Raiffeisen Bank International

Raiffeisen CENTROBANK

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Austria and CEE: Turning for the better

- **Real GDP in CEE to grow by 2.6 per cent in 2012, while GDP in eurozone set to shrink by 0.5 per cent**
- **Austrian GDP to expand by 0.3 per cent**
- **No signs of a credit crunch in CEE**
- **Company results: Review of fourth quarter 2011 better than expected**
- **Earnings growth in all markets expected until end of year**
- **Austrian top-picks: Immofinanz, AMAG, OMV, Erste Group, Flughafen Wien, Mayr-Melnhof**
- **CEE favorites: Bogdanka, Cyfrowy Polsat, MTS**

"Since the winter months the attitudes of business managers in Central and Eastern Europe (CEE)[1] and in Austria have begun to improve," reports Peter Brezinschek, Head of Raiffeisen Research, a unit of Raiffeisen Bank International AG (RBI). According to him, particularly the enhancement of economic prospects in Germany, which is by far the most important destination for exports of many countries in CEE was the reason for rising up the GDP forecasts. "At the moment, it does not seem as if the European sovereign debt crisis will affect core countries in CEE," he adds. The chief analyst expects the CEE region as a whole to post an average GDP growth of 2.6 per cent for 2012, against the prior forecast of 2 per cent in December last year. "Keeping in mind that the eurozone's GDP is about to shrink by 0.5 per cent, it becomes clear that CEE is once again Europe's growth region," Brezinschek states.

Based on the upswing of the German economy, Raiffeisen Research's chief economist anticipates a growth of 1.4 per cent for Central Europe (CE) for 2012 while Southeastern Europe (SEE) still feels the effects of the recession. "In SEE structural weaknesses have yet to be consistently eradicated, and the negative impacts of the recession in southern countries of the eurozone are most pronounced here. This is why we expect that GDP will stagnate at 0.3 per cent throughout SEE in 2012," Brezinschek explains. The powerful increases in the price of oil have also prompted the analysts to raise the 2012 forecast for Russia to 3.7 per cent, which results in a GDP growth for the whole Commonwealth of Independent States (CIS) of 3.7 per cent for 2012.

For Austria Raiffeisen Research's analysts have assumed an upwards development of 0.3 per cent for 2012-GDP. "The Austrian economy is set to weaken in the first quarter of this year as well, but then the worst part should be over. It should be pointed out that private consumption will reach almost 1 per cent real growth, supported by reasonable wage growth and robust employment data. For 2013 we expect real GDP growth of plus 1.3 per cent y-o-y," says Raiffeisen Research's chief analyst. The high inflation rates witnessed at the beginning of the year will decrease moderately within the course of the year. Thus the inflation rate will have to be raised to 2.3 per cent.

[1] Central and Eastern Europe (CEE) consists of the sub-regions Central Europe (CE) – Czech Republic, Hungary, Poland, Slovakia and Slovenia; Southeastern Europe (SEE) – Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Romania and Serbia; and Commonwealth of Independent States (CIS) – Russia, Ukraine and Belarus.

No signs of a credit crunch in CEE

Raiffeisen Resarch's analysts want to refute widespread fears that CEE will be hit hard by the deleveraging process in the Western European banking sector. "We do not see any signs of a 'credit crunch' in CIS and CE, excluding Hungary," Brezinschek says. It is indisputable that we might face challenging banking sector trends in some SEE countries, with low loan growth and still rising non-performing loan ratios. "Nevertheless, deposit collection remains at healthy levels in all CEE countries. As a result, loan-to-deposit ratios were on a downtrend in a lot of CEE countries over the past nine to twelve months", the chief analyst adds. In addition, the expert sees stabilizing non-performing loan ratios in the most solid CEE banking sectors like in Poland, Russia, Czech Republic and Slovakia.

Interest rate cuts in Hungary, Romania and Russia likely until autumn

The higher prices of foods, and above all energy, resulted in higher than expected inflation in the CEE region in the first couple of months of 2012. "For this reason the local Central Banks did not cut their interest rates, for example in Poland and the Czech Republic, or postponed them until the second half of 2012," Brezinschek explains and reckons that as soon as the situation calms down, rates would be cut in Hungary, Romania and Russia until autumn.

CEE currencies firmed up following injections of liquidity by ECB

According to Brezinschek, the injections of liquidity by the European Central Bank (ECB) have also had an impact in CEE: "For example, the Polish zloty, the Hungarian forint, the Czech koruna and also the Russian rouble in particular have managed to firm up significantly following the decline in risk aversion." In parallel, Raiffeisen Research's analysts have seen a moderate decline in yields on the main bond markets, while CEE countries have successfully managed to place eurobonds. "In the second quarter we reckon that FXs and yields will stabilise for the most part at their current levels," Brezinschek explains. He believes that the clearly positive yield spread justifies selective buyings in local currency bonds.

Buy recommendation for CEE equities

Following the injections of liquidity by the ECB, the friendly climate on the stock exchanges in core European countries has now also spread to the CEE exchanges. "But the situation still differs from country to country. Paradoxically, the countries facing the biggest problems, such as Romania and Hungary, have managed to generate double-digit growth in prices – alongside Austria, while those countries that are fundamentally stronger, such as Poland, the Czech Republic and Russia, have lagged behind somewhat," the chief analyst says. He believes that prices across the CEE region will rise on average by 6 to 11 per cent in the second quarter: "Therefore, we still uphold a general buy recommendation for three to six months in respect of all exchanges."

Good reporting season – especially in Austria

The reporting season for the final quarter of 2011 was rather good especially in Austria. Almost one third of the companies beat the estimates of Raiffeisen Centrobank's analysts or general consensus expectations. Notable positive surprises are OMV, Erste Group, Raiffeisenbank International, RHI, Andritz, Mayr-Melnhof and S-IMMO. Stefan Maxian, chief analyst of Raiffeisen Centrobank (RCB), explains, "In our opinion, it is a good sign for the Austrian equity market that particularly highly capitalised companies were able to beat market expectations – contrary to previous quarters." In CEE, the reporting season was a touch weaker. Even though sales expectations were largely met, profitability to some extent lagged behind forecasts due to weaker CEE currencies and rising input costs. In Poland, the largest market, mainly construction and real estate companies were disappointing.

Outlook: Until year end rises in share prices for all markets expected

For this year, RCB forecasts adjusted earnings growth of 14 per cent. Valuation levels have not grown markedly in spite of the strong performance since the beginning of the year: the ATX has increased by about 10 per cent ytd. Also, with a Price/Earnings ratio of 10.1 for 2012 the evaluation remains beyond the longtime average. RCB rates the Austrian equity market a 'buy' with an ATX target of 2,350 points in June and 2,450 points at year-end. ATX companies should also report reasonable business results for 1Q 2012. "The liquidity measures undertaken by the European Central Bank and sentiment improvement should have led to satisfactory business trends. In particular OMV, Erste Group and Verbund are expected to present good results," says Maxian.

Austrian top-picks: Immofinanz, AMAG, OMV, Erste Group, Flughafen Wien, Mayr-Melnhof

In the real estate universe the analysts of Raiffeisen Centrobank prefer Immofinanz because the company is in a position to generate dividends on a sustainable basis from operational earnings without selling real estate. Furthermore, potential for optimization exists.

In the industrial segment, the focus is currently on AMAG and Mayr-Melnhof. AMAG thrives on rising demand for aluminium products. Even though 2012 is rather considered a transitional year due to capacity bottlenecks, the group is expected to resume its growth trend driven by higher volumes in the downstream business and higher aluminium prices in 2013. For Mayr-Melnhof the market environment has improved considerably, not least due to positive demand effects since the inventory reduction in the cartonboard industry has come to an end.

The OMV share is currently being fuelled by the high oil price level (Brent crude is quoted at USD 125 per barrel), the restart of production in Libya (the main driver of production growth this year) and better refining margins in Romania. Also rumours that IPIC might increase its stake in OMV above 25 per cent lend support to the share price.

The banking sector should be able to present good results for the first quarter. The sector benefited from the liquidity supply of the European Central Bank and the Research Department of RCB therefore anticipates support of net interest income figures. In addition, the results will be supported by one-off effects (repurchase of hybrid bonds quoted below par).

The analysts of RCB recently upgraded the share of Flughafen Wien to "buy" due to strong traffic results at the beginning of the year (as passenger growth increased by 9.6 per cent yoy in the period January-February) and the optimistic outlook of the group.

CEE favourites: Bogdanka, Cyfrowy Polsat, MTS

Raiffeisen Centrobank currently considers Bogdanka, Cyfrowy Polsat and MTS as top-picks.

Bogdanka is the most efficient and attractively valued producer of thermal coal in Poland with annual output of roughly 6 mn t which is to increase to 11.5 mn t until 2014. On the one hand, Polish electricity generation is almost exclusively based on coal and on the other hand, there are signs of a bottleneck in coal imports. Bogdanka benefits from this shortage of supply.

In the Polish media sector we currently favour Cyfrowy Polsat. The profitability of the defensive pay-TV business in 2H 2011 came as a positive surprise. In addition, the recovery of the Polish zloty should translate into higher operating margins than originally expected. Cyfrowy Polsat is expanding into new areas of growth and therefore recently required a licence for mobile TV.

The market environment in 1Q 2012 was favourable for the Russian telecom stock MTS. Rising real wages and disposable incomes should have exerted a positive influence on telecommunications revenues. Apart from attractive macroeconomic conditions we see indications of receding competitive pressure in mobile communications. The latest quarterly results provided positive evidence that the group's new customer retention strategy is paying off.

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Raiffeisen Bank International AG (RBI) regards both Austria, where it is a leading corporate and investment bank, and Central and Eastern Europe (CEE) as its home market. In CEE, RBI operates an extensive network of subsidiary banks, leasing companies and a range of other specialised financial service providers in 17 markets.

RBI is the only Austrian bank with a presence in both the world's financial centres and in Asia, the group's further geographical area of focus.

In total, around 59,000 employees service about 13.8 million customers through around 2,900 business outlets, the great majority of which are located in CEE.

RBI is a fully-consolidated subsidiary of Raiffeisen Zentralbank Österreich AG (RZB). RZB indirectly owns around 78.5 per cent of the common stock, the remainder is in free float. RBI's shares are listed on the Vienna Stock Exchange. RZB is the central institution of the Austrian Raiffeisen Banking Group, the country's largest banking group, and serves as the head office of the entire RZB Group, including RBI.

For further information please contact Ingrid Krenn-Ditz (+43-1-71 707-6055, ingrid.krenn-ditz@rbinternational.com) or Alexandra Jocham ((+43-1-71 707-5627, alexandra.jocham@rbinternational.com).
http://www.rbinternational.com, http://www.rzb.at

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For further information please contact Andrea Pelinka-Kinz (+43-1-51 520-614, andrea.pelinka-kinz@rcb.at)
http://www.rcb.at