Erste Bank Analysten: Austria and Poland are the best places within the CEE Equity markets to await better weather in Q2

07.04.2008

Markets expected to still remain volatile and to take quick profits on yesterday's gains
CEE markets still hold substantial growth differentials to western markets, key advantage in a US decoupling scenario
Within SEE, Romania expected to be first one benefiting from any broader recovery

Erste Bank analysts say their forecasts for Q1 have been realized and 2007 reporting has resulted in some financial institutions giving a clearer picture on the full damage of the US sub-prime crisis. They say this "reporting effect" could be seen as fading out, even though indications are that first quarter figures are still showing some existing difficulties. However, they say recession talk in the US and fears on spill-over on real economy globally will take over headlines.

"Our view is that markets have yet to bottom out and we still expect volatility for some time, together with quick profit taking on yesterday's gains. However, nervousness should start to faded. In the best case, a decoupling from the US economy becomes a reasonable theme for markets", says Henning Esskuchen, Co-Head of CEE Equity research at Erste Bank. "We continue to believe that CEE markets still have substantial growth differentials to western markets on the cards and this card could be played well within a decoupling scenario," adds Esskuchen.

Erste Bank analysts say recent the ZEW/Erste Bank sentiment indicator yielded a fairly positive view on the current situation, while survey participants had an improving view on economic expectations for both, Eurozone and CEE. While most participants expect some slowdown in activity, still 20% see
accelerating M&A activities. Romania and Poland were mentioned as the most attractive targets, while on the investor side Germany was in the leading position closely followed by Austria, confirming the seamless integration of Austria into the CEE growth story.

Erste Bank analysts are expecting markets to bottom out, but no immediate take-off afterwards is seen. They say some more sideward movements should prevail into the second quarter and they recommend sticking to liquidity and size, although some positioning for calmer markets in the second half of the year should already be considered. "Austria and Poland are seen as the best places to wait for better weather. Within SEE we would remain cautious, but see Romania as the first one to benefit from any broader recovery, once investors are willing to tap smaller markets again. For Russia and Turkey risk aversion will need to improve considerably before these markets become more favorable again", says Esskuchen.

CEE markets expected to experience some slow down in growth, but mostly in line with maturing business cycles. Austrian and Polish markets rated with overweight.

Austria's 12M forward P/E (10) is significantly below its historical average (12.9) and the current spread between benchmark yield and earnings yields (5.9) is much above the historical average of 3.4, asking for a bit overdone risk premium for Austrian equities. CEE growth channeled into the Austrian market will remain appealing.
Compared to other CEE markets, **Poland** might appear a bit "expensive" on a P/E of 15.4 on 2008 earnings and also risk premiums for equities are at about the historical average. Under current cir-cumstances liquidity and size remain strong arguments and Poland remains second after Austria with an average daily turnover of EUR 253mn (single counted) in 2007. Assuming a bottom in 2H, the depth of the market could be another argument, in a way that it offers sound second line ideas among small and mid-caps.
Given the kind of turn-around nature of the entire market, **Hungary** would be rated as an over-weight, but current environment calls for prudence.
A low weighting for **Czech market** appears to be justified within the current market environment, when volatile markets recommend remaining rather in big size.
Slovenia together with **Croatia** remain the most demandingly valued markets. Local liquidity should be able to lift prices occasionally again, but within the current environment of risk aversion investors are recommended to stay away, even though a few stock picking opportunities prevail (Krka, Gorenje).
For **South East European** markets selective stock picking opportunities remain, but the market overall has still a lot of vision priced in and vision does not sell well these days.
Notoriously expensive **Romanian** market has given back a lot of its premium and trades now at P/Es of 13.2 and 9.5 on 2008 and 2009 earnings, respectively. Admittedly the country runs risks (with regards to CA deficits, corresponding impacts on currency etc.); however, these risks seem acceptable for a market in this stage of development and would have been accepted in any other environment. FDI greatly cover the CA deficit and will contribute to profitability increases and ex-ports in the mid to long-term.
The low valuation of the **Turkish** market has to be seen relative to growth and the accumulated negative expected return for the market. In total, market to be called a neutral weight.
Russia is pretty similar to Turkey: more neutral weight. The change in presidency went smoothly and the political program recently announced sounds business friendly. As long as uncertainty re-mains, investments in commodities might remain an option (assuming that recession fears do not massively steer sentiment).

CEE Equity Strategy 2.Q 2008 [pdf; 1,3 MB]
CEE Equity Strategy 2Q 2008 Outlook 2008 [ppt; 533,0 KB]

April 2008

CEE Equity Strategy

2Q 2008

- Markets approaching bottom - not ready to take off yet
- Focus to remain on large caps so far
- ZEW: Romania seen as most attractive/active M&A market
- Selling pressure prevails, but softened in February
- Poland, Austria overweight

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CEE Equity Strategy Team

Hans Engel **+43 (0)50 100 19835**
Global markets hans.engel@erstebank.at

Henning Eßkuchen **+43 (0)50 100 19634**
CEE Strategy henning.esskuchen@erstebank.at

Marcin Kopaczynski **+43 (0)50 100 11948**
Quant research, model calculation marcin.kopaczynski@erstebank.at

Fritz Mostböck, CEFA **+43 (0)50 100 11902**
Global markets, ZEW indicator friedrich.mostboeck@erstebank.at

Rainer Singer **+43 (0)50 100 11185**
CEE Macro economy rainer.singer@erstebank.at

Georg Wachberger **+43 (0)50 100 11944**
Quant research, model calculation georg.wachberger@erstebank.at

Summary

The basic scenario mentioned in our 1Q outlook included the idea that 2007 reporting would result in some "Big Bang“ issues, with financial institutions giving a clearer picture of the full damage inflicted by the US sub-prime crisis. This is indeed what happened. This "reporting effect" can be seen as fading away now, even though the indications are that first quarter figures could still pose some trouble. However, market reactions to the latest write-down requirements of major banks indicated that the markets tend to take this as a kind of "that's it". Consequently, recession talk in the US and fears of a spill-over into the real economy globally will take over the headlines.

All said, we would not simply call a market bottom. We expect markets to remain volatile for some time, quickly taking profits on yesterday's gains. However, the nervousness should start to fade out. In the best case, a decoupling from the US economy becomes a reasonable theme for markets. We continue to believe that, in particular, CEE markets still have substantial growth differentials to Western markets in the cards, which could be played well within a decoupling scenario. Of course, CEE markets will also experience a slowdown in growth, but we continue to believe that this will be mostly in line with maturing business cycles.

The recent ZEW/Erste Bank sentiment indicator again yielded not only a still fairly positive view on the current situation (Romania scored a nice increase), but survey participants also allowed themselves an improving view on economic expectations for both the Eurozone and CEE. The special question in this survey was looking for views on corporate transactions in the CEE region. In general, the majority expects some slowdown in activity, but still 20% of participants even anticipate accelerating M&A activities. Romania and Poland were mentioned as the most attractive targets, while, on the investor side, Germany was seen leading, closely followed by Austria, confirming the seamless integration of Austria into the CEE growth story.

Selling pressure prevailed for both Developed and Emerging Markets and cash positions increased in February on an aggregated level. For the same month, however, net selling already softened compared to January 2008. The same picture was seen among Emerging Europe Equity Funds. Russia and Ukraine experienced the biggest net sales, while Poland and the Czech Republic actually had some net purchases already. In terms of flows, EMEA funds indeed saw some cash inflows again in February 2008, which, together with Latin America, supported inflows for Global Emerging Market funds. The weight of Emerging markets increased again (slightly) for Global Equity funds. Within Emerging Europe Equity funds, Russia and Turkey were the biggest losers in terms of weight, while Poland was the strongest gainer. Domestically, Poland continued to see little support from local mutual funds, even though the net cash outflows softened significantly to EUR 280mn in February.

We expect the markets to reach some bottom, but no take-off immediately thereafter is anticipated. More sideways movements should prevail well into the second quarter. Consequently, we would stick to liquidity and size. However, some positioning for calmer markets in the second half of the year should be considered already. Austria and Poland are seen as the best places to wait for better weather. Within SEE, we would remain cautious, but see Romania as the first to benefit from any broader recovery, once investors are willing to tap smaller markets again. Russia and Turkey are also plays on size and liquidity. However, risk aversion should improve much more before these markets become favorable again.

Austria and Poland are both rated with overweight, confirming the outcome of our quantitative allocation model. Austria's 12M forward P/E (10) is significantly below its historical average (12.9) and the current spread between the benchmark yield and earnings yields (5.9) is well above the historical average of 3.4, asking for a bit overdone risk premium for Austrian equities. We remain confident that CEE growth channeled into the Austrian market will remain appealing. Compared to other CEE markets, Poland might appear a bit "expensive" at a P/E of 15.4 on 2008 earnings, and risk premiums for equities are around the historical average. However, the arguments for the market remain the same. Under current circumstances, liquidity and size remain strong arguments and Poland is still second (after Austria), with an average daily turnover of EUR 253mn (single counted) in 2007. Assuming that we could see a bottom in 2H, the depth of the market could be another argument in that it offers sound second-line ideas among small and mid-caps. Inflation has been picking up and the National Bank already responded with rate hikes. However, we expect to see inflation peak in the second quarter. All in all, we confirm the model outcome.

Hungary was again awarded an overweight rating by our allocation model. Admittedly, valuation is at the lower end, but the market as such should rather remain a macro story. Reforms seem not to have had the full intended impact yet and rising inflation is a disappointment, in light of the austerity program. Consequently, rates have been hiked. The speed of reforms got another question mark, with political tension within the current government. Supposedly, early elections do not appear too likely, given current polls, and a minority government was said to be one of the most likely outcomes. In any case, the current situation is not really supportive of speeding up necessary reforms. Our model has based its overweight outcome strongly on long-term growth and technical analysis. Given the kind of turn-around nature of the entire market, this is certainly a good and reasonable argument, but we would not depend too strongly on it, given the current environment. Hence, we soften the outcome from our quantitative model to a moderate overweight, as we did in our previous issue.

Our model has calculated negative expected returns for the Czech Republic. The strongest part stems from our size and liquidity measures. The low weighting appears to be justified within the current market environment, when volatility recommends remaining in larger markets. Assuming that we might see some lasting overall recovery, we would put the Czech market in a waiting position again and confirm the neutral position in our proposed allocation.

Slovenia and Croatia remain the most demandingly valued markets. Local liquidity should be able to lift prices occasionally, but, given the current environment of risk aversion, we would continue to stay away from these markets, although a few stock picking opportunities prevail (Krka, Gorenje).

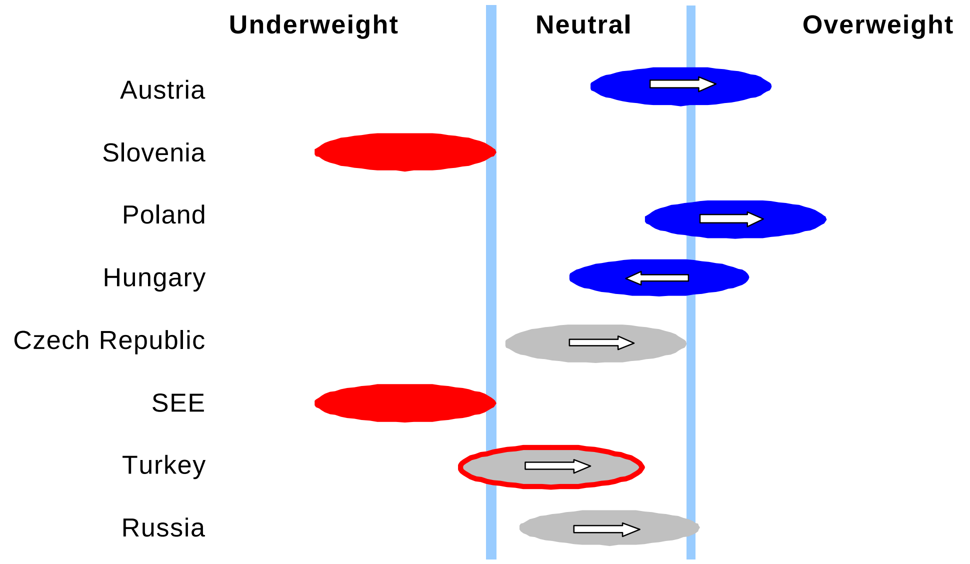
South East European markets strongly confirmed our underweight decision for the first quarter. However, we would like to stress that this was and will be a preliminary decision. For the region as such, valuation again yielded quite significant negative expected returns (but growth still delivers nice expected returns). However, getting back to the potential recovery, overall it might be worth splitting markets in SEE a bit and getting ready to position yourself. For Croatia, basically the argument is the same as for Slovenia. Again, selective stock picking opportunities remain, but the market overall still has a lot of vision priced in and vision does not sell well these days. Serbia is a pretty obvious decision, given the current political tensions; the market had its risk already without the Kosovo situation. Romania, however, remains a different story. First of all, the notoriously expensive market has given back a lot of its premium and now trades at P/Es of 13.2 and 9.5 on 2008 and 2009 earnings, respectively. Secondly, we maintain our view that the country admittedly runs serious risks with regards to it CA deficits and corresponding impacts on currency, etc. However, we think that these risks are acceptable for a market in this stage of development and would have been accepted in any other environment. The current risk aversion has just caught the market at the wrong moment. One of our main arguments for why the market worries are overdone is that FDI greatly covers the CA deficit and will contribute to profitability increases and exports in the mid- to long-term. This view is further confirmed by the recent ZEW review. The special question for the current survey revealed that Romania is still seen as the most attractive target for foreign investments and M&A activities. Hence, by separating the

SEE group a bit, we would not necessarily divert from the current underweight for the region, but would look at Romania first, once sentiment turns.

For Turkey, our allocation model yields negative expected returns, based on the growth outlook and on momentum. Correspondingly, the low valuation of the Turkish market has to be seen relative to growth, and the valuation component (which alone provides for positive expected returns) cannot offset the accumulated negative expected return for the market. In total, we would call the market a neutral weight, slightly contravening the model outcome. If we see some recovery later this year, it might worth it to be positioned in one of the most liquid markets.

Russia also came out with negative expected returns based on growth, while valuation yielded the opposite. In total, the result is pretty much the same as in the case of Turkey. We moderate the model outcome to a more neutral weight. The change of president went smoothly and the announced political program sounds business-friendly. As long as the uncertainty remains, investments in commodities might remain an option (assuming that recession fears do not massively steer sentiment).

Erste Bank Allocation Proposal



Arrows indicate deviation from pure model results; Source: Erste Bank

USA

Stock market

Review

In the last few months, most international equity markets have been heavily influenced by the continuing lack of trust among many US financial corporations. Falling prices in the housing market put a lot of pressure on banks to write down further parts of their credit portfolio.

Investors also became aware that the financial institutions in the US also had to write down more and more derivative positions, as they had to realize that, in many cases, there was no market in which to sell them. The problem with illiquid derivate positions on the books of US banks and insurers will become more obvious in the coming months. Therefore, we assume that many investors will realize that the present liquidity crisis is just one side-effect of a giant extension of credit in the past few years.

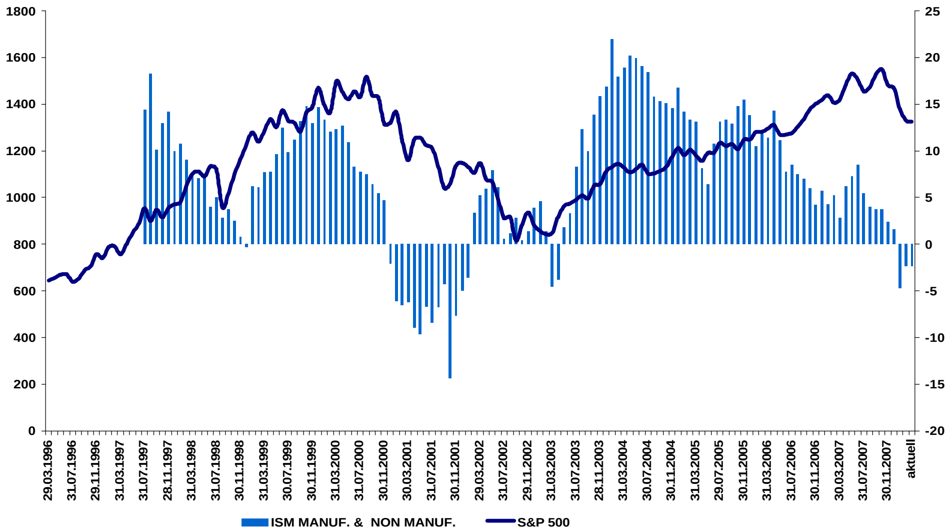
The present crisis in the US reached its peak in the middle of March, with the collapse of the well-known investment company Bear Stearns. Only a concerted action by the FED and J.P. Morgan was able to stave off bankruptcy. The stakeholders in Bear Stearns were confronted with a real disaster, seeing their equity going down meaningfully, since J.P. Morgan was offering just a marginal amount of money for the remaining shares in the troubled company. The uniqueness of this rescue operation was evident as soon as it came out that the FED and J.P. Morgan Chase had arranged a deal that essentially prevented competitors from quoting a higher offer for Bear Stearns. In the course of the recent turmoil, the FED also reduced the Federal Funds Rate to 2.25% and is now also offering access to liquidity to brokerage companies, and not just US banks.

Considering these adverse circumstances, it is not surprising that most US equity indices have performed poorly within the first quarter of 2008. The S&P 500 has fallen 10% and the NASDAQ Composite has lost 14.5%. A very obvious development was the increase of the Amex Gold Bugs Index, which coincided with the recent all-time high of the gold price.

Sentiment indicators

To evaluate the prevailing sentiment among US purchasing managers, we use an aggregated sentiment indicator. This indicator quantifies the optimism or pessimism of the purchasing managers from the manufacturing and service sectors. The chart below shows the current status quo. There it can be recognized that the indicator has been decreasing for a long time and that it is in negative terrain, with no recent signs of improvement. This is clearly a sign of the weakening of the US economy in the recent year. As long as the labor market is also showing an increase in unemployment, we cannot expect any improvement here soon.

ISM vs. S&P 500

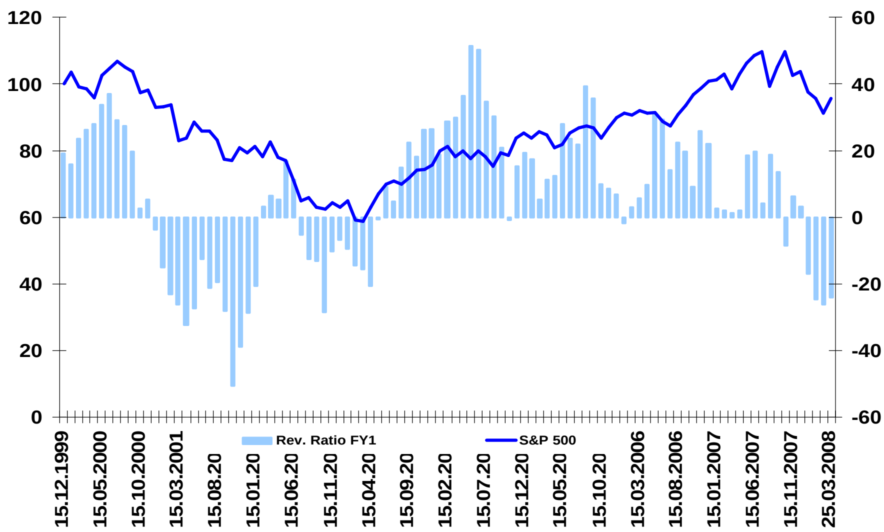


Source: Erste Bank calculations

Earnings revisions

Analyzing earnings revisions for US companies, we see a clear deterioration regarding the revision ratio and come to a similar negative conclusion. We would like to see any meaningful improvement, but at the moment, this indicator is also showing weakness. The chart below illustrates this situation:

S&P 500: Revision Ratio EPS



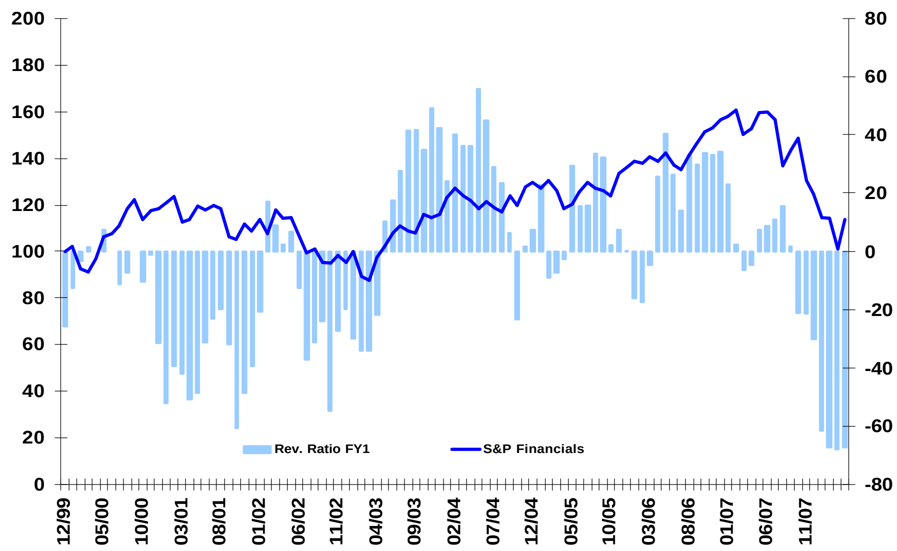
Source: JCF, Erste Bank calculations

Due to the strained situation prevailing on the US equity market, it is not surprising that the revision ratio for the NASDAQ is also deeply in negative territory.

As financial companies represent an important part of the market capitalization within the US economy, we are analyzing this sector at regular intervals. The conclusion now is not surprising: the present situation is bad, with no clear signs of significant improvement within a predictable period of time. The side-effects of excessive credit growth remain and illiquid derivative products cannot be made into cash and therefore have to be written down further.

In line with the terrifying state of many financial companies, it is not surprising that the revision ratio for this sector is even more negative compared with the S&P 500.

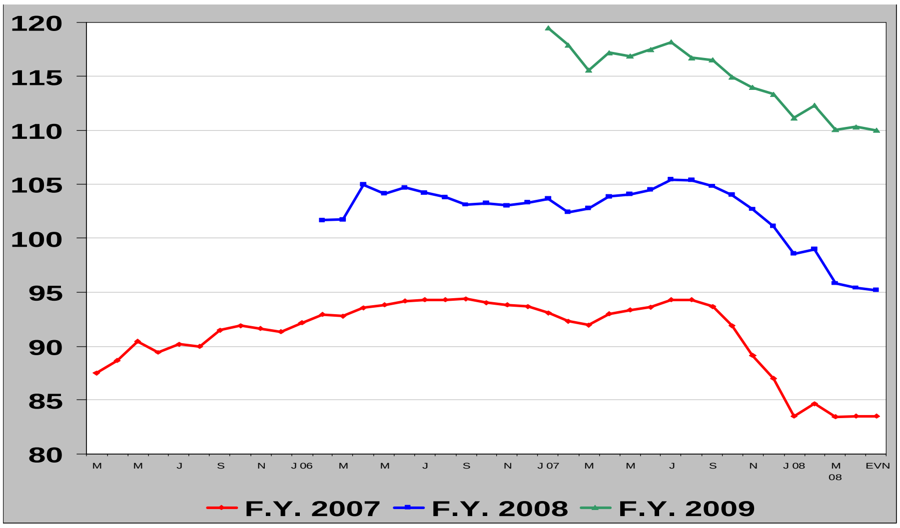
Revision Ratio US-Financials



Source: JCF, Erste Bank calculations

Despite these negative circumstances, the earnings estimates for US stocks suggest a meaningful advance within the next two years, even if the trend of the consensus forecasts is down. The chart below illustrates the JCF consensus forecast for the median earnings per share for the S&P 500 index.

EPS forecast S&P 500

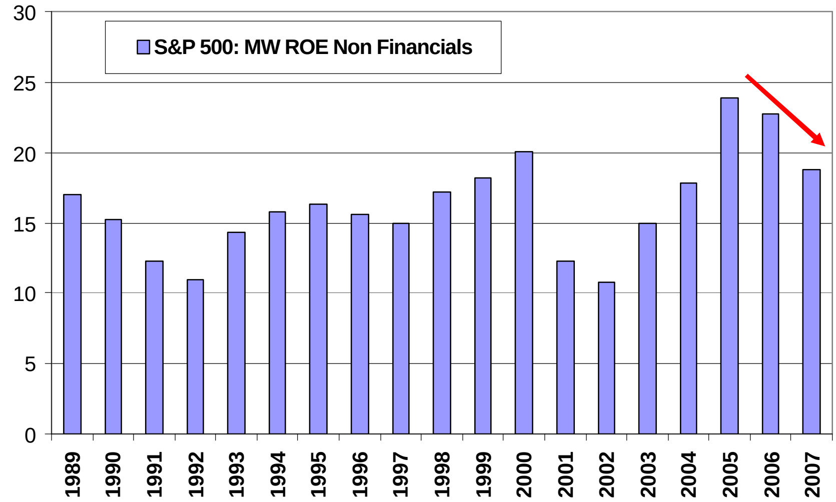


Source: JCF, Erste Bank calculations

Consensus much too high

From our point of view, we consider these forecast figures much too high. Therefore, we expect more negative surprises coming up within the next few months. We think that the falling trend of the consensus estimates only reflects the decrease in the profitability of US companies that has occurred in the last year. The chart below shows that companies outside the financial sector have also experienced a significant decline of their ROEs.

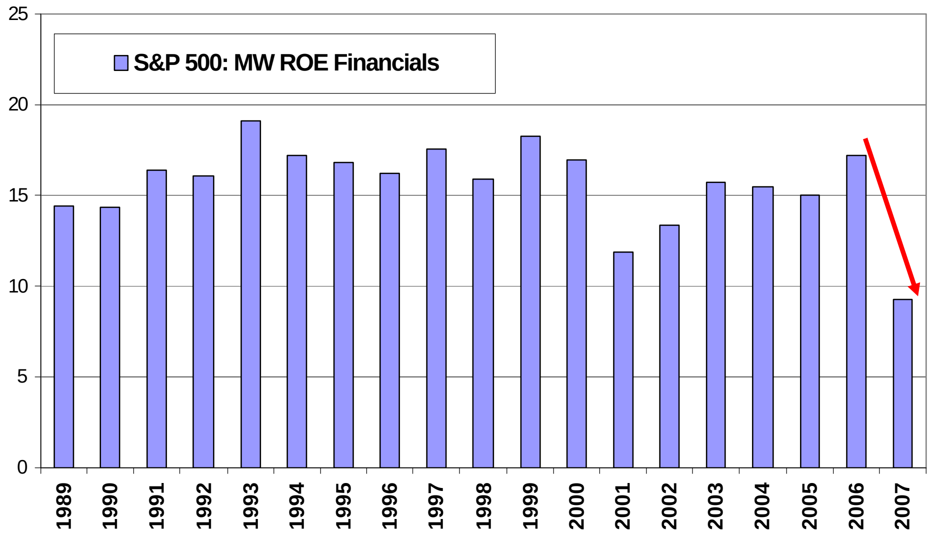
S&P Non Financials: ROE



Source: Bloomberg

On the other hand, it is not surprising that the ROEs from US financial companies were collapsing last year. This year, investors must realize that the troubles for this sector will certainly not come to an end, as the highly leveraged balance sheets of many financial companies do not offer meaningful protection against outside adverse effects.

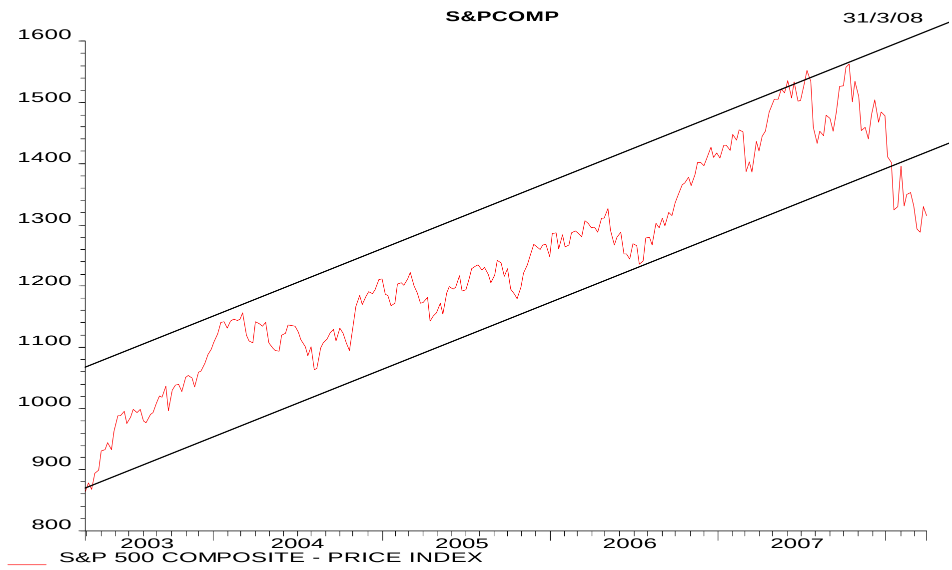
S&P Financials: ROE



Source: Bloomberg

We are sure there are much more interesting investment opportunities in the US besides the financial sector. In particular, globally-oriented industrial companies with low leverage ratios can reap profits from sales in faster growing economies and a weak currency.

Technical situation of the S&P 500



Source: Datastream

The S&P 500 has clearly broken its medium-term upward trend in the past few weeks. Nevertheless, it has established an important bottom at the level of about 1.330 points. Regarding this constellation, we think it is highly possible that we will see a short-term bear market rally, which could last for about six weeks.

Afterwards, we think that the news flow will not be positive enough to support the interim advance. Many market participants will probably tend to realize profits sooner than later and therefore put pressure on the market. Considering all important aspects, we suggest that investors underweight stocks as an asset class, and especially US stocks. It seems reasonable to hold a sufficient cash position to be able to profit from opportunities when they come along.

On the other hand, we think investors should emphasize investments in other regions than the US. Emerging markets stocks and European stocks are our clear favorites again for this year. It is the combination of stronger growth and more attractive valuations that prompts us to recommend overweighting European stocks and emerging markets. One should keep in mind that the room for negative surprises is larger for US stocks. Europe also is gradually increasing its economic and moral power to play an important role within the context of a globalized world. Dangers for our positive attitude towards Europe could arise in the case that the ECB lowers their rates, which could cause accelerated inflation in the Euro region.

The table on the next page shows the present consensus growth rates and valuation ratios for major markets:

Europe and Emerging markets

International Equity Markets: EPS Growth and Valuation

	EPS Growth %			Price/Cashflow		
	2007e	2008e	2009e	2007e	2008e	2009e
USA	-2.2%	14.8%	14.8%	10.8	9.6	8.6
Euroland	3.7%	8.7%	9.6%	6.4	6.2	5.8
Germany	12.8%	7.6%	12.0%	6.5	6.0	5.5
France	0.8%	14.2%	9.5%	7.2	6.7	6.2
Netherlands	6.1%	-3.7%	5.7%	7.1	6.9	6.5
Switzerland	-13.3%	24.0%	12.0%	10.8	11.1	10.0
Japan	5.0%	6.2%	7.9%	6.5	6.2	5.8

Source: JCF

Emerging Markets: EPS Growth and Valuation

	EPS Growth %			Price/Cashflow		
	2007e	2008e	2009e	2007e	2008e	2009e
Brazil	13.5%	14.0%	24.0%	8.1	7.7	6.6
Argentina	-14.1%	19.6%	19.4%	7.5	n.a	n.a.
Mexico	17.6%	5.8%	12.4%	9.1	8.0	7.8
	5.7%	**13.1%**	**18.6%**	**8.2**	**7.9**	**7.2**
India	22.5%	19.9%	16.4%	15.0	12.6	10.9
Malaysia	29.2%	13.9%	8.6%	8.9	9.2	8.5
Thailand	-9.0%	20.1%	13.7%	8.3	7.5	6.9
Korea	11.1%	17.2%	13.3%	8.2	7.5	6.9
Hs China Enterprise	40.0%	20.2%	10.6%	9.5	8.2	7.0
Hong Kong	33.5%	12.0%	11.3%	10.4	9.3	7.8
	21.2%	**17.2%**	**12.3%**	**10.0**	**9.1**	**8.0**
Hungary	-11.2%	10.7%	10.2%	5.9	5.6	5.3
Poland	20.7%	5.9%	8.9%	7.7	7.3	6.8
Czech Republic	34.9%	21.6%	10.1%	9.9	8.5	7.8
Russia	21.8%	15.6%	5.6%	8.1	8.4	7.6
	16.5%	**13.5%**	**8.7%**	**7.9**	**7.5**	**6.9**

Source: JCF

Emerging markets are mostly well financed at present, which is a huge difference compared to the past. For this reason, we believe that these countries are much more autonomous than in recent years. In general, the risks for negative surprises in emerging markets are much lower than is commonly supposed. So, we feel that foresighted investors will find lots of opportunities in these markets now, despite their mostly higher volatility.

CEE Macro economy

So far, no spillovers from sub-prime crisis recognizable

Overall, CEE economies have weathered the "sub-prime storm" pretty well so far. Part of this was attributable to the fact that the (by far) most important export market - Euroland - has kept up pretty well. The other reason is structural advantages of the countries, mainly the favorable productivity - cost relationship. The competitive advantage of the region has been mirrored by solidly performing labor markets, which are the basis for domestic demand. This provides good immunization against global jitters. However, a severe downturn of the world economy would of course also have serious effects on CEE, but this is not what we expect.

Central banks' focus will remain on inflation

Looking into 2Q, currently we do not see any indications that point to a sharp slowdown. Sure, the financial crisis and the US economy have not bottomed out yet and high commodity prices weigh on purchasing power globally. A relaxation might still take some time, but at the same time, we do not think these negative forces will last long enough to trigger a downward spiral of the world economy. After a long phase of strong economic expansion and no signs of a significant slowdown ahead, keeping inflation in check will remain the priority of central banks in the period ahead. Except for Slovakia, where pending EMU accession is the determinant for monetary policy, there is a clear risk of interest rates rising further. Expectations differ for the countries and in some cases we think the peak has already been reached. However, with the current environment, central banks might have to step harder on the brakes than currently anticipated.

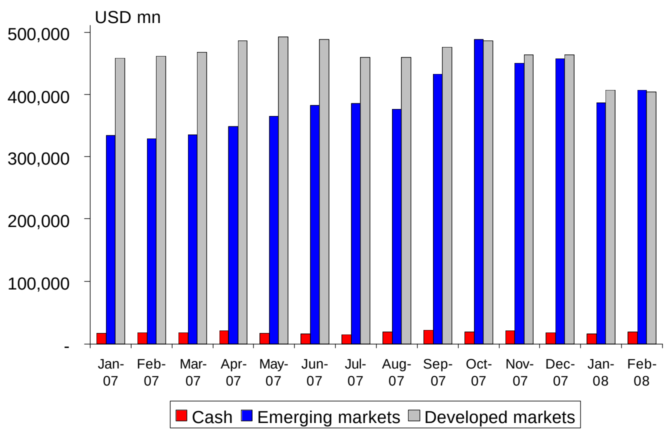
Global sentiment to determine FX markets

Given that we see still a bumpy ride ahead for capital markets for most of 2Q, FX markets should be mainly determined by global risk appetite. So, especially for countries with high current account deficits, FX volatility will remain an issue for the time being. At the same time, the (increasing) interest rate differential vs. the US and Euroland should compensate for any future sentiment downturn, making any currency losses only temporary. Furthermore, it must be considered that the markets that have taken the heaviest beatings during the current crisis are the ones that should profit the most once global markets normalize.

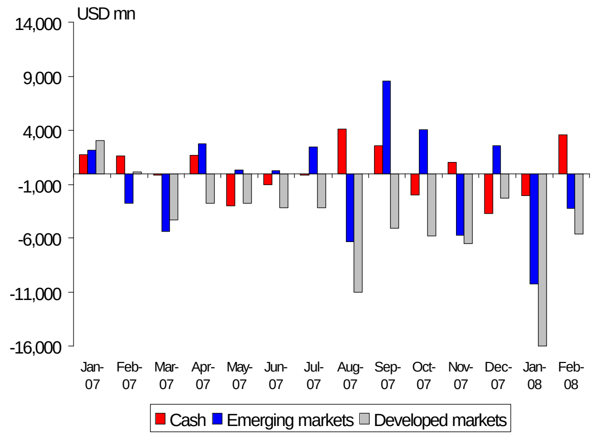
Fund flow

The flight into cash appears to have been the dominant theme, at least for February 2008. Emerging Market funds still saw some net purchases, at least in December 2007. Net selling has prevailed since then, as has been the case for Developed Markets already for quite some time. January 2008 was certainly the biggest month in terms of net selling, but Developed Markets were hit even harder. While Emerging Markets were sold at a rate of -2.6% of holdings, Developed Markets saw a rate of -3.6%. In February, the situation calmed down a bit, with Emerging Markets again doing slightly better (-0.8% vs. -1.4%). In January, European (West) equities were hit the hardest, with net selling of USD 10bn. In February, Emerging Asia, Pacific and Europe (West) all lost about USD 3bn, while cash increased by USD 3bn and Latin and North America even saw some net purchases. EMEA lost some USD 400mn via net selling.

Total holdings, eop



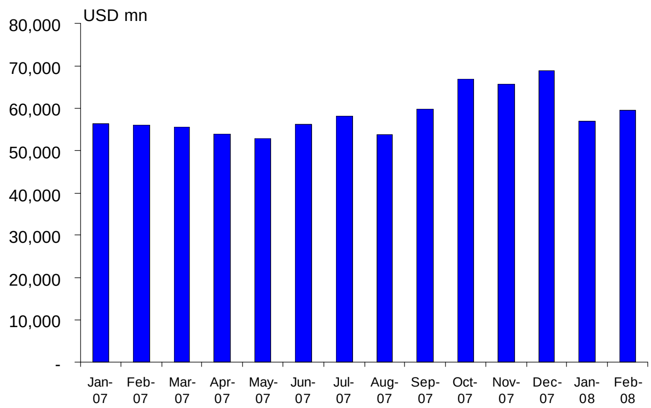
Net purchases/sales



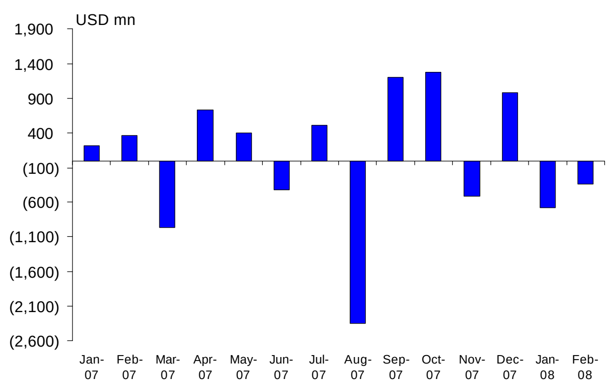
Source: Emerging Portfolio Research; ***Total holdings:*** *market value of all holdings for all funds covered* ***Net purchases/sales:*** *change in market value of holdings - increase (decrease) of market value of holdings*

Total holdings of Emerging Europe funds (here including Greece) recovered slightly in February 2008. Actually, only Estonia and Greece saw decreasing values. The selling pressure softened in February. After sales of a bit less than USD 700mn for the combined Emerging Europe funds in January, selling eased to about USD 340mn. The biggest selling was still seen in Russia and Ukraine (USD 200mn and USD 100mn, respectively). The Czech Republic and Poland saw net purchases and Romania was about flat.

Emerging Europe: total holdings, eop...



...net purchases/sales

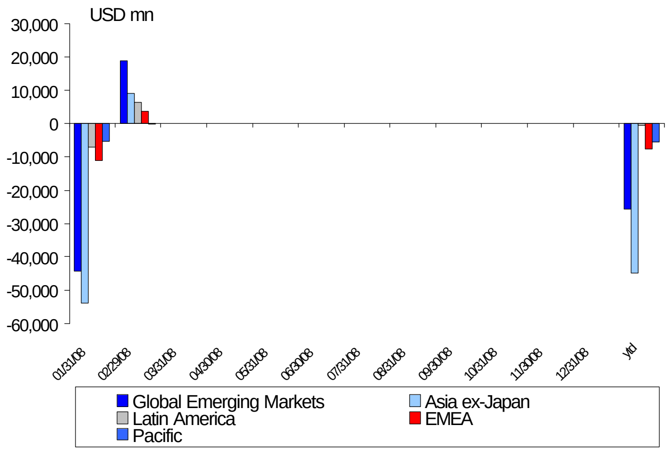


Source: Emerging Portfolio Research; ***Total holdings:*** *market value of all holdings for all Emerging Europe funds covered* ***Net purchases/sales:*** *change in market value of holdings - increase (decrease) of market value of holdings for all Emerging Europe funds covered*

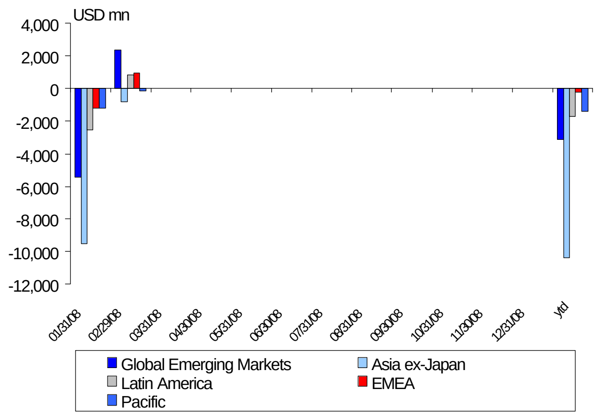
Fund flow

In terms of redemptions, Asian funds (ex Japan) were hit hardest year-to-date. While all markets have experienced outflows based on year-to-date figures, Asian and Pacific funds are the only ones to have seen no inflows in February 2008. Global Emerging Market funds attracted inflows of about 0.8% of assets in February, while both Latin America and EMEA received 1.5% of assets as inflows.

Monthly net change



Monthly flows

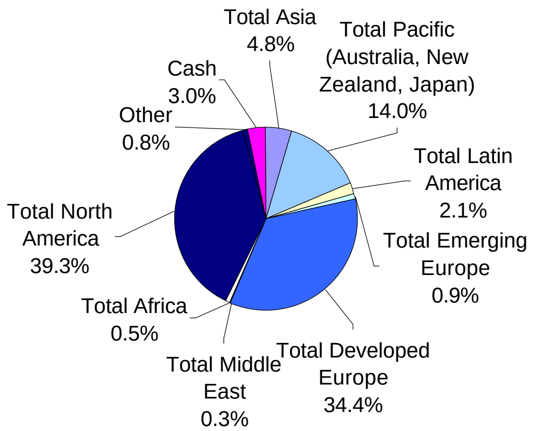


Source: Emerging Portfolio Research; ***Monthly net change:*** *change in assets minus forex change = portfolio change + monthly flows /* ***Monthly flows****: change in assets minus portfolio change, minus forex change = contribution/redemption to funds*

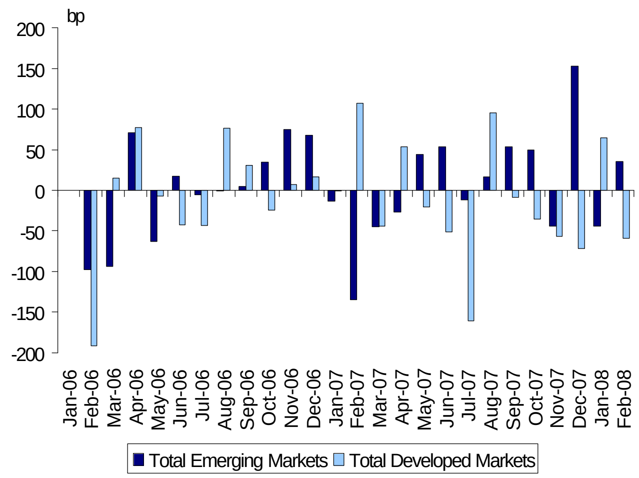
Within Global Equity Market funds, Emerging Markets again gained weight in February. Following the flow of funds, Developed Europe was the biggest loser, while North America even gained in weight. Also on the winning side in terms of weight, we find Emerging Europe and Latin America, accounting for most of the Emerging Market gain in weight.

Emerging markets - weight in Global Equity Funds

Current...



...over time



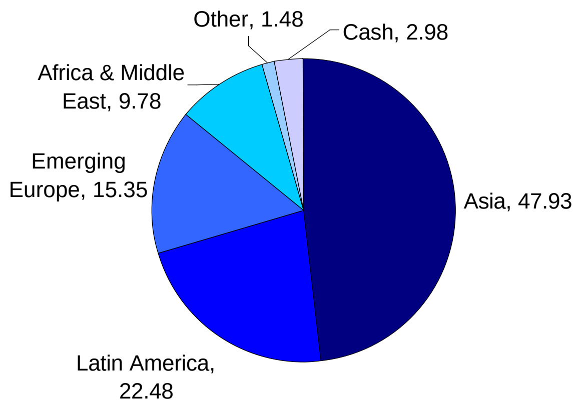
Source: Emerging Portfolio Research

Fund flow

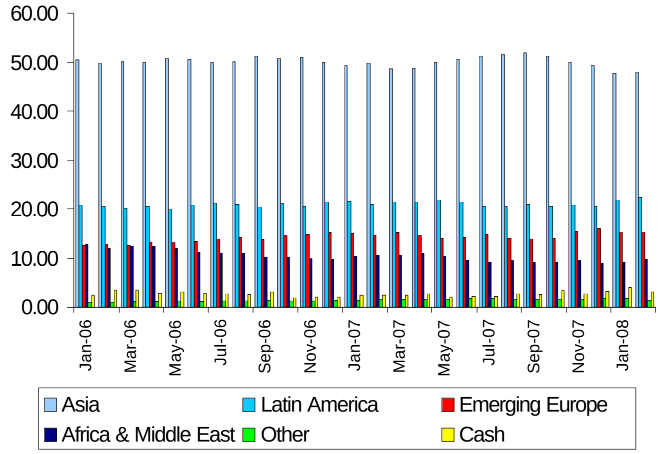
Within Global Emerging Market funds, the reduction of cash and other investments was predominantly distributed to gains in weight for Latin America, as well as Africa and the Middle East. Emerging Europe remained flat within this class of funds.

Emerging Europe - weight in Global Emerging Market Funds

Current...

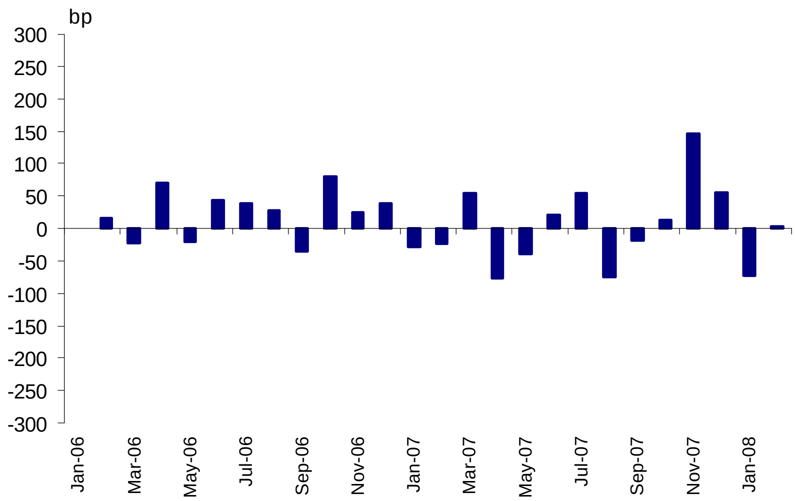


...over time



Source: Emerging Portfolio Research

Change in weigthing - Emerging Europe within Global Emerging Market Funds

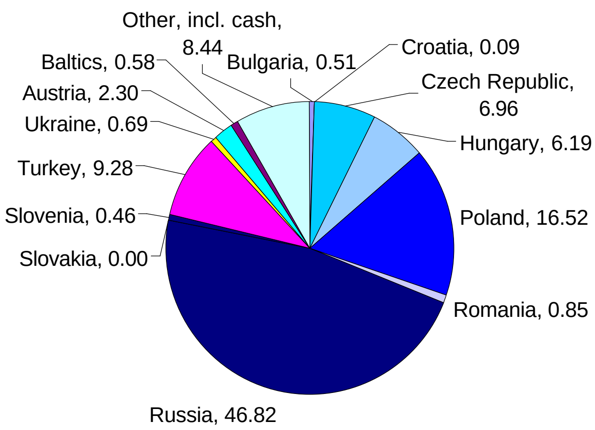


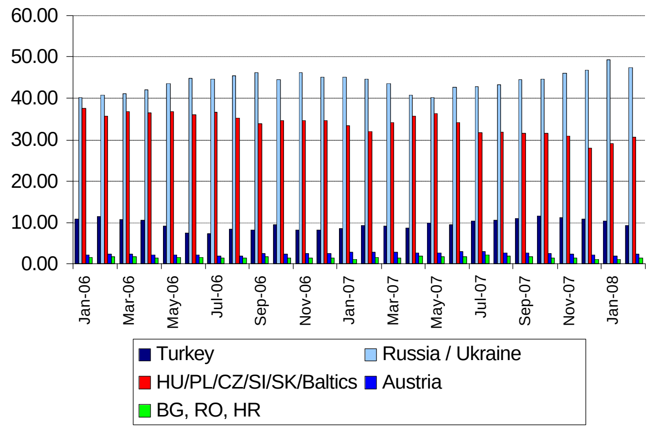
Source: Emerging Portfolio Research

Within Emerging Europe funds, the cash position saw a moderate increase of 50bps in weight. Russia and Turkey were the biggest losers here, facing decreases in weight of 180bps and 110bps, respectively. Unsurprisingly, Hungary saw a moderate reduction in weight, while Poland was the strongest gainer with an increase of 160bps.

Fund flow

Emerging Europe - country weighting in Emerging Europe Funds

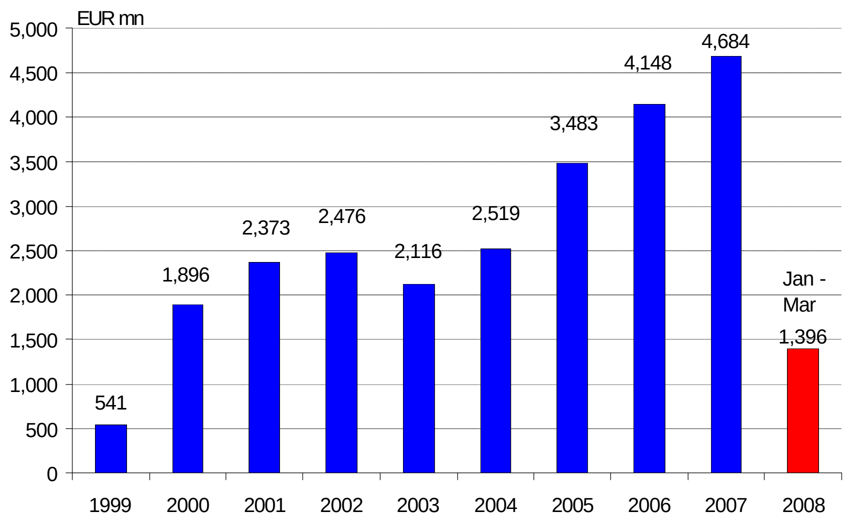




Source: Emerging Portfolio Research

Transfers into the Polish pension system saw a slump of 28% y/y in February 2008, but increased again by 47% y/y in March, bringing the total amount to some EUR 1.4bn thus far in 2008.

Transfers into Polish pension system

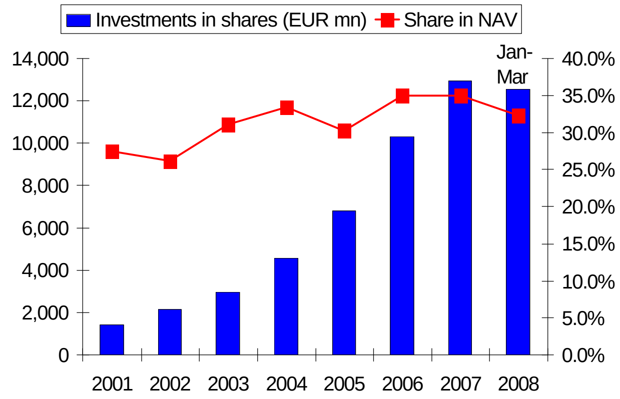


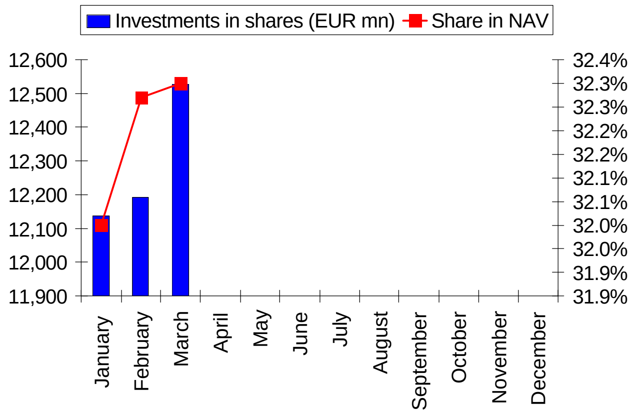
Source: ZUS

Consequently, investments in shares remained moderate in an annual comparison, falling from 35% in December 2007 to just 32.3% so far in 2008. Not only did the cash position increase slightly, but also bonds gained from 62% of NAV in December 2007 to 64% in February 2008. Hence, the Polish equity market is not really receiving strong support from this end.

Fund flow

Polish pension funds - development in share investments

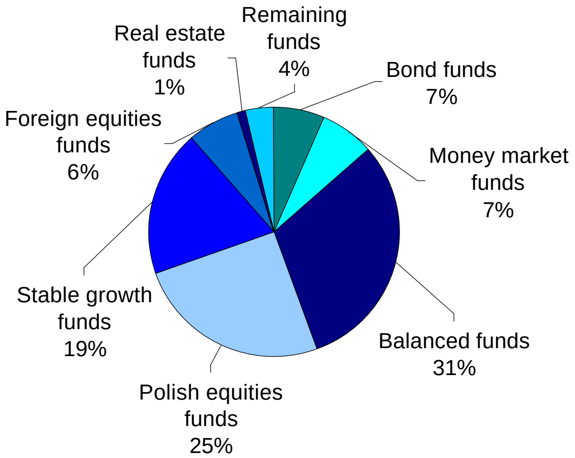




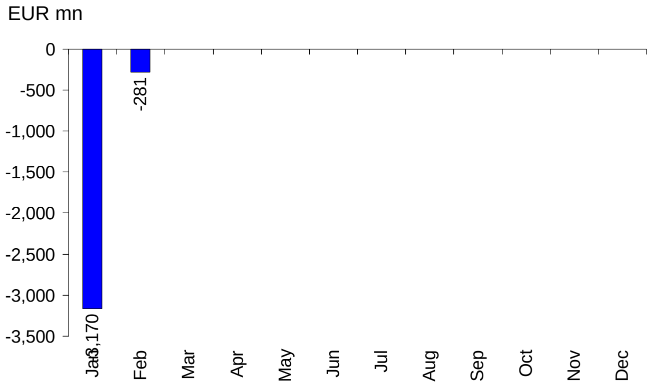
Source: Parkiet, Rzeczpospolita, PAP

Polish mutual funds were even less supportive, facing continued cash outflows since November 2007. Outflows peaked in January this year with redemptions of EUR 3.2bn, while the situation calmed down in February, when outflows moderated to EUR 280mn. The latest breakdown available puts the weight of equity investments at 38% (January), compared to 41% at the end of 2007. At least there is no drain out of the country, with the proportion of investment in overall Polish assets remaining stable at 81%.

Current breakdown of Polish Mutual funds

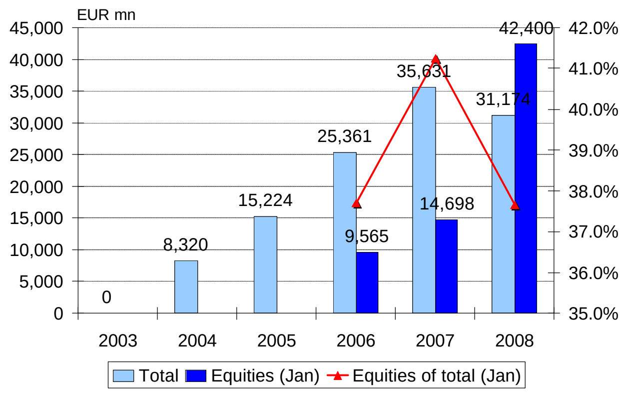


Net cash inflows (2008)

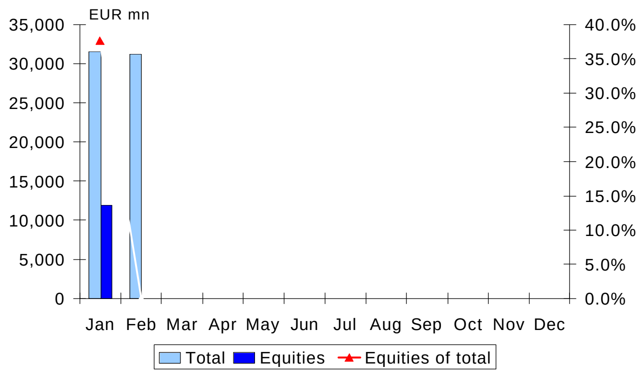


Development of equity portion...

...annually...



...and on a monthly basis



Source: Analyze Online

ZEW Indicator CEE

Economic Sentiment for Central and Eastern Europe recovers considerably

The economic sentiment indicator for Central and Eastern Europe (CEE), which is calculated on the basis of a monthly survey conducted by the Centre for European Economic Research (ZEW) and supported by Erste Bank der oesterreichischen Sparkassen AG, Vienna, has recovered in March. The CEE indicator rises by 6.4 points and now stands at minus 22.4 points. In the March survey the financial market experts evaluate the current economic situation for the CEE region and for most CEE countries more optimistically compared to the previous month. The forecasts for the development of the stock markets during the next six months remain favourable, similar to last month's survey.

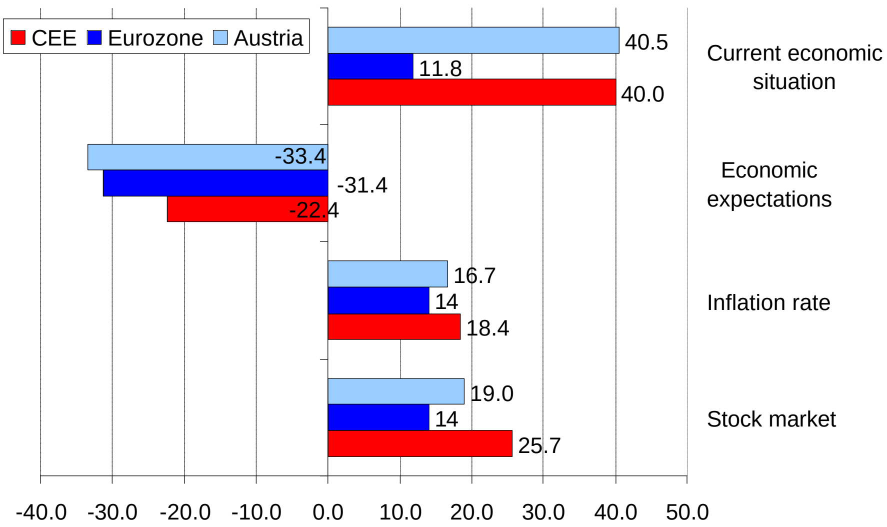
Economic outlook for CEE countries, Austria and the Eurozone

The CEE indicator, constructed as the balance of positive and negative assessments of the economic outlook for the next half year, increases for the second month in a row in March by 6.4 points to a level of minus 22.4 points. Furthermore, the assessment of the current economic situation in the CEE region also has improved markedly by 9.8 points and reaches 40.0 points. Not a single financial market expert views today's economic environment in the region as bad. The improvement of the balances is caused mainly by a reduction of the fraction of participants who do not expect a change of the economic situation and who evaluate the current state as acceptable. Still, this group remains the largest fraction of financial market experts participating in the survey. 49 percent (minus 6.8 percentage points compared to the February survey) of the respondents predict a stable CEE economy in the next six months and 60.0 percent (minus 6.0 percentage points) assess the current situation as acceptable.

Similar to last month, the economic expectations for the Eurozone have seen the strongest upturn. The indicator climbs by 15.0 points to minus 31.4 points. The current economic situation is assessed as positive as well. The corresponding balance increases by 2.4 points to 11.8 points. In Austria both indicators worsen by minus 10.7 points and minus 6.2 points respectively compared to the February survey.

The strong decreases in the balances for inflation rate expectations in February did not continue in March. While the balance for the CEE region drops slightly by 1.6 points to 18.4 points, the balances for the Eurozone and Austria increase by 4.3 points and 12.1 points to 14.0 points and 16.7 points respectively. Still, 54.2 percent of the participants expect an interest rate cut in the Eurozone in the second half of this year. However, the balance climbs by 7.1 points to minus 43.8 points.

ZEW indicator



Projections of the participants of the Financial Market Survey CEE, balance between positive and negative assessment; Source: ZEW

The forecasts for the development of the stock markets remain favourable, similar to last month. While 53.9 percent of the respondents consider a rising NTX probable, 28.2 percent anticipate a weaker CEE stock index. The balance declines slightly by 0.4 points to 25.7 points. The balances for the Austrian ATX and the Euro Stoxx 50 drop by 8.8 points and 4.4 points to 19.0 points and 14.0 points respectively.

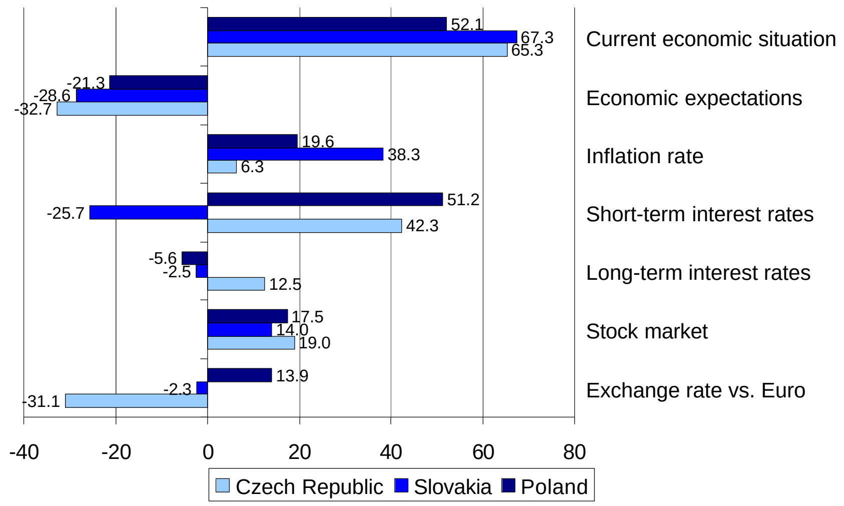
Very good economic situation in the Czech Republic and Slovakia; depreciation of both currencies expected

The financial experts assess the current economic situation in the Czech Republic and Slovakia as very good. The balances of answers opting for "good" versus "bad" are above 65.0 points for both countries in March. The balance for Slovakia shows the strongest growth by 14.3 points to 67.3 points, followed by the Czech Republic with an increase of 12.5 points to 65.3 points. The Polish economy is also evaluated mainly as good with a balance of 52.1 points. For Poland the economic expectations for the next six months even improved by 7.5 points, in contrast to the February survey, to a level of minus 21.3 points. The outlook for the Czech Republic deteriorates slightly by 2.6 points. Although the majority of experts (44.9 percent) predict the economic situation to worsen, a high proportion of participants (42.9 percent) do not expect a change. For the Polish and Slovakian economy the majority of survey participants do not expect a change in the next six months.

For all three countries the experts predict rising inflation rates. All in all, the risk for a rise in inflation has increased when compared to last month's results. Especially for Slovakia the balance rises by 11.5 points to 38.3 points. Consistent with the expectations of rising inflation rates in the Czech Republic and Poland, the financial market experts predict rising short-term interest rates. By contrast, in Slovakia the same proportion of experts (41.9 percent) expects decreasing as well as steady short-term rates. Due to the minority of experts expecting increasing interest rates (16.2 percent), the balance is negative (minus 25.7 points).

The expectations regarding the currency exchange rates are mixed. While a majority of experts predicts a depreciation of the Czech and Slovakian currencies compared to the Euro, they foresee an appreciation of the Polish currency. Especially the very fast appreciation of the Czech Koruna since mid-2007 is seen by the experts as not sustainable. That's why they believe the Koruna could cede part of its recent strong gains during the next six months.

ZEW indicator on country levels



Projections of the participants of the Financial Market Survey CEE, balance between positive and negative assessment; Source: ZEW

A brighter outlook for the Hungarian and Romanian economy; almost no change of the expectations for Croatia

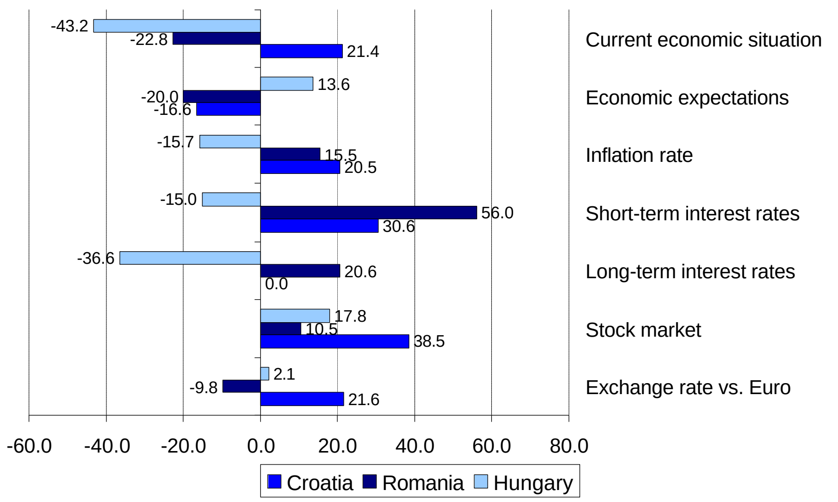
The evaluations of the current situation in Croatia, Hungary and Romania are mixed. While Romania's balance improves by 11.8 to minus 22.8 points, the balance for Hungary declines by 14.8 to minus 43.2 points. Croatia's balance rests almost unchanged at 21.4 points. Exactly half of the respondents expect Croatia's economic situation not to change over the next six months. The corresponding indicator remains almost unchanged at minus 16.6 points. The outlook for Hungary and Romania has improved in this month's survey. The expectations for the Hungarian economy for the upcoming six months continue to be at the highest level within the considered countries. The indicator climbs by 8.1 to 13.6 points. The balance for Romania is still negative (minus 20.0 points), but 13.4 points higher than in February.

Regarding inflation rates, a majority of survey participants predicts increasing inflation rates in Romania and Croatia, while most financial market experts opt for decreasing inflation rates in Hungary. This is reflected in the balances. Hungary's balance stands at minus 15.7, an increase of 20.2 points from last month. Again, Croatia's rests nearly unchanged at 20.5 points. The inflation expectations for Romania have decreased. The balance loses 13.0 points to 15.5 points.

The outlook with respect to short-term interest rates has changed in the three countries. With an almost neutral forecast in February, the absolute balance for Croatia in March increases by 27.8 to 30.6 points. Hungary's balance gains 13.5 points, but remains negative (minus 15.0 points). 65.8 percent of the respondents are confident that Romania's short-term interest rates will rise. This results in an indicator value of 56.0 points, down 9.9 points from last month.

Only small changes regarding the predictions for the stock markets can be detected. The outlook in all three countries remains favourable. The balance for the Croatian CROBEX stays on the highest level within the considered countries (38.5 points).

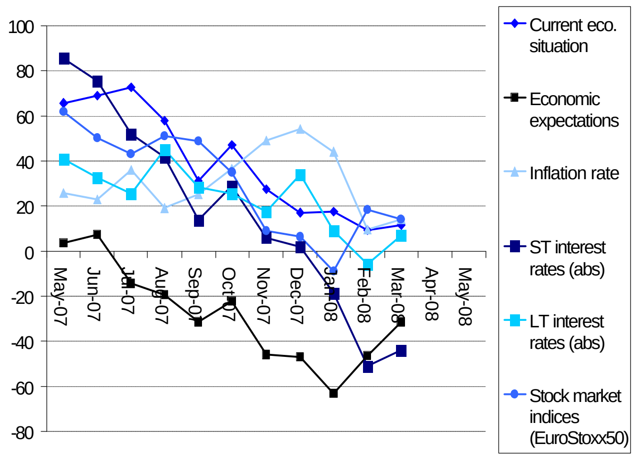
ZEW indicator on country levels



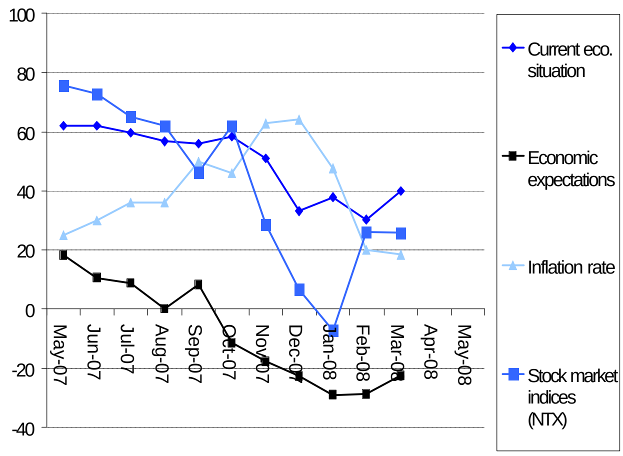
Projections of the participants of the Financial Market Survey CEE, balance between positive and negative assessment; Source: ZEW

ZEW indicator development

For Eurozone...



...and CEE



Projections of the participants of the Financial Market Survey CEE, balance between positive and negative assessment; Source: ZEW

Special Question: Corporate Transactions in the CEE Region

This month's special question focuses on corporate transactions in the CEE region, especially the mergers and acquisitions (M&A) activities. We started out by asking the financial market experts for their expectations concerning M&A-transactions in the CEE region this year. 31 percent of the participants predict decelerating M&A-activities in the CEE countries, while 20 percent expect accelerating activities. 26 percent think that M&A-activities will remain on the same level as last year. The majority of experts expect the CEE M&A-market to be dominated by cross-border transactions (54 percent), not by domestic transactions (14 percent). With regard to the country of origin of foreign investors in the CEE market, most respondents see German investors as the most active (33 percent). Austrian (20 percent) and U.S. investors (13 percent) are ranked second and third.

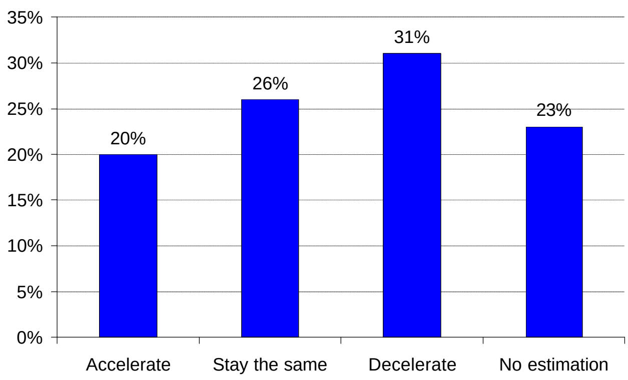
The CEE countries have been very attractive for foreign direct investment. International capital flows have contributed strongly to the performance of the CEE stock markets. In this context it is important to ascertain which markets are most appealing to international investors. The survey participants make it very clear that they consider Romania (37 percent) and Poland (34 percent) to be the most attractive. The Czech Republic comes in third with 9 percent of the answers.

We see a similar picture when regarding the experts' expectations where the highest number of corporate transactions will take place. According to our survey, this should be in Poland (61 percent), followed by Romania (22 percent). Hungary, Slovakia and Slovenia should experience the lowest number of transactions in 2008.

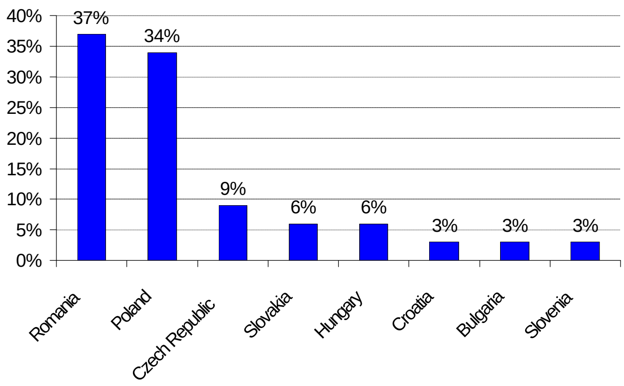
Finally, the financial market experts were asked to assess the intensity of M&A-activities in different sectors of the economy. Telecommunications and as well as Food and Beverages are the sectors where a rather low level of transactions is foreseen. In Financial Services a relatively high intensity of M&A-activities is predicted, but most activity should be recorded in the Energy and Utilities sector. When asked about a prominent take over in 2008, the respondents pointed towards the Austrian oil and gas company OMV increasing its stake in its Hungarian competitor MOL.

Source: ZEW

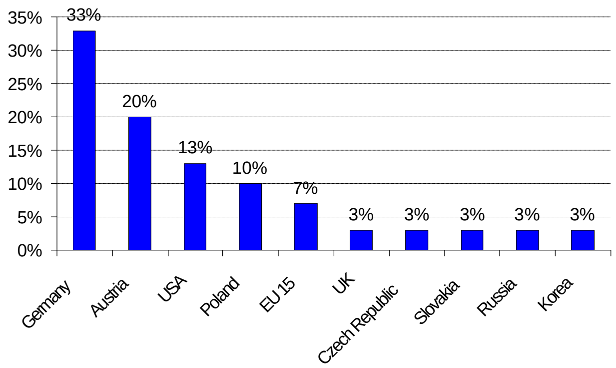
Expected development of M&A in CEE, 2008



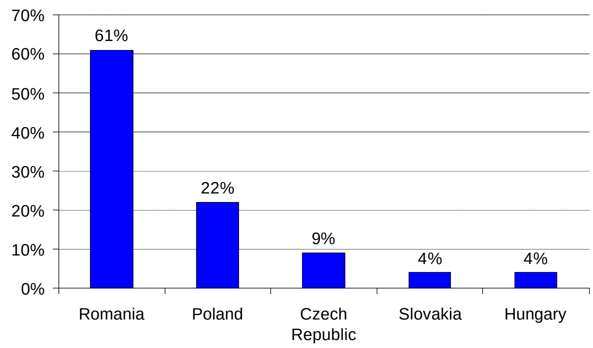
Most attractive country for international investors



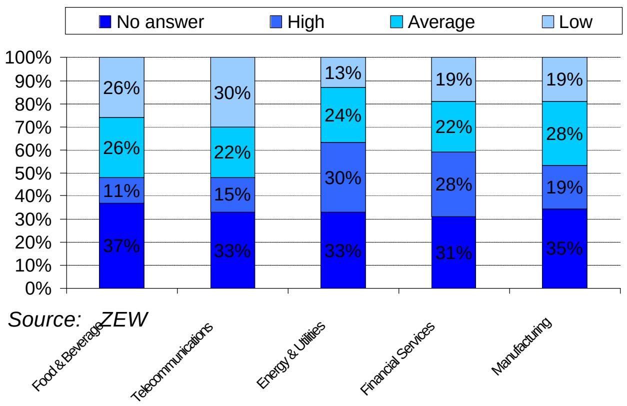
Most active foreign investors on CEE M&A markets



Countries with highest number of transactions



Expected M&A intensity by sector



Source: ZEW

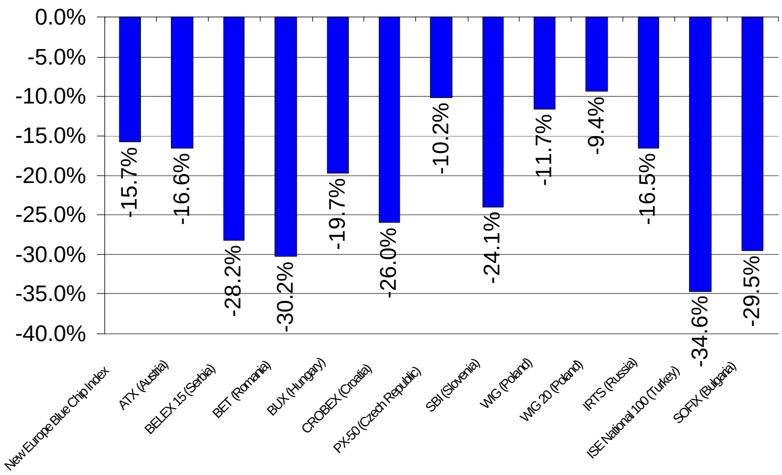
Explanation: Mode of operation / ZEW indicator

The indicators reflect the difference between the percentage of analysts who are optimistic and the percentage of analysts who are pessimistic. The possible outcome of the balance lies between -100 and +100 points. Positive values of the balance indicate that the number of participants expecting a rise in a particular variable outweigh the number of participants with negative expectations.

SEE - again underperformer

The underweight for SEE markets in 1Q08 appeared to be a good decision, given that markets in this region massively underperformed. Also, the rather cautious stand on Turkey (underweight) proved to be right, with the market giving away 34.6% in 1Q08. Slovenia, another underweight, also did not disappoint, losing quite substantially. For neutral and overweight ratings in 1Q, the only decisive question was who lost less. Russia, which we had placed in a neutral position, ranked in the middle in terms of losses. Poland, which we actually moved to an overweight position against the pure model outcome, was the "top performer", losing only 9.4% (WIG 20) and 11.7% (WIG). The Czech Republic surprised positively, given that our model rated the market at only a neutral position. Finally, Hungary did not really confirm its overweight position, and we feel validated in our decision to have reduced the overweight result of our model (indicating a move towards a neutral position).

1Q performance in EUR

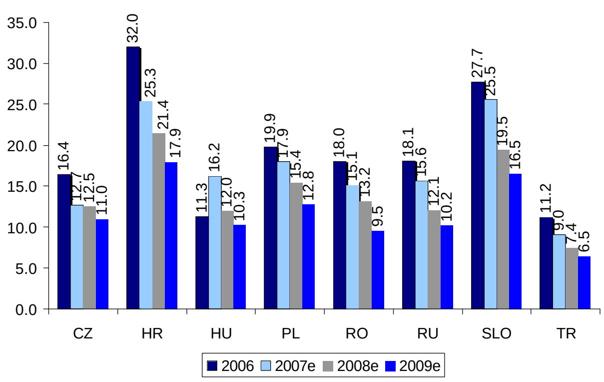


Source: Reuters, Erste Bank

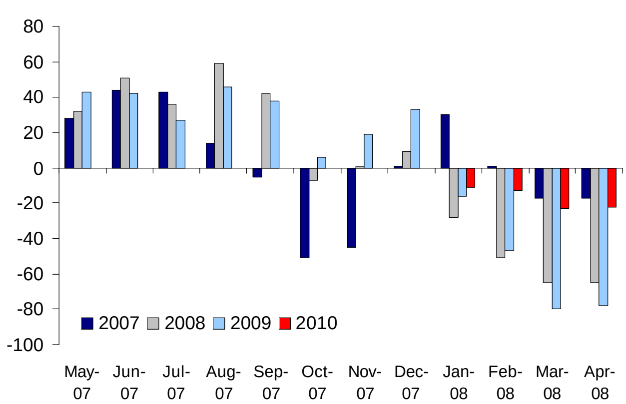
Valuation and technical analysis prompt strongest expected returns

We have further extended the basis for our quantitative allocation model and the number of stocks included in the model now reaches 430 (+100). Consequently, the quality of the model outcome should increase as well. Looking at the back test results (shown in the appendix), we feel much more confident with the model result compared to the latest issue (for the first quarter of 2008). Valuation again contributes prominently to the model outcome this time. Actually, markets are rather on the cheap side. Also, technical analysis would yield positive expected returns for most markets in our model. Given

Consensus valuation

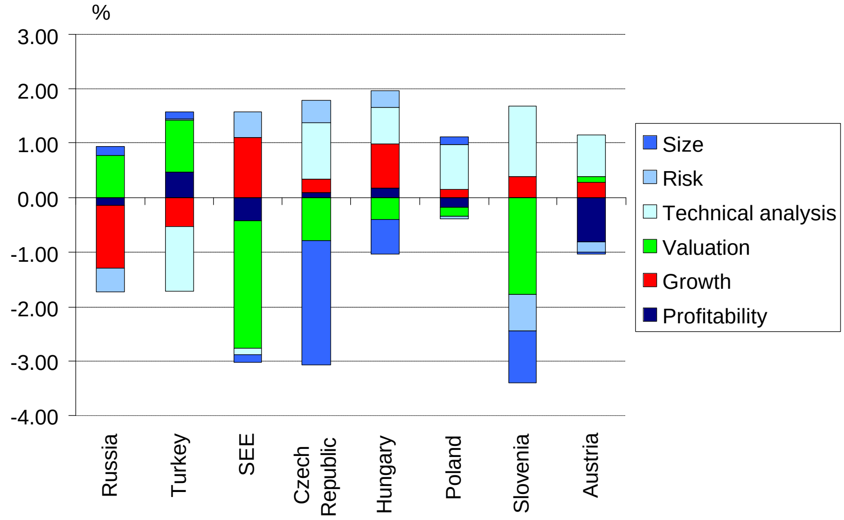


Earnings revision rate CEE*



**Revision rates for Austria,Czech Republic, Hungary, Poland and Romania Source: JCF Quant, own calculations* concerns on the reliability of earnings, there are some question marks, reflecting the concerns on a slowdown in growth, which could also hit the CEE region. Beginning with 2008, we observe a trend of negative earnings revisions exceeding positive revisions. This, however, is not a phenomenon seen exclusively in CEE - the EuroStoxx 50 has also experienced negative earnings revision balances for 2008 to 2010, starting with January 2008.

Summary of return of components



Source: Erste Bank

Austria - Overweight

Austria is expected to post positive returns, albeit on a thin margin. In the current environment, this would qualify for an overweight per se, but we think in general that the market still offers a quality that allows for a stronger weighting. The 12M forward P/E (10) is significantly below its historical average (12.9) and the current spread between the benchmark yield and earnings yields (5.9) is well above the historical average of 3.4, asking for a bit overdone risk premium for Austrian equities. Obviously, the market remains torn between strong-growth CEE markets and just being a small Western market. We remain confident that CEE growth channeled into the Austrian market will remain appealing. Overweight.

Poland - Overweight

Poland remains an overweight in our asset allocation proposal. Compared to other CEE markets, Poland might appear a bit "expensive" at a P/E of 15.4 on 2008 earnings and risk premiums for equities are at about the historical average. However, the arguments for the market remain the same. Under current circumstances, liquidity and size remain strong arguments and Poland is still second after Austria with an average daily turnover of EUR 253mn (single counted) in 2007. Assuming that we could see a bottom in 2H, the depth of the market could be another argument in that it offers sound second-line ideas among small and mid-caps. On the negative side, local contributors to liquidity - domestic mutual funds - have experienced cash outflows since November 2007. A peak of outflows, however, was seen in January 2008. On the macro side, Poland is still producing strong growth numbers. Also, domestic demand and wages are growing strongly. Inflation has been picking up and the National Bank responded already with rate hikes. However, we would expect to see inflation peaking in the second quarter. All in all, we confirm the model outcome. Overweight.

Hungary - moderate Overweight

Hungary was again awarded an overweight rating by our allocation model. Admittedly, valuation is at the lower end, but the market as such should rather remain a macro story. Reforms seem not to have had the full intended impact yet and rising inflation is a disappointment, in light of the austerity program. Consequently, rates have been hiked. The speed of reforms got another question mark, with political tension within the current government. Supposedly, early elections do not appear too likely, given current polls, and a minority government was said to be one of the most likely outcomes. In any case, the current situation is not really supportive of speeding up necessary reforms. Our model has based its overweight outcome strongly on long-term growth and technical analysis. Given the kind of turn-around nature of the entire market, this is certainly a good and reasonable argument, but we would not depend too strongly on it, given the current environment. Hence, we soften the outcome from our quantitative model to a moderate overweight, as we did in our previous issue.

Czech Republic - Neutral

Our model has calculated negative expected returns for the Czech Republic. The strongest part stems from our size and liquidity measures. The low weighting appears to be justified within the current market environment, when volatility recommends remaining in larger markets. Assuming that we might see some lasting overall recovery, we would put the Czech market in a waiting position again and confirm the neutral position in our proposed allocation.

Slovenia - Underweight

Slovenia and Croatia remain the most demandingly valued markets. Consequently, valuation, as well as size and liquidity, yielded negative expected returns. The market has performed badly in 1Q, confirming our previous underweight decision. The only reasonable support in terms of positive expected returns stems again from technical analysis, namely momentum. Local liquidity should be able to lift prices occasionally, but, given the current environment of risk aversion, we would continue to stay away from these markets, although a few stock picking opportunities prevail (Krka, Gorenje). Underweight.

SEE - underweight; Romania the first one to be re-weighted

South East European markets strongly confirmed our underweight decision for the first quarter. However, we would like to stress that this was and will be a preliminary decision. For the region as such, valuation again yielded quite significant negative expected returns (but growth still delivers nice expected returns). However, getting back to the potential recovery, overall it might be worth splitting markets in SEE a bit and getting ready to position yourself. For Croatia, basically the argument is the same as for Slovenia. Again, selective stock picking opportunities remain, but the market overall still has a lot of vision priced in and vision does not sell well these days. Serbia is a pretty obvious decision, given the current political tensions; the market had its risk already without the Kosovo situation. Romania, however, remains a different story. First of all, the notoriously expensive market has given back a lot of its premium and now trades at P/Es of 13.2 and 9.5 on 2008 and 2009 earnings, respectively. Secondly, we maintain our view that the country admittedly runs serious risks with regards to it CA deficits and corresponding impacts on currency, etc. However, we think that these risks are acceptable for a market in this stage of development and would have been accepted in any other environment. The current risk aversion has just caught the market at the wrong moment. One of our main arguments for why the market worries are overdone is that FDI greatly covers the CA deficit and will contribute to profitability increases and exports in the mid- to long-term. This view is further confirmed by the recent ZEW review. The special question for the current survey revealed that Romania is still seen as the most attractive target for foreign investments and M&A activities. Hence, by separating the SEE group a bit, we would not necessarily divert from the current underweight for the region, but would look at Romania first, once sentiment turns.

Turkey - moderate neutral

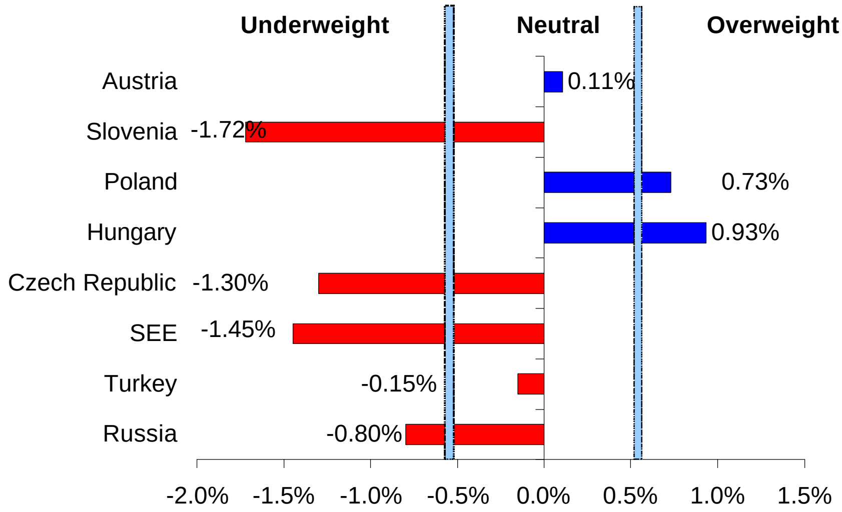
For Turkey, our allocation model yields negative expected returns, based on the growth outlook and on momentum. Correspondingly, the low valuation of the Turkish market has to be seen relative to growth, and the valuation component (which alone provides for positive expected returns) cannot offset the accumulated negative expected return for the market. In total, we would call the market a neutral weight, slightly contravening the model outcome. If we see some recovery later this year, it might worth it to be positioned in one of the most liquid markets.

CEE country allocation

Russia - Neutral

Russia also came out with negative expected returns based on growth, while valuation yielded the opposite. In total, the result is pretty much the same as in the case of Turkey. We moderate the model outcome to a more neutral weight. The change of president went smoothly and the announced political program sounds business-friendly. As long as the uncertainty remains, investments in commodities might remain an option (assuming that recession fears do not massively steer sentiment).

Allocation based on expected returns



Source: Erste Bank

Factor model description

In our approach to establishing a regional allocation, we employ a multi-factor model. The model screens a universe of the following countries:

- Austria
- Bulgaria (SEE)
- Croatia (SEE)
- Czech Republic
- Hungary
- Poland
- Romania (SEE)
- Russia
- Serbia (SEE)
- Slovenia
- Turkey

Due to data availability, we pooled Bulgaria, Croatia, Romania and Serbia into one region, which we called Southern and Eastern Europe (SEE). This was done because of the small number of available stocks in the data for this region.

The model refines its results by using a range of factors that are seen as significant in any asset allocation decision. Factors cover the topics of:

- Valuation
- Size/Liquidity
- Profitability
- Growth
- Corporate risk
- Technical analysis

In total, the model relies on 16 single factors.

We start our model view with Dezember 1999. Via a multiple-regression, we try to identify a relationship between our chosen factors at the end of a period and the observed return for the next period (in our case, we look at quarters). We run this multiple-regression for the first year of chosen history and summarize the results of the regression by calculating an average regression coefficient (b) for the first year (2000) for each factor.

As the next step, we use the average b from the past year (not including the current quarter) and the stock's current state for each factor to forecast an expected return for the next period. However, regression coefficients are estimated further on for all following periods. For each period, new forecasts are computed by calculating the past year's average of the regression coefficients for each factor.

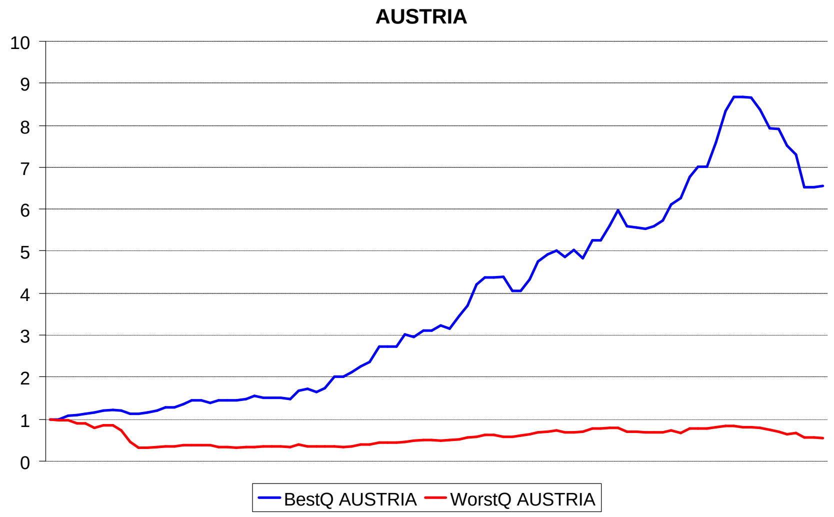
To cut it short, the model yields expected returns for each stock in our universe, which we finally aggregate to country levels.

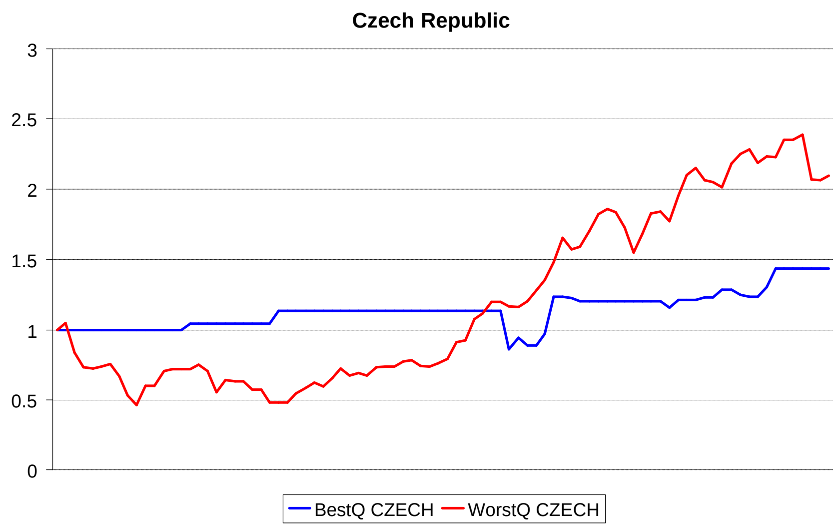
In order to check the outcome of our model, we run a forward looking back test, e.g. how much any portfolio based on the model outcome would have made in terms of return. We differentiate between quartiles and would expect the top quartile to have outperformed the bottom quartile. The outcome indeed indicates that the model works, at least for markets with rather good data quality and - even more importantly - a higher number of stocks being traded. Hence, this already demonstrates the downside of our approach, given the fact that some markets simply offer a limited amount of stocks, which are frequently traded and for which reliable data is available. However, based on this, we would not question the entire approach, but would clearly stress the functionality of our tool: It is an allocation indication, NOT a tradable mechanism. Hence, we allow ourselves to put the pure outcome of the model on a relative scale and use our own judgment to formulate a final view.

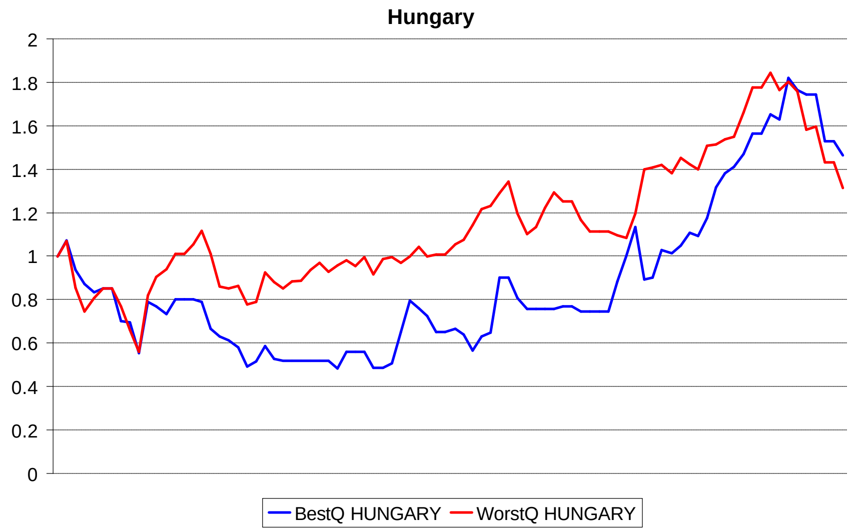
Finally, for interpretation of the outcome of our model, we use the overall expected return by country, as well as the spread between the high and low (top - last quartile) expected return stocks. The expected return by countries is the forecast, which is the actual state of the factors for each stock in the universe multiplied by the average of the coefficients (b) for each factor from last year's regressions. Since the expected return of each stock is composed of the sum of the expected return components for each factor, we can extract the information regarding from which factor the largest contribution to the expected return comes. Knowing this for each stock and each factor and aggregating on a country level gives us the average contribution of the factor to the total expected return for a country.

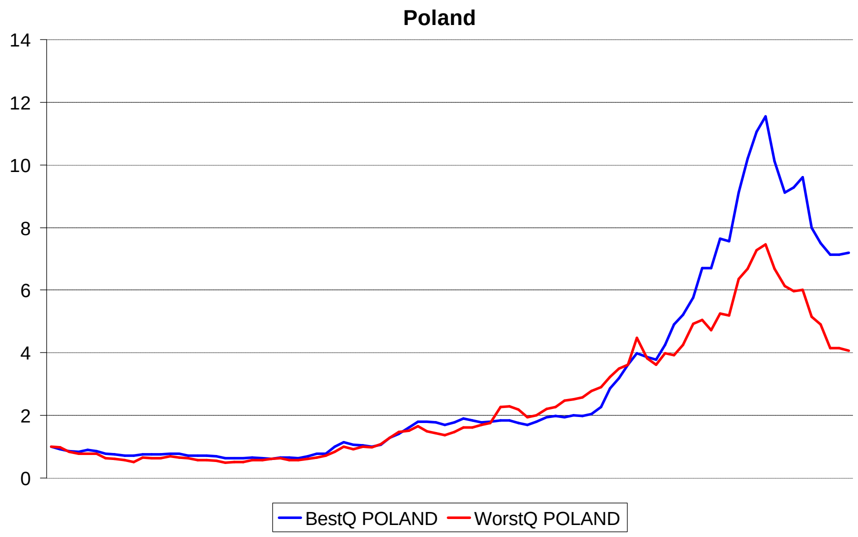
We have run a backtest, checking what our allocation model would have yielded. The following charts show the expected returns both for the best and the worth quartile.

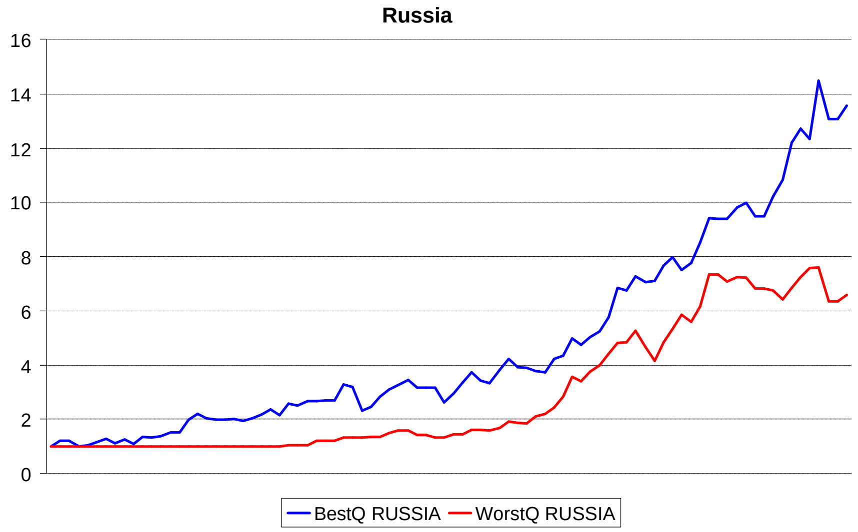
Backtest results

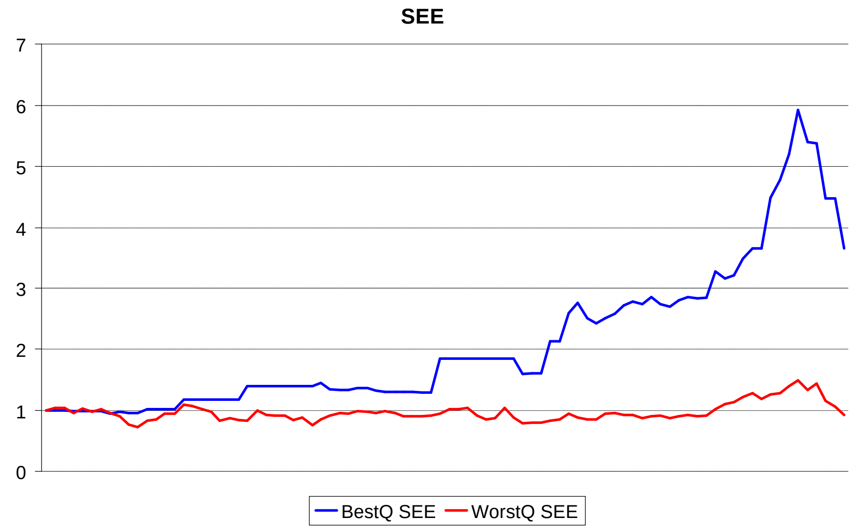


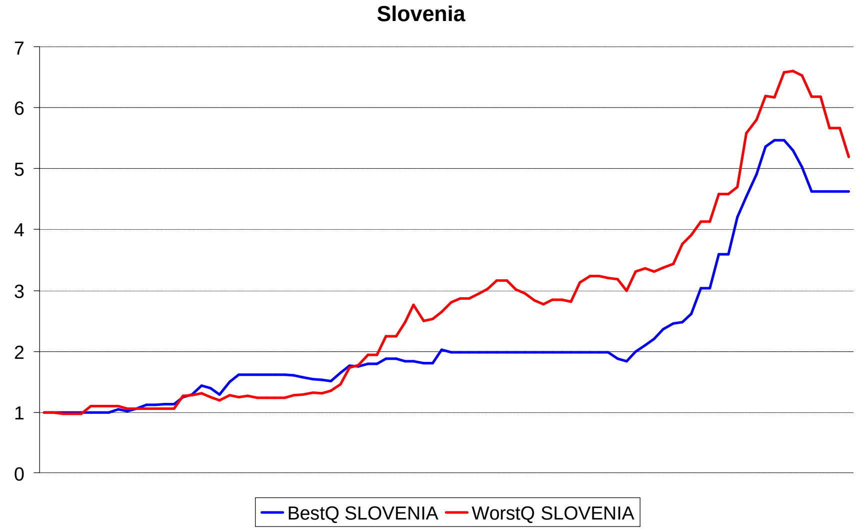


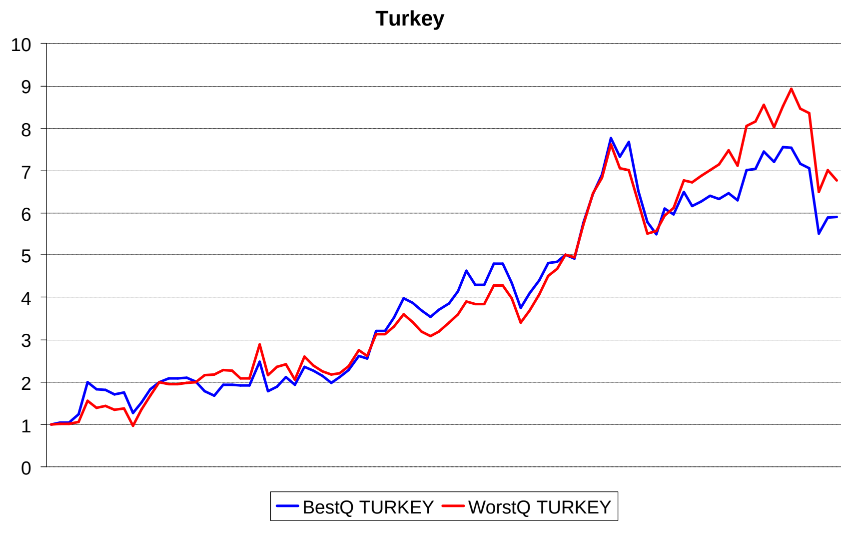

Hungary
2
1.8
1.6
1.4
1.2
1
0.8
0.6
0.4
0.2
0
BestQ HUNGARY
WorstQ HUNGARY


Poland
14
12
10
8
6
4
2
0
BestQ POLAND
WorstQ POLAND


Russia
16
14
12
10
8
6
4
2
0
BestQ RUSSIA
WorstQ RUSSIA







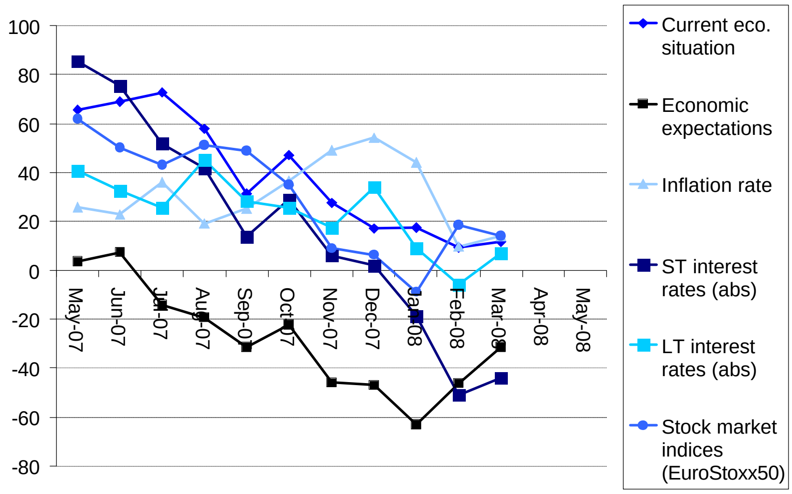
Source: Erste Bank

ZEW sentiment indicator

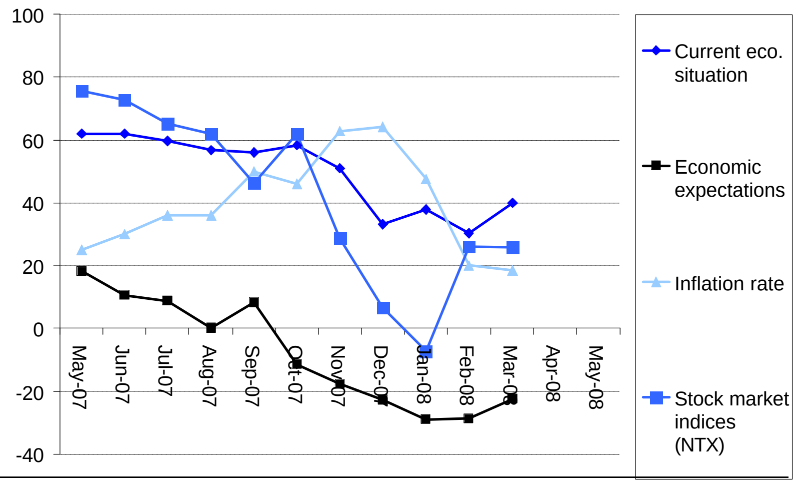
ZEW (Centre for European Economic Research, Mannheim, Germany) and Erste Bank joint established a sentiment indicator. Each month financial experts in the region are asked to give their assesment on various indicator for the CEE region. Here we show the development of the ZEW indicator over time, aggregated by region as well as on individual country levels. Since the first report was published in June 2007, history is just about to be built over time.

ZEW indicator development

EUROZONE	May-07	Jun-07	Jul-07	Aug-07	Sep-07	Oct-07	Nov-07	Dec-07	Jan-08	Feb-08	Mar-08
Current eco. situation	65.5	69.0	72.7	58.0	31.2	47.2	27.4	17.0	17.4	9.4	11.8
Economic expectations	3.6	7.3	-14.3	-19.2	-31.3	-22.2	-46.0	-47.1	-63.3	-46.4	-31.4
Inflation rate	25.9	22.7	36.0	19.1	25.1	36.5	49.0	54.0	44.2	9.7	14.0
ST interest rates (abs)	85.5	75.4	51.9	41.7	13.8	28.9	6.0	2.0	-18.6	-50.9	-43.8
LT interest rates (abs)	40.7	32.6	25.6	45.2	28.2	25.5	17.4	34.0	9.0	-6.0	6.8
Stock market indices (EuroStoxx50)	62.0	50	42.9	51.2	48.8	34.8	8.9	6.4	-9.0	18.4	14
Exchange rates (vs. Euro)	-	-	-	-	-	-	-	-	-	-	-

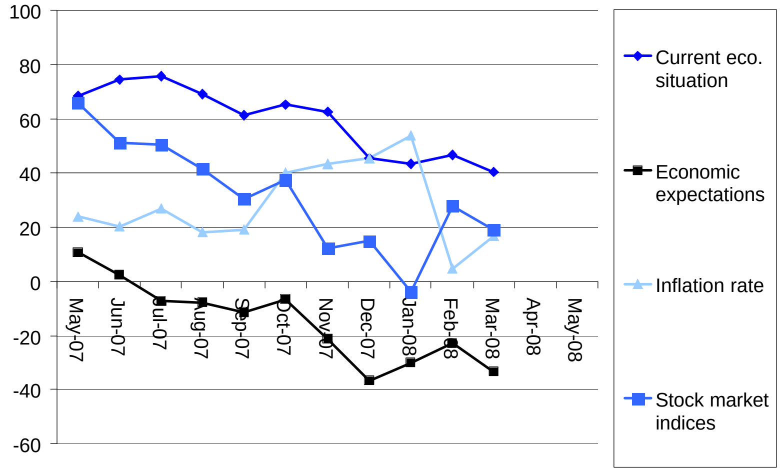


CEE	May-07	Jun-07	Jul-07	Aug-07	Sep-07	Oct-07	Nov-07	Dec-07	Jan-08	Feb-08	Mar-08
Current eco. situation	61.9	62.1	59.6	56.8	56	58.2	51.0	33.2	37.9	30.2	40.0
Economic expectations	18.3	10.6	8.8	0.0	8.3	-11.4	-17.7	-22.7	-29.0	-28.8	-22.4
Inflation rate	25.0	30.0	36.0	36.1	50.0	46.0	62.8	64.0	47.6	20.0	18.4
ST interest rates (abs)	-	-	-	-	-	-	-	-	-	-	-
LT interest rates (abs)	-	-	-	-		-	-	-	-	-	-
Stock market indices (NTX)	75.6	72.7	65.2	62.0	46.3	61.9	28.6	6.6	-7.3	26.1	25.7
Exchange rates (vs. Euro)	-	-	-	-	-	-	-	-	-	-	-

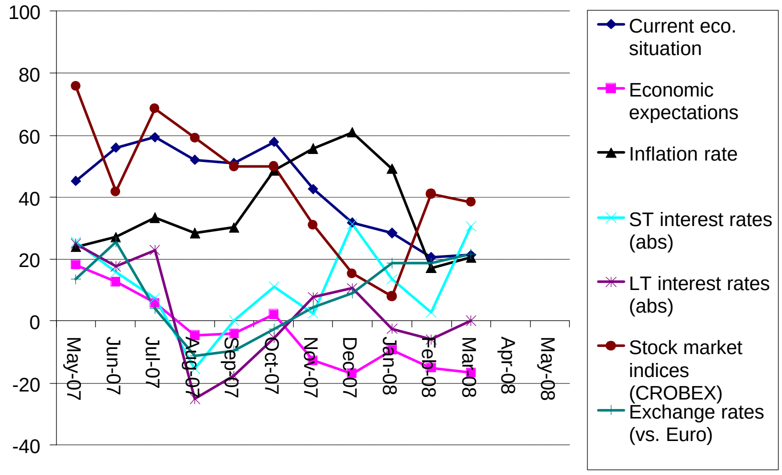


ZEW indicator development (continued)

AUSTRIA	May-07	Jun-07	Jul-07	Aug-07	Sep-07	Oct-07	Nov-07	Dec-07	Jan-08	Feb-08	Mar-08
Current eco. situation	68.6	74.5	75.6	69.2	61.4	65.2	62.5	45.5	43.4	46.7	40.5
Economic expectations	10.6	2.3	-7.3	-7.9	-11.6	-6.8	-21.3	-36.5	-30.1	-22.7	-33.4
Inflation rate	24.0	20.4	26.9	18.3	19.1	40.1	43.3	45.6	53.8	4.6	16.7
ST interest rates (abs)	-	-	-	-	-	-	-	-	-	-	-
LT interest rates (abs)	-	-	-	-	-	-	-	-	-	-	-
Stock market indices	65.8	51.2	50.6	41.6	30.6	37.5	12.3	15.0	-4.0	27.8	19.0
Exchange rates (vs. Euro)	-	-	-	-	-	-	-	-	-	-	-

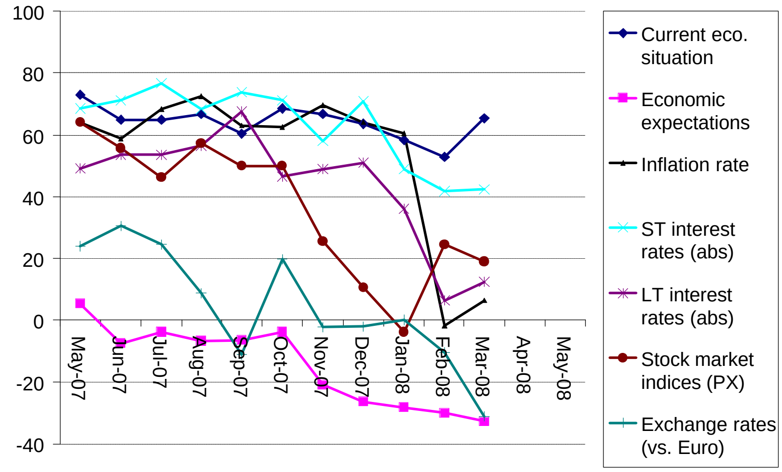


CROATIA	May-07	Jun-07	Jul-07	Aug-07	Sep-07	Oct-07	Nov-07	Dec-07	Jan-08	Feb-08	Mar-08
Current eco. situation	45.2	56	59.3	52.0	51.1	57.8	42.6	31.9	28.3	20.5	21.4
Economic expectations	18.3	12.7	5.9	-4.6	-4.2	2.2	-12.8	-17.0	-9.4	-15.0	-16.6
Inflation rate	24.1	27.1	33.4	28.3	30.2	48.7	55.8	61.0	49.1	17.1	20.5
ST interest rates (abs)	25.5	15.8	7.5	-15.3	0.1	11.0	2.6	31.4	13.6	2.8	30.6
LT interest rates (abs)	25.0	17.7	22.9	-25	-17.6	-5.4	7.7	10.6	-2.4	-5.9	0.0
Stock market indices (CROBEX)	76.0	41.8	68.6	59.1	50.0	50.0	31.0	15.3	7.9	40.9	38.5
Exchange rates (vs. Euro)	13.6	25.5	4.1	-11.1	-9.6	-2.4	4.5	8.9	18.7	18.7	21.6

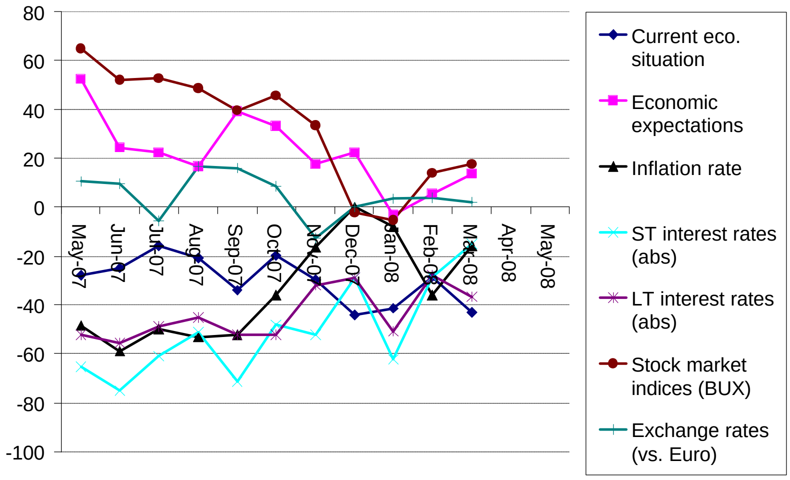


ZEW indicator development (continued)

CZECH REPUBLIC	May-07	Jun-07	Jul-07	Aug-07	Sep-07	Oct-07	Nov-07	Dec-07	Jan-08	Feb-08	Mar-08
Current eco. situation	72.9	64.8	64.9	66.7	60.3	68.5	66.7	63.5	58.3	52.8	65.3
Economic expectations	5.3	-7.4	-3.8	-6.8	-6.5	-3.9	-20.9	-26.3	-28.3	-30.1	-32.7
Inflation rate	64.2	58.9	68.4	72.4	63.0	62.4	69.6	64.2	60.4	-1.8	6.3
ST interest rates (abs)	68.5	71.2	76.7	68.4	73.8	71.2	58.1	70.8	48.9	41.7	42.3
LT interest rates (abs)	49.2	53.6	53.5	56.5	67.5	46.6	48.8	51.1	36.0	6.4	12.5
Stock market indices (PX)	64	55.6	46.2	57.2	50.0	50.0	25.6	10.7	-3.9	24.5	19
Exchange rates (vs. Euro)	24	30.6	24.5	8.7	-11.1	19.9	-2.2	-1.9	0.1	-10.4	-31.1



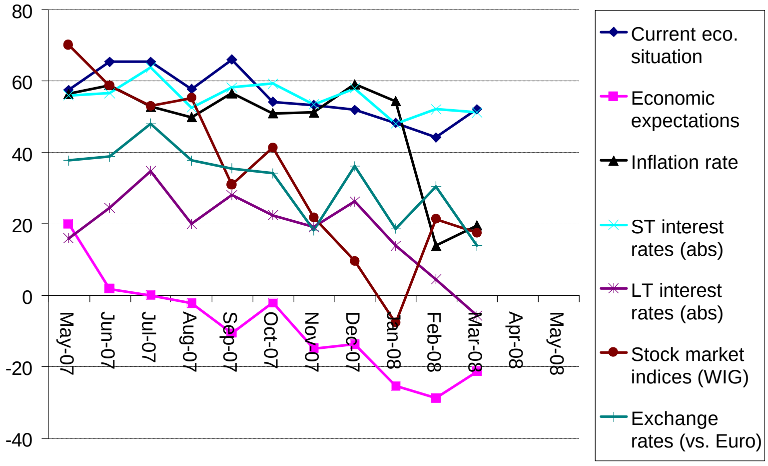
HUNGARY	May-07	Jun-07	Jul-07	Aug-07	Sep-07	Oct-07	Nov-07	Dec-07	Jan-08	Feb-08	Mar-08
Current eco. situation	-27.9	-24.9	-15.6	-20.9	-34.0	-19.9	-29.5	-44.2	-41.3	-28.4	-43.2
Economic expectations	52.5	24.5	22.3	16.6	39.2	33.3	17.6	22.2	-3.3	5.5	13.6
Inflation rate	-48.3	-59	-49.9	-53.2	-52.0	-36.0	-16.4	0.0	-8.0	-35.9	-15.7
ST interest rates (abs)	-65.3	-75.1	-60.8	-51.2	-71.4	-48.0	-52.1	-28.8	-62.4	-28.5	-15.0
LT interest rates (abs)	-52.0	-55.6	-48.9	-45.2	-52.1	-52.1	-32.0	-28.8	-50.8	-27.7	-36.6
Stock market indices (BUX)	64.8	52.0	52.8	48.8	39.4	45.5	33.4	-2.1	-5.2	14.0	17.8
Exchange rates (vs. Euro)	10.5	9.5	-5.6	16.6	16.0	8.4	-12.6	0.0	3.4	3.9	2.1



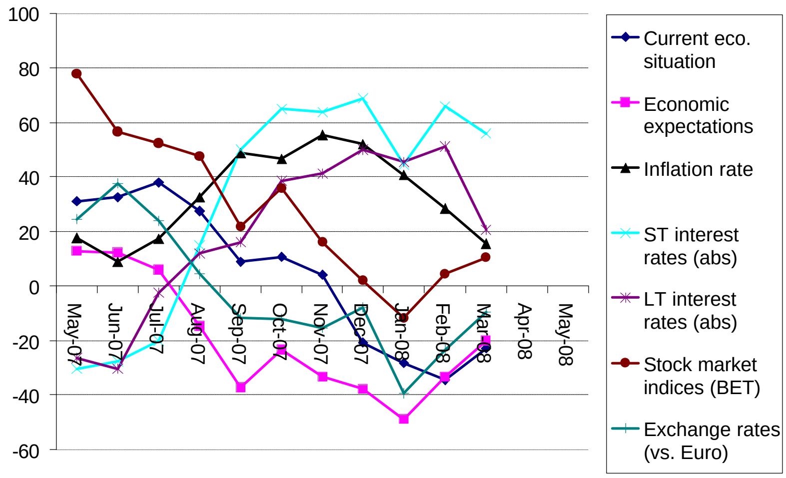
Appendix

ZEW indicator development (continued)

POLAND	May-07	Jun-07	Jul-07	Aug-07	Sep-07	Oct-07	Nov-07	Dec-07	Jan-08	Feb-08	Mar-08
Current eco. situation	57.6	65.5	65.5	57.7	66	54.2	53.2	52.0	48.4	44.3	52.1
Economic expectations	20.0	1.9	-0.1	-2.2	-10.6	-2.0	-14.9	-13.7	-25.4	-28.8	-21.3
Inflation rate	56.4	58.8	52.8	50.0	56.6	51.1	51.2	59.1	54.4	14.0	19.6
ST interest rates (abs)	56.0	56.7	63.9	52.5	58.1	59.4	53.4	58.0	48.2	52.2	51.2
LT interest rates (abs)	16.0	24.4	34.9	20.0	28.1	22.5	19.1	26.3	14.0	4.5	-5.6
Stock market indices (WIG)	70.2	58.7	53.0	55.2	30.9	41.4	21.9	9.6	-7.6	21.3	17.5
Exchange rates (vs. Euro)	37.8	38.8	48.1	37.7	35.5	34.1	18.2	36.2	18.6	30.5	13.9



ROMANIA	May-07	Jun-07	Jul-07	Aug-07	Sep-07	Oct-07	Nov-07	Dec-07	Jan-08	Feb-08	Mar-08
Current eco. situation	31.1	32.6	38	27.6	9.0	10.6	4.0	-20.8	-28.2	-34.6	-22.8
Economic expectations	12.7	12.3	6.0	-14.8	-37.2	-23.4	-33.4	-37.8	-49.0	-33.4	-20.0
Inflation rate	17.7	9.0	17.4	32.5	48.7	46.6	55.5	52.0	40.7	28.5	15.5
ST interest rates (abs)	-30.4	-27.5	-20.0	15	50.1	65.0	63.6	68.9	44.6	65.9	56.0
LT interest rates (abs)	-26.3	-30.4	-2.5	11.8	16.2	38.6	41.4	50.1	45.5	51.3	20.6
Stock market indices (BET)	77.9	56.7	52.3	47.5	21.7	36.0	16.0	2.1	-11.7	4.5	10.5
Exchange rates (vs. Euro)	24.5	37.8	23.8	4.4	-11.8	-12	-15.5	-7.8	-39.2	-23.4	-9.8



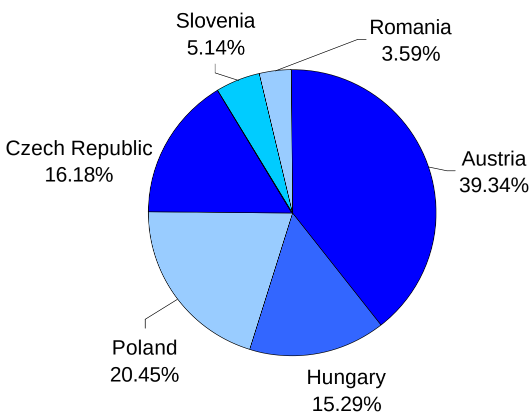
Note: Financial experts were asked about their expectations for the next 6 months. Balances refer to the differences between positive and negative assessments. Source: ZEW

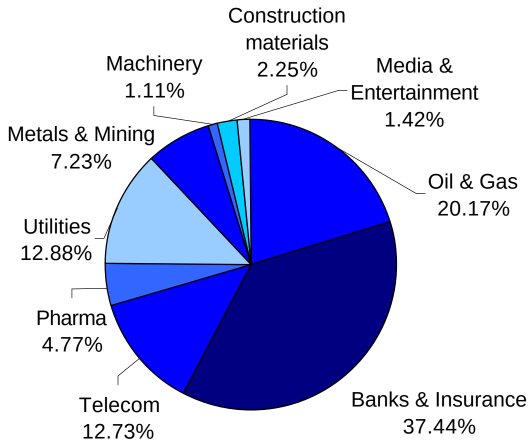
Appendix

New Europe Blue Chip Index (NTX)

In September 2005 Erste Bank together with the Vienna Stock Exchange launched the New Europe Blue Chip Index (NTX). The NTX was designed to summarize the regional convergence theme in Central and Eastern Europe by also offering an investable universe. The index includes the top 30 regional stocks ranked by free float. The NTX is calculated by the Vienna Stock Exchange, quoted real-time and in EUR (.NTX; NTX index <GO>).

Current index structure





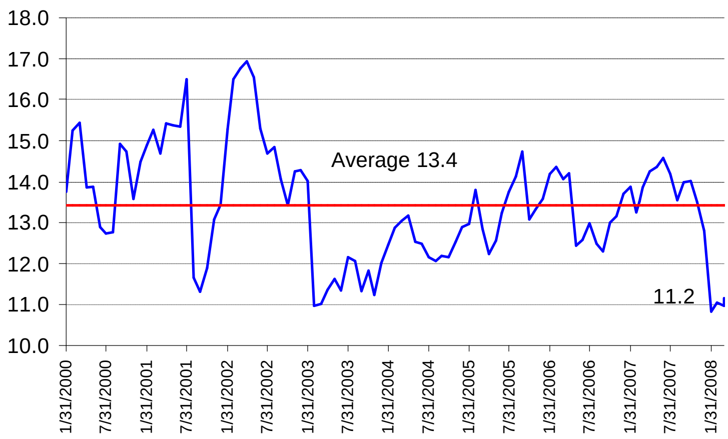
Rank	Company	Country	Sector	Free float EUR	Weight
1	CEZ	Czech Republic	Utility	11,879,411,641	9.70%
2	Erste Bank	Austria	Banks & Insurance	9,737,745,894	7.95%
3	OMV	Austria	Oil & Gas	9,418,500,000	7.69%
4	Bank Pekao	Poland	Banks & Insurance	7,350,225,630	6.00%
5	OTP Bank	Hungary	Banks & Insurance	7,249,990,410	5.92%
6	MOL	Hungary	Oil & Gas	6,780,795,471	5.54%
7	Raiffeisen International	Austria	Banks & Insurance	6,677,769,313	5.45%
8	PKO BP	Poland	Banks & Insurance	6,268,122,122	5.12%
9	Voestalpine	Austria	Metals & Mining	5,426,488,089	4.43%
10	Telekom Austria	Austria	Telecom	4,516,050,000	3.69%
11	KGHM	Poland	Metals & Mining	4,366,365,342	3.57%
12	TP SA	Poland	Telecom	4,299,546,396	3.51%
13	PKN Orlen	Poland	Oil & Gas	3,606,492,701	2.95%
14	Verbund	Austria	Utility	3,404,700,810	2.78%
15	Krka	Slovenia	Pharmaceuticals	3,295,443,961	2.69%
16	Telefonica O2 CR	Czech Republic	Telecom	3,265,562,712	2.67%
17	Komercni banka	Czech Republic	Banks & Insurance	2,876,339,830	2.35%
18	Wienerberger	Austria	Construction & materials	2,828,197,642	2.31%
19	Wiener Staedtische	Austria	Banks & Insurance	2,547,825,000	2.08%
20	BRD-Group SG	Romania	Oil & Gas	1,874,845,479	1.53%
21	CME	Czech Republic	Media & Entertainment	1,869,754,254	1.53%
22	Hrvatski Telekom	Croatia	Telecom	1,824,318,673	1.49%
23	Richter Gedeon	Hungary	Pharmaceuticals	1,823,069,136	1.49%
24	PGNiG	Poland	Banks & Insurance	1,789,719,427	1.46%
25	Magyar Telekom	Hungary	Telecom	1,617,977,679	1.32%
26	BRE Bank	Poland	Banks & Insurance	1,523,476,328	1.24%
27	Andritz	Austria	Engineering	1,356,030,000	1.11%
28	Banca Transilvania	Romania	Banks & Insurance	1,194,071,693	0.98%
29	Petrol	Slovenia	Oil & Gas	956,408,885	0.78%
30	STRABAG SE	Austria	Construction & materials	827,278,925	0.68%
	Total			**122,452,523,444**	**100.00%**

Source: Vienna Stock Exchange, Erste Bank

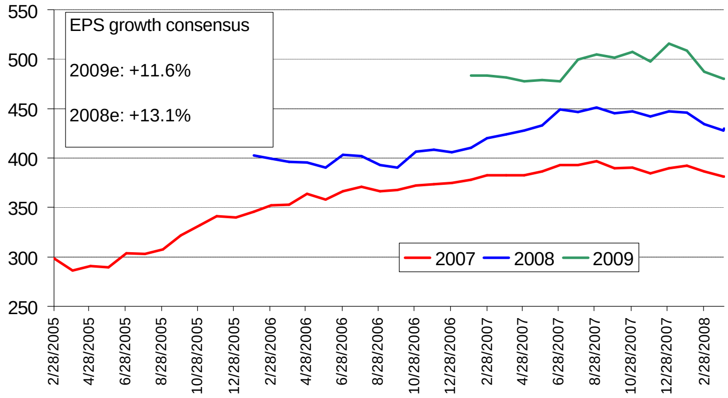
Regional valuation and sentiment

In order to get an overview on valuation, growth and risk premiums, we have summarized the region via the markets of Poland (WIG 20), the Czech Republic (PX), Hungary (BUX) and Austria (ATX). Admittedly, the overview is also somehow dictated by the availability of reliable consensus data.

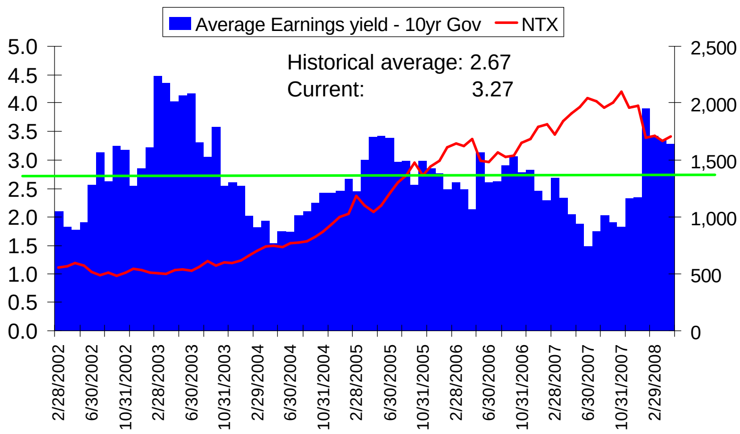
Regional forward PER vs historical average



Development of EPS consensus estimates



Development of risk premium



Source: JCF, Erste Bank

Notes

Contacts

Group Research

Head of Group Research	
Friedrich Mostböck, CEFA	+43 (0)5 0100 - 11902
CEE Equity Research	
Co-Head: Günther Artner, CFA	+43 (0)5 0100 - 11523
Co-Head: Henning Eßkuchen	+43 (0)5 0100 - 19634
Günter Hohberger *(Banks)*	+43 (0)5 0100 - 17354
Franz Hörl, CFA *(Steel, Construction)*	+43 (0)5 0100 - 18506
Gernot Jany, CFA *(Banks, Real Estate)*	+43 (0)5 0100 - 11903
Daniel Lion *(IT)*	+43 (0)5 0100 - 17420
Martina Valenta, MBA *(Transp., Paper)*	+43 (0)5 0100 - 11913
Christoph Schultes *(Insurance, Utilities)*	+43 (0)5 0100 - 16314
Vera Sutedja, CFA *(Telecom)*	+43 (0)5 0100 - 11905
Vladimira Urbankova *(Pharma)*	+43 (0)5 0100 - 17343
Gerald Walek, CFA *(Machinery)*	+43 (0)5 0100 - 16360
International Equities	
Hans Engel *(Market strategist)*	+43 (0)5 0100 - 19835
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Jürgen Rene Ulamec, CEFA *(Europe)*	+43 (0)5 0100 - 16574
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Co-Head CEE: Rainer Singer (*Macro/FI*)	+43 (0)5 0100 - 11185
Editor Research CEE	
Brett Aarons	+420 2 24995 - 904
Research, Croatia/Serbia	
Head:Mladen Dodig	+38 1 112200 - 866
Damir Cukman *(Equity)*	+38 5 6237 - 2820
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Ulrich Inhofner	+43 (0)5 0100 - 84324
Karin Rauscher	+43 (0)5 0100 - 84112
Michael Schmotz	+43 (0)5 0100 - 84114

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ERSTE GROUP

CEE Equity Strategy 2Q 2008
Outlook 2008

Erste Group Research
CEE Equity Research

Henning Eßkuchen
Co-Head CEE Equity Research

Content

Outlook 2Q 2008
Basic scenario

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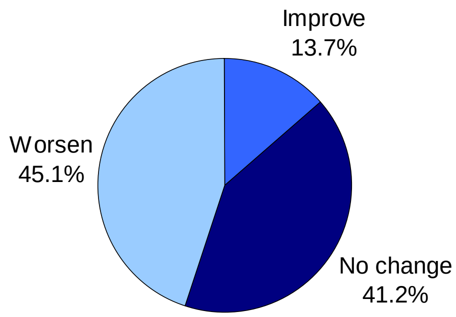
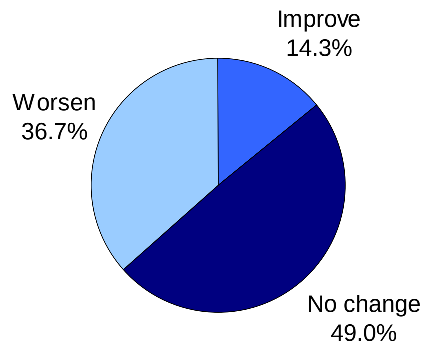
- Base scenario is a slowdown in growth also in CEE
- CEE will maintain an appealing growth differential to Western markets
- US recession talks to dominate headlines
- Big Bang events to be over (2007 reporting)
- Markets to approach bottom, but not yet ready to take off.
- During 1H only very cautious signs of improving sentiment

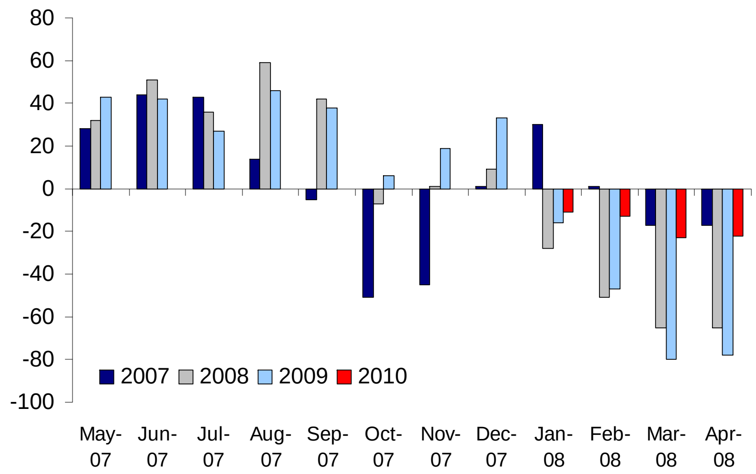
Expectations: Euroland



CEE



Earnings revision rate in CEE*



** aggregate: A, HU, PL, CZ, RO*

Source: ZEW, JCF

Content

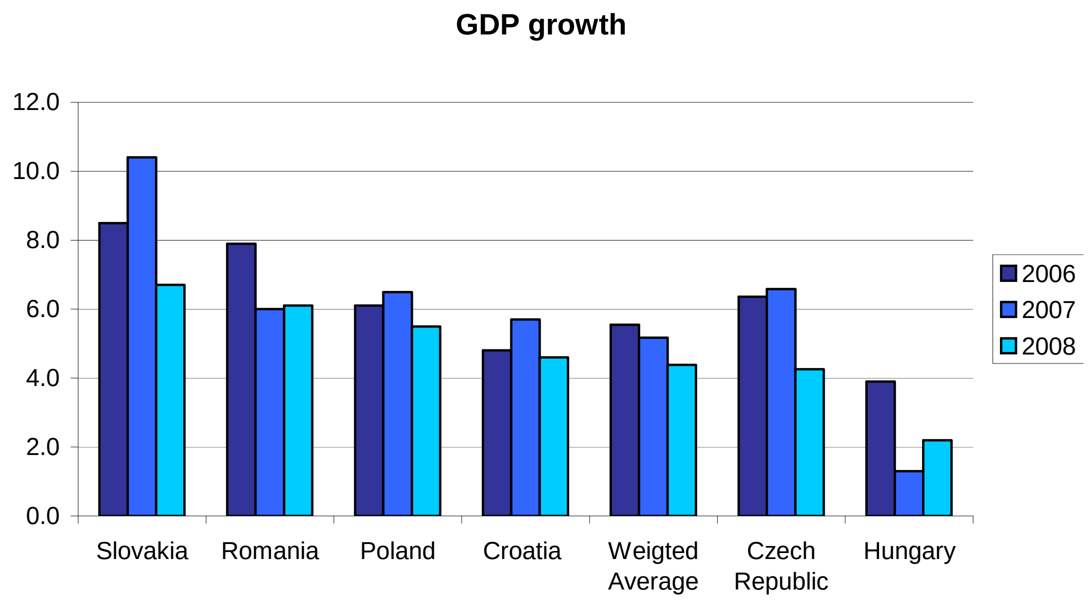
Macro economy
In a nutshell

ERSTE GROUP

- Slight slowdown of the economies in 2008, due to maturing business cycle.
- Inflation overall on the rise, but central banks will keep dynamic in cheque.
- Still, overall macro picture differs significantly, which is mirrored in the interest rate level.
- Catching up process speaks for above EU economic growth for many years to come.

Macro economy
Regional growth still close to 5%

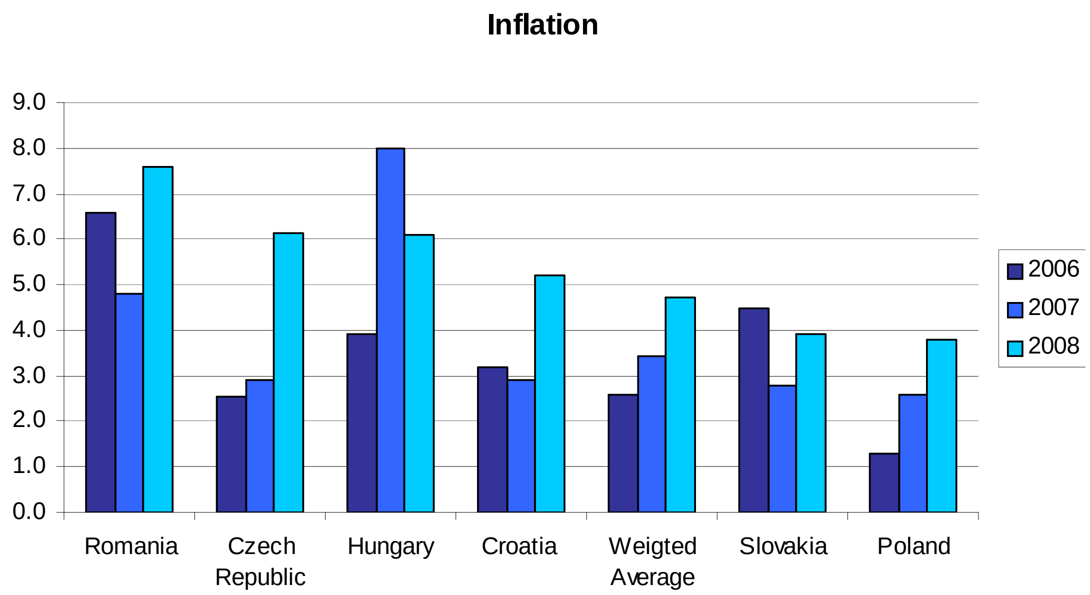
– **After two years of strong economic growth we expect a slight slowdown in 2008. This is mainly due to cyclical reasons, as the rate of expansion seen in 2006 and 2007 is not sustainable (tight labor markets) and needs to slow to keep inflationary pressures in cheque.**



Source: Bloomberg, Erste Group Research

Macro economy
Inflation slightly rising

– **Average inflation is on the rise as is normal in a maturing business cycle.**
– **Higher indirect taxes in the Czech Republic next year will boost the inflation rate.**
– **The (negative) effects of the austerity package will drop out of the calculation in Hungary.**



Source: Bloomberg, Erste Group Research

Macro economy
Country view - Croatia

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Things to watch:

- Monetary policy will remain restrictive
- Politics: Negative effects on tourist season from any unrest in Serbia

Croatia	2006	2007	2008	2009
Real GDP (growth y/y %)	4.80	5.70	4.60	4.80
GDP per Capita (in EUR)	7780	8538	9413	10148
CPI (y/y, average%)	3.20	2.90	5.20	3.20
Current account balance (% of GDP)	-7.80	-8.30	-8.10	-7.90
Govt. budget balance (% of GDP)	-3.00	-2.30	-2.80	-3.00
Public debt (% of GDP)	49.60	50.30	50.00	50.50
Short term interest rate (3 months) year-end	4.60	6.93	6.00	5.00
Long term interest rate (10 years) year-end	4.72	5.53	5.30	5.00
Loc. Curr./EUR year-end	7.35	7.33	7.30	7.30

Source: Statistical offices, Erste Group Research

Macro economy
Country view – Czech Republic

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Things to watch:

- Inflation: Increase due to higher indirect taxes and global factors, but risks exist from the domestic sphere.
- Monetary policy: Next interest rate hike in Q2 2008 expected, dependent on CZK weakening.
- Politics: Stalemate in parliament between the two political groups.

Czech Republic	2006	2007	2008	2009
Real GDP (growth y/y %)	6.4	6.6	4.3	5.4
GDP per Capita (in EUR)	11071	12477	14274	15710
CPI (y/y, average%)	2.5	2.9	6.1	4.3
Current account balance (% of GDP)	-3.0	-3.2	-3.6	-2.2
Govt. budget balance (% of GDP)	-2.9	-1.9	-2.9	-2.7
Public debt (% of GDP)	24.7	24.5	25.1	25.8
Short term interest rate (3 months) year-end	2.7	4.1	4.1	4.6
Long term interest rate (10 years) year-end	4.1	4.7	4.5	4.7
Loc. Curr./EUR year-end	28.0	26.9	25.9	25.3

Source: Statistical offices, Erste Group Research

Macro economy
Country view – Hungary

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Things to watch:

- Economy: Slow recovery to set in this year
- Inflation: Global factors got in the way of faster inflation reduction.
- Monetary policy: Lower interest rates only likely in 2HY.

Hungary	2006	2007	2008	2009
Real GDP (growth y/y %)	3.9	1.3	2.2	3.2
GDP per Capita (in EUR)	8921	10039	10427	11312
CPI (y/y, average%)	3.9	8.0	6.1	3.5
Current account balance (% of GDP)	-6.5	-5.2	-4.7	-4.3
Govt. budget balance (% of GDP)	-9.2	-5.7	-4.0	-3.9
Public debt (% of GDP)	66.0	67.0	67.0	66.0
Short term interest rate (3 months) year-end	8.1	7.5	7.0	5.9
Long term interest rate (10 years) year-end	6.7	7.1	6.5	5.5
Loc. Curr./EUR year-end	252	253	256	250

Source: Statistical offices, Erste Group Research

Macro economy
Country view – Poland

Things to watch:

- Economy: Labor market still performing strongly – posing inflationary risks
- Monetary policy: Risk of more interest rate hikes significant.

Poland	2006	2007	2008	2009
Real GDP (growth y/y %)	6.1	6.5	5.5	5.7
GDP per Capita (in EUR)	7139	8055	9395	10573
CPI (y/y, average%)	1.3	2.6	3.8	3.2
Current account balance (% of GDP)	-3.2	-3.7	-5.0	-5.6
Govt. budget balance (% of GDP)	-3.9	-2.6	-3.2	-2.9
Public debt (% of GDP)	47.7	47.0	47.5	47.4
Short term interest rate (3 months) year-end	4.2	5.7	6.0	5.2
Long term interest rate (10 years) year-end	5.2	5.9	5.6	5.1
Loc. Curr./EUR year-end	3.83	3.58	3.51	3.43

Source: Statistical offices, Erste Group Research

Macro economy
Country view – Romania

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Things to watch:

- Economy: Growth to stay high, but high current account deficit is a cause for concern.
- Monetary policy: Interest rates to remain among the highest in the region
- Capital markets: High exposure of currency to international sentiment.
- Politics: Parliamentary elections scheduled for November

Romania	2006	2007	2008	2009
Real GDP (growth y/y %)	7.9	6.0	6.1	6.0
GDP per Capita (in EUR)	4532	5646	6092	7125
CPI (y/y, average%)	6.6	4.8	7.6	4.8
Current account balance (% of GDP)	-10.4	-13.9	-15.0	-15.0
Govt. budget balance (% of GDP)	-1.6	-2.3	-2.7	-2.7
Public debt (% of GDP)	18.2	18.3	19.7	19.2
Short term interest rate (3 months) year-end	8.6	8.4	9.5	7.5
Loc. Curr./EUR year-end	3.38	3.61	3.50	3.50

Source: Statistical offices, Erste Group Research

Macro economy
Country view – Slovakia

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Things to watch:

- EMU: Beginning of May convergence report scheduled. Final decision in June.
- Monetary policy: Central bank to bring rates in line with ECB after official admission to EMU.
- FX: Speculation on entry rate to increase during Q2.

Slovakia	2006	2007	2008	2009
Real GDP (growth y/y %)	8.5	10.4	6.7	5.0
GDP per Capita (in EUR)	8271	10136	11562	12589
CPI (y/y, average%)	4.5	2.8	3.9	3.8
Current account balance (% of GDP)	-7.2	-5.3	-4.5	-4.1
Govt. budget balance (% of GDP)	-3.7	-2.2	-2.1	-2.4
Public debt (% of GDP)	30.4	28.3	26.5	24.1
Short term interest rate (3 months) year-end	4.7	4.3	3.7	4.7
Long term interest rate (10 years) year-end	4.3	4.8	4.8	5.1
Loc. Curr./EUR year-end	34.6	33.6	32.5	32.5

Source: Statistical offices, Erste Group Research

Macro economy
Country view – Serbia

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Things to watch:

- Politics: May, 11 elections to decide on future EU convergence
- Economy: Fundamentally, growth should remain strong, inflation is to increase and the current account deficit is to be watched
- FX: Currently politics prevail, but fundamentals point to an appreciation.

Serbia	2006	2007	2008	2009
Real GDP (growth y/y %)	5.74	7.30	6.30	6.80
GDP per Capita (in EUR)	2777	3265	3929	4521
CPI (y/y, average%)	12.79	6.80	9.20	5.10
Current account balance (% of GDP)	-11.70	-16.80	-15.80	-16.00
Govt. budget balance (% of GDP)	-3.10	-2.00	-1.50	-1.00
Public debt (% of GDP)	38.00	30.70	n.a	n.a.
Short term interest rate (3 months) year-end	15.57	10.32	12.50	10.00
Loc. Curr./EUR year-end	79.00	79.24	80.00	78.00

Source: Statistical offices, Erste Group Research

Macro economy
Country view – Ukraine

Things to watch:

- Economic growth remains strong supported mainly by domestic demand.
- Growing external imbalances are still compensated by investment inflow
- Monetary policies do not seem to be sufficient to bring inflation to single digit this year
- Widening of the currency band (revaluation) likely this year

Ukraine	2006	2007	2008	2009
Real GDP (growth y/y %)	7.1	7.3	6.6	6
GDP per Capita (in EUR)	1819	2219	2735	3712
CPI (y/y, average%)	9.20	12.80	19.60	13.60
Current account balance (% of GDP)	-2.90	-4.10	-5.90	-5.70
Govt. budget balance (% of GDP)	-0.69	-1.50	-2.00	-3.00
Public debt (% of GDP)	14.80	13.00	11.20	11.00
Short term interest rate (3 months) year-end	15.00	11.36	10.50	9.50
Long term interest rate (5 years) year-end	6.00	6.48	7.00	6.50
Loc. Curr./EUR year-end	6.65	7.42	6.55	5.94

Source: Statistical offices, Erste Group Research

Macro economy
EMU + Elections

	Target	Czech Republic	Hungary	Poland	Slovakia	Romania	Croatia
New Debt in % of GDP (2007)	3	-1.9	-5.7	-2.6	-2.2	-2.3	-2.3
Overall indebtedeness in % of GDP	60	24	67	47	28	18	50
Inflation (HCPI), 12m aver.	1.6 + 1.5 = 3.1	3.9	7.8	2.9	2.1	5.4	3.6
Long-term interest rates (10y) current	3.9 + 2 = 5.9	4.75	8.15	5.98	4.58	10	5.83
Estimated EMU Entry		2013	2013	2013	2009	2014	2013

Country	Next Elections	Risk of early Elections
Czech Republic	Paliamant 2010	moderate
Croatia	Parliament 2012	moderate
Hungary	Parliament 2010	moderate
Poland	Poland 2012/ President 2010	moderate/low
Romania	Parliament 2008/ President 2009	low/low
Slovakia	Parliament 2010/ President 2009	low/low

Source: Erste Group Research

Macro economy
Return/Risk – CEE vs. US

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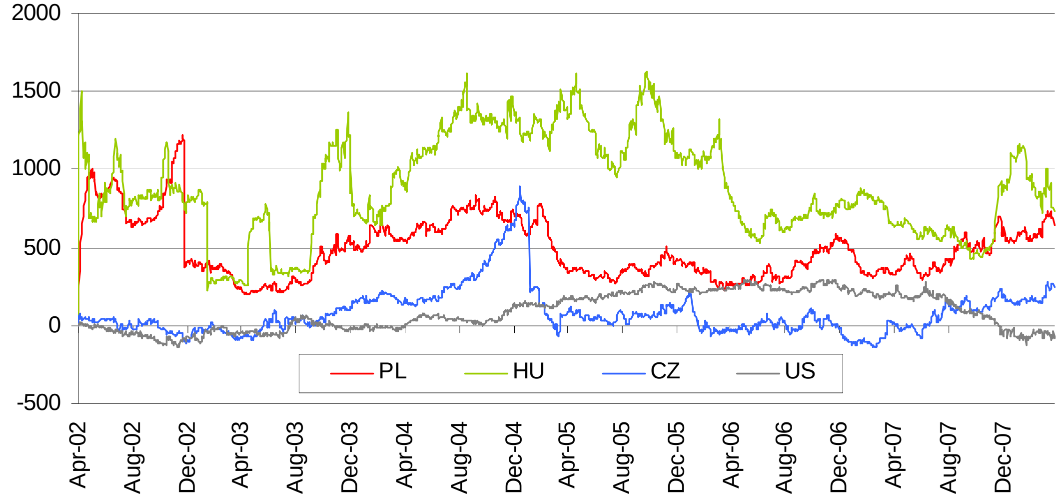
- **Most liquid CEE bond markets offer „FX risk adjusted“ better returns then US.**

Return/Risk (10y Spread/FX Vola vs. Euroland)

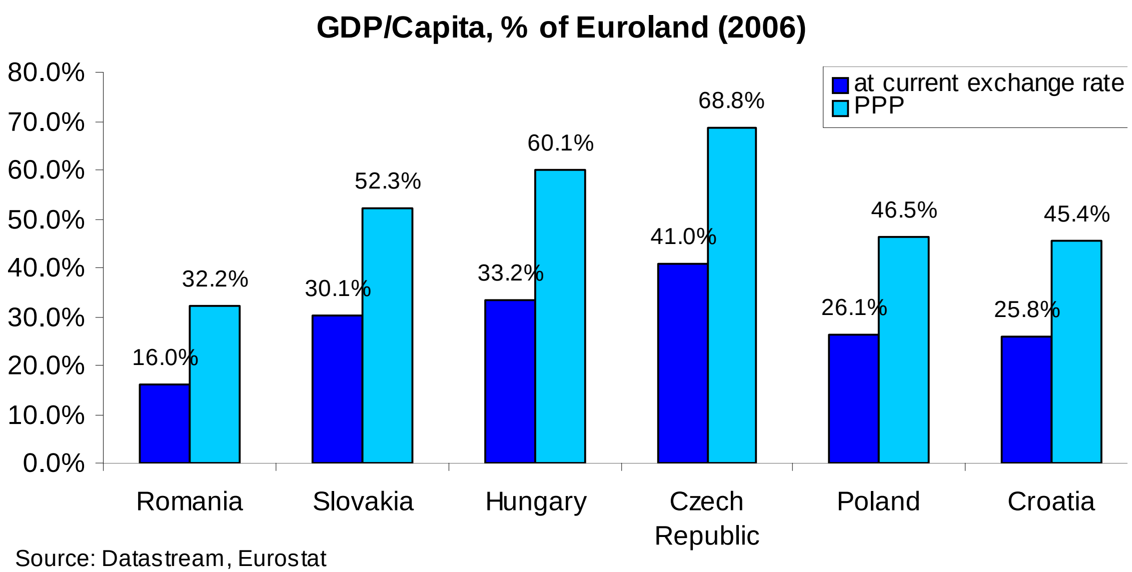


Source: Bloomberg, Erste Group Research

Macro economy
Long-term outlook

ERSTE GROUP

- **Differential between nominal GDP and at PPP will at least be reduced by FX appreciation and/or higher inflation during the next several years**



Source: Datastream, Eurostat

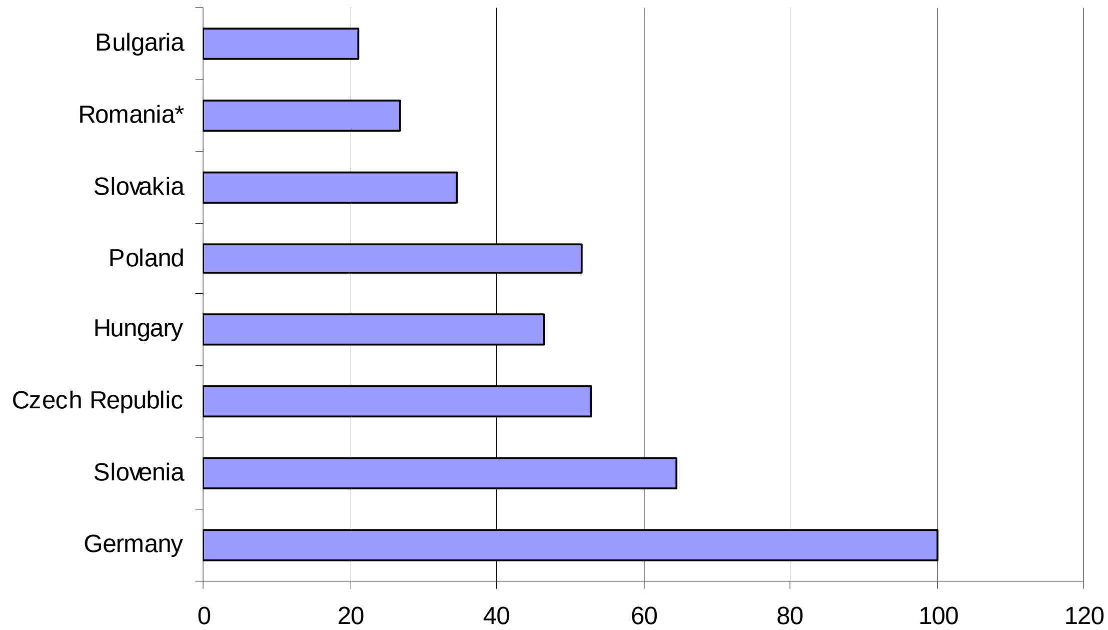
Macro economy
Long-term outlook

ERSTE GROUP

3 arguments for economic growth above EU average for many years to come

- Low wages in relation to productivity (= Unit Labor Costs) show a clear competitive advantage.
- Productivity should approach Euroland levels further.
- Wages should catch up, which will support domestic demand.

Unit Labor Costs, (Germany = 100)



*Productivity deviate from monthly productivity data

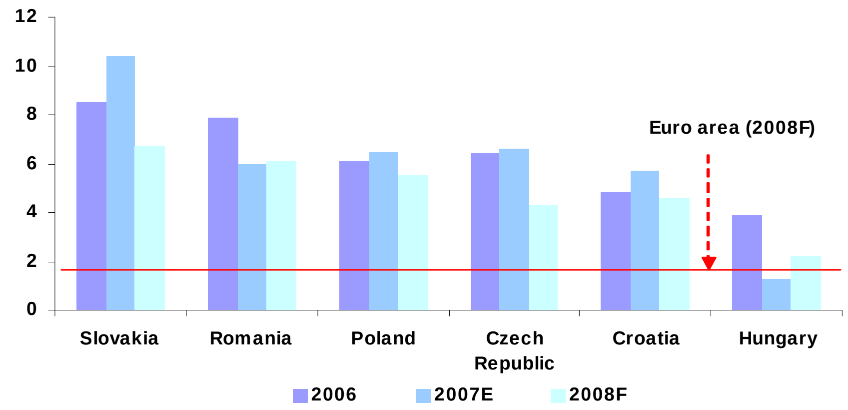
Source: Datastream, Eurostat

Macro economy
Liquidity crunch impact on CEE

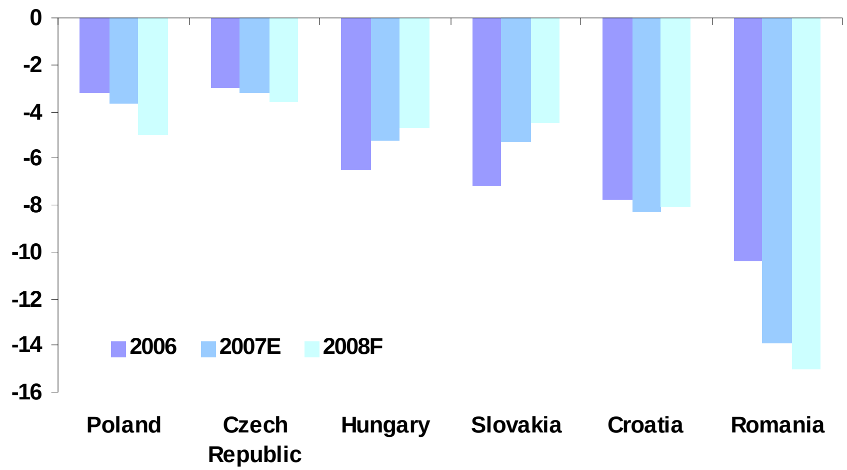
ERSTE GROUP

- CEE economies grow much faster than Euroland economies
- Countries have been relying on strong capital inflows
- Rising fears have emerged that lack of capital (or credit crunch) might slow down the economic growth
- How to finance C/A deficits if FDI inflows significantly slow down?

GDP growth (%)



C/A balance to GDP (%)



Source: Bloomberg, Erste Group Research

Macro economy
The key risk factors for CEE economies

ERSTE GROUP

Weaker foreign demand hampering GDP growth

- *Slovakia, Czech Republic and Hungary rank among TOP 5 EU countries with the highest share of exports to GDP*
- BUT less exposed to US - share of exports to US is at very low level in CEE (3%)
- Competitive production serves as a shield in “bad times” - Unit labor costs in CEE countries are less than half of EU average
- Surging household consumption provides temporal cushion against denting external demand

Liquidity squeeze followed by credit crunch

- *Issuing of new debt or rolling FX-denominated debt over might be more difficult (or expensive) in tight credit markets*
- There have not been any signs of deteriorating asset quality in CEE or big exposure to US market or derivatives, thus no reason for “preference of liquidity” in CEE which would cause credit crunch on local markets
- Liquidity surplus (up to 25% of GDP) on local markets should help to overcome potential credit crunch in foreign currency loans

Pressure on foreign debt and currency volatility

- *Deteriorated C/A in Romania raised concerns about further foreign borrowing needs if FDI inflow dries up*
- Investment driven imports deteriorated C/A deficits, lower FDIs would narrow the C/A deficit
- Converging countries used to exhibit large C/A deficits – Slovakia in five out of 7 years (1996-2002) close to 8% of GDP
- Coverage of short-term external debt by FX liquid reserves is sufficiently high

Bottom line: We do not think that CEE economies face risk of credit crunch (at least on local markets), excessive demand for foreign currency, resulting in a running out of FX reserves

Content

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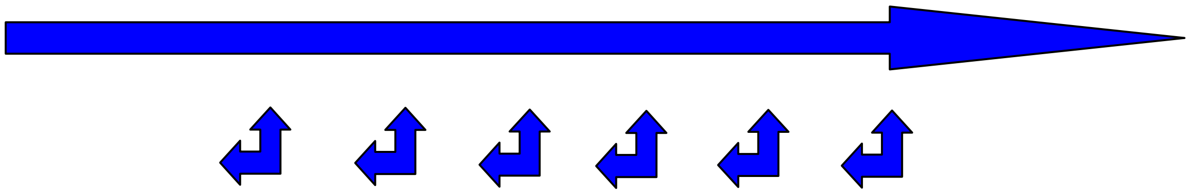
Allocation model
Basic idea

- Countries: A, CZ, HU, PL, RU, SLO,TR, SEE (BG, HR, RO, RS) – 330 stocks
- Factors: valuation, size/liquidity, profitability, growth, corporate risk, technical analysis
- Multiple regression indicating relation between factors and observed return
- Regression used to calculate expected returns – aggregated to country level



Calculate average regression coefficients (12 month)

Calculate expected returns based on average regression coefficients for every quarter

Continuously calculating further regression coefficients

Source: Erste Group Research

Allocation model
CEE Equity Strategy

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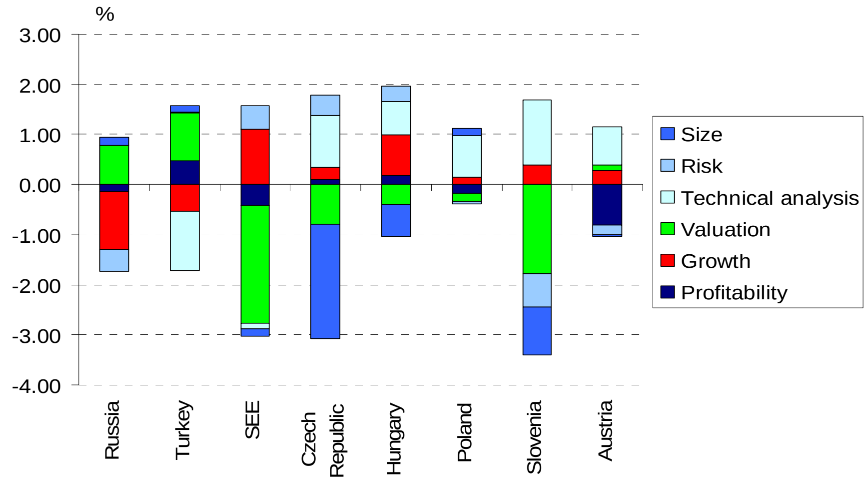
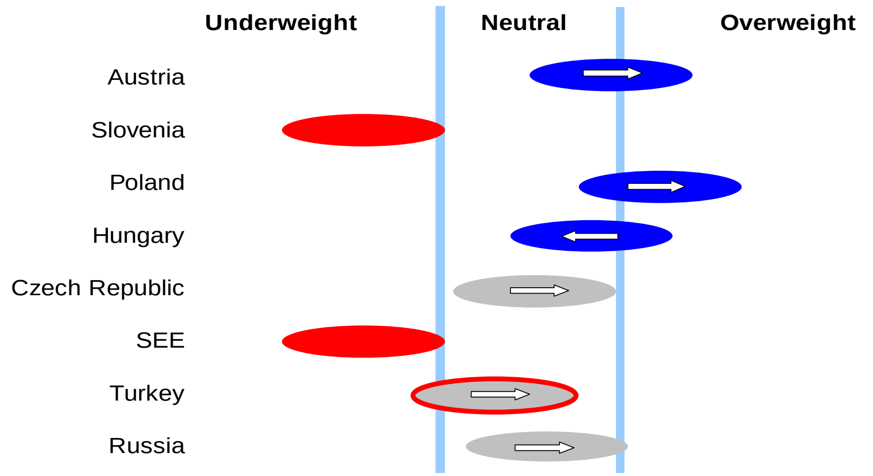
- Overweight signal for Poland, Austria confirmed, Hungary a weak overweight
- SEE remains underweight – if recovery Romania first
- Slovenia remains underweight for valuation reasons
- Turkey remains in a cautious underweight/neutral position
- Russia remains neutral rating

Expected returns



Allocation proposal



Source: Erste Bank

Allocation model
Quarterly performance

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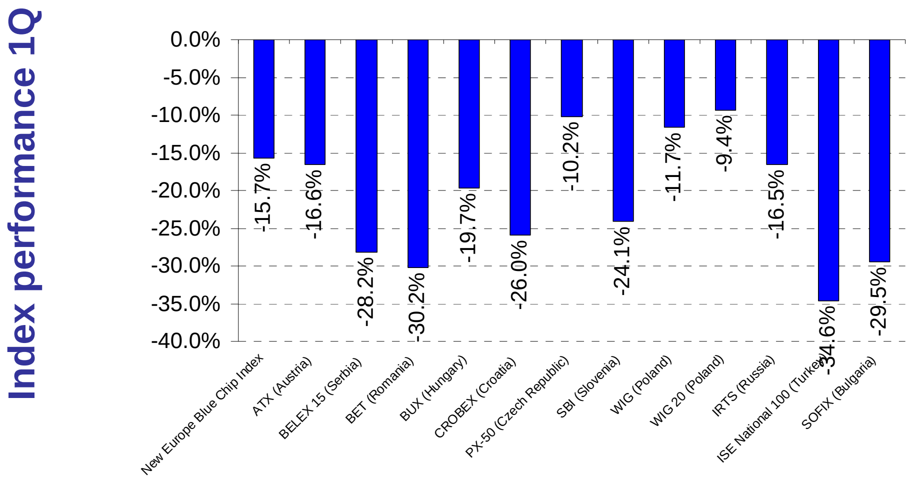
- Previous underweight for SEE has prevented the worst
- Losing the least – Poland's overweight was the right call

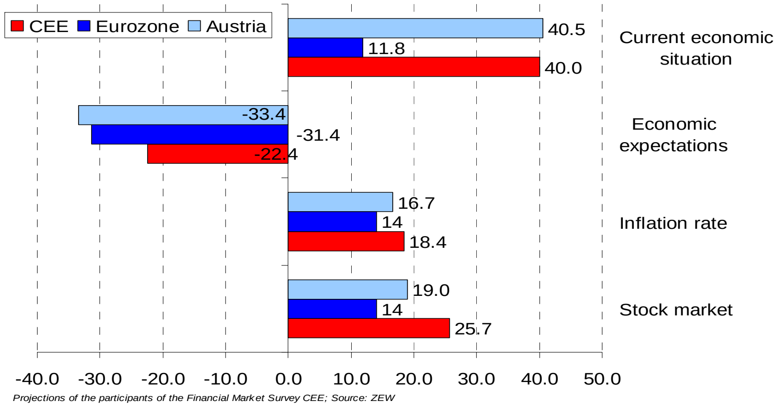


Source: Reuters. Erste Group Research

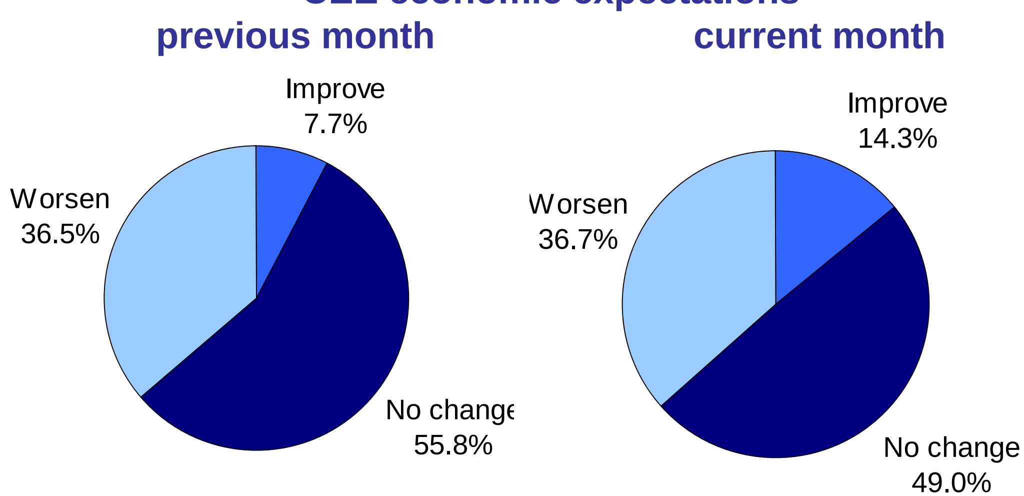
Allocation model
CEE still leads in long-term outlook

- Latest survey indicated improving views on current situation, but also on expectations for both, CEE and Eurozone

ZEW/Erste Bank CEE sentiment indicator



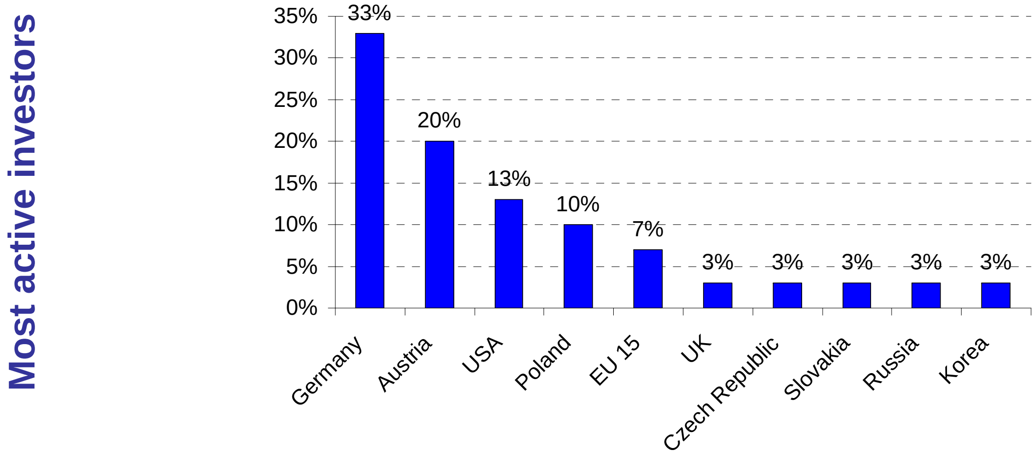
CEE economic expectations

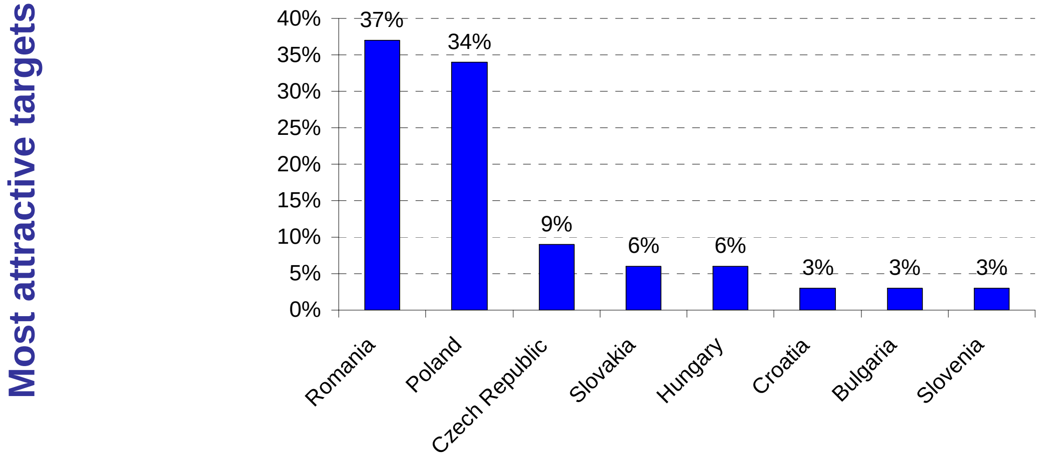


Source: ZEW

Allocation model
ZEW – Special question

- ZEW – Participants were asked about views on M&A activities in CEE
- Romania and Poland scored highest among targets
- Austria seen as second strongest investor after Germany – in relative terms Austria should be bigger





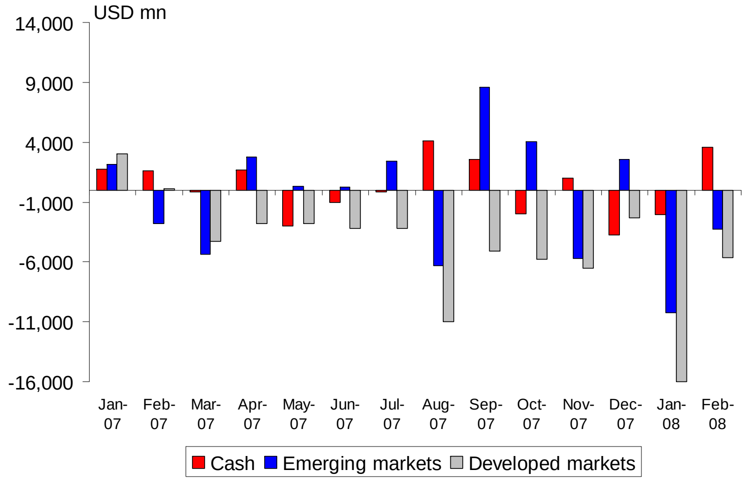
Source: ZEW

Allocation model
Aggregated funds

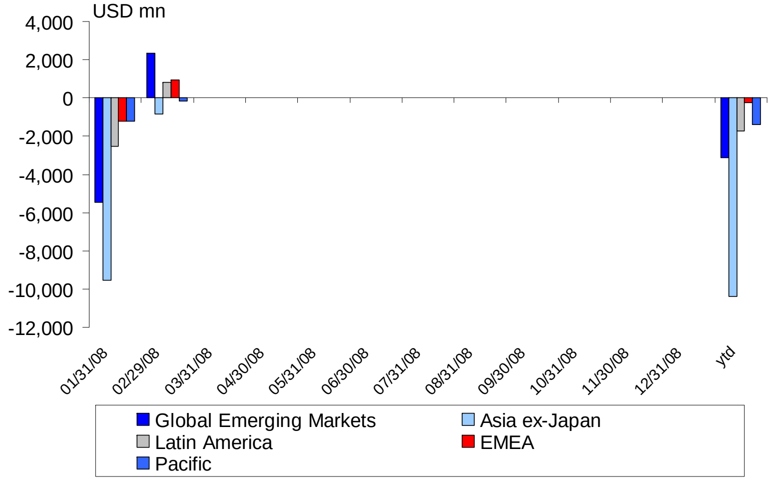
ERSTE GROUP

- Selling pressure remained in February…
- …but at lower levels
- Redemptions also came down…
- …with EMEA even facing inflows again (as well as Latin America)

Net selling/bying



Flows (redemptions/inflows)

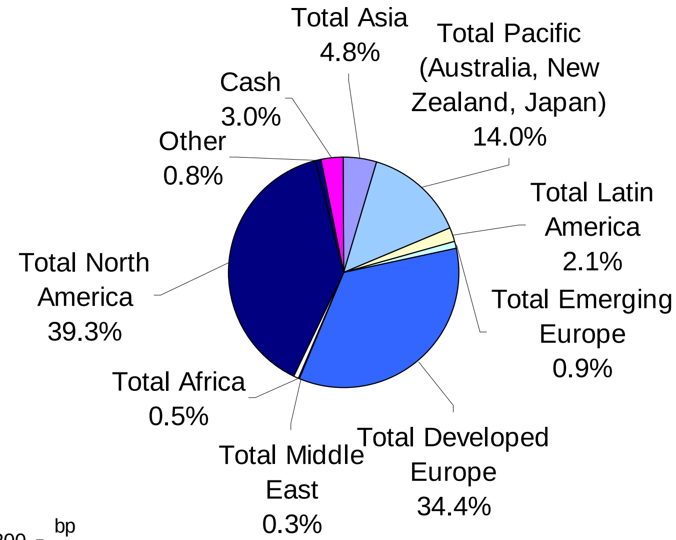


Source: Emerging Portfolio Research

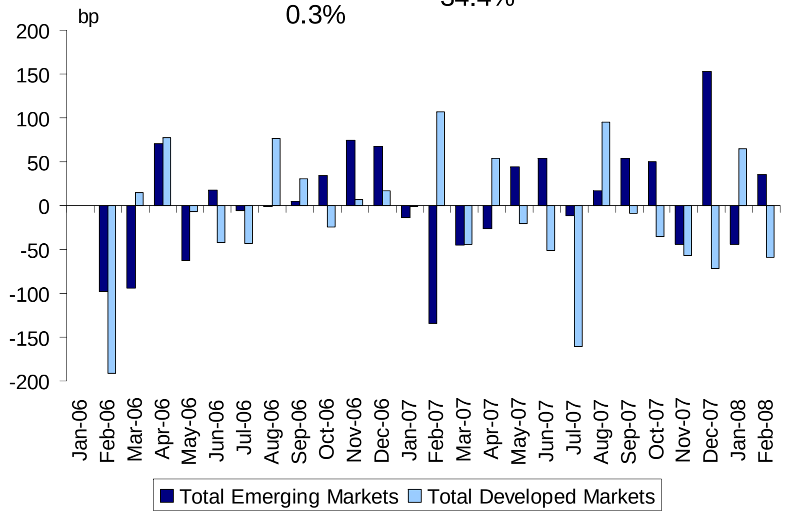
Allocation model
Global allocations

- Global Equity Funds allocate ~8.5% for emerging markets globally
- Global emerging markets even gained in weight
- Emerging Europe gained mildly in weight
- Cash increased moderately

Global Funds



Change of weight of Emerging Markets in Global Funds

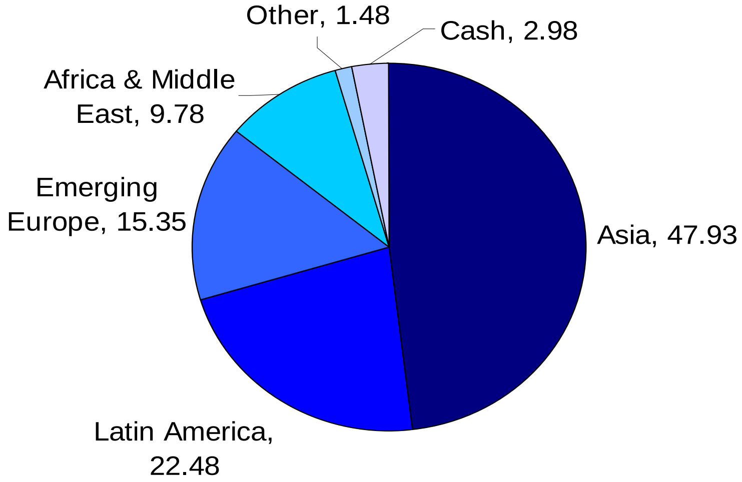


Source: Emerging Portfolio Research

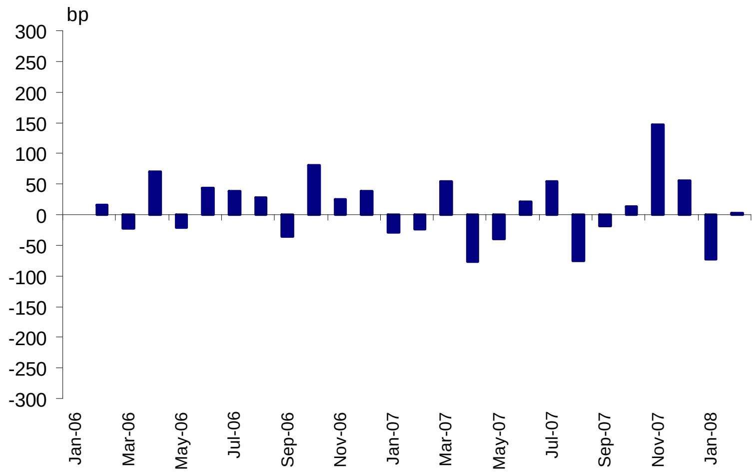
Allocation model
Global Emerging market allocations

- All markets saw slight increases in weight at the expense of cash (down 1ppt)
- Latin America strongest gainer
- Emerging Europe remained almost stable

GEM Funds



Weighting of Ermerging Europe in GEM

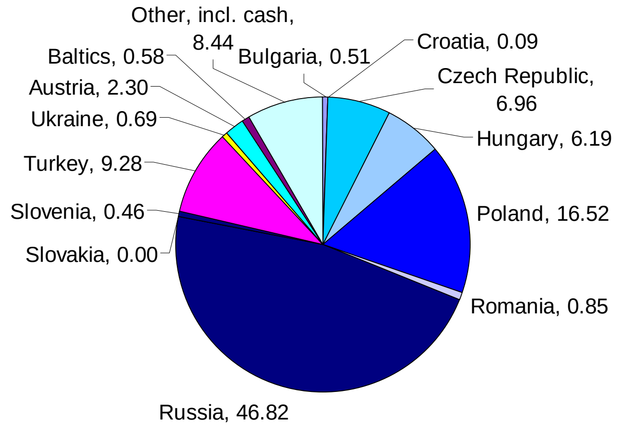


Source: Emerging Portfolio Research

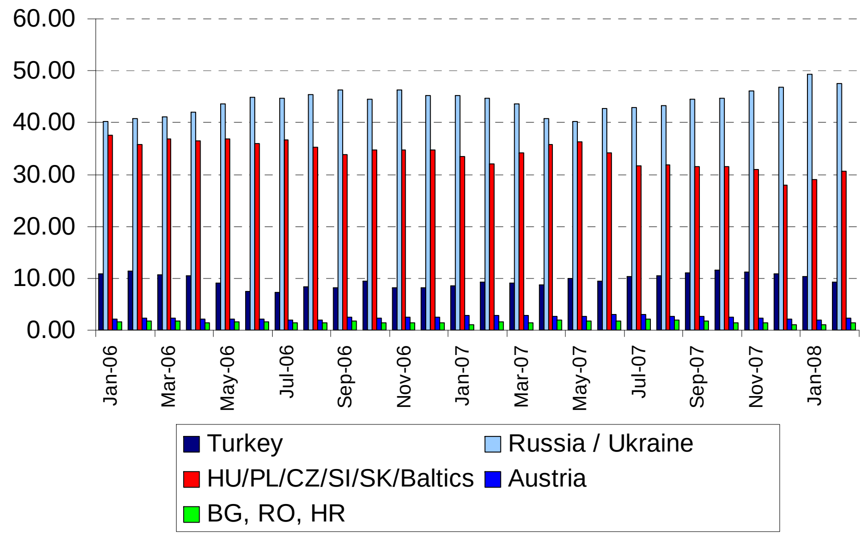
Allocation model
Emerging Europe allocations

- Russia and Turkey lost substantially in weight
- Poland gained strongly

Weighting Emerging Europe



Change in weights



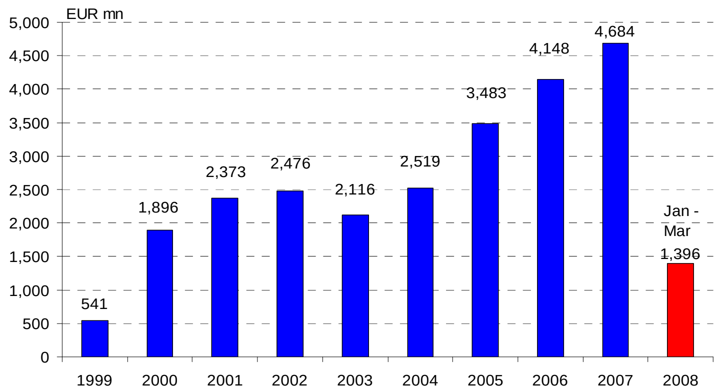
Source: Emerging Portfolio Research

Allocation model
Special situation – Poland pension funds

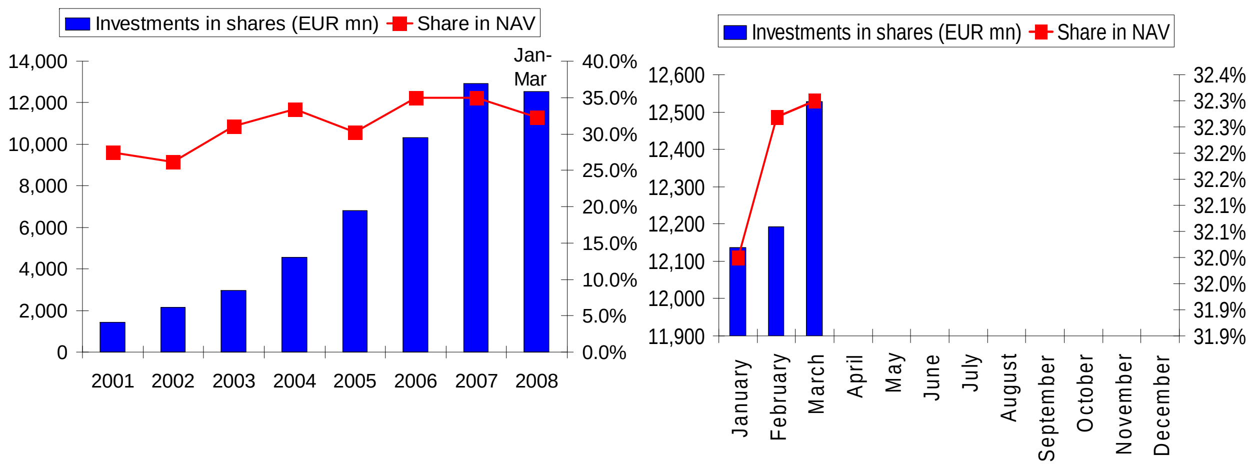
ERSTE GROUP

- Transfers into Polish pension system also supported by rising wages
- Share of equity in NAV reduced already prior to correction after getting close to 40% cap (currently at 32.3%)
- Cash position slightly
- However, risk of money leaving the country once, remains

Total transfers into Polish pension system



Investments in equities

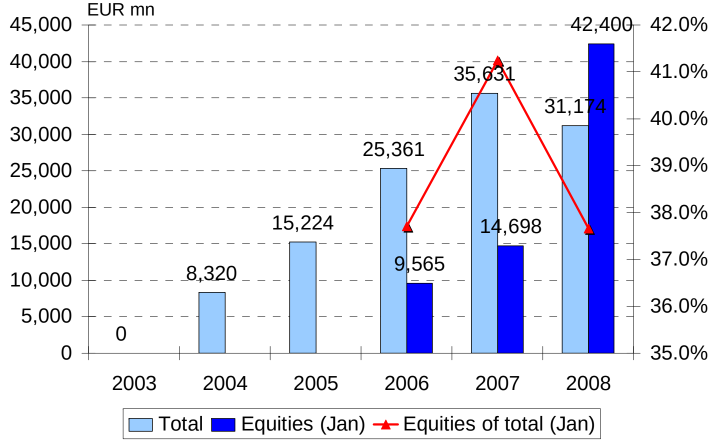


Source: Parkiet, Rzeczpospolita, PAP

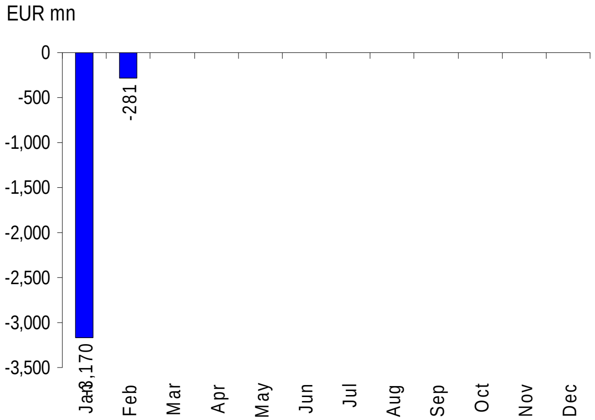
Allocation model
Special situation – Poland mutual funds

- Along with increasing wealth, Polish citizens invest increasingly in more sophisticated investment instruments
- Cash outflows for the first time ever in November 2007…
- …continued in 2008, but softened significantly in February 2008
- Level of investments in Polish assets stable at slightly more than 80%

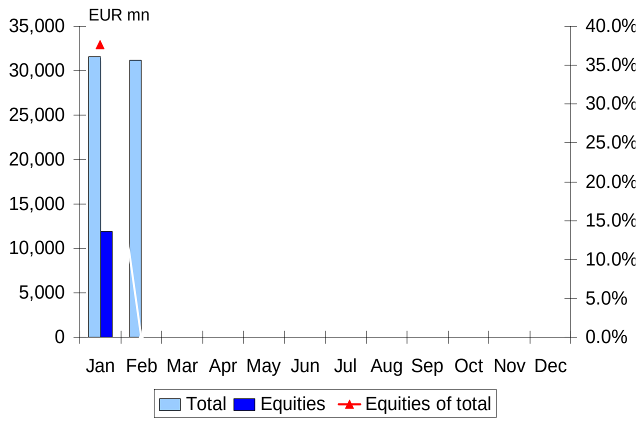
Total transfers into Polish mutual funds



Net cash inflow



Investments in equities



Source: Analyze Online

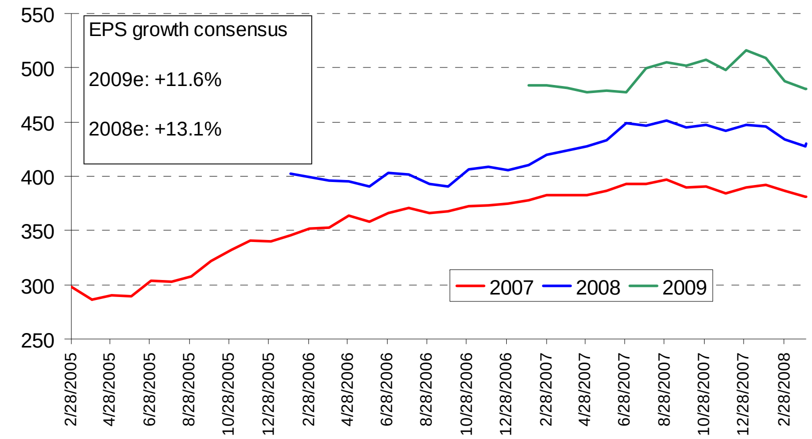
Content

1. Outlook 2008
2. Macro economy
2. Allocation model
3. **Equity markets**

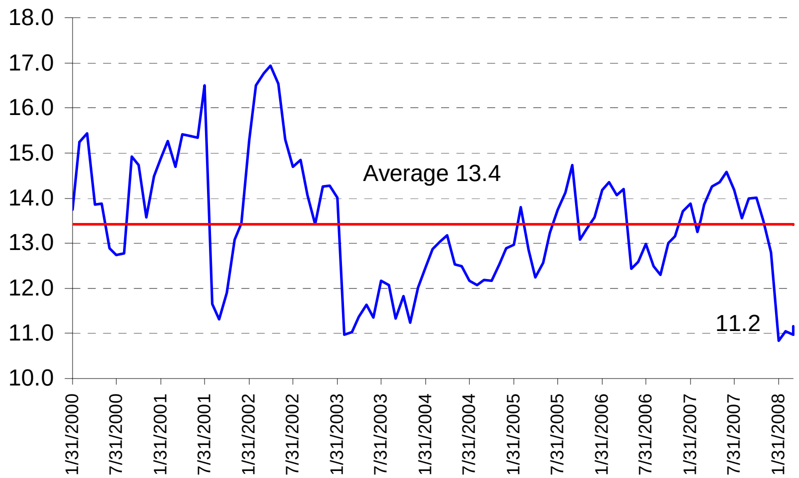
Equity markets
Regional view – growth and valuation

- **In summary still positive outlook, flattening but on still sound levels**
- **2009 outlook depends strongest on overall global outlook, as well as impacted by maturing business cycle**
- **Valuation way below historical averages**

EPS consensus trend



Forward P/E

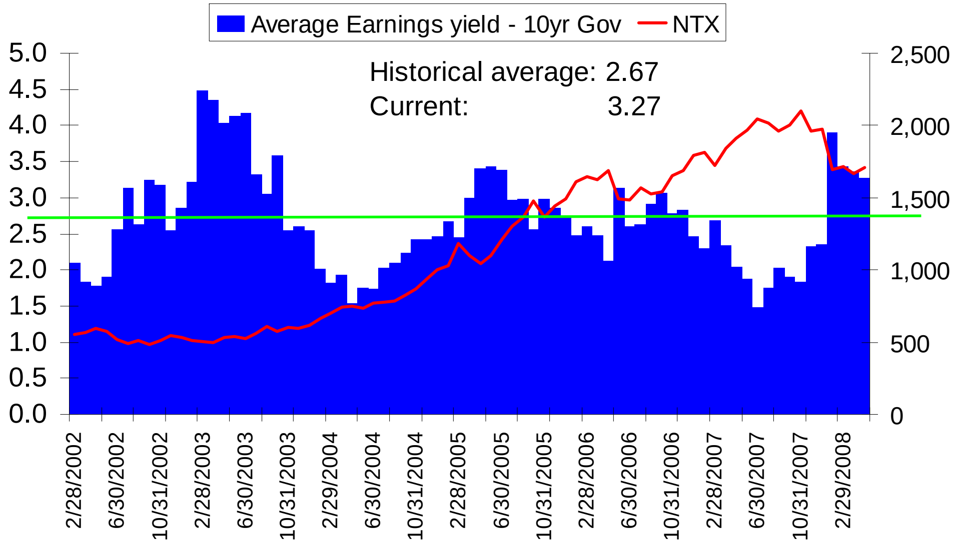


Source: JCF, Erste Group Research

Equity markets
Regional view – risk premiums

- Risk aversion increased globally
- CEE region much above historical average
- Spreads at levels seen last in 2003

Spreads between and earnings and government yields

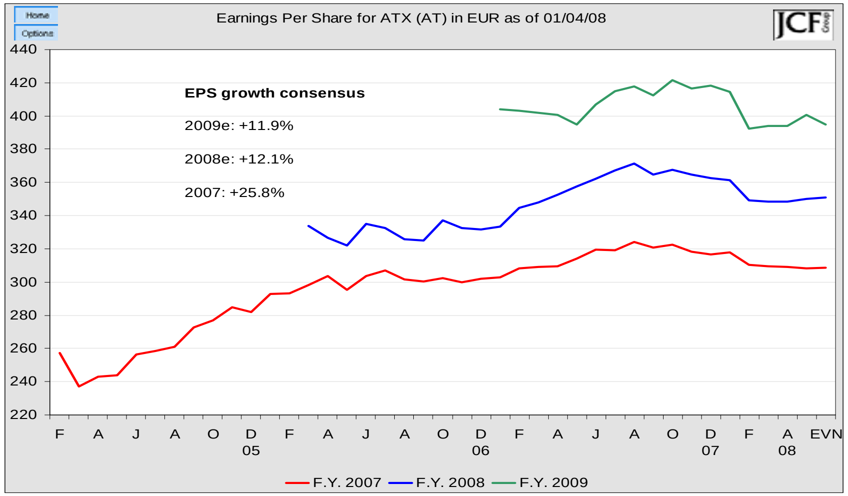


Source: Bloomberg, JCF, Erste Group Research

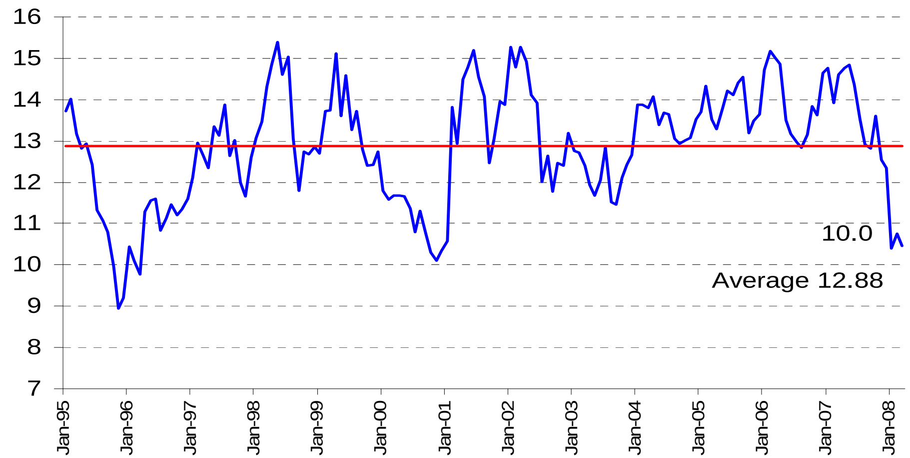
Equity markets
Country view – Austria

- Growth outlook still on high levels
- 2009 outlook actually see recovery as of late
- Austria is among the cheapest markets in the region

EPS consensus trend ATX



12-month forward P/E ATX

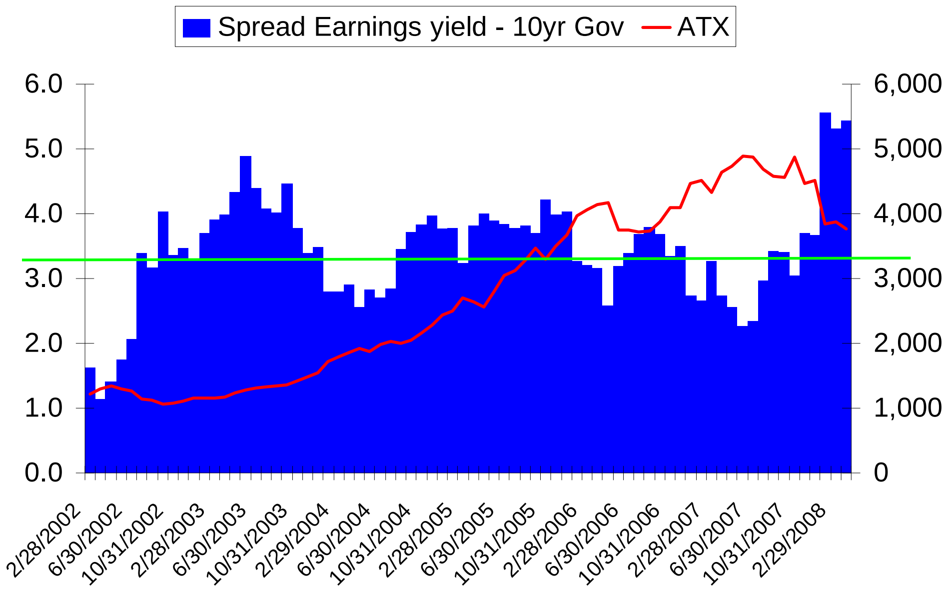


Source: JCF, Erste Group Research

Equity markets
Country view – Austria

- Market shows more than significant spreads

Spreads between and earnings and government yields

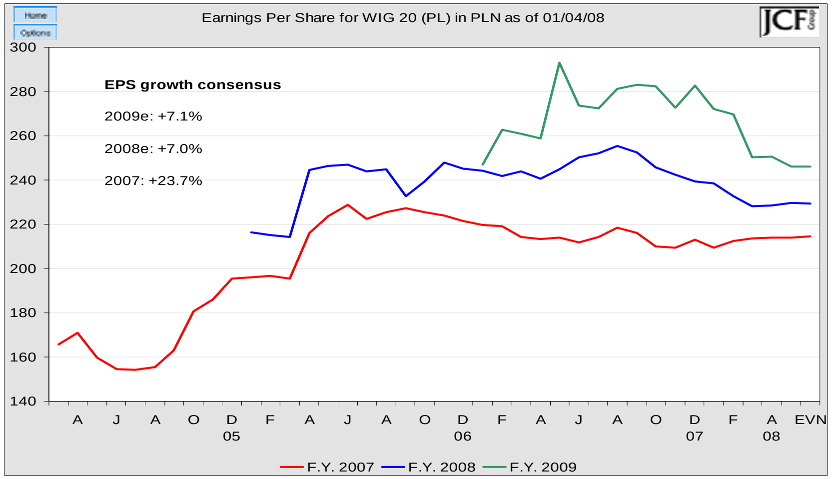


Source: Bloomberg, JCF, Erste Group Research

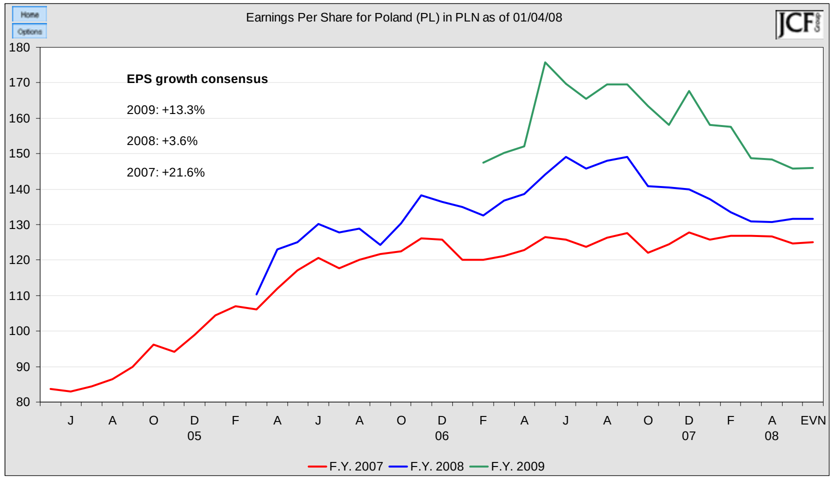
Equity markets
Country view – Poland (WIG 20/broad market)

- Outlook flattening for both market segments – still on comfortably high levels
- Long-term outlook strongly dependent on German economy

Consensus trend WIG20



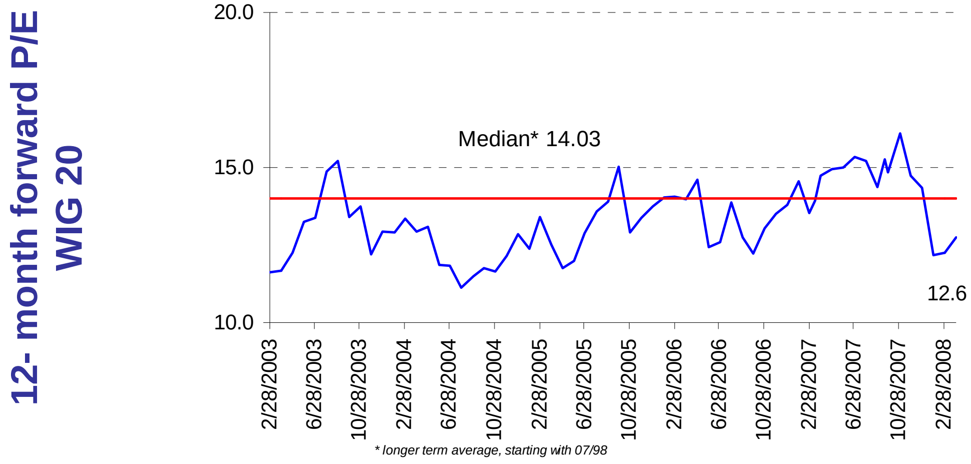
Consensus trend broad

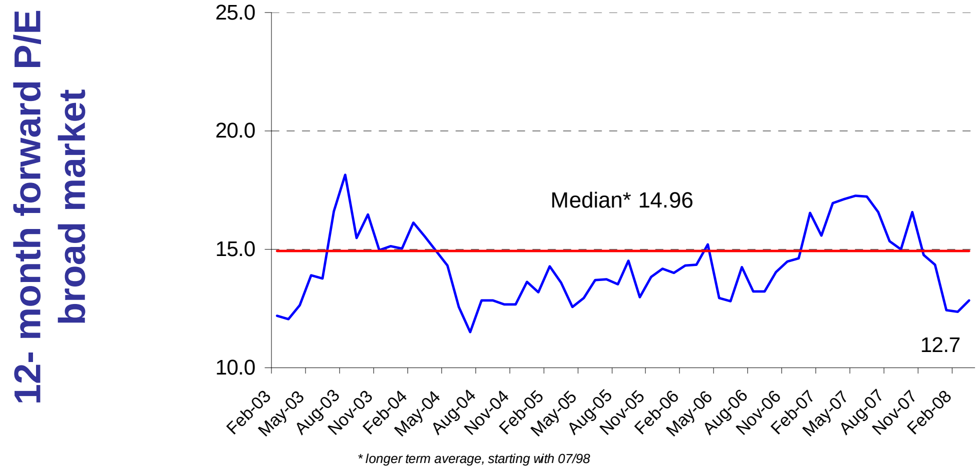


Source: JCF, Erste Group Research

Equity markets
Country view – Poland (WIG 20/broad market)

- Valuation for both segments way below historical averages
- Really attractive levels for the biggest market in CEE after Austria





Source: JCF, Erste Group Research

Equity markets
Country view – Poland (WIG 20/broad market)

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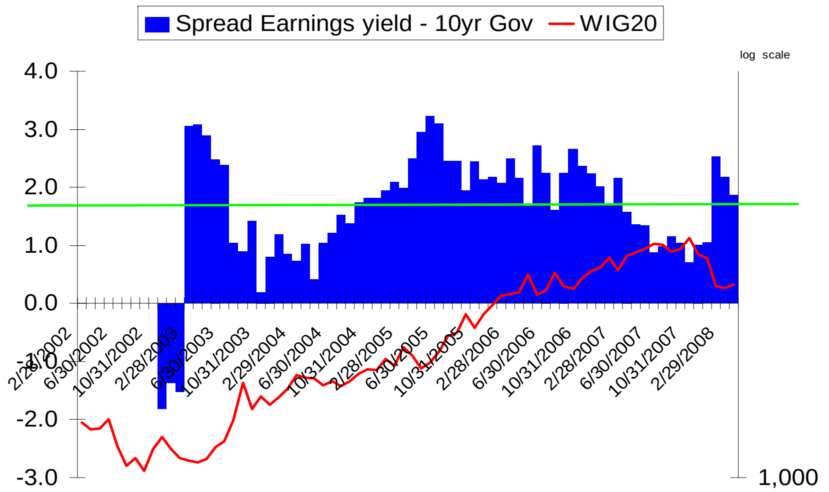
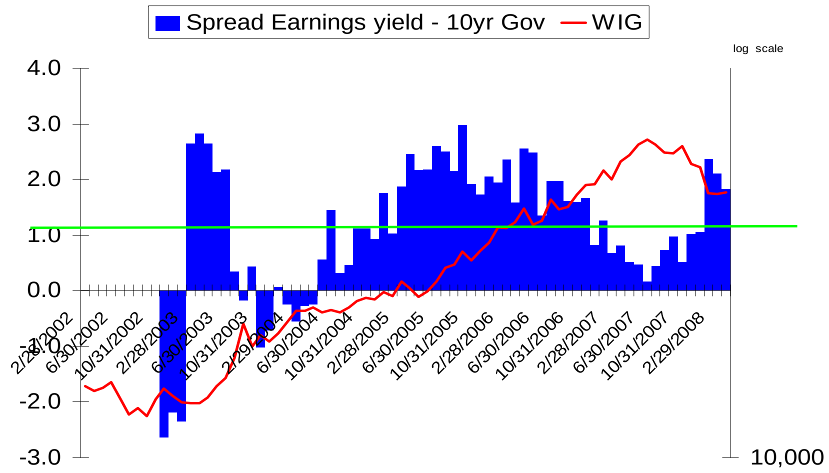
- Significant risk premiums build in right now
- Market has just seen an interest rate hike

WIG 20



Broad market



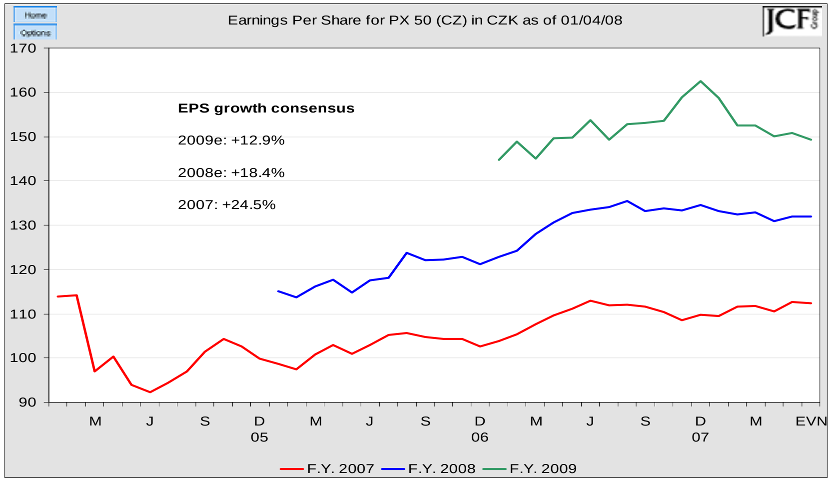
Source: xxxxxx

Equity markets
Country view – Czech Republic (PX)

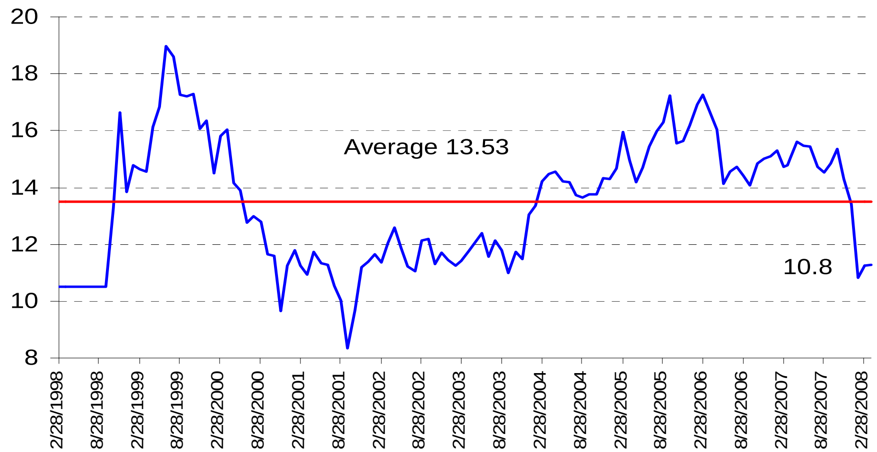
ERSTE GROUP

- Growth outlook still promising
- 2009 in particular
- Valuation rather at the high end
- Narrow market

Consensus trend PX



12-month forward P/E



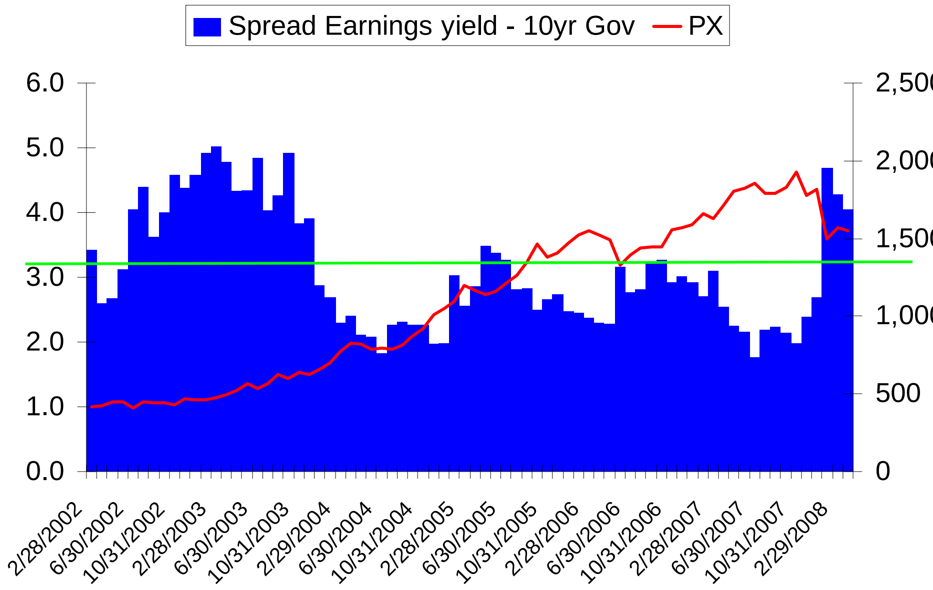
Source: JCF, Erste Group Research

Equity markets
Country view – Czech Republic (PX)

ERSTE GROUP

- Same picture as in other markets
- Lowest interest rates in the region
- Rate hike to be expected later this year, after keeping rates stable recently

Spreads between and earnings and government yields

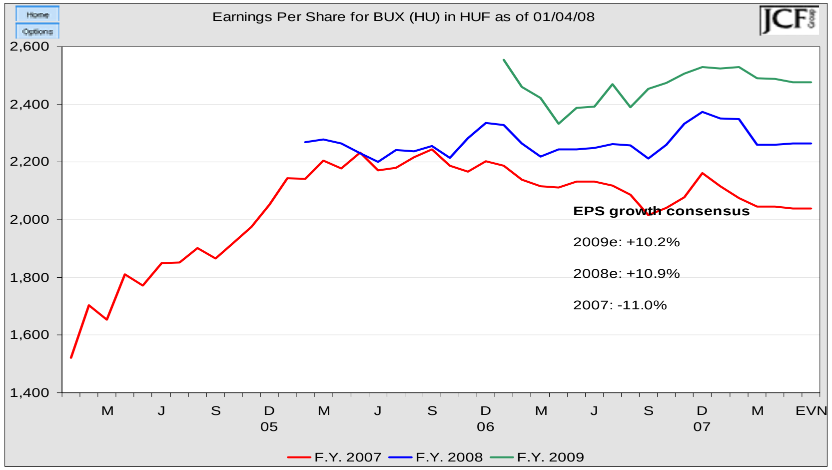


Source: Bloomberg, JCF, Erste Group Research

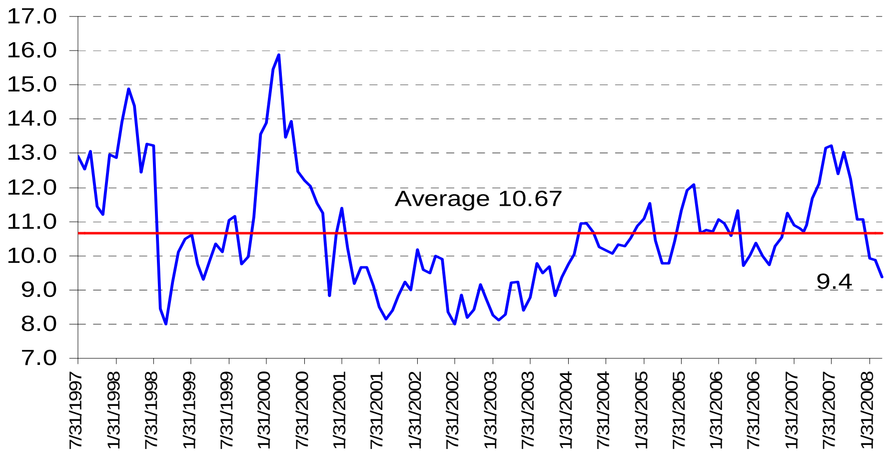
Equity markets
Country view – Hungary (BUX)

- Weak 2007, 2008 wit a slight question mark as of late
- Market remains a recovery story based on macro environment
- Cheapest market in the region

Consensus trend BUX



12-month forward P/E

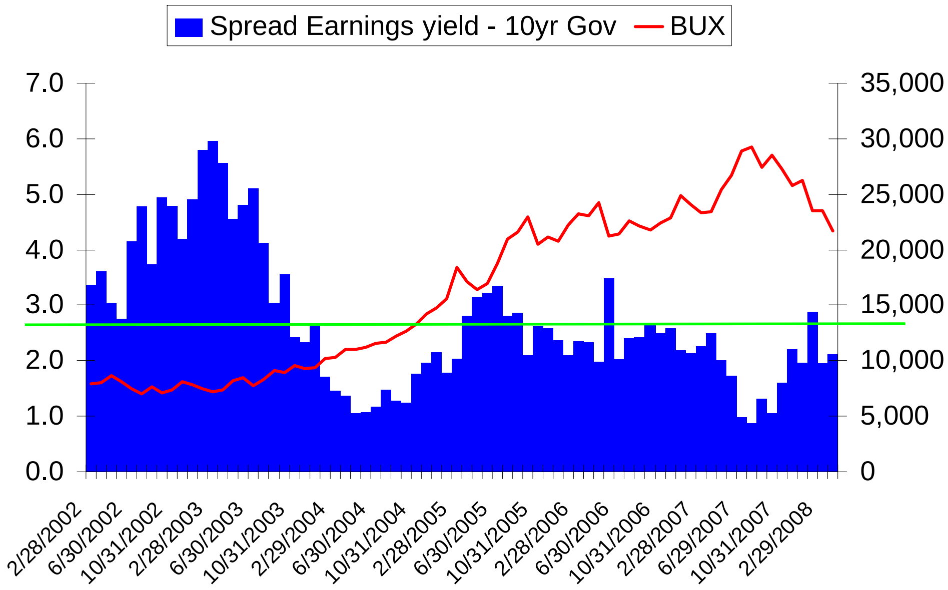


Source: JCF, Erste Group Research

Equity markets
Country view – Hungary (BUX)

– **Risk premiums at historical average do not provide for an easy argument to support the market**

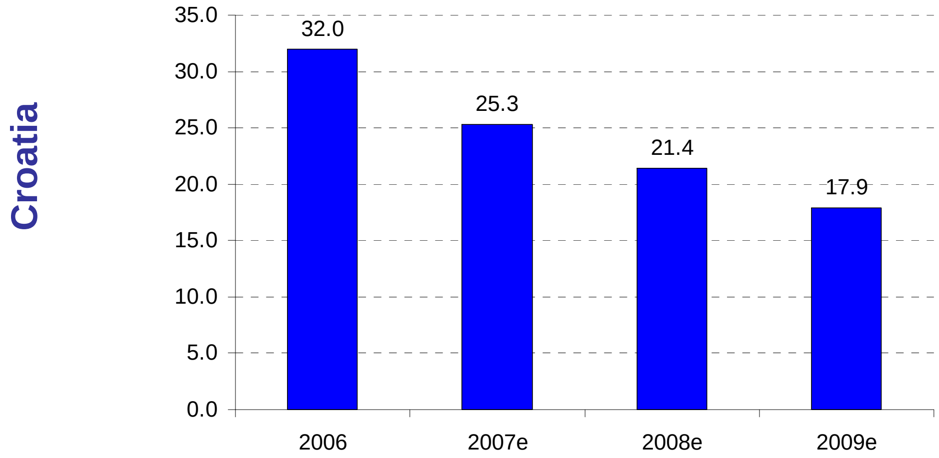
Spreads between and earnings and government yields

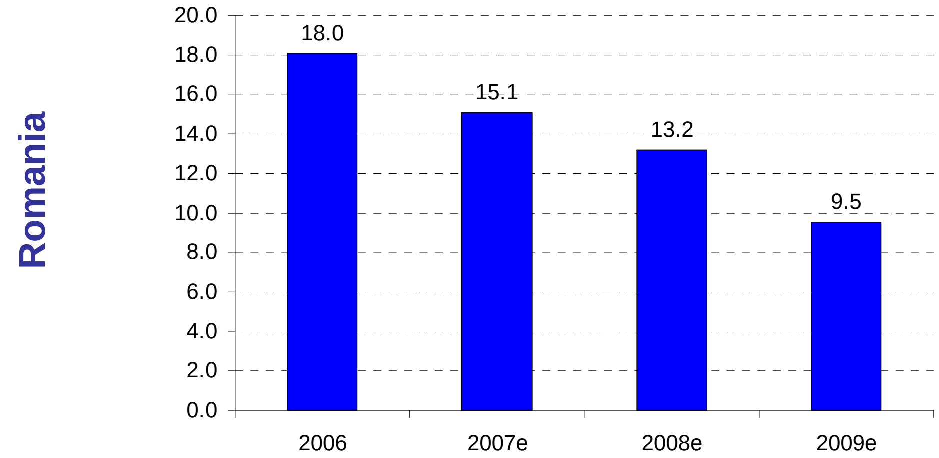


Source: Bloomberg, JCF, Erste Group Research

Equity markets
Country view – Croatia / Romania

- Croatia: Valuations range at the high end
- A lot of growth outlook has been priced in already
- Continued reporting needs to support valuation levels
- Romania came down a lot in terms of valuation
- Macro worries keep the market from tapping its potential



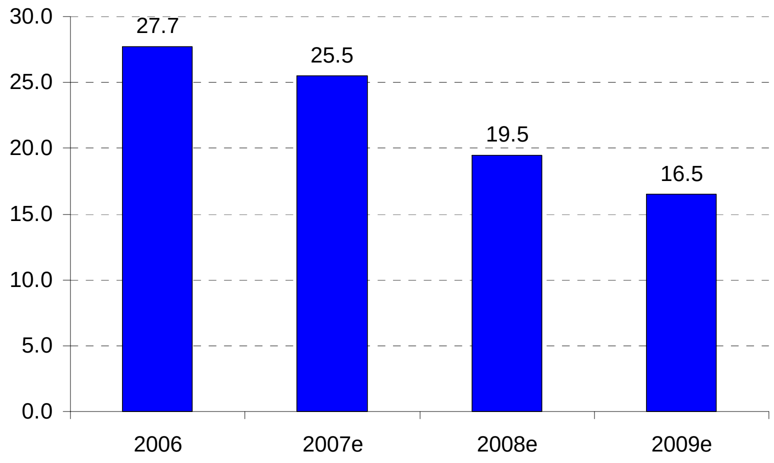


Source: JCF, Erste Group Research

Equity markets
Country view – Slovenia

- Small market with limited but improving liquidity
- Domestic demand meets limited investment choice
- Consequently, valuations are rather at the higher end

Consensus P/E



Source: JCF, Erste Group Research