quarter in a row. Both domestic demand and net exports expanded. Consumption is not overly strong yet, at around 2% (as in Q2), but gross fixed capital investment has been strong for a year now, growing robustly at 7% in Q3. Likewise, export performance continues to improve and reached 6.8% in Q3. Net exports added 1.4pp to GDP growth. Therefore, growth is currently balanced between internal and external factors.

We see Slovenia's economic prospects better than previously and further increase our GDP growth projections: 2014 to 2.5% and 2015 and 2016 to 2.0%. Thus, expected growth remains slightly below the regional CE average (which is dominated by buoyant Poland). Unemployment is slowly inching down from its high above 10%, falling towards 8-9% in 2015-2016. With export performance strong, the country will continue to show a current account surplus of around 5%. With the large public deficits in support of the banking sector now behind us, the **deficit will fall towards 3-4% over the next two years** – the EU Commission sees the deficit even slightly below the 3% Maastricht line. Inflation dropped to below zero in recent months, but will be slightly positive for 2014 as a whole. Given the continued recovery of the economy, prices may rise slowly in 2015 at slightly below 1% and accelerate further in 2016 to 1-2%. The better-than-expected economic situation in Slovenia can be also attributed to the fact that banking sector restructuring in 2013 and 2014 was finally substantial and far-reaching. The overall economic situation in Slovenia is pointing to the chance that the country may finally become a successful turn-around story within the group of euro area countries that experienced a credit-driven boom-bust cycle (with material impact on the public sector balance sheet).

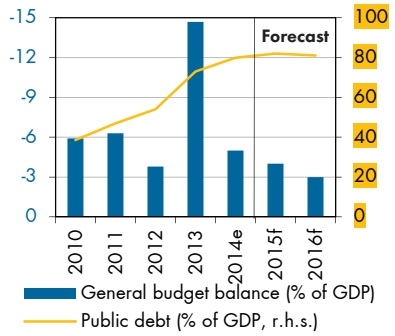
Financial analysts: Andreas Schwabe, CFA, Gunter Deuber, RBI Vienna

Real GDP (% yoy)



Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

Budget balance and public debt



Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

Key economic figures and forecasts*

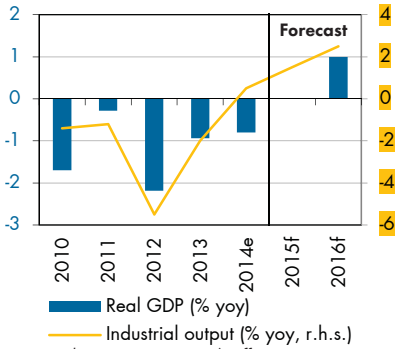
	2010	2011	2012	2013	2014e	2015f	2016f
Nominal GDP (EUR bn)	35.5	36.2	35.3	35.3	36.5	37.8	39.2
Real GDP (% yoy)	1.2	0.7	-2.5	-1.1	2.5	2.0	2.0
Industrial output (% yoy)	7.1	1.3	-1.1	-0.9	4.0	4.0	3.0
Unemployment rate (avg, %)	7.3	8.2	8.9	10.1	10.0	9.5	8.5
Consumer prices (avg, % yoy)	1.8	1.8	2.6	1.8	0.3	0.8	1.5
Consumer prices (eop, % yoy)	1.9	2.0	2.7	1.5	0.3	1.0	1.5
General budget balance (% of GDP)	-5.9	-6.3	-3.8	-14.7	-5.0	-4.0	-3.0
Public debt (% of GDP)	38.6	46.9	54.0	73.0	80.0	82.0	81.0
Current account balance (% of GDP)	-0.1	0.4	3.3	6.5	6.3	4.9	4.7
Official FX reserves (EUR bn)	0.8	0.8	0.7	0.7	0.7	0.7	0.7
Gross foreign debt (% of GDP)	114.7	110.9	115.6	113.3	112.3	112.5	112.2

** euro area entry on 1 January 2007*
Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

No reforms, no growth

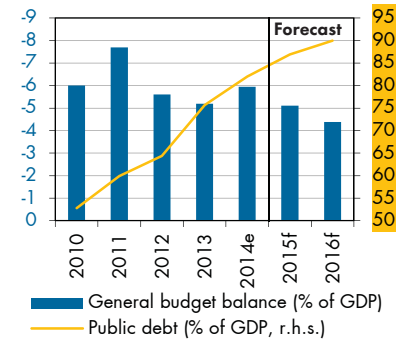
- **Suffering from deep-rooted structural problems**
- **Recovery limited by the lack of domestic demand**
- **Weak fiscal metrics and lack of growth sources threaten the state's credit rating**
- **EUR/HRK to continue sliding towards higher levels, with low volatility**

Real GDP (% yoy)



Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

Budget balance and public debt



Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

Economic outlook

For the 12th quarter in a row, GDP contracted in Q3 2014 confirming that 2014 will be one more year of recession. **Unfavourable developments were mitigated only by export growth**, but due to its relatively modest share this component was not able to reverse the negative trends. The country continues to suffer from deep-rooted structural problems (uncompetitive export industries, a significant private debt overhang, a weak labour market, (overly) large and at the same time expensive and inefficient public administration and poor governance of public finances), all of which are problems that came to the surface during the crisis. Consequently, after the projected GDP fall of 0.8% in 2014, 2015 will probably be a year of stagnation at very low levels.

The start of a **recovery continues to be significantly limited by the lack of domestic demand**. Household consumption is not expected to grow even after the announced reduction of the income tax burden. Similar to the situation in the corporate sector, in addition to high indebtedness, too many changes in tax legislation create insecurity and motivate households to save and deleverage. Investments are bogged down by the deep recession in construction, slack conditions in the real sector, the weak capability to utilise EU funds and pessimism. Nevertheless, we project a mild recovery thanks to the base effect, along with the realisation of some projects and the fact that public investments usually grow during election years. Ultimately, the poor fiscal metrics, i.e. the high general government deficit and unsustainable public debt – which according to the ESA2010 methodology will exceed 80% of GDP – also remain a focus of attention. Obviously, the **EDP target might not be reached within the three-year period**.The budget adopted 2015 is based on overly optimistic estimates and will already be revised again in H1 2015.

Financial analyst: Zrinka Živković Matijević, Raiffeisenbank Austria d.d., Zagreb

Key economic figures and forecasts

	2010	2011	2012	2013	2014e	2015f	2016f
Nominal GDP (EUR bn)	45.0	44.7	44.0	43.6	42.9	43.2	44.2
Real GDP (% yoy)	-1.7	-0.3	-2.2	-0.9	-0.8	0.0	1.0
Industrial output (% yoy)	-1.4	-1.2	-5.5	-2.0	0.5	1.5	2.5
Unemployment rate (avg, %)	11.8	13.5	15.8	17.2	17.4	17.3	17.1
Nominal industrial wages (% yoy)	0.0	1.3	1.9	-1.0	0.0	2.0	2.1
Producer prices (avg, % yoy)	4.3	6.4	7.0	0.5	-2.6	1.5	2.0
Consumer prices (avg, % yoy)	1.1	2.3	3.4	2.2	0.0	1.2	1.5
Consumer prices (eop, % yoy)	1.8	2.1	4.7	0.3	0.5	1.2	2.3
General budget balance (% of GDP)	-6.0	-7.7	-5.6	-5.2	-6.0	-5.1	-4.4
Public debt (% of GDP)	52.8	59.9	64.4	75.7	82.0	86.9	90.0
Current account balance (% of GDP)	-1.1	-0.8	-0.1	0.9	0.5	0.4	0.7
Official FX reserves (EUR bn)	10.7	11.2	11.2	12.9	12.5	12.6	12.7
Gross foreign debt (% of GDP)	103.3	102.6	102.1	104.8	106.8	106.9	105.3
EUR/HRK (avg)	7.29	7.43	7.52	7.58	7.64	7.65	7.66
USD/HRK (avg)	5.49	5.34	5.85	5.71	5.74	6.54	6.44

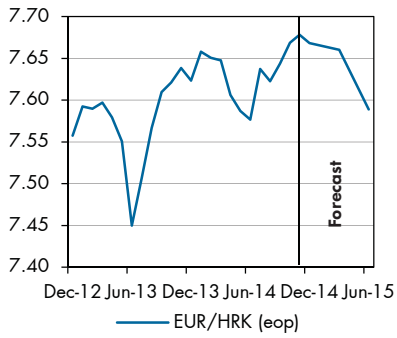
Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

Financial market outlook

In contrast to the fundamentals, but in line with ample liquidity and the low interest rate environment, the local debt market continues to be marked by yield compression. Moreover, not surprisingly, yields also touched historically low levels. Still, the elevated **Croatian spreads** compared to regional peers **clearly reflect the weaker economic fundamentals** as well as the intense risk perception towards Croatian financial markets. In periods of increased volatility we would therefore expect Croatian risk premiums to react more sensitively than other CEE debt markets. Looking ahead, we expect that LCY and FCY bonds will remain around the current low, but still attractive levels compared to EA yield levels in the upcoming quarters, supported by the still comfortable liquidity conditions and buoyed by the accommodative ECB stance in a reach-for-yield environment. Despite the relatively favourable circumstances on the debt market, the Ministry of Finance only partially used the opportunity to pre-finance the liabilities in 2015. The overall **government refinancing needs in 2015 are projected at 22% of GDP.** Excluding the liabilities under issued short-term T-bills, the government's total (re)financing needs in 2015 exceed EUR 5.7 bn. Although we do not see any refinancing risk, it is noticeable that weak fiscal metrics and the lack of growth sources still threaten the state's credit rating. Looking ahead, we at least expect Moody's to follow the suit of S&P and Fitch and adjust Croatia's rating downwards. As this is widely anticipated by market participants, the move should not trigger any material market reaction, as was the case with Fitch's rating downgrade during summer. In the meantime, EUR/HRK has continued to move higher reflecting the unchanged market conditions. The lack of FCY inflow and persistent demand for euros (particularly from corporate and banking sector) keep supporting **slight depreciation pressures of HRK**. Since volatility remains at extremely low levels, there was no need for central bank interventions. Considering that 2015 is also not expected to see any more significant changes in the economy or the market, the EUR/HRK exchange rate is expected to continue sliding towards higher levels, with low volatility. The lack of economic recovery, fiscal risks, increasing bank provisioning and the usual demand for foreign exchange by the corporate sector are factors that should continue to support weakening of the kuna against the euro. The risks of depreciation are also present in the 75% share of public debt denominated in foreign currency, predominantly in euro. Seasonal movements in the exchange rate should continue to be less prominent as was the case in 2014. Divergences (possibly temporary) are possible ahead of sovereign issuances or in the case of FCY inflows from borrowing by (public) enterprises or announced privatisation. Ultimately, we are convinced that the **CNB will remain committed to its stable exchange rate policy**, and the strengthening of Croatia's exports would be of great help (and the inflow of resulting FCY).

Financial analyst: Zrinka Živković Matijević, Raiffeisenbank Austria d.d., Zagreb

Exchange rate development



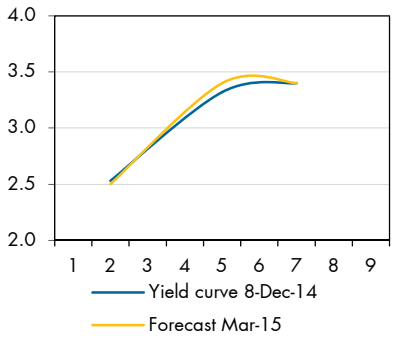
EUR/HRK: 5y high 7.68, 5y low 7.18
Source: Bloomberg, RBI/Raiffeisen RESEARCH

Exchange rate forecasts

	8-Dec[1]	Mar-15	Jun-15	Sep-15	Dec-15
EUR/HRK	7.67	7.66	7.59	7.65	7.70
Cons.		*7.67*	*7.64*	*7.64*	*7.67*
USD/HRK	6.23	6.38	6.49	6.65	6.88
Cons.		*6.11*	*6.15*	*6.19*	*6.28*

[1] 5:00 p.m. (CET)
Source: Bloomberg, RBI/Raiffeisen RESEARCH

HRK yield curve (%)*



** 2y – 10y LCY government bond yields*
Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

Interest rate forecasts

	8-Dec[1]	Mar-15	Jun-15	Sep-15	Dec-15
1 month[2]	0.90	0.80	0.82	0.83	1.00
3 month[2]	1.09	0.90	0.95	1.00	1.20
Consensus		*0.74*	*0.80*	*0.84*	*0.75*
6 month[2]	1.31	1.40	1.40	1.46	1.50

[1] 5:00 p.m. (CET) [2] Offered rate
Source: Bloomberg, RBI/Raiffeisen RESEARCH

Yield forecasts

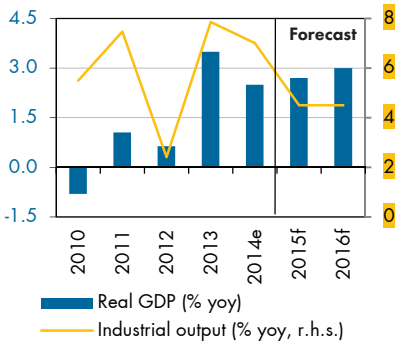
	8-Dec[1]	Mar-15	Jun-15	Sep-15	Dec-15
2y T-bond[2]	2.60	2.5	2.6	2.7	2.8
Consensus		*n.v.*	*n.v.*	*n.v.*	*n.v.*
5y T-bond[2]	3.34	3.4	3.5	3.6	3.6
7y T-bond[2]	3.40	3.4	3.6	3.6	3.7
Consensus		*n.v.*	*n.v.*	*n.v.*	*n.v.*

[1] 5:00 p.m. (CET) [2] Ask yield
Source: Bloomberg, RBI/Raiffeisen RESEARCH

Intact upward trend in economic activity

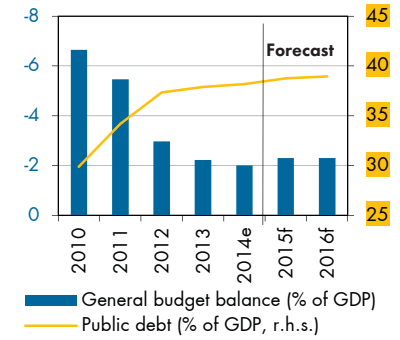
- **While delivering a big surprise, presidential elections are not a game changer**
- **Recovery in consumption and investment remains the main bet for GDP growth in 2015**
- **Favourable inflation outlook and easing by the ECB allows for additional easing of monetary policy**
- **Major policy slippages likely to be avoided even if agreements with the IMF and EC derail**

Real GDP (% yoy)



Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

Budget balance and public debt



Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

Economic outlook

Following a surprising contraction in Q2, real GDP bounced back unexpectedly vigorously in Q3 (+1.8% qoq and 3.2% yoy). This rebound was driven by private consumption on the expenditure side, while industry, services and agriculture all showed positive dynamics. With room to pursue a very large public budget deficit in Q4 2014 (amounting to a maximum of 2.3% of GDP in cash terms), public spending should make a positive contribution to GDP dynamics in Q4. However, we do not expect a visible long-lasting impact on GDP dynamics stemming from this large fiscal impulse. Our expectations are that **GDP dynamics in 2015 will remain close to the levels from 2014**, in the case of a close-to-normal year for agriculture. The upward trend in private consumption should be preserved in the context of positive dynamics for real disposable income supported by increases in nominal wages and employment, low inflation and low interest rates. **Private gross fixed investments have the largest room to recover** following the very poor performance over the past year, and an increase in public investments is likely, as well.

Mr. Iohannis, the candidate of the right-centre alliance won the presidential elections, and this was quite a major surprise. The left-centre alliance led by the Social Democratic Party (PSD) has enough seats in parliament to maintain the government in power in the near term. Mr Ponta faces some risks of missing support from his own party and its allies after losing the presidential race. However, we do not expect this to happen and we expect Mr Ponta to continue as Prime Minister with a reshuffled government. We do not look for major policy slippages in the near term even if the precautionary agreements with the IMF and the EC derail. A **public budget deficit of around 2-2.3% of GDP should not worry** investors too much. But failure to go forward with reforms is the main risk on the domestic front, and this is the area where political commitment makes the difference.

Financial analyst: Nicolae Covrig, Raiffeisen BANK S.A., Bucharest

Key economic figures and forecasts

	2010	2011	2012	2013	2014e	2015f	2016f
Nominal GDP (EUR bn)	126.8	133.3	133.8	144.7	151.1	159.1	170.0
Real GDP (% yoy)	-0.8	1.1	0.6	3.5	2.5	2.7	3.0
Industrial output (% yoy)	5.5	7.5	2.4	7.9	7.0	4.5	4.5
Unemployment rate (avg, %)	7.0	7.2	6.8	7.1	7.0	6.8	6.8
Nominal industrial wages (% yoy)	8.3	6.7	4.6	4.2	6.0	5.5	5.5
Producer prices (avg, % yoy)	4.4	7.1	5.4	2.1	-0.1	0.2	2.5
Consumer prices (avg, % yoy)	6.1	5.8	3.3	4.0	1.1	1.4	2.4
Consumer prices (eop, % yoy)	8.0	3.1	5.0	1.6	1.4	2.0	2.8
General budget balance (% of GDP)	-6.6	-5.5	-3.0	-2.2	-2.0	-2.3	-2.3
Public debt (% of GDP)	29.9	34.2	37.3	37.9	38.2	38.8	39.0
Current account balance (% of GDP)	-4.6	-4.6	-4.5	-0.8	-0.9	-1.5	-2.0
Official FX reserves (EUR bn)	32.4	33.2	31.2	32.5	31.5	32.5	33.5
Gross foreign debt (% of GDP)	73.9	75.0	75.4	67.8	63.5	62.8	61.8
EUR/RON (avg)	4.21	4.24	4.46	4.42	4.44	4.43	4.40
USD/RON (avg)	3.17	3.05	3.47	3.33	3.34	3.79	3.70

Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

Financial market outlook

Inflation dynamics in recent months were slower than expected, thanks to a broad range of factors: depressed domestic demand, low imported inflationary pressures, decreasing petrol prices, and a freeze on household tariffs for natural gas from domestic production. Moreover, the inflation outlook remains favourable. We expect the annual inflation rate to fluctuate below a level of 1.0% yoy until May 2015 before increasing gradually towards 2.0% yoy by the end of 2015. Besides the favourable domestic inflation outlook, the additional quantitative easing measures expected to be put in place by the ECB also boost the leeway of the **Romanian central bank (NBR) to lower the monetary policy rate**. In our baseline, we look for the NBR to reduce the key rate by another 50bp, from 2.75% to 2.25% (two consecutive cuts of 25bp in Jan and Feb 2015). But more importantly, in H1 2015 the overall stance of monetary policy has good chances to be less restrictive as the level of the monetary policy rate would suggest. We expect the sentiment of foreign investors for **RON T-securities to remain positive due to their attractive risk-return profile** (attractive level of yields in a global low interest rate environment, limited risks of major policy slippages even if agreements with the IMF and the EC derail, low macroeconomic imbalances, large liquidity buffers of the central bank and of the Finance Ministry). In this context, we see room for the central bank not to fully sterilise the liquidity surplus from the money market, which would result in a low level of money market interest rates in H1 2015. The large spike in public spending from November and December 2014 should result in a large liquidity surplus in the money market that will only gradually dissipate in Q1 2015 (by a public budget surplus and net positive issuance in RON T-securities). If the positive sentiment towards RON assets persists, the NBR can refresh the liquidity surplus by cutting RON minimum reserve requirements if necessary.

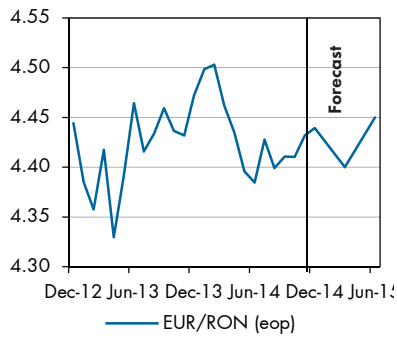
Favourable liquidity conditions in the money market should anchor the short-end of the RON yield curve at low levels in H1 2015, while the easing by the ECB should anchor the long-end of the curve. We expect the **RON yield curve to shift upwards in H2 2015 on the back of higher yields on the external markets** and higher domestic inflationary pressures.

Portfolio flows are likely to remain the main factor shaping moves and inducing volatility in the leu exchange rate. As previously, we expect the NBR to continue smoothing large fluctuations.

Key risks to our baseline scenario relate to an increase in risk aversion of investors towards CEE assets and an increase in domestic inflation due to materialisation of adverse supply side shocks which are not possible to predict (i.e. bad weather conditions).

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

Exchange rate development



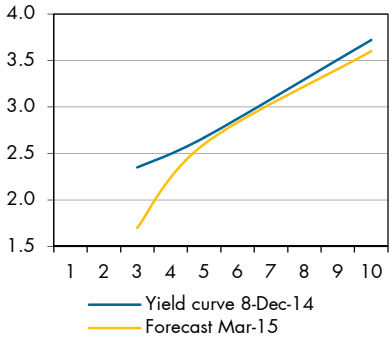
EUR/RON: 5y high 4.64, 5y low 4.06
Source: Bloomberg, RBI/Raiffeisen RESEARCH

Exchange rate forecasts

	8-Dec[1]	Mar-15	Jun-15	Sep-15	Dec-15
EUR/RON	4.44	4.40	4.45	4.45	4.40
Cons.		*4.45*	*4.43*	*4.40*	*4.40*
USD/RON	3.61	3.67	3.80	3.87	3.93
Cons.		*3.64*	*3.69*	*3.70*	*3.73*

[1] 5:00 p.m. (CET)
Source: Bloomberg, RBI/Raiffeisen RESEARCH

RON yield curve (%)*



** 2y – 10y LCY government bond yields*
Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

Interest rate forecasts

	8-Dec[1]	Mar-15	Jun-15	Sep-15	Dec-15
Key rate	2.75	2.25	2.25	2.25	2.25
Consensus		*2.55*	*2.55*	*2.60*	*2.70*
1 month[2]	0.26	0.70	1.10	1.30	1.50
3 month[2]	1.17	1.10	1.30	1.50	1.70
Consensus		*2.03*	*2.16*	*2.49*	*2.66*
6 month[2]	1.23	1.15	1.25	1.40	1.50
12 month[2]	1.25	1.15	1.30	1.45	1.50

[1] 5:00 p.m. (CET) [2] Bid rate
Source: Bloomberg, RBI/Raiffeisen RESEARCH

Yield forecasts

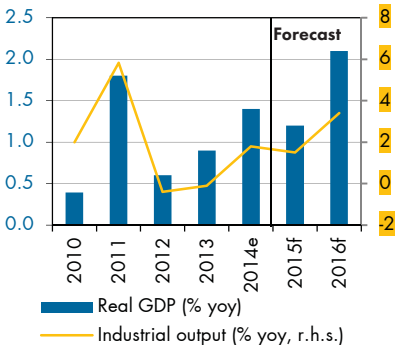
	8-Dec[1]	Mar-15	Jun-15	Sep-15	Dec-15
2y T-bond[2]	1.75	1.7	1.9	2.1	2.2
Consensus		*n.v.*	*n.v.*	*n.v.*	*n.v.*
5y T-bond[2]	2.54	2.6	2.7	2.9	3.1
10y T-bond[2]	3.59	3.6	3.7	3.9	4.1
Consensus		*n.v.*	*n.v.*	*n.v.*	*n.v.*

[1] 5:00 p.m. (CET) [2] Ask yield
Source: Bloomberg, RBI/Raiffeisen RESEARCH

Will higher public debt lead to sustainable growth?

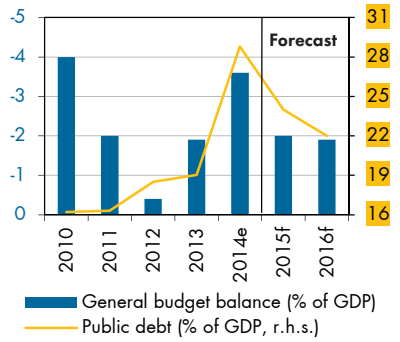
- **Temporary governments are often the most durable**
- **Growth in 2015 affected by the collapse of Corporate Commercial Bank**
- **Deflationary pressure declines – moderate inflation expected**
- **Increasing lending continues in Q1 2015**

Real GDP (% yoy)



Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

Budget balance and public debt



Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

The new pro-European, pro-Atlantic government coalition of 4 parties and coalitions was voted in on 7 November. It inherited a serious budget deficit of 3.7% of GDP, which is to be covered by a large amount of new public debt (EUR 2.3 bn). Despite the unusually large coalition for a country with precarious experience with coalition governments, the **new government seems to stay in power at least for a year**, since people and parties are currently not convinced about the benefits of new elections, as they do not believe that anything substantial is going to change. However, if the government demonstrates a strong commitment to governing openly and solving real economic and social problems, it could remain in power until the end of its mandate.

Real GDP grew by 0.4% on a quarterly basis and 1.5% on annual basis in the third quarter, with final consumption decelerating to 0.8% yoy but sustainable growth of gross fixed capital formation. Compared to 2013 economic growth of 1.4% yoy is a reasonable projection for 2014, driven by stronger domestic demand and gross fixed capital formation. The **accumulated financial imbalances from the collapse of Corporate Commercial Bank** (KTB), once the fourth-largest bank in Bulgaria, **will become effective in 2015** and will hinder growth, which is only expected to reach 1.2%. Nevertheless, the problems in the banking system caused by KTB and First Investment Bank (third largest) remained isolated cases and did not affect the stability of the banking sector and the currency board. The currency board remained stable: in October 2014 the coverage of the monetary base with FX reserves reached 175.5%, with 100% required. On the other hand, lending has expanded since the beginning of 2014 and is expected to rise further in Q1 2015 and beyond, on the back of moderate declines in interest rates and high liquidity in the sector.

Financial analyst: Emil S. Kalchev, Raiffeisenbank (Bulgaria) JSC, Sofia

Key economic figures and forecasts

	2010	2011	2012	2013	2014e	2015f	2016f
Nominal GDP (EUR bn)	36.1	38.5	39.9	39.9	40.0	41.2	42.9
Real GDP (% yoy)	0.4	1.8	0.6	0.9	1.4	1.2	2.1
Industrial output (% yoy)	2.0	5.8	-0.4	-0.1	1.8	1.5	3.4
Unemployment rate (avg, %)	10.2	11.3	12.3	12.9	11.9	11.7	10.7
Nominal industrial wages (% yoy)	8.6	10.1	11.5	0.9	2.4	6.3	4.8
Producer prices (avg, % yoy)	8.7	9.4	4.2	-1.4	-1.4	2.8	2.9
Consumer prices (avg, % yoy)	2.4	4.2	3.0	0.9	-1.2	1.9	3.2
Consumer prices (eop, % yoy)	4.5	2.8	4.2	-1.6	0.1	3.0	3.0
General budget balance (% of GDP)	-4.0	-2.0	-0.4	-1.9	-3.6	-2.0	-1.9
Public debt (% of GDP)	16.2	16.3	18.5	19.0	28.8	24.0	22.0
Current account balance (% of GDP)	-1.5	0.1	-0.8	1.9	0.3	-0.5	-0.8
Official FX reserves (EUR bn)	13.0	13.3	15.6	14.4	15.9	17.9	20.2
Gross foreign debt (% of GDP)	102.7	94.3	94.3	93.5	100.2	96.2	93.8
EUR/BGN (avg)	1.96	1.96	1.96	1.96	1.96	1.96	1.96
USD/BGN (avg)	1.47	1.41	1.52	1.47	1.47	1.67	1.64

Source: Thomson Reuters, wiiw, Raiffeisen RESEARCH

Sluggish economic recovery amidst public sector reforms

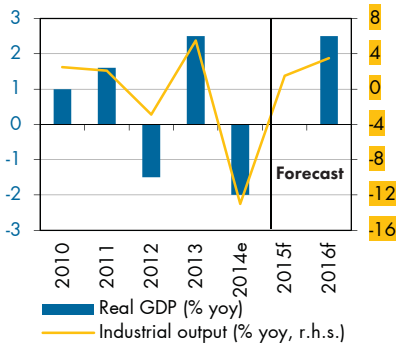
- **Further EUR/RSD weakening amidst slowing exports and shaken investor confidence**
- **Falling inflation supports the easing of monetary policy**
- **Privatisation/closure of SOEs tops the agenda, IMF deal may help in reforming**
- **Credit supply will remain tight amidst high NPLs**

Following the recession caused by the flooding damage, in our new forecast **we expect that GDP will show zero growth in 2015**. Downside triggers continue to be weak credit supply hampered by high NPLs, lacklustre retail and public demand, along with a tough reform agenda and high geopolitical risks. A ray of hope will come from exports after the Beograd-Bar railway starts operating from the end of Q1 2015, in addition to the translation of FDI from 2013-2014 into new exports and the impact of flood-related infrastructure projects. We did not take into account the start of the Gazprom-sponsored South Stream gas pipeline, so if cancellation of the project actually occurs this would not have an impact on our forecasts. An attractive investment incentive scheme will support flows of FDI, but – despite hard currency inflows – **EUR/RSD weakening in Q1 2015 will continue** to be driven by the slack economy and weak risk appetite for local debt. We reckon that increases in regulated prices will be delayed again due to the weak purchasing power, the supportive low inflation environment and gradual key rate cuts in H1 2015. However, we could expect key rate hikes from Q3 2015 amidst persistent EUR/RSD weakening.

The IMF arrangement will be focused on **restructuring of the large state-owned enterprises** (SOEs), namely electricity, gas, railways and road companies, as the biggest budget drainers. In 2015 we might see the closure of 100-200 SOEs (out of 502 SOEs in the privatisation process), along with finding strategic partner(s) or/and introducing local professional management for the rest of SOEs. It could be that the state-owned Telekom will be finally sold, and privatisation preparation is under way for the largest state-owned Komercijalna Banka (scheduled for 2016/17). There are also a few state-owned banks that will need recapitalisation because of high NPLs, and the postponement of price hikes for communal services will increase SOEs' losses. We reckon that the first tangible results of implementing reform measures will reignite demand for local debt.

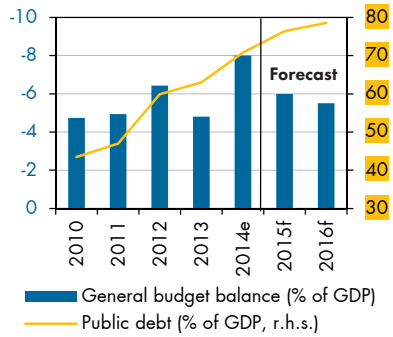
Financial analyst: Ljiljana Grubic, Raiffeisenbank a.d., Belgrade

Real GDP (% yoy)



Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

Budget balance and public debt



Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

Key economic figures and forecasts

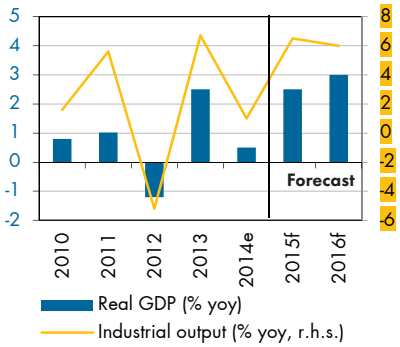
	2010	2011	2012	2013	2014e	2015f	2016f
Nominal GDP (EUR bn)	28.0	31.5	29.6	32.0	31.9	32.1	33.1
Real GDP (% yoy)	1.0	1.6	-1.5	2.5	-2.0	0.0	2.5
Industrial output (% yoy)	2.5	2.1	-2.9	5.5	-13.0	1.5	3.5
Unemployment rate (avg, %)	19.2	23.0	23.9	22.1	22.0	23.0	22.0
Nominal industrial wages (% yoy)	10.0	5.0	1.5	1.5	4.0	5.0	4.0
Producer prices (avg, % yoy)	12.7	14.2	5.6	3.6	1.3	2.0	3.0
Consumer prices (avg, % yoy)	6.3	11.3	7.8	7.8	2.1	3.3	4.3
Consumer prices (eop, % yoy)	10.3	7.0	12.2	2.2	2.6	4.0	4.5
General budget balance (% of GDP)	-4.7	-4.9	-6.4	-4.8	-8.0	-6.0	-5.5
Public debt (% of GDP)	43.5	47.0	59.9	63.0	70.8	76.4	78.5
Current account balance (% of GDP)	-6.7	-9.1	-12.3	-6.5	-6.3	-6.9	-7.9
Official FX reserves (EUR bn)	10.0	12.1	10.9	11.2	11.9	12.3	12.0
Gross foreign debt (% of GDP)	84.9	76.7	86.9	80.8	83.9	86.8	85.8
EUR/RSD (avg)	103.0	102.0	113.0	113.1	117.3	123.2	125.8
USD/RSD (avg)	77.6	73.3	87.9	85.1	88.2	105.3	105.7

Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

In expectation of the new State Government

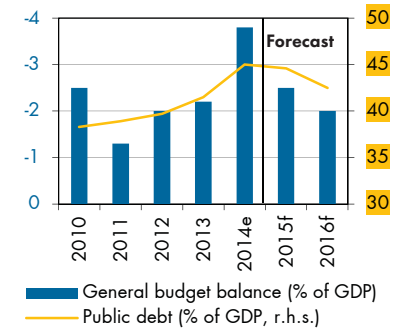
- **Resilience of the real economy after the flooding disaster proved to be better than expected**
- **Slower-than-expected progress in reconstruction dampens 2015 outlook**
- **Right-oriented parties will form the State-level government**
- **We do not expect drastic acceleration of the EU integration process**

Real GDP (% yoy)



Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

Budget balance and public debt



Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

Currently, the hottest topic in the country is the ongoing negotiations on the formation of the **State-level government**, which **will be formed mostly by the right-oriented parties**, which were the overall winners of the elections. In the best-case scenario, we expect a government to be formed in January 2015: it will likely consist of the SDA-HDZ and DF from the Federation of B&H, while the toughest negotiations are related to the parties which will form the majority from the Republic of Srpska (SDS and its coalition partners now have a more than 90% chance). On the other hand, the **real economy showed better-than-expected resilience to the natural disaster** which strongly impacted the B&H economy in May 2014 with heavy flooding resulting in damages and losses on the order of 14.8% of GDP. Hence, real GDP contracted only in Q2 (-1.2% qoq and yoy) followed by a solid stabilisation and recovery in the major drivers of the economy in Q3: industrial production, exports of goods and retail sales (up by 0.4%, 6.3% and 2.2%, respectively) correlated with real growth of GDP of around 0.4%-0.5% yoy in Q4. In Q4, we expect to see further acceleration in exports and industrial production, which is anticipated to result in real GDP growth in the range of 1-1.2% yoy. Hence, we have slightly **revised our real GDP estimate for 2014 up to 0.5% yoy**. Taking into account very sluggish pace of reconstruction work in the country in both the areas of public and private investments which was one of the major downside risks to our mid-term outlook, we have also revised real GDP growth rates for 2015 and 2016. We do not expect to see double-digit growth rates in gross fixed capital formation, but only a moderate single-digit range of 5-6% yoy driven by the infrastructure projects in the country (Corridor Vc and electro-cycle: TP Tuzla in FB&H and TP Stanari in RS) and reconstruction work. On the other hand, the robust growth in exports of goods and services followed by moderate growth in private and public consumption were left unchanged as the key drivers of our GDP growth estimate.

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

Key economic figures and forecasts

	2010	2011	2012	2013	2014e	2015f	2016f
Nominal GDP (EUR bn)	12.7	13.2	13.2	13.4	13.6	14.2	14.9
Real GDP (% yoy)	0.8	1.0	-1.2	2.5	0.5	2.5	3.0
Industrial output (% yoy)	1.6	5.6	-5.2	6.7	1.0	6.5	6.0
Unemployment rate (avg, %)	27.2	27.6	28.0	27.5	28.2	26.5	24.0
Nominal industrial wages (% yoy)	2.4	6.8	2.2	-0.5	0.3	3.0	5.0
Producer prices (avg, % yoy)	0.9	3.7	1.9	-1.8	0.0	1.0	2.0
Consumer prices (avg, % yoy)	2.1	3.7	2.1	-0.1	-0.9	1.5	2.5
Consumer prices (eop, % yoy)	3.1	3.1	1.8	-1.2	0.0	2.0	2.6
General budget balance (% of GDP)	-2.5	-1.3	-2.0	-2.2	-3.8	-2.5	-2.0
Public debt (% of GDP)	38.3	38.9	39.7	41.5	45.0	44.6	42.5
Current account balance (% of GDP)	-6.1	-9.7	-9.3	-6.0	-9.6	-8.5	-7.4
Official FX reserves (EUR bn)	3.3	3.3	3.3	3.6	3.9	4.1	4.3
Gross foreign debt (% of GDP)	57.3	66.8	63.1	62.5	66.4	63.6	58.3
EUR/BAM (avg)	1.96	1.96	1.96	1.96	1.96	1.96	1.96
USD/BAM (avg)	1.47	1.41	1.52	1.47	1.47	1.67	1.64

Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

Painful reforms, IMF programme on track

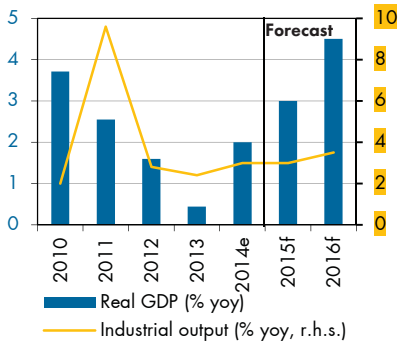
- **Economic growth recovering at a moderate level of 3.0%**
- **Structural reforms moving in the right direction**
- **2015 budget and fiscal package cuts budget deficit to 4.1% of GDP by end-2015**
- **Local elections to be held by mid-2015 and will eventually raise the political heat**

Despite the poor 0.6% growth rate registered for Q2 2014, which was also due to the low level of public investment, the economy is expected to grow at a rate of 2% in 2014. In 2015, growth is estimated at 3%, supported by external demand and an eventual moderate recovery in domestic demand. The base rate was cut by another 25bp to 2.25% in late November 2014, marking a new historical low, and **monetary policy will remain expansive in 2015** as no inflationary pressures are expected. FDI and export growth are expected to accelerate compared to 2014, and with the start of the TAP project in 2015 new investments in the oil sector and hydropower plants are expected as well. By late January 2015, Albania is expecting the disbursement of about EUR 53 mn from the IMF loan programme after approval of the second and third reviews. By November 2015, **Albania might tap the international market again**, as its EUR 300 mn 5y Eurobond is maturing. So far, the rating agency S&P has upgraded the outlook for Albania from "stable" to "positive", rewarding the ambitious plans of the government in terms of shrinking the budget deficit and reforming the justice system. However, as local elections will be held mid-2015, the new territorial administrative reform is expected to impact the local elections and eventually increase the political heat by that time.

In line with the fiscal consolidation policy, the government reduced the budget deficit by 31.1% yoy in the first ten months of the year, reflecting an increase in revenues of 12.0% yoy and prudent government spending. Furthermore, the **budget approved for 2015 and the new fiscal policy aim to reduce the budget deficit** to 4.1% of GDP by end-2015 and lower public debt to 65.5% of GDP by end-2017. This consolidation of public finances will be sustained by the structural reforms approved so far and the energy sector reform that is ongoing to kick in. The energy sector is going to facilitate a loan of EUR 100 mn from the World Bank. Capital expenses in 2015 are foreseen at 5.4% of GDP, with a focus on water sector, infrastructure, energy and tourism.

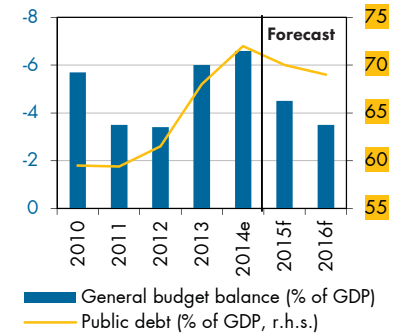
Financial analyst: Valbona Gjeka, Raiffeisen Bank Sh.a., Tirana

Real GDP (% yoy)



Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

Budget balance and public debt



Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

Key economic figures and forecasts

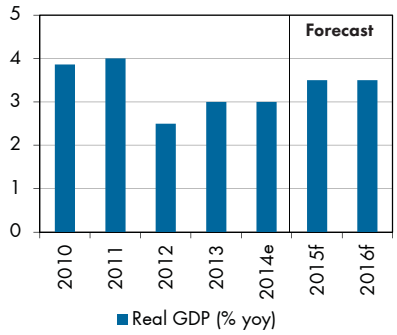
	2010	2011	2012	2013	2014e	2015f	2016f
Nominal GDP (EUR bn)	8.9	9.4	9.7	9.8	10.3	11.0	11.9
Real GDP (% yoy)	3.7	2.6	1.6	0.4	2.0	3.0	4.5
Industrial output (% yoy)	2.0	9.6	2.8	2.4	3.0	3.0	3.5
Unemployment rate (avg, %)	13.5	14.0	13.3	17.0	17.5	17.0	15.0
Nominal industrial wages (% yoy)	8.0	8.0	8.0	8.0	8.0	8.0	3.0
Producer prices (avg, % yoy)	0.2	2.6	1.1	-0.4	-1.0	5.0	4.0
Consumer prices (avg, % yoy)	4.0	3.5	2.0	1.9	1.8	2.5	2.8
Consumer prices (eop, % yoy)	3.5	1.7	2.4	1.9	1.8	2.4	3.0
General budget balance (% of GDP)	-5.7	-3.5	-3.4	-6.0	-6.6	-4.5	-3.5
Public debt (% of GDP)	59.5	59.4	61.5	68.0	72.0	70.0	69.0
Current account balance (% of GDP)	-10.8	-11.8	-9.3	-10.4	-10.2	-10.5	-9.9
Official FX reserves (EUR bn)	1.9	1.9	1.9	1.9	1.9	1.9	2.0
Gross foreign debt (% of GDP)	24.7	24.5	25.8	28.2	28.5	29.3	30.8
EUR/ALL (avg)	137.8	140.4	139.0	140.3	140.1	140.3	139.9
USD/ALL (avg)	103.9	100.8	108.2	105.6	105.3	119.9	117.5

Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

Overcoming political stalemate

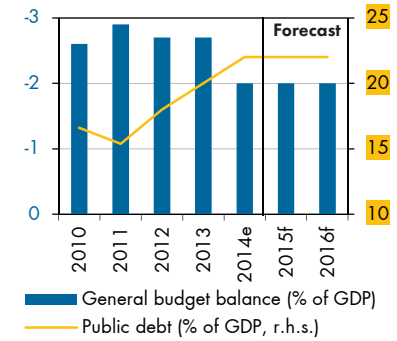
- **Economic growth expectations for 2014 lowered**
- **Decrease in FDI and public investment**
- **Increase in remittances**
- **Still no developments on government formation since national elections in June 2014**

Real GDP (% yoy)



Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

Budget balance and public debt



Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

Economic growth estimates for 2014 were lowered because of the decrease in public investments and foreign direct investment and also the increase in the trade deficit. At the beginning of 2014, growth of 3.7% was forecast and now this has been lowered to 3.1%. **Consumption is expected to continue its growth trend in Q1 2015**, due to the expected increase in wages by 25% in the public sector and as remittances grew 6.9% up to September 2014 with this trend projected to continue.

The price trend is very similar to international market prices as Albania is highly dependent on imports, which is also shown in the similar movement of the import price index. Until September 2014, the CPI was 0.6%. Budget income has reached the amount of EUR 964 mn, but until September 2014 revenues were not collected in form of dividends from public enterprises. Capital investments have decreased by 36.2%, mostly due to finalisation of the R7 highway construction as well as the postponement of many projects, due to the delay in the formation of the institutions. Banking sector assets increased by 7.3% yoy, which is mostly attributed to growth of investment in securities and the balance with the commercial banks and loan activity. Profit growth in the banking sector was the highest since the beginning of the functioning of the banking sector, reaching the amount of EUR 46.9 mn. Loans grew by 3.2%, while deposits grew by 7.4%.

The political situation has affected the development of the country very significantly, as it has been six months since the elections were held and the institutions still have not yet been formed. The **government is expected to be formed until the end of the first quarter 2015**, but the budget for 2015 has to be approved, as well. This situation has impacted the lower foreign direct investments and as well as the budget deficit. President Atifete Jahjaga could call extraordinary elections if political leaders do not manage to reach an agreement for getting out of the current situation in Kosovo.

Financial analyst: Arta Kastrati, Raiffeisen Bank Kosovo J.S.C., Pristina

Key economic figures and forecasts*

	2010	2011	2012	2013	2014e	2015f	2016f
Nominal GDP (EUR bn)	4.1	4.6	4.7	4.9	5.1	5.4	5.8
Real GDP (% yoy)	3.9	4.0	2.5	3.0	3.0	3.5	3.5
Unemployment rate (avg, %)	45.1	41.4	44.8	30.5	30.5	31.0	31.0
Producer prices (avg, % yoy)	4.7	6.5	0.8	3.5	0.2	2.5	2.5
Consumer prices (avg, % yoy)	3.5	7.3	2.5	1.8	0.6	2.5	3.0
Consumer prices (eop, % yoy)	6.6	3.6	3.7	0.5	0.6	2.5	2.5
General budget balance (% of GDP)	-2.6	-2.9	-2.7	-2.7	-2.0	-2.0	-2.0
Public debt (% of GDP)	16.6	15.4	18.0	20.0	22.0	22.0	22.0
Current account balance (% of GDP)	-12.6	-14.4	-8.0	-7.0	-7.6	-7.5	-6.5
Official FX reserves (EUR bn)	0.7	0.6	1.2	1.4	1.4	1.5	1.5
Gross foreign debt (% of GDP)	17.1	15.8	14.8	14.4	13.7	12.9	12.1

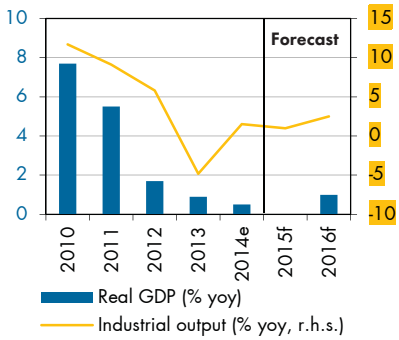
** EUR official currency in Kosovo*
Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

Where will the growth come from?

- **Domestic demand loses steam as the main driver of GDP growth**
- **Weakening Russian economy already an impact as exports fall**
- **Weaker RUB increases depreciation pressure on BYR, but no policy change ahead of elections**
- **Financing needs remain high, requiring new bilateral loans and possibly market access**

Belarus showed modest, but stable economic growth in recent months with a GDP growth rate amounting to around 1.5% yoy. This slightly stronger economic activity is based on a revival in capital investment, higher potash exports and less demand for intermediary non-energy imports. On the other hand, the recent sharp devaluation of the Russian rouble and the overall weakening of the neighbouring economy has put additional pressure on Belarusian industry and led to decreasing competitiveness and losses for exporters. Given the bleak outlook for the Russian economy in the coming years and weaker household consumption amidst decreasing real wages, we remain rather conservative about the medium to long-term economic development of Belarus, expecting **deteriorating GDP growth rates in the years ahead**. Other sectors of the economy (e.g. industry, construction) will also not be able to provide any strong support to GDP growth. In general, our projections correspond with the official forecast of 0.2-0.7% GDP growth in 2015.

Real GDP (% yoy)

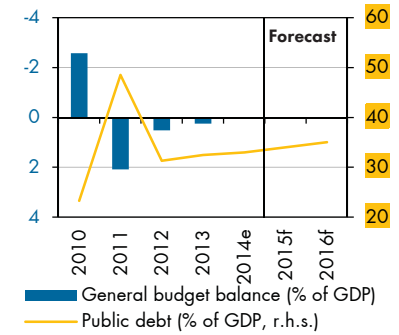


Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

Up to now, smooth, predictable depreciation of the Belarusian rouble against the US dollar (14% ytd) is considered by the National Bank as a key issue for maintaining stability on the money market, and preventing BYR deposit outflows and high demand for FX. We believe that the policy of **gradual depreciation of the local currency will be continued next year**, and dramatic changes will be avoided ahead of the presidential elections in November 2015, resulting in 15-16% devaluation of BYR in 2015. However, we would not rule out the possibility of accelerated weakening of the local currency in 2016, due to appreciation of the real exchange rate against RUB, continued inflationary pressures and high repayments on external debt. In 2015-2016, Belarus should repay more than USD 6 bn in external debt, which should be covered by new bilateral loans, FX borrowings in the local market and a possible new Eurobond issue for the one maturing in 2015.

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

Budget balance and public debt



Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

Key economic figures and forecasts

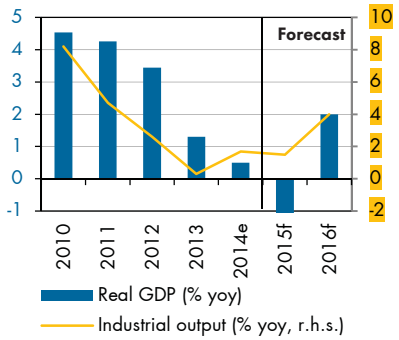
	2010	2011	2012	2013	2014e	2015f	2016f
Nominal GDP (EUR bn)	41.6	40.9	49.3	53.8	57.0	66.1	62.7
Real GDP (% yoy)	7.7	5.5	1.7	0.9	0.5	0.0	1.0
Industrial output (% yoy)	11.7	9.1	5.8	-4.8	1.5	1.0	2.5
Unemployment rate (avg, %)	0.7	0.6	0.5	0.5	1.0	1.0	1.0
Nominal industrial wages (% yoy)	25.3	59.2	93.8	35.2	25.0	15.0	15.0
Producer prices (avg, % yoy)	13.6	71.4	76.0	13.6	12.9	12.5	10.0
Consumer prices (avg, % yoy)	7.7	53.2	59.2	18.3	19.0	18.0	15.0
Consumer prices (eop, % yoy)	9.9	108.7	21.8	16.5	21.0	15.0	15.0
General budget balance (% of GDP)	-2.6	2.1	0.5	0.2	0.0	0.0	0.0
Public debt (% of GDP)	23.3	48.5	31.3	32.5	33.0	34.0	35.0
Current account balance (% of GDP)	-15.0	-9.0	-2.9	-10.2	-5.4	-5.9	-7.5
Official FX reserves (EUR bn)	2.6	4.6	4.4	3.6	2.9	2.9	2.4
Gross foreign debt (% of GDP)	51.0	64.1	51.9	52.7	52.9	53.0	56.3
EUR/BYR (avg)	3,954	7,263	10,748	11,828	13,591	13,842	17,136
USD/BYR (avg)	2,981	5,218	8,360	8,906	10,219	11,831	14,400

Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

Major hurdles ahead as sanctions bite

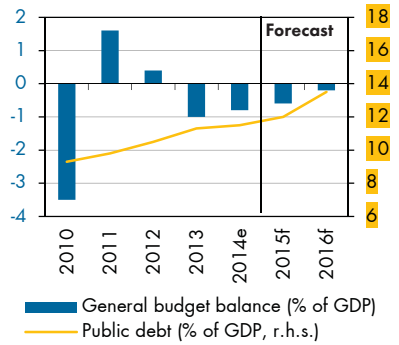
- **Negative growth expected in 2015 due to weaker oil price and the "Ukraine factor"**
- **Further monetary policy tightening is likely as CPI is on the rise**
- **Russian rouble under severe pressure as oil price declines**
- **OFZs pricing looks quite expensive vs key rate**

Real GDP (% yoy)



Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

Budget balance and public debt



Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

Economic outlook

The negative impacts of Western sanctions have not fully materialised and will become even more acute in 2015. We expect GDP contraction of 1.5% in 2015, while we see a possibility of recovery by 2% in 2016, with a long-term path of economic growth at 1-2% yoy. Deteriorating business sentiment, the rising cost of borrowing and inflationary pressure will lead to a prolonged pause in investment. Additional risks stem from the bleaker outlook for the oil price. State infrastructure projects financed from the **National Welfare Fund (up to EUR 7 bn in 3 years) and higher public investment will not be enough** to relaunch investment growth. Producers have been revising downward their expectations for demand, which leads to ongoing destocking, and this tendency should not reverse until 2016. Weaker economic activity and private investments risks create the threat of further **deceleration in real wages, which may slip into the red zone** in 2015.

Inflationary and RUB devaluation expectations as well as higher interest rates would also reduce purchasing power. Food consumption continues to decrease among other reasons driven by the imports ban, while the intensified consumption of durables (supported by willingness to prevent savings from depreciation) could diminish in future. Now imports substitution is limited, although we see some acceleration in the production of some food products. At the same time, imports substitution at the current level is not enough to curb inflationary pressure. With the anticipated oil price decrease in 2015, there will be **more significant RUB depreciation and a larger pass-through effect**. We increased our forecast for CPI in 2015, but still expect it to decelerate in the mid-term. We think that the Central Bank of Russia (CBR) will continue with its **monetary policy tightening until the end of H1 2015**.

Financial analyst: Maria Pomelnikova, ZAO Raiffeisenbank, Moscow

Key economic figures and forecasts

	2010	2011	2012	2013	2014e	2015f	2016f
Nominal GDP (EUR bn)	1,149.2	1,359.7	1,547.6	1,575.9	1,426.2	1,158.4	1,332.2
Real GDP (% yoy)	4.5	4.3	3.4	1.3	0.5	-1.5	2.0
Industrial output (% yoy)	8.2	4.7	2.6	0.3	1.7	1.5	4.0
Unemployment rate (avg, %)	7.5	6.6	5.7	5.6	5.5	5.8	6.0
Average gross wages (% yoy)	12.4	11.5	13.9	12.5	9.0	7.0	7.0
Producer prices (avg, % yoy)	16.7	12.0	5.1	3.7	6.5	5.5	4.5
Consumer prices (avg, % yoy)	6.9	8.5	5.1	6.8	7.6	9.4	7.0
Consumer prices (eop, % yoy)	8.8	6.1	6.6	6.5	9.4	8.0	6.5
General budget balance (% of GDP)	-3.5	1.6	0.4	-1.0	-0.8	-0.6	-0.2
Public debt (% of GDP)	9.3	9.8	10.5	11.3	11.5	12.0	13.5
Current account balance (% of GDP)	4.4	5.1	3.6	1.6	3.4	3.7	2.5
Official FX reserves (EUR bn)	331.0	349.7	369.1	342.9	332.8	357.1	320.0
Gross foreign debt (% of GDP)	31.8	30.7	31.3	33.6	34.7	47.0	37.2
EUR/RUB (avg)	40.3	40.9	39.9	42.3	50.5	66.6	62.9
USD/RUB (avg)	30.4	29.4	31.1	31.9	38.2	56.7	53.2
Basket/RUB (avg)	34.8	34.6	35.1	36.6	43.7	61.1	57.6

Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

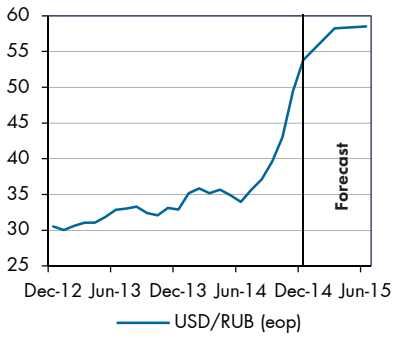
Financial market outlook

The rouble witnessed a severe depreciation trend throughout Q4 2014 mainly hit by the oil price decline, but with rising influence from speculative attacks (the rouble depreciated even during oil price recovery periods). The CBR reacted with rate increases and decided in November to let the rouble float freely, also in an attempt to prevent further declines of its FX reserves. At the same time, the CBR left a door open for intervention in case of financial distress, thereby spurring market speculation as to when the CBR might opt to intervene. Currently, RUB is under pressure from numerous sides: the weak economy, sanctions due to the Ukraine conflict and in the recent past the oil price. **For H1 2015, we project this pressure to continue**, thereby driving RUB to even weaker levels. The scope of depreciation is not only explained by the fundamentals, which increases the risks of more acute depreciation in H1 2015. Possibly the trend could be stopped by a sudden intervention policy of the CBR, but we currently project that the USD/RUB rate could hit levels close to 60 in H1. In Q2, the rouble will remain under pressure from the sanctions extension by the euro area (euro area sanctions against Russia are imposed for one year and must then be renewed) and the low oil price. Nevertheless, the outlook for a possible lifting of euro area sanctions and a slowly rising oil price could give the oversold rouble some support later in the second half of 2015.

In September-December the main factor which affected local bond market was the intensified RUB depreciation driven by a sharp oil price drop as well as the demand for FX for external debt redemption (USD 15 bn scheduled for September) and the shift to a free-float regime. Although the CBR hiked the key rate by 150bp in October (400bp since the start of the year), yields on long-dated domestic government bonds (OFZ) have not increased that much. Their spreads over CBR's REPO rate have narrowed to minimum levels (100-120bp). The increase in OFZ yields would have been more significant if MinFin had not taken a pause in issuing new papers. This decision was supported by no strong need for borrowings as the federal budget is expected to be in surplus in 2014. Going forward, OFZ pricing will continue to depend mostly on the level at which oil prices stabilise (global leading oil exporters have no will to reduce supply). **OFZ yields are likely to remain at elevated levels** at least in the short run. Compared to REPO rates, OFZs still look expensive (spreads are around 70-120bp, whereas before market liberalisation they were 250-300bp). Given RUB devaluation and the high likelihood of further rate hikes, we recommend selling long-dated OFZ.

Financial analysts: Denis Poryvay, ZAO Raiffeisenbank, Moscow
Stephan Imre, RBI Vienna

Exchange rate development



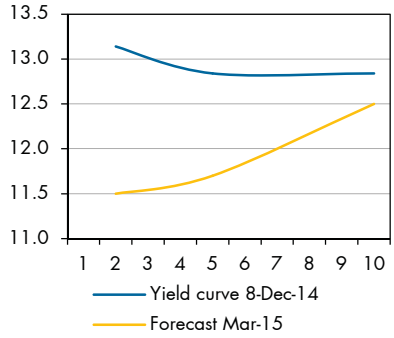
USD/RUB: 5y high 54.46, 5y low 27.28
Source: Bloomberg, RBI/Raiffeisen RESEARCH

Exchange rate forecasts

	8-Dec[1]	Mar-15	Jun-15	Sep-15	Dec-15
EUR/RUB	66.13	69.9	68.5	64.6	60.6
Cons.		*57.71*	*57.00*	*55.67*	*54.58*
USD/RUB	53.80	58.3	58.5	56.2	54.1
Cons.		*47.13*	*47.19*	*46.77*	*45.38*
RUB basket	59.34	63.5	63.0	60.0	57.0

[1] 5:00 p.m. (CET)
Source: Bloomberg, RBI/Raiffeisen RESEARCH

RUB yield curve (%)*



** 2y – 10y LCY government bond yields*
Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

Interest rate forecasts

	8-Dec[1]	Mar-15	Jun-15	Sep-15	Dec-15
Key rate	9.50	11.00	11.00	10.00	9.00
Consensus		*9.55*	*9.40*	*8.95*	*8.40*
1 month[2]	12.75	11.60	11.80	10.80	10.00
3 month[2]	13.49	12.20	12.40	11.40	10.60
6 month[2]	13.72	12.60	12.80	11.80	11.00

[1] 5:00 p.m. (CET) [2] Bid rate
Source: Bloomberg, RBI/Raiffeisen RESEARCH

Yield forecasts

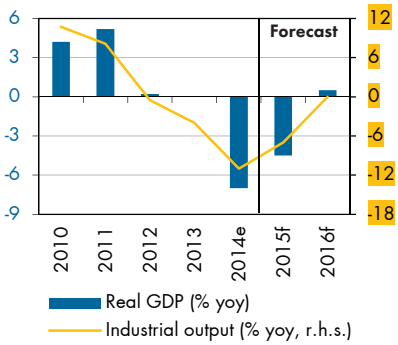
	8-Dec[1]	Mar-15	Jun-15	Sep-15	Dec-15
2y T-bond[2]	11.63	11.5	11.5	10.8	9.7
Consensus		*n.v.*	*n.v.*	*n.v.*	*n.v.*
5y T-bond[2]	12.41	12.2	12.0	11.5	10.3
10y T-bond[2]	12.49	12.5	12.1	11.8	10.8
Consensus		*n.v.*	*n.v.*	*n.v.*	*n.v.*

[1] 5:00 p.m. (CET) [2] Ask yield
Source: Bloomberg, RBI/Raiffeisen RESEARCH

Still teetering on the edge with uncertain prospects

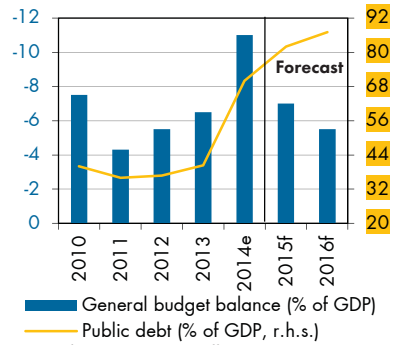
- **No resolution to the military stand-off in Donbass in the near future**
- **Financial meltdown to be averted, if external financial support is massively increased**
- **UAH depreciation trend to continue as environment remains unsupportive**
- **Restructuring of public debt should not be ruled out**

Real GDP (% yoy)



Source: Thomson Reuters, Raiffeisen RESEARCH

Budget balance and public debt



Source: Thomson Reuters, Raiffeisen RESEARCH

Economic outlook

The political situation in Ukraine remains extremely tense amid continued military conflict in Donbass. No signs of reconciliation have appeared so far as the separatists continue to hold around one third of the territory of the Luhansk and Donetsk regions, with the alleged support of Russian regular troops. Ukraine's government continues to insist on the removal of Russian troops from Donbass and creation of the buffer zone and recently made the decision to **cut all budget payments to the occupied territories**. On the other side, **Russia refuses to acknowledge its active role in Donbass conflict** and calls for deep federalisation of Ukraine (which is unacceptable to the vast majority of Ukrainians). Hence, given the widely diverging positions of both sides, we do **not see much prospect for smooth and peaceful resolution** of the conflict. The snap parliamentary elections, held in late October, brought an overwhelming victory for the democratic, pro-European parties, albeit the unreasonable delay in the coalition formation increases the strain on the already fragile economy. Political forces, united around the idea of a strong independent and unified Ukraine, took around **80% of votes**, which theoretically gives a **strong mandate for deep and comprehensive structural reforms**. However, in reality formation of the new coalition was delayed by apparent political bickering, for which Ukraine has been (in)famous for the last 10 years. As a result, the delay in coalition formation until late November has added to the economic woes (i.e. currency lost over 15% this side of the elections) and increased the risk of major economic and political fallout.

The economic dynamics have recently improved slightly compared to the summer months amid the boost in agricultural output and a certain revival in production activity in the war-torn Donbass area. In particular, **GDP fell by 5.3% yoy in Q3, after slumping by 4.6% yoy in Q2** (which is much better than was expected), and that is likely to bring the annual figure to -7% yoy in 2014. In 2015, we expect the

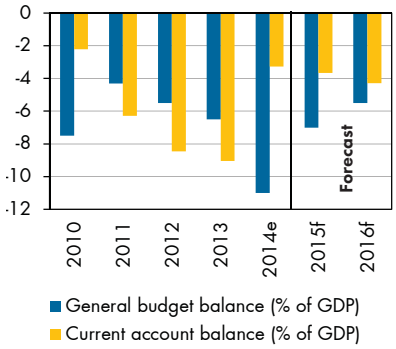
Key economic figures and forecasts

	2010	2011	2012	2013	2014e	2015f	2016f
Nominal GDP (EUR bn)	102.7	117.2	135.8	134.3	95.7	84.0	86.3
Real GDP (% yoy)	4.2	5.2	0.2	0.0	-7.0	-4.5	0.5
Industrial output (% yoy)	10.7	8.1	-0.5	-4.0	-11.0	-7.0	0.0
Unemployment rate (avg, %)	8.1	7.9	7.7	7.5	8.5	9.5	9.5
Nominal industrial wages (% yoy)	21.9	20.9	15.0	8.0	4.0	2.0	5.0
Producer prices (avg, % yoy)	20.9	19.0	3.6	-0.1	15.5	19.0	11.0
Consumer prices (avg, % yoy)	9.4	8.0	0.6	-0.2	12.1	24.7	12.0
Consumer prices (eop, % yoy)	9.1	4.6	-0.2	0.5	25.0	17.0	9.0
General budget balance (% of GDP)	-7.5	-4.3	-5.5	-6.5	-11.0	-7.0	-5.5
Public debt (% of GDP)	40.0	36.0	36.8	40.3	70.0	82.0	87.0
Current account balance (% of GDP)	-2.2	-6.3	-8.5	-9.0	-3.3	-3.7	-4.3
Official FX reserves (EUR bn)	24.8	23.4	17.2	12.5	13.0	14.3	15.1
Gross foreign debt (% of GDP)	85.2	83.1	74.3	77.0	109.1	147.2	146.1
EUR/UAH (avg)	10.5	11.1	10.4	10.8	15.9	19.6	20.8
USD/UAH (avg)	7.9	8.0	8.1	8.2	11.9	16.8	17.5

Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

economic slump to persist at least in H1 on the back of little hope for smooth resolution of Donbass conflict. Thus, according to our projections, GDP will decrease by 4.5% yoy in 2015, followed by agradual recovery to 0.5% growth in 2016. Inflation continues to increase on the back of large-scale exchange rate adjustment and administrative tariff hikes. We now expect CPI to increase by 25% yoy in 2014, while next year's CPI growth will decelerate to 17% on the back of continued economic downturn and much smaller exchange rate adjustment. On the positive side, **C/A has adjusted massively already**, mostly due to the sharp drop in imports, albeit export performance has been dampened by the trade war with Russia and the production halt in the Donbass region. We expect the C/A deficit to amount to around 4% of GDP in 2014 (down from over 9% in 2013) and then fall further to 1.5% in 2015 as exports might pick up on the back of diminishing security risk.

Budget and current account balance



Source: State Statistics Committee of Ukraine, RBI/Raiffeisen RESEARCH

Financial market outlook

Given the continued military stand-off in Donbass and the deteriorating economic situation, the local currency has been under huge stress since late July. The authorities tried to limit UAH depreciation in the run-up to the elections using a mixture of administrative and market measures (i.e. FX interventions), but had to abandon this (political) quasi-peg in early November, facing severe declines in FX reserves (to less than 2 months of imports) and the growing risk of FX market moving into the shadows. Since then UAH has lost an additional 15% against USD, bringing ytd depreciation to 80% (45% loss in value). The outlook for the currency remains extremely uncertain on the back of low reserve cover, unstable expectations and a large external financing gap for the next year (we estimate it at USD 8 bn, not counting the need to replenish reserves). Hence, Ukraine badly needs additional external financial support on the back of USD 8.6 bn received this year and around USD 15 bn committed for 2015. The prospects for getting these funds and whether it will be enough if the conflict in Donbass continues are pretty unclear. Therefore, **we should not rule out a further slide in local currency value, as well as a restructuring of public external debt.**

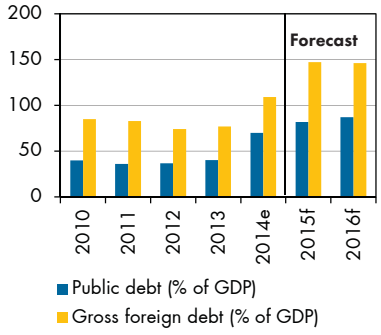
Financial analyst: Dmytro Sologub, Raiffeisen Bank Aval Public Joint Stock Company, Kiev

Exchange rate forecasts

	8-Dec[1]	Mar-15	Jun-15	Sep-15	Dec-15
EUR/UAH	19.18	19.2	19.9	20.1	19.6
Cons.		*18.2*	*18.1*	*18.5*	*19.0*
USD/UAH	15.58	16.0	17.0	17.5	17.5
Cons.		*14.7*	*14.7*	*15.1*	*15.6*

[1] *5:00 p.m. (CET)*
Source: Bloomberg, RBI/Raiffeisen RESEARCH

Public and external debt



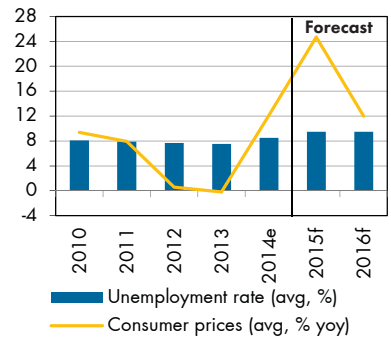
Source: State Statistics Committee of Ukraine, RBI/Raiffeisen RESEARCH

Focus on: Some thoughts on potential public debt restructuring

The steep UAH devaluation seen over the last 12-18 months is among the worst currency crisis in the modern emerging markets history. Historical experience with such large-scale currency devaluations shows that such events are usually closely correlated with sovereign debt restructurings. Moreover, we would like to stress that this time Ukraine public and external debt levels look at least similar or even worse than at the end of the 1990s when Ukraine also restructured its public debt (in a fairly mild way), while the dynamics in public and external debt-to-GDP ratios are more or less as bad as end of the 1990s. Therefore, we are seeing certain risks that a restructuring of public external debt might be in the cards in Ukraine. Moreover, such an exercise could be needed to make additional substantial external financing to Ukraine politically feasible. As things stand large parts of the additional financing gap (compared to the baseline assumptions in the IMF deal) will have to be covered by bilateral donors. The sums IMF and EU itself can provide to Ukraine are already at their practical and/or legal limits. Taking historical experience with other sovereign debt restructurings into account such an exercise should at least provide a debt relief of 15-20% of GDP in order to provide a sufficient contribution to the medium-term stabilisation of the economic situation in Ukraine. It remains to be seen whether a sufficient debt relief can be provided by restructuring public external debt only, which implies that there is a certain risk of a broader public debt restructuring in Ukraine (not our baseline scenario).

Financial analyst: Gunter Deuber, RBI Vienna

Inflation outlook

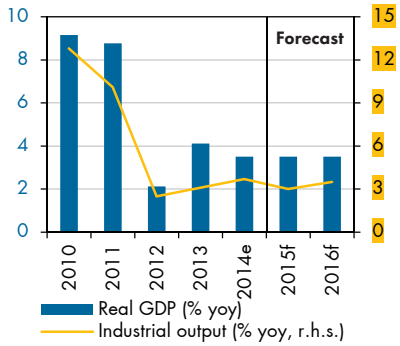


Source: State Statistics Committee of Ukraine, RBI/Raiffeisen RESEARCH

Q3 GDP growth dissapoints

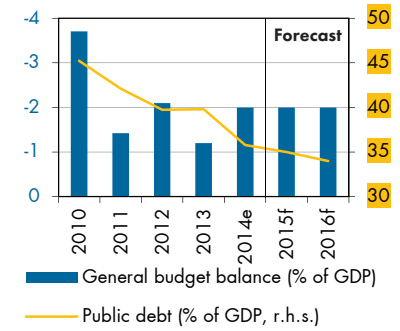
- **Robust industrial production in Q3 underpins moderate growth outlook**
- **Turkey to gain substantially from lower energy prices, falling inflation and the C/A deficit**
- **TRY weakness against USD to continue**
- **TURKGB with only limited room for further gains following impressive rally**

Real GDP (% yoy)



Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

Budget balance and public debt



Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

Economic outlook

In the third quarter, Turkish business sentiment improved somewhat (PMI +3.7 points to 52.2 in November). Positive sentiment is also underlined by robust growth in industrial production, which expanded by 3.5% in the third quarter after a weaker second quarter in Q2 at just 2.6% yoy. However, Q3 GDP disappointed at 1.7% yoy, growing by only 0.4% in seasonally adjusted terms in comparison to the previous quarter. Especially growth in household demand stagnated and inventories negatively contributed. Therefore, the risk to our 3.5% GDP projection is on the downside (the government sees FY 2014 growth at 3.2% yoy). **For next year we see similar growth dynamics as this year, i.e. economic growth of 3-4%**. In its medium-term programme, the government recently cut its forecast for 2015 from 5% to 4%, but this is still above the consensus of 3.3-3.5%. Risks to the Turkish economy include a slowdown in major trade partners' economies (such as the euro area) or further escalation of the wars in Syria or Iraq.

One of the **key positive developments in recent years is the decline in the C/A deficit**. Exports performed positively in Jan-Sep, rising by 6.6%, while merchandise imports contracted by 4%. Thus, in the first three quarters of 2014, the C/A deficit amounted to "just" USD 30 bn – down from USD 45 bn at the same time last year. Moreover, the recent reduction in oil prices (which will be sustained for most of 2015 according to our oil price forecast of USD 89/bbl for 2015) supports economic growth and reduces import costs. Thus, we would not exclude that the C/A deficit could fall in 2015 below 5% of GDP after 5.2% in 2014.

Meanwhile, **CPI inflation is still running high**, amounting to 9% for 2014 (after 7.5% in 2013). Not only is headline inflation high, the core rate is also close to 10% yoy. For next year we expect some easing, given a more stable currency in 2014 (TRY devalued in 2013) and the effect of lower energy import prices.

Financial analyst: Andreas Schwabe, CFA

Key economic figures and forecasts

	2010	2011	2012	2013	2014e	2015f	2016f
Nominal GDP (EUR bn)	549.5	554.7	611.6	622.4	607.3	737.8	792.7
Real GDP (% yoy)	9.2	8.8	2.1	4.1	3.5	3.5	3.5
Industrial output (% yoy)	12.8	10.1	2.5	3.1	3.7	3.0	3.5
Unemployment rate (avg, %)	11.1	9.1	8.4	9.0	9.6	9.5	9.2
Consumer prices (avg, % yoy)	8.6	6.5	8.9	7.5	9.0	7.0	6.9
Consumer prices (eop, % yoy)	6.4	10.5	6.1	7.4	9.5	6.7	7.0
General budget balance (% of GDP)	-3.7	-1.4	-2.1	-1.2	-2.0	-2.0	-2.0
Public debt (% of GDP)	45.2	42.1	39.7	39.8	35.8	35.0	34.0
Current account balance (% of GDP)	-6.2	-9.7	-6.2	-7.9	-5.2	-4.2	-4.9
Official FX reserves (EUR bn)	60.2	60.3	75.8	80.5	80.0	92.0	103.0
Gross foreign debt (% of GDP)	39.7	42.6	41.9	45.3	55.8	53.5	48.2
EUR/TRY (avg)	2.00	2.34	2.31	2.53	2.91	2.67	2.74
USD/TRY (avg)	1.51	1.68	1.80	1.91	2.19	2.28	2.30

Source: Thomson Reuters, wiiw, Raiffeisen RESEARCH

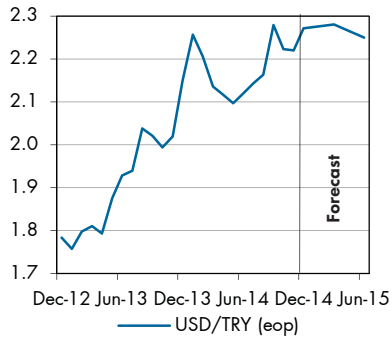
Financial market outlook

Compared to mid-May, when the Turkish lira reached its strongest level this year, the currency has depreciated by almost 8% against USD. The lira has even reached weaker levels by the end of the third quarter but could appreciate slightly since then. On the one hand TRY could gain against euro, shaped by the weak economic development of the euro area and the QE program of the ECB. Lira appreciation against USD hinges thereby crucially on economic data from the US. That said disappointing US economic data lead to market speculation that the US Fed could carry out its monetary policy turn later than previously thought. However, we consider the probability of stronger lira movements against USD as quite low. However, the **Turkish lira remains highly exposed to external market risks.** Market sentiment is affected by the geopolitical conflicts in Syria and Iraq and, as already emphasized, even more by US monetary policy. We expect MP tightening in the US to occur by the end of Q1 at the earliest (if not March than by June at the latest). Furthermore, the political situation in Turkey could become a matter again in mid-2015, when parliamentary elections are due (13 June 2015). All in all, TRY weakness against USD will very likely continue, all the more if USD appreciation against EUR is lasting.

Improving economic fundamentals and therefore, an improved risk profile of Turkey were the main reasons for the sentiment shift towards Turkish financial markets in recent months. Against this backdrop, the local currency debt market posted considerable gains in the past few months outperforming regional peers. Starting from more than 9.5% in early-October, the 2y benchmark bond yield fell gradually and managed to undershoot the 7.5% mark by the end of November. Performance at the back-end of the yield curve was similar. Looking ahead, we expect the still fairly flat YC to normalise in line with the expected bear steepening of the TURKGB curve. MP easing on the local scene should anchor the short-end of the YC at least in the short run on the improved inflation outlook. We expect a **moderate downwards adjustment of the policy rate in Q1 2015** and pencilled-in 50bp cuts under the assumption that the long-awaited deflationary dynamics show-up eventually in numbers early-2015. **Longer tenors are likely to be more at risk when it comes to MP tightening in the US.** This holds also true in comparison to regional peers, where local currencies and – in turn – local financial markets are set to remain more resilient to a possible US MP shock.

Financial analysts: Andreas Schwabe, CFA, Martin Stelzeneder, CEFA, RBI Vienna

Exchange rate development



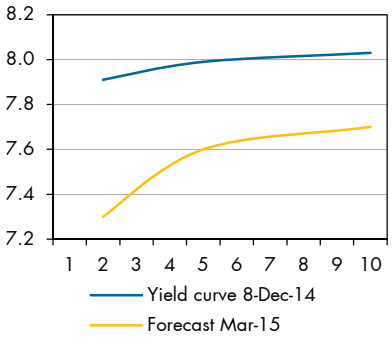
USD/TRY: 5y high 2.34, 5y low 1.4
Source: Bloomberg, RBI/Raiffeisen RESEARCH

Exchange rate forecasts

	8-Dec[1]	Mar-15	Jun-15	Sep-15	Dec-15
EUR/TRY	2.80	2.74	2.63	2.62	2.58
Cons.		*2.85*	*2.84*	*2.84*	*2.85*
USD/TRY	2.27	2.28	2.25	2.28	2.30
Cons.		*2.31*	*2.33*	*2.35*	*2.37*

[1] 5:00 p.m. (CET)
Source: Bloomberg, RBI/Raiffeisen RESEARCH

TRY yield curve (%)*



** 2y – 10y LCY government bond yields*
Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

Interest rate forecasts

	8-Dec[1]	Mar-15	Jun-15	Sep-15	Dec-15
Key rate	8.25	*7.75*	*7.75*	*7.75*	*7.75*
Consensus		*8.00*	*7.95*	*8.00*	*8.25*
1 month[2]	9.34	8.35	8.50	8.80	9.00
3 month[2]	9.25	8.40	8.55	8.85	9.05
Consensus		*9.12*	*9.32*	*9.61*	*9.79*
6 month[2]	9.25	8.50	8.70	9.00	9.10
12 month[2]	9.24	8.54	8.77	9.05	9.30

[1] 5:00 p.m. (CET) [2] Bid rate
Source: Bloomberg, RBI/Raiffeisen RESEARCH

Yield forecasts

	8-Dec[1]	Mar-15	Jun-15	Sep-15	Dec-15
2y T-bond[2]	7.74	7.3	7.8	7.9	8.0
Consensus		*8.90*	*9.19*	*9.39*	*9.44*
5y T-bond[2]	7.96	7.6	8.3	8.6	8.7
10y T-bond[2]	8.01	7.7	8.5	8.9	9.1
Consensus		*9.22*	*9.52*	*9.91*	*10.00*

[1] 5:00 p.m. (CET) [2] Ask yield
Source: Bloomberg, RBI/Raiffeisen RESEARCH

Next year to be a bumpy ride

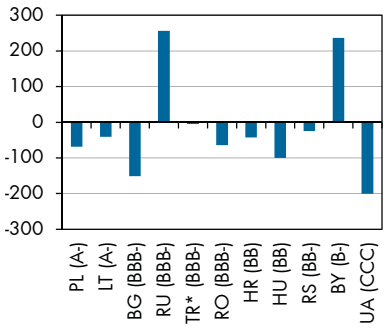
- **CEE Eurobonds ex-CIS experienced fairly good performance**
- **Sovereign placement is likely to drop slightly to USD 40 bn in 2015 while issuers are likely to prefer EUR segment**
- **The "Russian" politics factor and the UST tail risk could be casting a cloud over the CEE outlook**
- **Performance wise we would rank CE countries over SEE while we would continue to underweight CIS**

EMBIG USD value & spreads*

	8-Dec[1]		Spread values, bp		
	Index	Spread, bp	qoq	5y min	5y max
PL (A-)	576	83	-15	80	361
LT (A-)	164	110	-9	91	493
BG (BBB-)	1018	68	0	31	378
RO (BBB-)	143	154	-21	149	528
TR* (BBB-)	697	214	-40	137	411
RU (BBB-)	843	476	167	151	476
HU (BB)	282	191	-21	149	726
HR (BB)	143	248	-15	156	657
RS (BB-)	211	267	-30	217	724
BY (B-)	143	638	106	476	1706
UA (CCC)	486	1627	567	393	1690
Europe*	**989**	**329**	**49**	**171**	**485**
Africa	885	299	16	183	462
Asia	582	191	-8	133	335
Mid East	470	384	19	280	514
Latam	592	482	79	285	526
Global	669	369	48	227	476
Inv.grade	524	223	15	135	324
BB	622	300	32	188	500
B	1069	401	24	377	1099

[1] closing prices 5:00 p.m. (CET)
** TR - Turkey Fitch rating, Europe - CEE*
5y - 5-year minimum and maximum
Source: Thomson-Reuters, RBI/Raiffeisen RESEARCH

CEE EMBIG rating spread, bp*



** JPM USD EMBI Global index family, TR - Turkey Fitch rating, rating spread is sovereign spread minus respective rating aggregated spread (EMBIG)*
Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

Market trends

The CEE Eurobond market experienced fairly good performance excluding the negative price effects from Russia and CIS but it would inch slightly down if CIS countries to be taken into account. Our buy recommendation for Turkey, Romania and Hungary, as well as the idea to sell Ukraine, brought substantial outperformance over the general index. At the same time our decision to leave Russia on hold instead of selling brought us a negative result so the overall portfolio performance would be just slightly better than Europe (CEE) EMBIG USD price return. Due to the higher volatility for Russia and Ukraine the overall volatility measure for the CEE region fell only marginally down. The rating outlook remains a bit complex as the CEE region average rating remains in the BBB area but the outlook tends to negative. Naturally **Russia and Ukraine political-economic crisis continues to exert strong negative rating pressure on the CEE rating score**. On the other hand the CIS region is not a sole source of trouble since Croatia and Serbia also come under negative pressure due to the combination of fiscal and structural issues.

Primary markets

The Eurobond placement in CEE sovereign primary market picked up at USD 7.8 bn in Q4 so far after a dismal USD 1.2 bn in Q3. Interestingly, despite the absence of Russia from primary Eurobond markets the cumulative CEE sovereign issuance in 2014 grossed up USD 44.2 bn and reached nearly the 2013 levels. Due to the Russian exclusion factor we observed a clear change in the issuer geography. Some CEE issuers grabbed their chance to fill in the gap by issuing more Eurobond debt. Top 5 CEE sovereign issuers included Slovenia, Turkey, Romania, Poland and Hungary. Going ahead we believe the **2015 outlook for the primary markets will be more challenging due to the upcoming rate hikes in the US and the ongoing Russia-Ukraine crisis** both reducing the investors' risk appetite. Therefore the rising funding costs could trim the issuance plans too. As a result the cumulative sovereign issuance is unlikely to top the 2014 volume while we would expect the issuance to drop slightly to USD 40 bn. At the same time more CEE sovereigns are likely to tap EUR-denominated Eurobond market in 2015 due to lower funding costs in euro area.

Outlook & Strategy

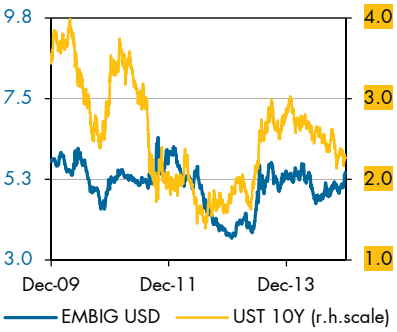
Although we project more balanced outlook which should lead only to mild spread widening across the CEE market in Q1 2015 we still see a number of factors which could challenging the outlook. First, and foremost, this is the "Russian factor". Indeed, as the odds for de-escalation of the situation in the East Ukraine are wearing thin, and the division between Russia and the West deepens, we could expect the sanctions to remain in place for longer time. So not only the Russian sovereign rating could be put at risk of single-notch downgrade but the entire CEE score would be automatically affected. The other factor is the tail risk from US treasuries' rising yields which could exert a negative pressure on CEE market pricing. Since the Fed is very likely to perform the interest rate hikes we

expect the rising UST yields in 2015 to push EM yields and Eurobond spreads up. The growing EM-specific risk in CIS and Latam will also reflect negatively on EM debt prices. In this context we project mildly negative performance in USD segment. Positively we expect a modest divergence between the EMBIG USD and EUR segments with the latter capable of slightly positive returns if the ECB delivers monetary easing including QE in 2015 as planned. We already seen EUR spreads fallen to low levels while the diverging trend could become supportive for EM and bring more primary issuance in EUR. So far we would recommend overweight EUR segment vs USD by taking lower beta sovereigns with stable fundamental situation. Performance wise we would rank CE countries over SEE while we continue to underweight CIS, specifically Russia and Ukraine. At the same time we expect the slowdown of investor "exodus" from Russia as the bond prices fell deep enough and further selling would require a "refreshing" rationale. So some investors could even consider closing relative trades in one of which Turkey was purchased along with Brazil vs Russia.

Among CEE sovereigns with investment ratings we like lower beta Lithuania and Poland. In Lithuania the economic situation is gradually improving while the government considerably strengthened fiscal discipline. The introduction of EUR in Lithuania from January 2015 could become a good stabilizing factor. Although we would not overrate the influence of the EUR introduction based on the experience of Latvia, there still could be expected slight positive volatility reduction. In Poland good economic situation and strengthened fiscal and debt management could bring positive change to the sovereign rating outlook and one-notch upgrade in a 12-month horizon. **We also recommend staying long Hungary due to good fundamentals** but bad government publicity and unorthodox economic policies could be delaying one-notch upgrade for Hungary on a 3-6 month perspective. Meanwhile the economic and market risks in Turkey look higher in the light of the upcoming monetary tightening by the Fed while a relative value trade vs Russia could be losing its attractiveness. So **we would recommend changing from buy to hold in Turkey**. Finally **we would underweight Russia because of the sanctions** and rating risk, and **sell Ukraine on the higher probability of sovereign debt restructuring.**

Financial analyst: Gintaras Shlizhyus, RBI Vienna

CEE EMBIG vs UST 10Y yields, %*



** JPM EMBI Global index family*
Source: Thomson-Reuters, Bloomberg, RBI/Raiffeisen RESEARCH

CEE Ratings Direction

	rating *	RBI View **
CZ	AA-/A1/A+	⇔
SK	A/A2/A+	⇧
PL	A-/A2/A-	⇧
LT	A-/Baa1/A-	⇔
SI	A-/Ba1/BBB+	⇧⇔
HU	BB/Ba1/BB+	⇧
RO	BBB-/Baa3/BBB-	⇔
BG	BBB-/Baa2/BBB-	⇔
TR	BB+/Baa3/BBB-	⇩⇔
HR	BB/Ba1/BB	⇩
RS	BB-/B1/B+	⇩
AL	B/B1/n.r.	⇔
BH	B/B3/n.r.	⇔
RU	BBB-/Baa2/BBB	⇩
BY	B-/B3/n.r.	⇩⇔
UA	CCC/Caa3/CCC	⇩

** rating - S&P/Moody's/Fitch*
*** RBI View - the likelihood of rating change in 3-12m*
⇔ no change
⇧ upgrade possible
⇩ downgrade possible
Source: Rating agencies, RBI/Raiffeisen RESEARCH

Benchmark Eurobond forecast and performance

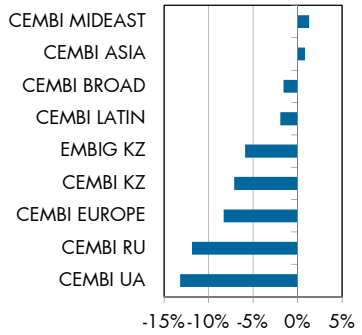
				Spread		Range			Spread	Range			Spread	Range		
		Rating	Dur.	8-Dec	Mar-15	min.	max.	Perf. (%)	Jun-15	min.	max.	Perf. (%)	Sep-15	min.	max.	Perf. (%)
PL 3% due 23	USD	A-	7.4	**73**	**65**	81	57	-2.6	**76**	92	68	-7.1	**79**	95	71	-8.0
PL 4.5% due 22	EUR	A-	6.2	**40**	**35**	44	30	0.3	**41**	50	36	-0.4	**42**	52	38	-1.1
LT 6.625% due 22	USD	A-	5.8	**92**	**80**	104	68	-3.1	**92**	117	80	-6.1	**96**	121	84	-7.0
LT 4.85% due 18	EUR	A-	2.9	**50**	**40**	59	30	0.5	**44**	63	34	0.4	**47**	67	37	0.3
BG 4.25% due 17	EUR	BBB-	2.5	**106**	**115**	98	124	-0.1	**143**	126	152	-1.0	**140**	123	149	-1.2
RU 4.5% due 22	USD	BBB-	6.1	**383**	**420**	347	457	-6.2	**526**	453	562	-15.1	**514**	441	550	-15.0
TR 3.25% due 23	USD*	BBB-	7.2	**170**	**175**	165	180	-3.5	**213**	203	218	-9.8	**211**	202	216	-10.4
TR 5.125% due 20	EUR*	BBB-	4.8	**218**	**215**	221	212	0.1	**256**	262	253	-2.1	**257**	263	254	-2.6
RO 4.375% due 23	USD	BBB-	7.3	**128**	**120**	136	112	-2.6	**133**	150	125	-7.2	**136**	152	128	-8.1
RO 4.875% due 19	EUR	BBB-	4.5	**144**	**140**	148	136	0.2	**159**	167	155	-0.9	**160**	168	156	-1.4
HR 5.5% due 23	USD	BB	6.7	**248**	**260**	235	272	-5.2	**319**	295	332	-11.8	**315**	290	328	-12.2
HR 6.5% due 15	EUR	BB	0.1	**54**	**60**	47	66	0.0	**76**	63	82	0.0	**74**	61	80	0.0
HU 5.375% due 23	USD	BB	6.7	**170**	**180**	160	190	-3.6	**194**	175	204	-7.9	**191**	171	201	-8.3
HU 3.875% due 20	EUR	BB	4.7	**173**	**170**	176	167	0.1	**185**	191	182	-0.8	**186**	192	183	-1.3
RS 7.25% due 21	USD	BB- *-	5.5	**257**	**270**	244	283	-4.2	**318**	292	331	-9.1	**314**	288	327	-9.4
BY 8.95% due 18	USD	B-	2.6	**592**	**650**	534	708	-2.0	**693**	577	751	-5.4	**673**	557	731	-5.2
UA 7.5% due 23	USD	CCC	5.5	**1,133**	**1,400**	866	1,667	-18.2	**1,764**	1,229	2,031	-40.4	**1,675**	1,140	1,942	-36.0

*[1] 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, RBI/Raiffeisen RESEARCH

CIS credits: Macro blows adding to the pain

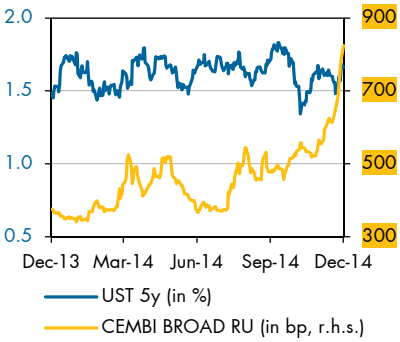
- **Outlook clouded by ongoing geopolitical risks and adverse macro conditions**
- **Investors stay cautious as sanctions are expected to last into 2015**
- **Strong fundamentals and limited sanction risk to remain the key investor focus**
- **Volatility expected to continue with a widening bias, given unfavourable macro drivers**

Q4 2014 qtd returns



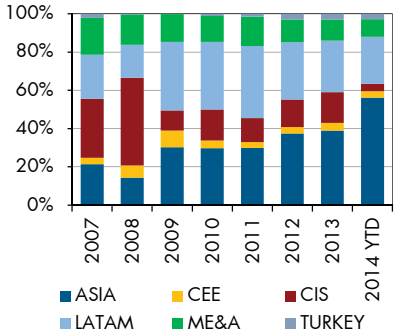
**data are for Broad Series*
5y average annual return in %: CEMBI Broad Mideast: 7.9, CEMBI Broad Asia: 7.0, EMBIG KZ: 7.0, CEMBI Broad: 6.6,CEMBI Broad Latin: 6.3, CEMBI Broad Europe: 5.2, CEMBI Broad RU: 4.5, CEMBI Broad UA: 3.7, CEMBI Broad KZ: 2.5
Source: JP Morgan, RBI/Raiffeisen RESEARCH

UST vs CEMBI RU Index



UST: 5y high: 2.74 %, 5y low: 0.54 %
CEMBI BROAD RU: 5y high: 825bp; 5y low: 254bp
Source: Bloomberg, JP Morgan, RBI/Raiffeisen RESEARCH

EM corporate issuance* (%)



** issues until 9/12/2014*
Source: Bond Radar, RBI/Raiffeisen RESEARCH

We expect Russian credits to remain hostage to the sanctions which are anticipated to last over the course of 2015, as no tangible efforts for a resolution of the Ukrainian situation are currently visible. **Fund flows will continue to be particularly sensible to headline risk,** with primary market activity remaining subdued. The refinancing risk in Q1 2015 should be manageable in our view, as a number of companies have taken pre-emptive measures including the accumulation of cash on the balance sheet and reductions in capex spending to strengthen their position in light of the restricted market access. Additionally, the pro-active involvement of the government, which is currently considering a number of supplemental financing options for corporates and banks, is seen as credit positive. We still think that the future shape of the Fed's monetary policy will be the key external factor for CIS bond valuations, with increasing US Treasury yields being clearly negative for total return investors.

In Q4 2014, the performance of CIS corporate bonds continued to be driven by the tense situation over Ukraine with additional pressure coming from the weakening RUB. **The expected recession scenario in Russia, coupled with the depreciation of the currency versus USD, will tangibly impact corporate performance** as it will drive the deterioration in the operating environment. The impact of the falling oil price on oil companies' performance is mitigated by the currency depreciation. The Q3 2014 reporting season already reflected the impact of the slowing economy on corporates' credit profiles, with visible deterioration expected in the course of 2015. The best positioned companies to withstand the adverse currency movement would be exporters with a significant portion of USD-denominated revenues, RUB costs and a low portion of USD-denominated debt. From the covered universe, the chemical sector (Phosagro) will be a clear winner with marginally positive impact expected for metals and mining (Alrosa), and neutral on the oil and gas companies due to their large portion of debt denominated in USD.

The global EM corporate credit index has returned -1.6% for the quarter-to-date (qtd). While the Asia and Mideast markets returned positive 0.8% and 1.3%, respectively, Europe was the main underperformer (-8.3%). All three main subregions recorded a negative return: Ukraine -13.2%, Russia -11.9% and Kazakhstan -7.1% qtd. The return on Kazakh corporates turned negative, reflecting the uncertainty about the overall impact of the declining oil prices on this oil-dependent economy. However looking at the ytd returns, the Kazakh market was the clear outperformer in the CEMBI Broad Europe index, returning -0.4% versus negative returns of -13.2% and -30.2% for Russia and Ukraine, respectively. While the Ukrainian and Russian markets were dragged down by the standoff between the West and Russia, Kazakh corporates showed resilience until performance was hit by wider macroeconomic fears in Q4. In terms of qtd spread developments, the global EM index widened by a modest 49bp. In the CIS remit, Ukraine and Russia continued to significantly underperform other emerging market peers. While the negative performance of the Ukrainian segment decelerated somehow (-286bp), we have also seen Kazakhstan adding to the negative pressure widening by 217bp, with qtd marking the worst performance period over the 2014 for Kazakh bond market.

Overall EM issuance for the quarter to date (qtd) has amounted to USD 103 bn, steadily approaching the Q4 2013 level of USD 107 bn. Despite the observed double-digits declines in issued volumes in most of the markets, the Asian contribution of USD 60 bn (+84% yoy) has offset the reductions seen elsewhere. CIS issuance activity continued to be subdued (-57% yoy) with the issued amount of USD 5.4 bn accounting for a mere 5% of total EM issuance. Within this figure, the long-awaited Kazakh sovereign issue, which was issued after a 14-year pause together with the quasi sovereign Kazmunaigaz bond, accounted for 75% of the CIS issued amount qtd. In Russia, we have seen four corporates issuers come to the market in November as the window of opportunity opened. Gazprom issued a USD 700 mn one-year Eurobond yielding an astonishing 4.5%. Investors rushed in, with the issue being three times oversubscribed with majority of accounts (77%) coming from the US and UK. In case of Alfa bank's Tier 2 issue, the interest was not that appealing, allowing the bank to place only half of the planned amount. As expected, there is interest in fundamentally strong issuers, but weaker credits which are more in need of financing are expected to be forced to make use of their banking relationships. We conclude that **in light of the lack of drivers for possible de-escalation, activity on the primary market will remain light well into 2015**.

In Russia, we recommend focusing on issuers with strong fundamental stories and limited exposure to sanction risks. In the oil and gas sector, the effect of the declining oil price is expected to be softened by the currency weakness. However, we recommend focusing on gas producers as they are set to benefit from the lower volatility of gas prices. Hence, we stick to the buy recommendation on Gazprom where the credit profile is additionally supported by the agreed intermediary gas contract with Ukraine, growing business exposure to China as well as proven ability to access the capital markets even during times of financial distress.

In the banking remit, we expect further deterioration in the operating environment which will hit asset quality and profitability. The banks are increasingly faced with difficult funding conditions and rising costs domestically, while the Western capital markets remain closed for all the government-controlled entities. Expected government support certainly would be key, especially for the banks with weaker business models. We recommend focusing on fundamentally strong names such as Sberbank.

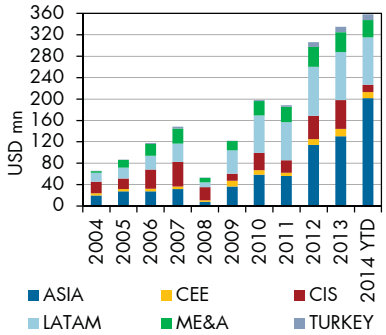
The railway sector is significantly correlated with industrial production, which is trending alongside the Russian economic growth expectations. Given the anticipated recession in Russia, railcar operators are increasingly faced with a challenging operating environment. Additionally, the currency mismatches between cash flows in RUB and FX-denominated debt make the issuers more vulnerable to the depreciating RUB. Therefore, we have recently changed our recommendation on Brunswick and FESCO to sell.

In Kazakhstan, despite the negative impact of the oil price collapse, we believe that the country is well positioned to withstand the pressure. **We like Halyk Bank** with its credit story supported by no exposure to Ukraine or sanctions risk, solid fundamental profile and improving regulatory environment. For the time being, we suggest **staying away from Ukrainian corporates** where performance remains largely driven by developments at the sovereign level.

From the total return perspective we would abstain from any aggressive long positions within our covered universe over next three months given the negative pressure from deteriorating macroeconomic environment.

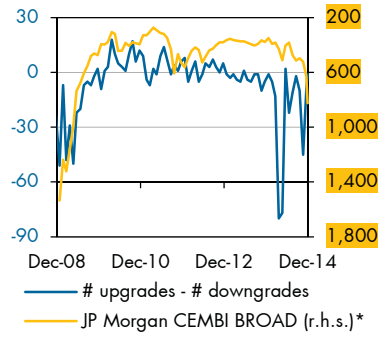
Financial analyst: Lubica Sikova, CFA

EM corporate bond issuance*



** issues until 09/12/2014*
Source: Bond Radar, RBI/Raiffeisen RESEARCH

Rating drift in Russia



** in bp, reverse order*
CEMBI BROAD: 5y high: 571bp; 5y low: 265bp
Source: Bloomberg, JP Morgan, RBI/Raiffeisen RESEARCH

Selected CIS Eurobonds

Issuer	ISIN	Maturity	Yield in %
Alfa Bank	XS0544362972	25/9/2017	8.6
Evraz	XS0618905219	27/4/2018	13.7
Gazprom	XS0708813810	23/1/2021	8.0
Halyk Bank	XS0298931287	3/5/2017	5.8
KazMunay-Gaz	XS0556885753	9/4/2021	5.6
Sberbank	XS0799357354	28/6/2019	7.9
VimpelCom	XS0587031096	2/2/2021	11.1

Source: Bloomberg, RBI/Raiffeisen RESEARCH

ECB policy fostering better sentiment for equities

- **Earnings expected to rebound in 2015**
- **ECB providing adequate liquidity**
- **Positive ATX performance anticipated in Q1**

Value matrix*

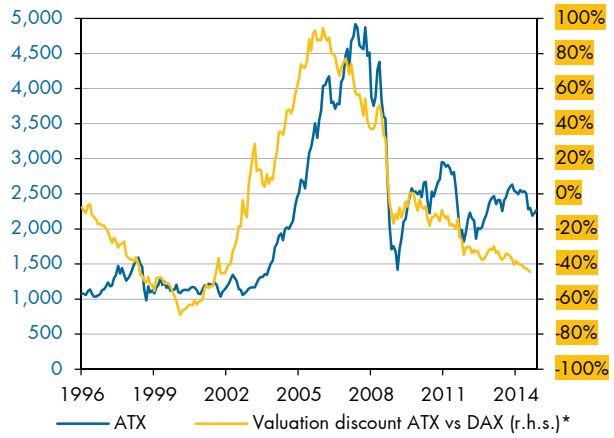
Domestic business activity		3	(3)
Exports	OECD - excl. Eastern Europe	3	(3)
	Eastern Europe	3	(3)
	Asia	2	(2)
Company earnings		3	(3)
Key sectors		3	(3)
Valuation - P/E-ratio		3	(3)
Interest rates / yields		1	(1)
Exchange rates		1	(1)
Foreign equity markets		2	(2)
European liquidity		1	(1)
Technical outlook		2	(4)

1 (4) denotes highly positive (negative) influence on the market. All factors are weighted equally, previous assessment in parentheses
** expected trend for the next 3 to 6 months*
Source: RBI/Raiffeisen RESEARCH, Raiffeisen Centrobank

2014 was anything but a positive year for the Austrian equity market. In light of the overall data situation, this was not really all that surprising either. The crisis involving Ukraine and Russia, several profit warnings by ATX companies, subdued prospects and the generally lacklustre economic data in the euro area were all factors that caused major problems for the ATX. The ATX's relative performance compared to most of its Western and Eastern European peers was particularly disappointing, however.

In general, we **only expect that the economic situation in the euro area will improve marginally**. Consequently, no major surges should be anticipated on the ATX. In **Austria**, the **economy** has already **slowed down considerably** this year as well. During the third quarter, output actually contracted compared to the previous quarter. Prospects for the coming year are also not looking that grand. The available leading indicators are painting a clear picture in this regard: as a result, we project real GDP growth of merely 0.7% yoy for 2015. With this, Austria will lag behind the average pace of growth for the euro area (+1.2%), in our view. Within the CEE region, we expect to see the best performance by the CE countries. On the other hand, the situation in Russia should remain difficult and to a great extent this will be the reason that the CIS region will bring up the rear for Eastern Europe.

ATX shows valuation discount



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

Based on our estimations, no major impetus for the equity markets should thus be expected from the economic data. One interesting aspect for the Austrian equity market, however, will be that many investors' worries about a recession and/or deflation in the euro area will turn out to be incorrect, based on our estimations.

The **ECB will play a major role** in 2015. With the announced expansion of its balance sheet, the ECB has prompted significant speculation among market participants. In particular, the possibility of government bond purchases has had a major impact on yields of fixed-income securities. In any case, we believe that the targeted purchases of assets will be able to contain the risks in the euro area.

Sector structure of the ATX

Sector	Company	Weight
Financials	CA Immobilien, conwert, Erste Group, Immofinanz, Raiffeisen Bank International, Uniqa, Vienna Insurance Group	48.8%
Industrials	Andritz, Flughafen Wien, Oesterreichische Post, Wienerberger, Zumtobel	18.8%
Energy	OMV, SBO	11.1%
Basic materials	Mayr-Melnhof, Lenzing, RHI, voestalpine	15.5%
Telecom	Telekom Austria	3.0%
Utilities	Verbund	2.9%

Source: RBI/Raiffeisen RESEARCH, Raiffeisen Centrobank, Vienna Stock Exchange

As in the second quarter, corporate results for Q3 were hardly spectacular. The sluggish economic environment and some profit warnings meant that the companies listed in the ATX did not really take any chances when it came to guidances. Another key reason why the ATX lagged behind all the other leading indices in 2014 was the slack development of earnings. Based on our estimates, at the aggregate level adjusted earnings probably dropped by around 15%, due to the performances of several index heavyweights. **For 2015**, however, we expect to see **earnings on the rise** again. Due to the lower basis, the rate of increase we calculate should be around 57%. Looking at the estimates, it is thus possible that valuations may decline significantly in 2015. At the moment, our forecast is for a P/E ratio of 12.0. In general, we still see some upside potential in the valuations. This is specifically due to the **ECB's more aggressive monetary policy**, which is intended to **keep the risks in the euro area at bay** and should result in lower level of risk premiums on equities. Furthermore, equities will remain more attractive in relative terms, considering the extremely low yield environment for government bonds.

Key topics from 2014 will remain with the equity markets in 2015 as well. Slack economic growth and the conflict between Ukraine and Russia, along with the related economic sanctions, deserve mention in this regard. While there does not appear to be a quick solution on the horizon in Ukraine, we also do not expect to see any further escalation of the situation. Despite all of this, the ATX should also benefit from our forecast of rising earnings at the aggregate level, which should also clearly help to ease the tensions in terms of valuations. We expect that the ECB will play a key role in the quarters ahead. Due to the expansion of its balance sheet, which may also include purchases of government bonds, we expect that worries about growth in the euro area will be held in check and that investors' risk aversion will thus be lower. All of this should help to generally improve sentiment in the equity segment. As a result, we expect to see **good performance by the ATX** in the first quarter. "Buy".

Financial analyst: Johannes Mattner

Fair value of ATX[1] - December 2015

	Bond yields (10y)		
EY-BY[2]	**0.75%**	**1.00%**	**1.25%**
7.50%	2,303	2,235	2,171
7.25%	2,374	2,303	2,235
7.00%	2,451	2,374	2,303
6.75%	2,533	2,451	2,374
6.50%	2,620	2,533	2,451
6.25%	2,714	2,620	2,533
6.00%	2,814	2,714	2,620
5.75%	2,922	2,814	2,714
5.50%	3,039	2,922	2,814
5.25%	3,166	3,039	2,922
5.00%	3,304	3,166	3,039
4.75%	3,454	3,304	3,166
4.50%	3,618	3,454	3,304
4.25%	3,799	3,618	3,454

[1] based on the expected earnings for 2014/2015 (i.e. 190.0 index points)
[2] earnings yield less bond yield
Source: RBI/Raiffeisen RESEARCH, Raiffeisen Centrobank

Earnings yield* less bond yield

** earnings yield = E/P; based on 12-month forward earnings*
Source: Thomson Reuters, RBI/Raiffeisen RESEARCH, Raiffeisen Centrobank

Valuation and forecasts

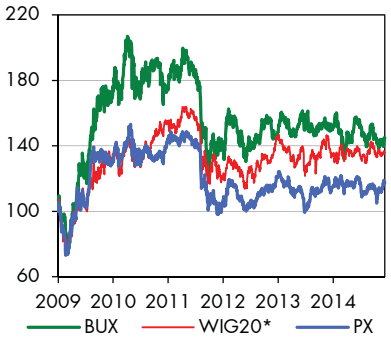
	8-Dec[1]	Mar-15	Jun-15	Sep-15	Dec-15
12-months forward earnings	190.1	137.8	155.1	172.5	190.0
Bond yield forecast	0.84	0.70	0.80	1.00	1.10
Earnings yield less bond yield (EY-BY)	**7.48**	**5.00**	**5.75**	**6.25**	**6.75**
ATX-forecast based on EY-BY		2418	2368	2380	2420
ATX-forecast	**2,286.3**	**2,370**	**2,320**	**2,400**	**2,450**
Expected price change		3.7%	1.5%	5.0%	7.2%
Range		2.100-2.550	2.150-2.600	2.200-2.650	2.200-2.650
P/E based on 12-month forward earnings	12.0	17.2	15.0	13.9	12.9

[1] 11:59 p.m. (CET); Source: RBI/Raiffeisen RESEARCH, Raiffeisen Centrobank

Positive start to the year expected

- **Geopolitical conflict in Ukraine continues to be an issue, and sanctions will most likely remain in force in 2015**
- **Index targets imply no further significant escalation between East and West**
- **Liquidity remains bountiful, providing support**
- **Valuations of CEE indices generally no longer cheap**

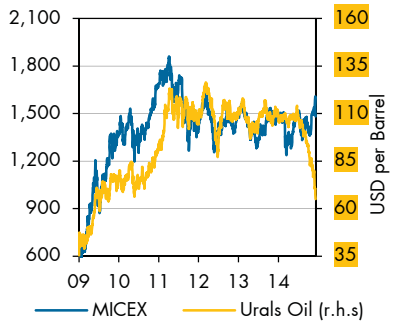
CE core indices



** Due to the short data history of the WIG 30 index we still use the WIG 20*
Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

During the fourth quarter 2014, the performance of the CEE equity markets was weak to modestly positive. The Russian equity market stood out, as this market profited from investors becoming accustomed to the crisis and the partial pricing out of political risks in relation to the **Ukraine conflict**. We expect that the situation will remain tense in 2015, even though there should not be any further escalation of the conflict. While it could flare up at any time and result in uncertainty on the equity markets, the conflict should not have any lasting negative effects on the region as a whole. Investors' attention will probably be focused much more on **monetary policy**, both in Europe and in the USA. During the first half of the year, the US Fed should start to push interest rates higher again, but this should not be cause for concern amongst stock investors in light of the very robust economic performance in the USA. In Europe, on the other hand, the ECB is more likely to expand its balance sheet total, which translates into purchases of government bonds and will thus make the hunt for better yielding alternative investments even more difficult. Consequently, we expect further support for equities as an asset class in the coming quarter.

MICEX vs Oil



Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

Following a solid recovery in recent weeks, the performance of the **Russian MICEX** for the 2014 year-to-date returned to positive territory. This gain must be seen in relative terms, however, due to the massive depreciation of the Russian rouble, which has lost one third against the euro this year. Economic sanctions on Russia will probably remain in effect in 2015. Nevertheless, the reasonability of sanctions is being called into question more and more in Europe as well, and there is a tangible increase in the pressure to find a solution. A call to develop an exit strategy recently came from the European Council on Foreign Relations, for example. Along with the sanctions, other risk factors for the Russian stock market include the weak oil price and the development of the rouble. FX reserves could again get under pressure, in particular to refinance companies which are cut off from the international capital markets (e.g. from the energy and financial sectors) as a result of the sanctions. Due to the persistent outflows of capital and the weakness of the rouble, the Russian central bank (CBR) will probably have no alternative but to move ahead with more intense increases in interest rates. As a result, the downside risks dominate, not to mention the weak earnings growth prospects for the companies in the index (MICEX aggregate 2015f: +0.8 %). Over

Value matrix stock markets

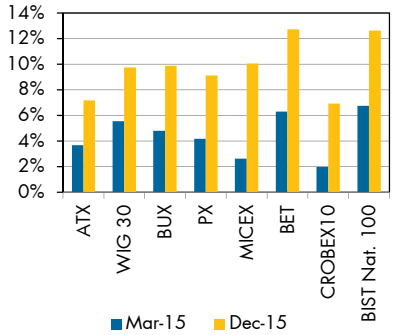
	PL		HU		CZ		RU		RO		HR		TR	
Politics	3	(2)	3	(3)	2	(2)	4	(4)	2	(2)	3	(3)	3	(3)
Interest rate trends	1	(1)	1	(2)	1	(1)	4	(3)	1	(1)	2	(2)	2	(2)
Earnings outlook	2	(3)	1	(2)	3	(3)	3	(3)	1	(2)	3	(4)	1	(2)
Key sectors	2	(2)	2	(2)	3	(2)	4	(3)	2	(2)	3	(3)	2	(2)
Valuation (P/E)	3	(3)	2	(2)	3	(3)	1	(1)	3	(3)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

the medium term, we expect oil prices to rise again and the rouble to appreciate, which is why we take a positive view of the MICEX over a one-year horizon. In the months ahead, however, we see no signs of easing tensions, neither in terms of the political risks nor in relation to the economic risks, and consequently we only see limited potential, despite the attractive valuations. **Hold**.

Turning to the **Polish** stock market, we have switched our benchmark from the previous WIG 20 to the slightly broader **WIG 30** (price index; maximum weighting of individual stocks 10%), which has 10 more constituents. The recovery in the Polish economy has progressed well so far, in conjunction with local demand and investment activity, prompting us to revise up our growth forecast for 2015 to 3.5%. At the same time, the WIG 30 index was hardly able to profit from the better macro-economic situation and tended to suffer instead from the lingering effects of the Ukraine/Russia crisis and the reform of the pension system. For 2015, we expect the latter to continue having a negative impact in particular: the upper limit for foreign investments is being raised from the current level of 10% to 20%, and this will likely result in stronger diversification at the expense of the local stock market. Earnings growth for 2015 is a modest 5.2%, and while the 2015f P/E ratio valuation of 14.0 looks moderate by historical standards, it is still somewhat higher than the Western European level. Nevertheless, in light of the solid macro-economic data and the low interest rate level, we expect to see rising inflows of capital into equities. **Buy**.

Expected index performance



Source: RBI/Raiffeisen RESEARCH

Indices in performance comparison

	2005	2006	2007	2008	2009	2010	2011	2012	2013	8-Dec-14[1]
ATX	50.8%	21.7%	1.1%	-61.2%	42.5%	16.4%	-34.9%	26.9%	6.1%	-10.2%
BUX	41.0%	19.5%	5.6%	-53.3%	73.4%	0.5%	-20.4%	7.1%	2.2%	-4.4%
WIG 20[2]	35.4%	23.7%	5.2%	-48.2%	33.5%	14.9%	-21.9%	20.4%	-7.0%	1.3%
PX	42.7%	7.9%	14.2%	-52.7%	30.2%	9.6%	-25.6%	14.0%	-4.8%	1.9%
MICEX	84.3%	67.5%	11.5%	-67.2%	121.1%	23.2%	-16.9%	5.2%	2.0%	-1.5%
BET	50.9%	22.2%	22.1%	-70.5%	61.7%	12.3%	-17.7%	18.7%	26.1%	7.9%
CROBEX	26.4%	62.2%	63.2%	-67.1%	16.4%	5.3%	-17.6%	0.0%	3.1%	-1.8%
BIST Nat. 100	n.a.	-1.7%	42.0%	-51.6%	96.6%	24.9%	-22.3%	52.6%	-13.3%	25.1%
CECE Composite Index	44.7%	14.7%	10.5%	-53.7%	40.5%	15.7%	-29.1%	25.7%	-9.6%	0.9%
DAX	27.1%	22.0%	22.3%	-40.4%	23.8%	16.1%	-14.7%	29.1%	25.5%	4.8%
Euro Stoxx 50	21.3%	15.1%	6.8%	-44.4%	21.1%	-5.8%	-17.1%	13.8%	17.9%	4.5%
S&P 500	3.0%	13.6%	3.5%	-38.5%	23.5%	12.8%	0.0%	13.4%	29.6%	11.5%
MSCI World	13.7%	13.5%	2.8%	-40.1%	22.8%	7.8%	-7.6%	13.1%	26.3%	8.4%

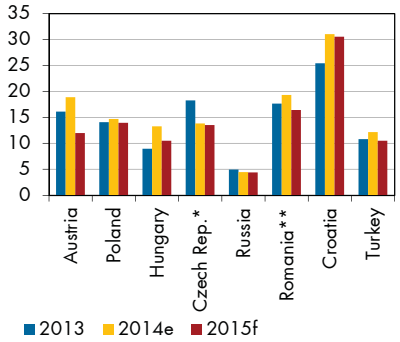
In local currency
[1] 11:59 p.m. (CET)
[2] Due to the short data history of the WIG 30 index we still use the WIG 20
Source: Bloomberg, Thomson Reuters, RBI/Raiffeisen RESEARCH

Stock market indicators

	Long-term growth	Earnings growth			Price/earnings ratio			Dividend yield
		13	14e	15f	13	14e	15f	14e
ATX	4.9%	-7.9%	-15.0%	57.3%	16.1	18.9	12.0	2.5%
WIG 30	3.2%	-23.4%	1.1%	5.2%	14.1	14.7	14.0	3.8%
BUX	3.8%	-2.0%	-32.8%	26.6%	9.0	13.3	10.5	2.8%
PX*	4.7%	-9.8%	30.6%	2.3%	18.3	13.8	13.5	4.8%
MICEX	2.6%	-8.3%	-5.8%	0.8%	5.0	4.5	4.4	6.0%
BET**	6.5%	14.2%	-4.8%	17.4%	17.6	19.3	16.4	5.5%
CROBEX10	1.8%	-4.4%	-24.4%	0.4%	25.4	31.0	30.6	2.3%
BIST Nat. 100	6.2%	3.5%	2.9%	15.7%	10.8	12.2	10.5	2.6%

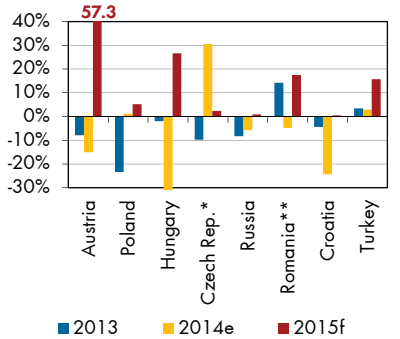
** Czech Rep. (PX): excl. New World Resources and Erste Group*
*** Romania (BET) excl. Fondul Proprietatea*
Source: Thomson Reuters, IBES, Bloomberg, RBI/Raiffeisen RESEARCH

P/E ratios in comparison



** Czech Rep. (PX): excl. New World Resources and Erste Group*
*** Romania (BET) excl. Fondul Proprietatea*
Source: Thomson Reuters, IBES, Bloomberg, RBI/Raiffeisen RESEARCH

Earnings growth



** Czech Rep. (PX): excl. New World Resources and Erste Group*
*** Romania (BET) excl. Fondul Proprietatea*
Source: Thomson Reuters, IBES, Bloomberg, RBI/Raiffeisen RESEARCH

Although the gain of nearly 2% for the **Czech PX** index since the beginning of the year 2014 ranges towards the back third of the pack for the Eastern European indices, the index has been able to make up some ground recently. Along with the good fundamental data (2015f GDP: 2.4%), we are also bullish on the latest export figures for this export-oriented economy. According to current estimates, exports in 2014 may advance to a new record high of CZK 3.5 trillion (approx. EUR 130 bn), despite the fact that the biggest importers of Czech goods (e.g. Germany or Austria) are nowhere near seeing robust economic conditions. If the improvement in the European economy which we expect to see occurs, Czech companies stand to profit disproportionately strongly from it. Furthermore, the current low interest rate environment and the FX intervention scheme being operated by the central bank should also have positive effects. **Buy**.

During the fourth quarter, the performance of the **Hungarian** stock market index **BUX** was weaker than its local peers, with the index in negative territory since the beginning of the year 2014. Macro-economic conditions continued to improve during the last quarter, prompting us to revise up our forecast for economic growth in 2014 to 3.2%. For 2015, we expect to see growth weaken again, due to external effects. Still, the forecast for aggregate earnings growth in 2015 does not seem too strongly undermined by this, with the anticipated gain of 26.6% driven mostly by the base effect (e.g. OTP Bank. etc.). Accordingly, the anticipated aggregate P/E ratio for 2015 amounts to 10.5, which we would view as relatively moderate. With regard to the Russia/Ukraine crisis, the Hungarian stock market shows a higher level of risk, due to the close economic times through OTP Bank and Gedeon Richter. However, as we do not expect any significant escalation of this conflict and the Hungarian stock market has some potential for catching up, we still take a moderately positive view of Hungary. **Buy**.

Regarding **Turkish stock market** one can say: "One man's meat is another mans poison…" would be a fitting saying when discussing the current slide in crude oil prices. Even the geopolitical unrest in Libya, Iraq and Ukraine has not been able to halt the declines. Naturally, the lower price of oil has a beneficial effect on the Turkish current account deficit, which is the Achilles' heel of the country's economy. As a result of the weaker inflationary pressure, we see leeway for large cuts in interest rates, which should have a positive effect on earnings prospects. Estimated at around 15% in both of the two coming years, earnings growth for the

Index estimates

	8-Dec[1]	Mar-15	Jun-15	Sep-15	Dec-15	Recommendation
ATX	2,286	2,370	2,320	2,400	2,450	**BUY**
Performance		3.7%	1.5%	5.0%	7.2%	
Range		2,100-2,550	2,150-2,600	22,00-2,650	2,200-2,650	
WIG 30	2,615	2,760	2740	2770	2870	**BUY**
Performance		5.5%	4.8%	5.9%	9.8%	
Range		2,400-2,950	2,400-2,900	2,450-2950	2,550-3050	
BUX	17,748	18,600	18100	18700	19500	**BUY**
Performance		4.8%	2.0%	5.4%	9.9%	
Range		16,000-19,500	16,000-19,000	16,500-19,500	17,500-20,500	
PX	1,008	1,050	1040	1060	1100	**BUY**
Performance		4.2%	3.2%	5.2%	9.1%	
Range		900-1,130	900-1,120	920-1,150	950-1,200	

In local currency
[1] 11:59 p.m. (CET)
Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

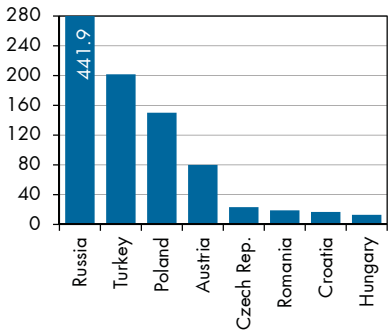
Turkish market looks attractive and reflects the favourable economic conditions. On an index basis, the valuation of the Turkish equity market looks moderate, with an aggregate P/E ratio of 10.5. Consequently, we see more upside potential for Turkish stocks. **Buy**.

With a gain of around 8% since the beginning of the year, the **Romanian** leading index **BET** left some of its Eastern European peers in the dust. A better performance was prevented by the performance of the heavyweight OMV Petrom, which was impacted by the falling oil price in recent weeks. The economic upswing remains intact in Romania (2015f GDP: +2.7%) and even the simmering Ukraine conflict has not undercut performance, especially since just 2.3% of all Romanian exports head to Russia. Although the Romanian key rate is currently at a new record-setting low of 2.75%, it is possible that even lower levels could still be reached. Inflation is subdued right now, leaving room for further measures to relax monetary policy. Thanks to this combination of circumstances and a dividend yield anticipated at 5.5% (2014e) on aggregate for the index, Romanian stocks still looks like an attractive investment opportunity. **Buy**.

The **Croatian CROBEX10** has posted an annual gain of 1.5% so far and is thus limping far behind its Eastern European peers. The poor economic conditions and lack of reforms in Croatia, which has been in recession since 2009, led to a sharp rise in national debt. The government is now well outside the plan for maintaining the targets set by the EU in the excessive deficit procedure. For instance, refinancing costs for 2015 will devour just over 22% of GDP. Consequently, we forecast another year with no growth in Croatia in 2015 (2015f GDP: 0.0%). Naturally, this backdrop will have an impact on Croatian companies and thus negatively affect the leading CROBEX10 index. With 2015f aggregate earnings growth of just 0.4%, we expect to see below-average performance for this market, which already features very expensive valuations (2015f P/E ratio: 30.6). **Hold**.

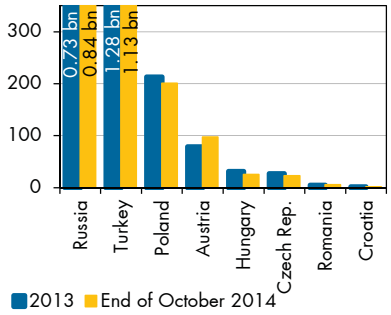
Financial analysts: Aaron Alber, Andreas Schiller, Christoph Vahs

Market capitalisation overview



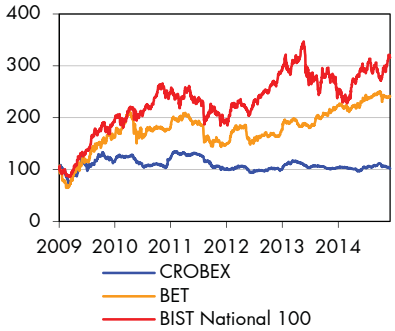
In EUR bn; end of October 2014
Source: FESE, WFE, ZSE, RBI/Raiffeisen RESEARCH

Avg. daily turnover (EUR mn)



Source: FESE, WFE, ZSE, RBI/Raiffeisen RESEARCH

SEE indices in comparison



Source: Bloomberg, RBI/Raiffeisen RESEARCH

Index estimates

	8-Dec[1]	Mar-15	Jun-15	Sep-15	Dec-15	Recommendation
MICEX	1,481	1,520	1,500	1,550	1,630	**HOLD**
Performance		2.6%	1.3%	4.7%	10.1%	
Range		1,250-1,650	1,250-1,600	1,300-1,700	1,400-1,800	
BET	7,008	7,450	7,400	7,600	7,900	**BUY**
Performance		6.3%	5.6%	8.4%	12.7%	
Range		64,00-7,900	6,400-7,900	6,600-8,200	7,000-8,600	
CROBEX10	1,010	1,030	1,000	1,030	1,080	**HOLD**
Performance		2.0%	-1.0%	2.0%	6.9%	
Range		920-1,150	920-1,130	950-1,180	990-1,220	
BIST Nat. 100	85,240	91,000	90,000	94,000	96,000	**BUY**
Performance		6.8%	5.6%	10.3%	12.6%	
Range		78,000-95,000	78,000-93,000	85,000-98,000	90,000-10,0000	

In local currency
[1] 11:59 p.m. (CET)
Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

Despite of bullish momentum confirmations are missing

ATX

ATX Index, 05.12.2014, 12:44 (CET)
Source: Bloomberg, RBI/Raiffeisen RESEARCH, 5y high: 3,000, 5y low: 1,652

ATX

Last: EUR 2,276 NEUTRAL

The two recent Doji candles constitute a sideways pattern within the range 2,300 and 2,254 that, up to date, resembles a bullish congestion area. In addition, the rebound off the low in October has led to the establishment of a Spike reversal; therefore, our long-term buy-signal at 2,310 is expected to get triggered.

Position:

Buy	EUR 2,310	-> 2,420 – 2,520
Sell	EUR 2,160	-> 2,000

BIST 100

XU100 Index, 05.12.2014, 11:57 (CET)
Source: Bloomberg, RBI/Raiffeisen RESEARCH, 5y high: 93,178, 5y low: 48,739

BIST 100

Last: TRY 86,548 BULLISH

Despite of its toppish shape the last sideways pattern (84,356 - 72,600) resembles a long-term bullish congestion area from which an upside breakout succeeded. This all hints on a Measured-Move, i.e. the increase in the first half of 2014 is expected to get replicated. According to this, the on-going advance is likely to get continued towards the former bullish Wedge's high close to 92,200.

Position:

Long -> TRY 90,250 – TRY 92,200
Stop TRY 81,500

BUX

BUX Index, 05.12.2014, 12:22 (CET)
Source: Bloomberg, RBI/Raiffeisen RESEARCH, 5y high: 25,322, 5y low: 14,929

BUX

Last: HUF 17,638 NEUTRAL

It is still trapped within a small triangular pattern (17,600 - 16,820)that in general has to be rated as neutral. Though, the larger pattern which has been established since the mid of 2014 looks similar to a bullish Wedge. Therefore, an increase towards the Wedge's resistance is expectable whose break would be required to confirm a reversal.

Position:

Buy HUF 18,120 -> HUF 18,475 – HUF 18,930
Sell HUF 16,730 -> HUF 16,400

CROBEX 10

Last: HRK 1,020 BEARISH

A bearish Spike pattern has been developed; furthermore, a minor support at 1,013 provided by a former reaction low is getting tested out. Consequently, an extension of the decline towards the major uptrend-line at 960.00 seems to be more likely than a recovery.

Position:
Short -> HRK 960.00
Stop HRK 1.056

CROBEX

CRO10 Index, 05.12.2014, 12:39 (CET)
Quelle: Bloomberg, RBI/Raiffeisen RESEARCH, 5y high: 1,282.84, 5y low: 879.42

MICEX

Last: RUB 1,564 NEUTRAL

Although the past months have been very bullish the major confirmation, i.e. the long-term sideways pattern's high at 1,635, has not yet been triggered. Furthermore, this month it seems a strong upper shadow is likely to get completed which commonly indicates a setback to follow. In this regard, a pullback towards the uptrend-line at 1,425 is expectable, consequently the rating is neutral.

Position:
Buy RUB 1,655 -> RUB 1,785
Sell RUB 1,380 -> RUB 1,240

MICEX

INDEXCF Index, 05.12.2014, 12:05 (CET)
Quelle: Bloomberg, RBI/Raiffeisen RESEARCH, 5y high: 1,859, 5y low: 1,197

WIG 30

Last: PLN 2,623 NEUTRAL

The index is hovering sideways around the Symmetrical Triangle's center-line at 2,605 that is developing since the beginning of 2014. Thus, it is rated neutral because neither a test of the resistance nor a decline towards the Triangle's support is being ruled out. Accordingly, only crossings through the Triangle's boundaries (2,730 - 2,460) would provide long-term confirmations.

Position:
Buy PLN 2,730 -> PLN 2,850
Sell PLN 2,460 -> PLN 2,340

WIG 30

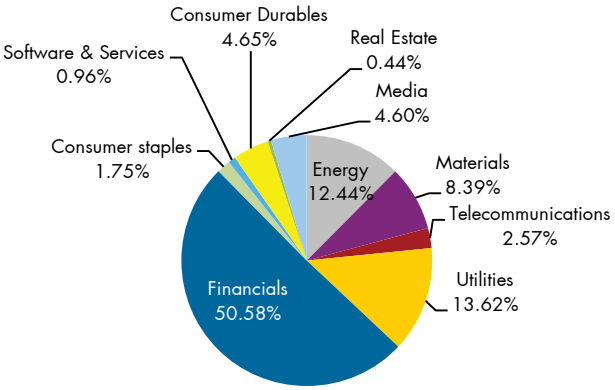
WIG30 Index, 05.12.2014, 12:27 (CET)
Source: Bloomberg, RBI/Raiffeisen RESEARCH, 5y high: 2,960, 5y low: 2,062

Financial analyst: Stefan Memmer

Sector weightings in comparison

Sector weightings Poland, WIG 30

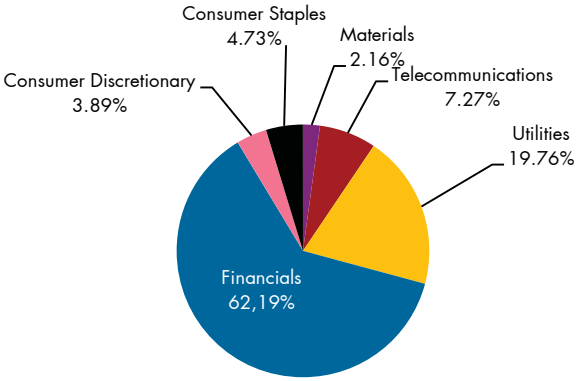
Dom. market cap.: EUR 150.1 bn (Source: FESE; 31-Oct14)



Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

Sector weightings Czech Republic, PX

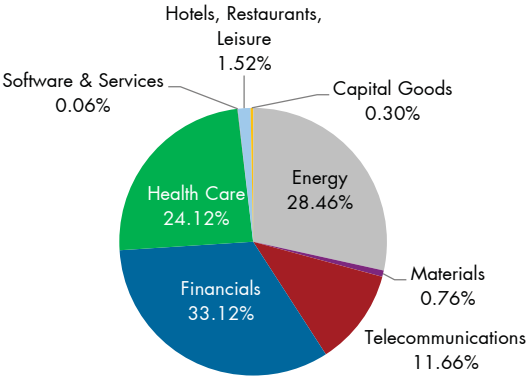
Dom. market cap.: EUR 23.2 bn (Source: FESE; 31-Oct14)



Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

Sector weightings Hungary, BUX

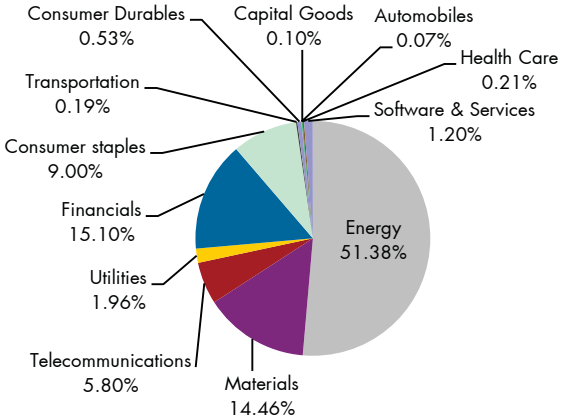
Dom. market cap.: EUR 12.7 bn (Source: FESE; 31-Oct14)



Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

Sector weightings Russia, MICEX

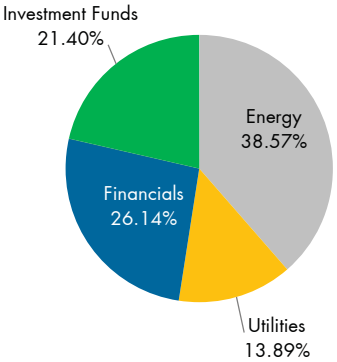
Dom. market cap.: EUR 441.9 bn (Source: WFE; 31-Oct14)



Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

Sector weightings Romania, BET

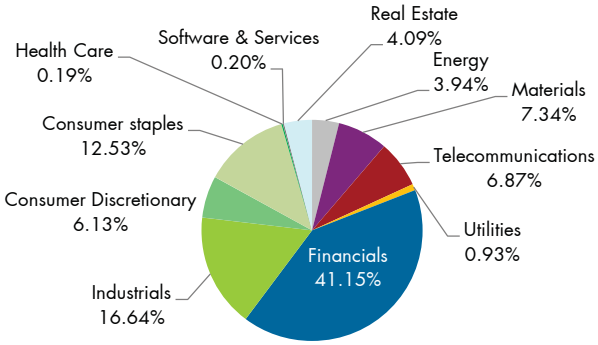
Dom. market cap.: EUR 18.8 bn (Source: FESE; 31-Oct14)



Source: Bloomberg, RBI/Raiffeisen RESEARCH

Sector weightings Turkey, ISE 100

Dom. market cap.: EUR 202 bn (Source: FESE; 31-Oct14)



Source: Thomson Reuters, RBI/Raiffeisen RESEARCH

Please note the risk notifications and explanations at the end of this document

Oil market witnesses structural changes

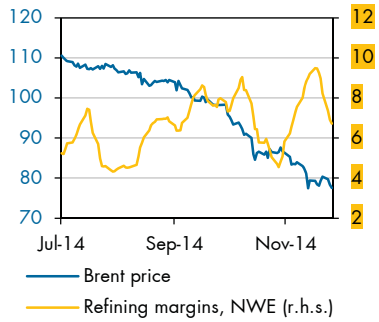
- **Global market oversupply expected to keep oil price weak for longer**
- **Downstream players to benefit from robust refining and petchem margins**
- **We favour PKN and underweight SBO and Russian oils**

Since its June peak, the Brent oil price had fallen by more than 40% by the beginning of December. With Saudi Arabia giving up its role of a swing producer and signalling that it does not want to bear the pain of falling oil prices alone, the world is witnessing a structurally changing market with the oversupply of crude having longer-term implications. The market was strongly disappointed by the OPEC decision not to cut output below its previous target of 30 mn boe/d, sending the Brent price to four-year lows. OPEC's lack of action coupled with Saudi Arabia's stronger focus on preserving its market share, rather than oil price stability, make us believe that as long as there are no clear signs of weakening global output, the Brent price should not rebound to strongly but rather hover around USD 80/bbl in the mid-term. Despite the fact that the offshore crude oil remains one of the most expensive to find, develop and produce, in our view, it is the shale crude producers in the USA that might be forced to cut their production first if the Brent oil price stays at USD 70/bbl or below. With a break-even point estimated at USD 65/bbl, it should become extremely challenging for the US shale producers to keep pumping more oil and at least keep production flat, considering that obtaining funding for new projects is getting more difficult. We would expect the crude production in the USA to come down over the next 1-2 years, which should then help the oil price stabilise or even rebound to its "fair value" of around USD 100/bbl, which represents the estimated marginal cost.

The implications for our coverage universe differ from segment to segment. Upstream companies should underperform the broad market. However, we expect OMV and MOL to face less pressure due to (i) their exposure to downstream (cc. 20% and 30% of EBITDA, respectively), (ii) a projected production increase in 2015e (6% and 15%, respectively) and (iii) weaker EUR and HUF vs USD. The oilfield service and equipment company SBO is expected to face a weaker environment. Lower E&P spending by oil companies into the development of new oilfields and possible postponement of non-critical maintenance of oilfields should lead to weaker global drilling activities and demand for repair and maintenance services. The winners should be the downstream players, PKN and Lotos, which benefit from cheaper feedstock. PKN is in a better position than Lotos due to an insignificant exposure to upstream, strong petchem and retail operations. We underweight Russian oils. Besides the weak oil price, they are expected to produce less oil in the medium term.

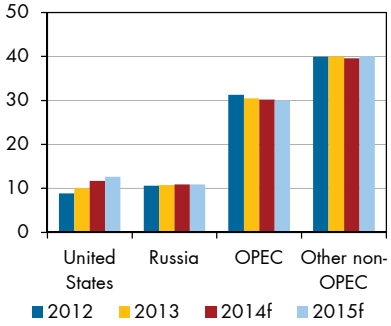
Financial analysts: Oleg Galbur

Oil price vs refining margins*



** in USD/bbl*
Source: Thomson Reuters

World total oil supply*



** mnboepd*
Source: IEA Oil Market Report Nov. 2014

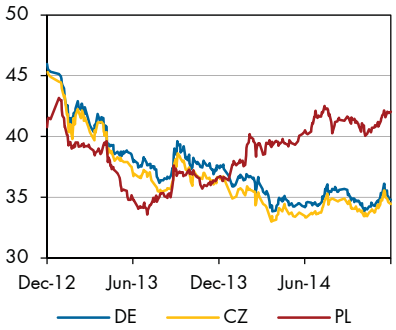
Utilities – new goals, old problems

- **Decoupling of markets, hardly any impetus for growth other than from politics**
- **Declining yields of regulated utilities to separate the wheat from the chaff**
- **BUY recommendations: EVN, CEZ, Enea, Tauron, E.ON Russia**

CO_2: Q4 recovery halted

Source: Bloomberg

Polish power up on capacity prices*



** in EUR/MWh*
Source: Bloomberg

The European utilities sector trailed a bit behind the broad market development in Q4. Regulated utilities tended to hold up stronger, while the share price performance of electricity generators was mediocre. In spite of some key events, any major share price jumps were few and far between.

At the end of October, the European Council agreed on the goals of climate policy until 2030. On the one hand, CO_2 emissions are to be lowered to 40% of the level of 1990, the share of electricity generation from renewable energies is to be raised to 30% and energy efficiency is to rise by 30%. On the other hand, crucial decisions about the overhang of CO_2 certificates were postponed until 2020. As a result, we anticipate little impetus for the electricity price until next year. CEE countries were once again able to negotiate exemptions for their coal power plants, albeit at lower levels than currently.

At the beginning of December, E.ON surprised the market by announcing its intention to split the group into a part that is mainly regulated and another (power plant) part that is oriented towards the electricity market by 2016. This separation in our view reflects market trends which have been characterised by a recovery of the regulated business (grids, end-customer business) at the expense of electricity in the past few years, because the latter turned out to be a risk-prone loss-making business depressed by falling electricity prices. We believe that similar measures as those taken by E.ON could also be seen in our universe.

Given the decline in yields also the regulated business could suffer in some countries. While Austria might be less affected because the regulator accepted a stable yield of 6.4% until 2018/19, Polish utilities are likely to feel the pinch of another slump in grid revenues starting in 2016e – unless the regulator introduces some other sort of promotion in view of the huge investments that are needed to improve grid quality. Details are expected to become known in the course of next year. The adverse situation of the Polish coal industry is another drag on Polish utilities, which have basically done well in 2014. The large state-owned coal mines are operating on the brink of bankruptcy, so that a sharing of the burden is likely to remain on the agenda until the parliamentary elections take place.

We have recently upgraded EVN, because the group should benefit from a stronger showing of the regulated business and the sale of a water treatment plant in Moscow next year. As regards Poland, we currently see no additional upside potential for electricity prices – hence our BUY recommendations for Enea and Tauron. In Russia we prefer E.ON Russia, which boasts a strong dividend.

Financial analyst: Teresa Schinwald

Andritz: Back in the limelight

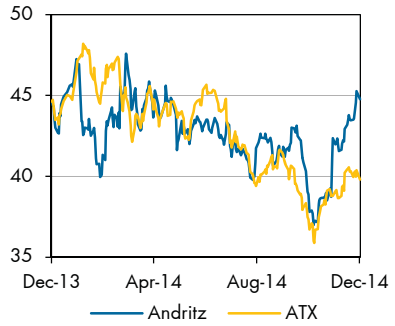
- **Current share price: EUR 45.26[1]**
- **Target price: EUR 52.00**
- **Market capitalisation: EUR 4,697 mn**

Andritz surprised the market with a strong set of Q3 results, with EUR 1.6 bn group order intake, EBITA of EUR 101 mn and an EBITA margin of 6.9%, which is quite close to the group target rate of 7%. Again, Andritz even beat our top-of the range forecast. While the market outlook for the hydro segment remained unchanged, we note the absence of comments on prices pressure. Q4 14 could see the order intake of the Lauca project in Angola to the tune of EUR 150 mn at least. We also appreciate the first order in tidal current turbines, as the product is to be tested for wider use in the mid-term. As indicated at the CMD, the Eldorado order is now more likely sometime in 2015, and while the economic outlook for Brazil is somewhat muted, management is confident for at least one project to go ahead given that 90% of pulp production is targeting exports. Additionally, management sees potential for a three-digit refurbishment order in Sweden and a long-fibre project in Finland, the latter having already been mentioned at the CMD. We consider pulp&paper's 5.8% EBITA margin in Q3 quite astonishing given that Andritz is still working on legacy low-margin projects. While "old metals" remained weak just enough to come in in the blacks management was positive on the aluminium part of the business. The metals segment should also benefit from the reversal of provisions at Schuler in Q4 14. Finally, we find the recovery of separation results quite encouraging, underpinning the bottoming out of the segment.

Due to the sharp and continuous decline of government bond yields, which impact our valuation by EUR 4 per share and also comparables trading slightly higher, we raise our price target to EUR 52 (EUR 47) and reiterate our BUY recommendation for Andritz. We reckon with a strong Q4 result (due to be reported on 5 March 2015), a good order book outlook and the gradual recovery of the separation segment, which has been weak in the past few years.

Financial analyst: Teresa Schinwald

Andritz



Andritz: 5y high: EUR 54.94 5y low: EUR 18.75
ATX: 5y high: 3,000.7, 5y low: 1,652.79
Source: Bloomberg

Income statement & balance sheet (IFRS)

in EUR mn	2013	2014e	2015f	2016f
Income Statement				
Consolidated sales	5,711	5,755	6,195	6,495
EBITDA	255	455	525	546
EBIT	90	291	361	411
EBT	80	288	368	423
Net profit b.m.	53	204	265	302
Net profit a.m.	67	201	263	300
Balance sheet				
Total assets	5,571	5,868	6,076	6,233
Shareholders' equity	900	1,049	1,211	1,240
Goodwill	530	530	530	530
NIBD	-780	-1,137	-1,309	-1,370

Source: Andritz, Raiffeisen Centrobank estimates

Key ratios

	2013	2014e	2015f	2016f
EPS	0.64	1.94	2.53	2.89
PER	70.8	23.3	17.9	15.6
Operating CF per share	2.64	5.39	4.37	4.66
Price cash flow	17.3	8.4	10.4	9.7
Book value per share	8.67	10.11	11.67	11.94
Price book value	5.3	4.5	3.9	3.8
Dividend yield	1.1%	2.1%	2.8%	3.2%
ROE	7.0%	20.7%	23.2%	24.5%
ROCE	4.5%	14.0%	17.1%	19.2%
EV/EBITDA	19.4	10.3	8.7	8.4

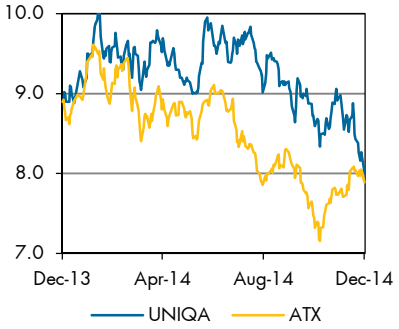
Source: Andritz, Raiffeisen Centrobank estimates

[1] *the indicated price is the last price as available at 6.30 a.m. (CET) on 9 December 2014*

UNIQA: Appealing valuation despite lowered targets

- **Current share price: EUR 8.27[1]**
- **Target price: EUR 10.00**
- **Market capitalisation: EUR 2,555 mn**

UNIQA



UNIQA: 5y high: EUR 16.46 5y low: EUR 8.27
ATX: 5y high: 3,000.7, 5y low: 1,652.79
Source: Bloomberg

Trading around EUR 8 not much benefits of the ongoing restructuring program are discounted on our view. Following the downward revision of the company's targets in the end of November we maintained our BUY recommendation for UNIQA but lowered the TP from EUR 10.8 to EUR 10.0 on the reduced earnings forecast. The profit warning clearly lowers confidence in the ongoing restructuring and shines a light on the unfavourable environment especially in the CEE insurance sector (price pressure, negative FX effects). Nevertheless, we regard the new company targets as realistic to achieve assuming intensified efforts on the cost side. Also, a forecast of EPS 15e growth of 18% despite the cut of estimates does not look bad, in our view. UNIQA currently trades at a PER 15e discount of more than 20% which is attractive. Also PBV 15e of 0.7x vs. the peer group median of 1.0x looks appealing even despite slightly lower ROE 15e of 9.6% vs. the peer group median of 10.9%. Although we assume a discount to the peer group as justified given the recent reduction of targets and relatively low underlying top line momentum we regard the current magnitude as somewhat too high. In addition the guided pay-out ratio of 40-50% pointing to DPS 14e of EUR 0.40 yields 5%.

UNIQA has revised its PBT 15e target from "up to EUR 550 mn" to EUR 425 – 450 mn and guides PBT 14e of EUR 370 – 380 mn. The insurer attributes about 1/3 of the downward revision of the guidance to lower than assumed premium growth, 1/3 to the lower yield environment hurting investment income and 1/3 to the fact that the cost/claims targets were not reached, naming slower macro dynamics burdening premium generation, negative FX effects and the low interest rate levels. A downward revision was clearly in the market, but the guidance is somewhat lower than expected, in our view.

We derive our TP of EUR 10.0 stressing a ROE/PBV regression, a ROTE/COTE equation, peer group PER and a Dividend Discount Gordon Growth model yielding fair values in a range of between EUR 9 – 12 per share.

Financial analyst: Bernd Maurer

Income statement & balance sheet (IFRS)

in EUR mn	2013	2014e	2015f	2016f
Income Statement				
Gross written premiums	5,158	5,361	5,475	5,617
Net earned premiums	4,936	5,124	5,234	5,375
Net investment income	780	789	776	731
Insurence benefits net	-3,955	-4,143	-4,178	-4,268
Profit before tax	306	374	437	459
Net profit a.m.	284	273	321	336
Balance sheet				
Total assets	31,069	33,942	35,580	37,275
Shareholders' equity	2,768	3,265	3,433	3,562
Intangible assets	1,463	1,521	1,582	1,614
Investments	18,990	20,907	21,892	22,925

Source: UNIQA, Raiffeisen estimates

Key ratios

	2013	2014e	2015f	2016f
Cost ratio net group	-24.1%	-23.1%	-22.6%	-21.9%
Benefit ratio net group	-80.1%	-80.9%	-79.8%	-79.4%
Combined Ratio	-99.9%	99.3%	98.5%	96.9%
DPS	0.35	0.40	0.48	0.55
Dividend yield	3.8%	4.8%	5.8%	6.7%
EPS adj.	0.77	0.88	1.04	1.09
PER adj.	11.8	9.4	7.9	7.6
Book value per share	9.0	10.6	11.1	11.5
Price book value	1.0	0.8	0.7	0.7
ROE	9.9%	9.0%	9.6%	9.6%

Source: UNIQA, Raiffeisen estimates

[1] *the indicated price is the last price as available at 6.30 a.m. (CET) on 9 December 2014*

MOL: Playing a special dividend story

- **Current share price: HUF 12,180[1]**
- **Target price: HUF 13,800**
- **Market capitalisation: EUR 3,970 mn**

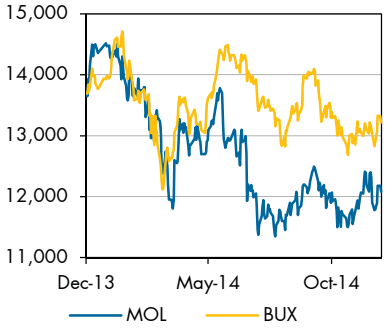
Despite a significant drop of the oil price since mid-June, MOL's share price has displayed an impressive resilience. This could be partially explained by a strong underperformance in H1 2014, but also by a remarkable improvement of its downstream segment on the back of a successful implementation of the efficiency improvement program over 2013-14.

MOL's upstream assets in Kurdistan and the UK's North Sea are expected to enter a more aggressive growth phase in 2015, which should offset the negative impact of the weaker oil price as well as the production decline in Hungary. The average production in Kurdistan is projected to be 4x higher in 2015e (yoy), while the North Sea contribution is expected at 10 kboepd. In addition to the production growth, we expect MOL to benefit from a benign environment in refining and petchem. With an increased vertical integration in its core markets, MOL aims at further expansion of its retail network that should help it generate stronger margins. This strategy is underscored by a new downstream program to be announced in Q1 15, which is to focus on margin generation (the first program aimed at cost optimisation). Consequently, we expect MOL's downstream segment to remain a strong contributor to the overall results.

In addition to the robust operating results, we reckon that there are high chances for MOL to pay a special dividend, as it was the case this year (HUF 590/share). Should INA's shareholders approve a payout of an extraordinary dividend of HRK 2.0 bn (cc. HUF 800/share), as requested by MOL, we believe that the chance for a special dividend to be paid by MOL would be even higher. According to comments by INA's CFO, the company should not have any cash constraints, since it can rely on existing credit lines. So far, the Croatian Prime Minister showed a soft reaction to MOL's request, stating that the government would examine the proposal. More clarity on this issue is expected after the presidential elections in Croatia (first round scheduled for December 28).

Financial analyst: Oleg Galbur

MOL



MOL: 5y high: HUF 25,550 5y low: HUF 11,345
BUX: 5y high: 25,322.96, 5y low: 14,929.76
Source: Bloomberg

Income statement & balance sheet (IFRS)

in HUF mn	2013	2014e	2015f	2016f
Income Statement				
Consolidated sales	5,401,059	5,132,778	5,446,309	5,484,326
EBITDA	520,384	423,950	499,860	560,910
EBIT	-18,710	120,493	193,385	247,687
EBT	-55,840	80,601	134,499	188,620
Net profit b.m.	-18,428	64,481	108,944	150,413
Net profit a.m.	21,687	54,481	100,944	142,413
Balance sheet				
Total assets	4,640,873	4,411,166	4,533,732	4,644,063
Shareholders' equity	1,687,099	1,348,263	1,398,184	1,489,574
Goodwill	0	0	0	0
NIBD	417,605	999,645	1,063,601	1,034,648

Source: MOL, Raiffeisen Centrobank estimates

Key ratios

	2013	2014e	2015f	2016f
EPS	213.30	681.93	1,263.49	1,782.55
PER	67.9	17.9	9.6	6.8
Operating CF per share	6,029.27	4,366.18	5,224.72	5,783.07
Price cash flow	2.4	2.8	2.3	2.1
Book value per share	16,592.93	13,212.17	13,701.36	14,596.93
Price book value	0.9	0.9	0.9	0.8
Dividend yield	4.1%	4.1%	4.1%	4.5%
ROE	1.3%	3.6%	7.4%	9.9%
ROCE	0.3%	4.2%	6.0%	7.1%
EV/EBITDA	4.3	6.1	5.3	4.7

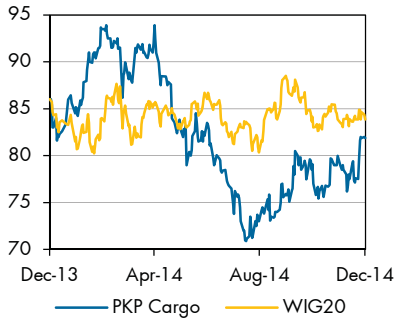
Source: MOL, Raiffeisen Centrobank estimates

[1] *the indicated price is the last price as available at 6.30 a.m. (CET) on 9 December 2014*

PKP Cargo: Diversified exposure to the economy, cash for M&A

- **Current share price: PLN 81.99[1]**
- **Target price: PLN 90.00**
- **Market capitalisation: EUR 883 mn**

PKP Cargo



PKP Cargo: 5y high: PLN 93.89 5y low: PLN 68.00
WIG20: 5y high: 2932.62, 5y low: 2035.8
Source: Bloomberg

While PKP Cargo was hit by lower revenues on coal transportation it managed to improve its EBITDA margin in Q2 14 and Q3 14. Cost cuts in 2014 being a combination of workforce reduction, group reorganisation, renegotiation of contracts and an infrastructure tariff decline indirectly reflecting the EU stance towards improving competitiveness of rail transport which should, in our opinion, outweigh the negative effect on the top line. In the following years we no longer expect a significant decline of coal revenues, while we bet on growth of aggregates transportation driven by EU-funds and finally a positive dynamics in intermodal transport. The company seems to be on track to deliver its promises of market expansion. As the competition remains high some of the rivals decided to start selling assets with PKP Cargo being potentially an acquirer of AWT Group (8% market share in the Czech Republic), CTL Logistics (7% share in Poland) or Pol-Miedz-Trans (2% market share in Poland). Any of the transactions would result in synergies due to higher scale of activity and may improve the capital structure as PKP Cargo is currently practically debt-free. The high number of acquisition targets may also strengthen the negotiating position of buyers.

We see upside in cost restructuring as the reorganisation of repair and modernisation units may help to reduce opex and capital expenditure related to mandatory fleet maintenance. We also believe in the support from EU authorities to enforce the realisation of its target to shift medium- and long-distance freight transport from road to rail.

We rate PKP Cargo BUY with a target price of PLN 90. The share trades at EV/EBITDA ratios below 5.0x in FY 14e and FY 15e. We like the dividend yield that approaches 4% and see some upside in a stronger than expected market rebound and potentially lower capex after the group and fleet reorganisation is completed. We also see a chance for inclusion into the WIG30 and international indices in the mid-term following the recent increase of free-float, which should support the share's liquidity.

Financial analyst: Dominik Niszcz

Income statement & balance sheet (IFRS)

in PLN mn	2013	2014e	2015f	2016f
Income Statement				
Consolidated sales	4,554	4,417	4,536	4,678
EBITDA	499	762	793	853
EBIT	110	351	365	413
EBT	89	350	368	420
Net profit b.m.	65	270	287	332
Net profit a.m.	74	267	285	329
Balance sheet				
Total assets	5,744	5,650	5,794	6,008
Shareholders' equity	3,447	3,576	3,726	3,911
Goodwill	3	3	3	3
NIBD	-331	-295	-351	-437

Source: PKP Cargo, Raiffeisen Centrobank estimates

Key ratios

	2013	2014e	2015f	2016f
EPS	1.65	5.96	6.36	7.35
PER	52.0	13.8	12.9	11.2
Operating CF per share	15.63	14.98	16.30	17.53
Price cash flow	5.5	5.5	5.0	4.7
Book value per share	76.95	79.85	83.19	87.33
Price book value	1.1	1.0	1.0	0.9
Dividend yield	3.6%	3.7%	3.9%	4.5%
ROE	2.2%	7.6%	7.8%	8.6%
ROCE	2.4%	7.0%	7.2%	8.0%
EV/EBITDA	7.1	5.0	4.7	4.3

Source: PKP Cargo, Raiffeisen Centrobank estimates

[1] *the indicated price is the last price as available at 6.30 a.m. (CET) on 9 December 2014*

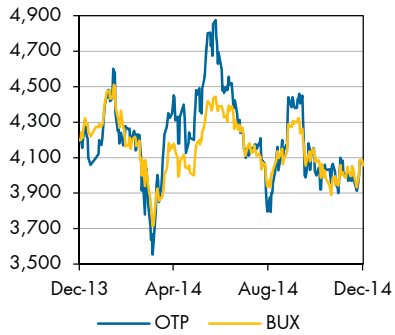
OTP: Further rate cuts might help to ease conversion pain

- **Current share price: HUF 4,080[1]**
- **Target price: HUF 4,550**
- **Market capitalisation: EUR 3,685 mn**

While the implementation of the "Fair Banking Act" and the RUB/UAH depreciation are taking their toll on OTP's equity we continue to see a share price around HUF 4,000 as a good entry point.

The conversion of FX mortgages and the regulation of the pricing for new HUF mortgages have a clear impact on the banks NII (estimated at ca. HUF 13 bn p.a.). However, further rate cuts by the National Bank (more likely in a QE scenario in the Eurozone) should alleviate the margin pressure and help retail loan volumes to bottom out with OTP as a clear beneficiary of this trend. The fading FX-related credit risk in Hungary and the reduced mortgage instalments should help risk costs in Hungary to remain on the low level of the last quarter - as indicated by the management. The recently improved macro environment in Hungary with momentum shifting from the public to the private sector should help the loan growth to gradually bottom-up and risk cost to stabilize.

OTP



OTP: 5y high: HUF 7,400 5y low: HUF 2,798
BUX: 5y high: 25322.96, 5y low: 14929.76
Source: Bloomberg

Q3 results have recently exceeded our expectations on lower risk costs in Hungary and Bulgaria and management expects this level to continue in the next quarters. The flipside of the coin however refers to the earnings development in Ukraine and Russia, where management still expects high risk cost to continue in the next quarters.We have cut our 2015e and 2016e estimates below current consensus accounting for the weaker RUB and the above-mentioned impact of the FX loan conversion, but the current valuation (its P/E 2015e of 9.9 and P/B of 0.8 are still significantly below most of its peers) should support the share price. Estimated CET1 remains strong at 14.0% as of year-end (i.e. assuming that management intends to keep a CET 1 ratio of 12% (B3), the excess capital amounts to roughly HUF 500 per share). Our target price of HUF 4,550 equates to estimated tangible BVBP plus a DPS 2014e at the last years level. More upside potential could be possible in case of a reduction of the bank tax in Hungary, which does not seem to be on the agenda at the moment.

Financial analyst: Stefan Maxian

Income statement & balance sheet (IFRS)

in HUF mn	2013	2014e	2015f	2016f
Income statement				
Net interest income	653,728	631,745	617,892	638,551
Risk provisions	-262,569	-393,903	-224,087	-200,923
Net commission income	201,757	212,053	216,978	224,418
Net trading result	11,546	11,089	7,726	7,726
Pre-tax profit	85,052	-123,430	140,031	177,257
Net profit after minorities	83,687	79,887	114,315	145,794
Balance sheet				
Loans and advances to customers	7,480,844	7,349,663	7,520,683	7,800,733
Amounts owed to customers	6,866,606	7,360,333	7,729,814	8,069,697
Shareholders' equity	1,504,565	1,305,850	1,379,594	1,476,610
Total assets	10,381,047	10,720,839	11,160,812	11,619,045

Source: OTP, Raiffeisen Centrobank estimates

Key ratios

	2013	2014e	2015f	2016f
EPS adjusted	303.02	288.96	413.63	527.54
PER	17.64	-12.47	9.86	7.73
Book value per share	5,466.67	4,744.19	4,975.61	5,368.42
Price book ratio	0.75	0.86	0.82	0.76
Price tang. book value	0.83	0.95	0.89	0.83
Dividend per share	146.93	148.17	177.86	204.54
Dividend yield (%)	3.6%	3.6%	4.4%	5.0%
RoE adj.	5.6%	5.7%	8.5%	10.2%
Loans/deposits	108.9%	99.9%	97.3%	96.7%
Tier 1 ratio	17.4%	14.0%	15.3%	16.2%

Source: OTP, Raiffeisen Centrobank estimates

[1] *the indicated price is the last price as available at 6.30 a.m. (CET) on 9 December 2014*

RBI Risk Indicator

Performance since 2009*

	Mean return. annualized	Max drawdown	Sharpe ratio**	Volatility
RBI Risk Indicator strategy	10.9%	-10.1%	0.988	11.0%
Benchmark***	6.8%	-17.5%	0.743	8.9%

Yearly performance*

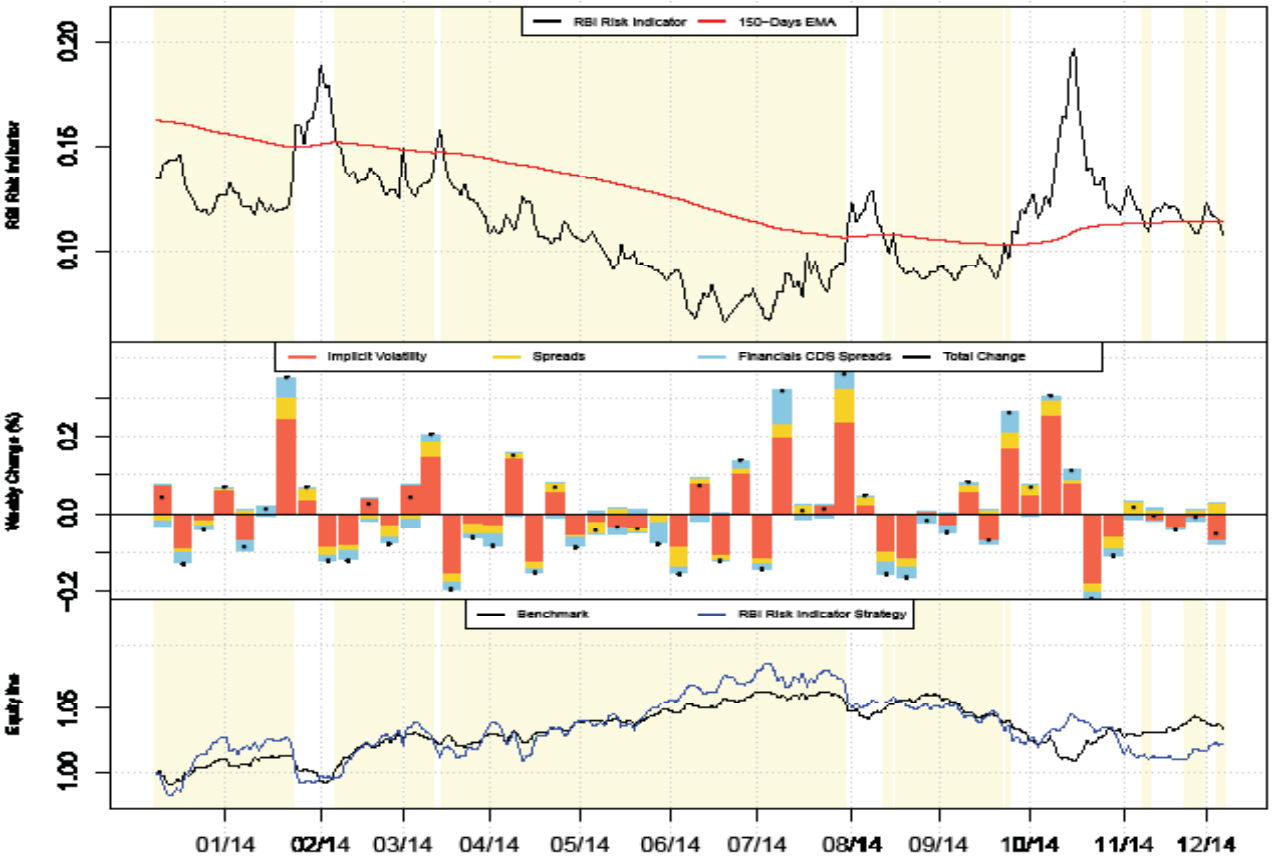
	2009	2010	2011	2012	2013	2014 ytd
RBI Risk Indicator strategy	27.3%	13.5%	-0.6%	13.9%	15.7%	-0.4%
Benchmark***	14.6%	8.4%	0.0%	7.1%	9.0%	2.3%

** All performance measures based on signals generated using end of week closing prices (12-Sep) and restructuring on the following Monday (8-Dec). **risk free rate = 0 %; ***composed from MSCI World and JPM Global Bonds*
Source: Thomson Reuters. RBI/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, RBI/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 then the factor.

Up-Beta: Up-beta > 1: The equtiy index rises more then the factor in positive periods.

Down-Beta: Down-beta > 1: The equtiy index decreases more then the factor in negative periods.

Beta to MSCI World

	Beta	Up-Beta	Down-Beta	Up-Down
EM Europe	1.04	1.31	0.61	0.69
Czech Republic	0.56	0.91	0.92	0.00
Poland	0.73	0.67	0.71	-0.04
Russia	1.09	1.64	0.38	1.25
Hungary	0.61	0.23	0.55	-0.32

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

Beta to MSCI EM

	Beta	Up-Beta	Down-Beta	Up-Down
EM Europe	1.01	1.25	0.71	0.54
Czech Republic	0.59	0.30	0.89	-0.59
Poland	0.58	0.49	0.97	-0.48
Russia	1.05	1.51	0.38	1.13
Hungary	0.68	0.54	0.22	0.32

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

Risk notifications and explanations

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- 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.

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Disclosure of circumstances and interests which may jeopardise the objectivity of RBI (as per Sec 48f [5] and [6] of the Stock Exchange Act): www.raiffeisenresearch.at/disclosuresobjectivity

Corporate Credits

Recommendations history for 12 months

Brunswick Rail		
	Start of coverage	10/03/2014
	Date of recommendation	Recommendation
RBNRL 6.5% due 2017	10/03/2014	Buy
RBNRL 6.5% due 2017	13/06/2014	Buy
RBNRL 6.5% due 2017	19/11/2014	Sell
Fesco		
	Start of coverage	10/03/2014
	Date of recommendation	Recommendation
FESHRU 8.75% due 2020	11/07/2014	Sell
FESHRU 8.75% due 2020	04/09/2014	Buy
FESHRU 8.75% due 2020	02/12/2014	Sell
Gazprom		
	Start of coverage	17/04/2008
	Date of recommendation	Recommendation
GAZPRU 6.212% due 2016	31/01/2014	Buy
GAZPRU 3.85% due 2020	06/05/2014	Sell
GAZPRU 5.999% due 2021	15/09/2014	Buy
Halyk		
	Start of coverage	17/04/2008
	Date of recommendation	Recommendation
HSBKKZ 7.25% due 2017	18/11/2014	buy
HSBKKZ 7.25% due 2017	20/09/2014	hold
SBERBANK		
	Start of coverage	06/05/2009
	Date of recommendation	Recommendation
SBERRU 5.4% due in 2017	31/03/2014	Buy
SBERRU 5.4% due in 2017	11/07/2014	Buy
SBERRU 5.18% due in 2019	01/09/2014	Buy

Bonds

Recommendations history: Local currency government bonds (B: buy; H: hold; S: sell; I: no change)*

	CZ			CZK	HU			HUF	PL			PLN	RO			RON	RU**			RUB	TR**			TRY
Date of change	2y	5y	10y		2y	5y	10y		2y	5y	10y		2y	5y	10y		2y	5y	10y		2y	5y	10y	
19/03/2014	Hold	Hold	Hold	Buy	Hold	Hold	Sell	Sell	Hold	Hold	Sell	Buy	Hold	Hold	Hold	Hold	Buy	Buy	Hold	Sell	Buy	Hold	Buy	Hold
02/05/2014	I	I	I	I	I	I	Hold	Hold	Buy	Buy	Buy	I	I	I	I	I	Hold	Hold	I	I	Hold	I	Sell	Sell
14/05/2014	Buy	Buy	Buy	I	I	I	I	I	I	I	I	I	I	I	I	I	I	I	I	I	I	I	I	I
20/06/2014	Hold	Hold	Hold	Hold	I	I	I	Sell	Hold	Hold	Hold	Hold	I	I	I	I	Sell	Sell	Sell	I	I	I	Hold	Buy
06/08/2014	I	I	I	I	I	I	I	Hold	I	I	I	I	I	I	I	I	Hold	Hold	Hold	Hold	I	I	I	I
16/09/2014	I	I	I	I	I	I	I	I	Buy	Buy	Buy	I	Buy	Buy	Buy	I	Buy	I	I	I	Buy	I	I	Hold
07/11/2014	I	I	I	I	I	I	I	I	I	I	I	I	I	Hold	Hold	I	Hold	I	I	I	Hold	I	I	I
09/12/2014	I	I	Buy	I	I	I	I	Sell	I	I	I	I	I	I	I	I	Sell	Sell	Sell	Sell	Buy	Buy	Buy	Hold

** recommendations based on absolute expected performance in LCY*
*** TRY and RUB vs USD; other FX vs EUR*
Source: RBI/Raiffeisen RESEARCH

Recommendations history: Sovereign Eurobonds (B: buy; H: hold; S: sell; I: no change)*

	BG		HR		CZ		HU		PL		RO		RU	
Date of change	EUR	USD	EUR	USD	EUR	USD	EUR	USD	EUR	USD	EUR	USD	EUR	USD
19/03/2014	Hold	–	Sell	Sell	Hold	Hold	Buy	Hold	Hold	Hold	Hold	Hold	–	Buy
29/04/2014	I	–	I	I	I	I	I	Buy	I	I	Buy	Buy	Sell	Sell
20/06/2014	I	–	I	I	I	I	I	I	Buy	I	Hold	Hold	Hold	Hold
06/08/2014	I	–	I	I	I	I	I	I	Hold	I	Buy	I	I	I
16/09/2014	I	–	I	I	I	I	I	I	Buy	Buy	I	I	I	I
09/12/2014	I	–	I	I	I	I	I	Hold	I	I	Hold	Hold	Sell	Sell

** recommendations based on absolute expected performance, i.e. expected spread change*
Source: RBI/Raiffeisen RESEARCH

Recommendations history: Sovereign Eurobonds (B: buy; H: hold; S: sell; I: no change)*

	RS		SK		SI		TR		UA		BY	
Date of change	EUR	USD	EUR	USD	EUR	USD	EUR	USD	EUR	USD	EUR	USD
19/03/2014	–	Hold	–	–	–	–	Buy	Hold	Sell	Sell	–	Hold
29/04/2014	–	I	–	–	–	–	Hold	I	I	I	–	I
20/06/2014	–	Buy	–	–	–	–	Buy	I	Hold	I	–	I
06/08/2014	–	Hold	–	–	–	–	Hold	I	I	I	–	I
16/09/2014	–	I	–	–	–	–	Buy	Buy	Sell	I	–	I
09/12/2014	–	I	–	–	–	–	Hold	Hold	I	I	–	I

** recommendations based on absolute expected performance, i.e. expected spread change*
Source: RBI/Raiffeisen RESEARCH

Equities, asset allocation

Recommendations history

Datum	MICEX	WIG 20	PX	BUX	BET	CROBEX 10	BIST 100	ATX
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	I	I	I	I	Sell	Hold	I
19/03/2014	I	I	I	Hold	I	I	Buy	I
20/06/2014	I	Hold	Hold	I	I	I	Hold	I
15/09/2014	I	Buy	Buy	Buy	Buy	Hold	Buy	Buy
14/11/2014	I	Hold	Hold	Hold	Hold	I	I	I
08/12/2014	I	Buy	Buy	Buy	Buy	I	I	I

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

Equities

Andritz

5y high: EUR 54.94 (11/03/2013), 5y low: EUR 19.745 (12/02/2010)
Start of Coverage: 01/02/2002

Recommendation history

Date	Rating	Target Price	Prev. day's close	Upside
09/12/2014	Buy	52.00	45.26	14.9%
06/11/2014	Buy	47.00	38.74	21.3%
08/08/2014	Buy	47.00	40.84	15.1%
27/05/2014	Hold	47.00	43.23	8.7%
26/03/2014	Hold	47.00	42.91	9.5%
20/02/2014	Hold	45.00	43.60	3.2%
01/08/2013	Hold	45.00	40.55	11.0%
02/05/2013	Reduce	45.00	49.48	-9.1%
27/03/2013	Hold	52.00	51.15	1.7%
13/02/2013	Hold	50.00	49.48	1.1%

Source: Raiffeisen Centrobank

UNIQA

5y high: EUR 16.5 (07/02/2011), 5y low: EUR 8 (10/12/2014)
Start of Coverage: 28/04/2003

Recommendation history

Date	Rating	Target Price	Prev. day's close	Upside
02/12/2014	Buy	10.00	8.38	19.3%
02/12/2014	Buy	10.00	8.38	19.3%
02/09/2014	Buy	10.80	9.16	18.0%
11/06/2014	Buy	11.10	9.60	15.6%
11/03/2014	Buy	10.90	9.47	15.1%
19/11/2013	Buy	10.75	8.50	26.5%

Source: Raiffeisen Centrobank

PKP Cargo

5y high: PLN 93.89 (09/04/2014), 5y low: PLN 70.9 (24/07/2014)
Start of Coverage: 17/01/2014

Recommendation history

Date	Rating	Target Price	Prev. day's close	Upside
15/09/2014	Buy	90.00	75.10	19.8%
19/05/2014	Buy	99.00	79.00	25.3%
17/01/2014	Buy	103.00	86.20	19.5%

Source: Raiffeisen Centrobank

CEZ

5y high: CZK 961 (13/05/2011), 5y low: CZK 427.9 (04/09/2013)
Start of Coverage: 01/02/2002

Recommendation history

Date	Rating	Target Price	Prev. day's close	Upside
11/04/2014	Buy	670	562	19.2%
24/03/2014	Buy	630	542	16.3%
20/02/2014	Buy	640	555	15.3%
30/10/2013	Buy	640	545	17.4%
27/03/2013	Buy	670	566	18.4%
21/02/2013	Hold	670	605	10.7%

Source: Raiffeisen Centrobank

Enea

5y high: PLN 24.35 (12/11/2010), 5y low: PLN 12.27 (18/04/2013)
Start of Coverage: 05/08/2011

Recommendation history

Date	Rating	Target Price	Prev. day's close	Upside
05/11/2014	Buy	18.50	15.90	16.4%
13/03/2014	Hold	15.30	14.68	4.2%
30/10/2013	Hold	15.30	15.15	1.0%
15/10/2013	Hold	15.30	14.40	6.3%
18/01/2013	Buy	18.40	15.80	16.5%

Source: Raiffeisen Centrobank

Tauron

5y high: PLN 6.89 (17/12/2010), 5y low: PLN 3.9 (18/04/2013)
Start of Coverage: 30/06/2010

Recommendation history

Date	Rating	Target Price	Prev. day's close	Upside
05/11/2014	Buy	6.20	5.29	17.2%
13/03/2014	Hold	5.30	4.90	8.2%
30/10/2013	Reduce	4.60	4.91	-6.3%
15/10/2013	Reduce	4.60	4.92	-6.5%
02/04/2013	Reduce	4.20	4.28	-1.9%
18/01/2013	Reduce	4.50	4.90	-8.2%

Source: Raiffeisen Centrobank

E.On Russia

5y high: RUB 3.305 (06/12/2010), 5y low: RUB 1.49 (10/12/2009)
Start of Coverage: 02/07/2012

Start of Coverage: 02/07/2012

Date	Rating	Target Price	Prev. day's close	Upside
19/05/2014	Buy	3.11	2.57	21.2%
28/10/2013	Buy	3.34	2.49	34.0%
10/04/2013	Buy	3.54	2.44	45.1%
12/02/2013	Buy	4.18	2.92	43.2%

Source: Raiffeisen Centrobank

PKN

5y high: PLN 57.9 (11/04/2011), 5y low: PLN 31 (18/12/2009)
Start of Coverage: 01/02/2002

Recommendation history

Date	Rating	Target Price	Prev. day's close	Upside
05/11/2014	Hold	44.00	41.99	4.8%
29/07/2014	Hold	40.00	38.58	3.7%
08/05/2014	Reduce	42.50	43.50	-2.3%
04/02/2014	Hold	41.50	38.80	7.0%
28/10/2013	Reduce	42.50	44.87	-5.3%
29/07/2013	Hold	45.40	43.00	5.6%
06/05/2013	Hold	50.30	47.00	7.0%
13/03/2013	Reduce	50.00	55.40	-9.7%
30/01/2013	Reduce	45.80	50.95	-10.1%

Source: Raiffeisen Centrobank

SBO

5y high: EUR 95.98 (04/07/2014), 5y low: EUR 30.81 (10/12/2009)
Start of Coverage: 01/02/2002

Recommendation history

Date	Rating	Target Price	Prev. day's close	Upside
17/09/2014	Buy	89.00	74.24	19.9%
25/08/2014	Hold	89.00	80.00	11.3%
28/05/2014	Hold	95.00	90.51	5.0%
14/03/2014	Hold	88.00	80.50	9.3%
17/01/2014	Hold	85.50	81.60	4.8%
23/05/2013	Hold	80.00	77.51	3.2%
26/03/2013	Hold	80.00	79.02	1.2%
20/02/2013	Hold	80.00	75.86	5.5%

Source: Raiffeisen Centrobank

OMV

5y high: EUR 39.69 (21/05/2013), 5y low: EUR 21.24 (22/11/2011)
Start of Coverage: 01/02/2002

Recommendation history

Date	Rating	Target Price	Prev. day's close	Upside
14/11/2014	Buy	31.50	24.04	31.0%
06/10/2014	Buy	34.50	25.36	36.0%
27/08/2014	Buy	35.50	29.28	21.3%
16/05/2014	Buy	37.00	31.09	19.0%
12/02/2014	Buy	39.50	33.06	19.5%
26/11/2013	Hold	40.00	36.10	10.8%
13/11/2013	Buy	42.80	36.00	18.9%
22/08/2013	Buy	42.40	33.45	26.8%
27/05/2013	Hold	39.20	37.48	4.6%
13/03/2013	Hold	35.90	34.40	4.4%

Source: Raiffeisen Centrobank

MOL

5y high: HUF 25550 (07/04/2011), 5y low: HUF 11345 (31/07/2014)
Start of Coverage: 01/02/2002

Recommendation history

Date	Rating	Target Price	Prev. day's close	Upside
06/08/2014	Buy	13,800	11,785	17.1%
01/07/2014	Buy	14,500	12,100	19.8%
10/06/2014	Hold	13,600	12,955	5.0%
07/03/2014	Hold	14,000	13,420	4.3%
17/12/2013	Buy	17,800	14,495	22.8%
17/12/2013	Buy	17,800	14,495	22.8%
10/12/2013	Buy	16,800	13,700	22.6%
27/08/2013	Hold	17,400	16,120	7.9%
18/06/2013	Hold	19,200	16,910	13.5%
05/06/2013	Buy	19,700	16,565	18.9%
13/03/2013	Buy	20,500	17,350	18.2%

Source: Raiffeisen Centrobank

Lotos

5y high: PLN 44.36 (21/04/2011), 5y low: PLN 19.15 (11/01/2012)
Start of Coverage: 10/01/2011

Recommendation history

Date	Rating	Target Price	Prev. day's close	Upside
17/11/2014	Buy	31.50	27.60	14.1%
09/09/2014	Hold	31.00	29.40	5.4%
06/05/2014	Hold	41.50	37.35	11.1%
04/12/2013	Hold	40.50	39.00	3.8%
03/09/2013	Sell	34.00	37.88	-10.2%
15/05/2013	Sell	35.00	39.50	-11.4%
13/03/2013	Sell	33.50	44.19	-24.2%
05/02/2013	Sell	33.50	38.09	-12.1%

Source: Raiffeisen Centrobank

OTP

5y high: HUF 7400 (25/03/2010), 5y low: HUF 2798 (23/09/2011)
Start of Coverage: 01/02/2002

Recommendation history

Date	Rating	Target Price	Prev. day's close	Upside
04/12/2014	Buy	4,550.00	3,970.00	14.6%
10/06/2014	Hold	4,900.00	4,693.00	4.4%
09/12/2013	Hold	4,900.00	4,255.00	15.2%
10/06/2013	Hold	5,100.00	5,050.00	1.0%

Source: Raiffeisen Centrobank

Coverage universe recommendation overview

Empty	buy	hold	reduce	sell	suspended	UR
Universe	54	47	10	5	8	12
Universe %	40%	35%	7%	4%	6%	9%
Investment banking services	18	16	3	0	1	2
Investment banking services %	45%	40%	8%	0%	3%	5%

Source: Raiffeisen Centrobank, rounding differences may occur

Technical analysis

Technical analysis: Historical recommendations

Date	ATX	BUX	BIST 100	CROBEX 10	MICEX	WIG 30
13/11/2013	NEUTRAL	BULLISH		BULLISH	NEUTRAL	
29/11/2013						
06/12/2013		BULLISH				
18/12/2013		NEUTRAL				
30/01/2014	BEARISH	BEARISH			BEARISH	
12/02/2014	BULLISH				BULLISH	BULLISH
20/02/2014	NEUTRAL			BEARISH	NEUTRAL	
27/02/2014	BEARISH			NEUTRAL		BEARISH
06/03/2014				BULLISH		BULLISH
12/03/2014	BEARISH	NEUTRAL		NEUTRAL	BEARISH	BEARISH
23/06/2014	BULLISH		NEUTRAL	BULLISH	BULLISH	BULLISH
16/09/2014	NEUTRAL	BULLISH	BULLISH			
05/12/2014		NEUTRAL		BEARISH	NEUTRAL	NEUTRAL

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 30	01/10/1996

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