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CEE developments reflect eurozone wobbles

- **Real GDP in CEE to grow by 2.0 per cent in 2012, while eurozone faces recession of -1.0 per cent**
- **Austria set to post GDP decline of 0.5 per cent**
- **Eurozone debt crisis to continue its temporary negative impact on equity markets**

“Central and Eastern Europe remains under the spell of the sovereign debt crisis in the eurozone,” Peter Brezinschek, Head of Raiffeisen Research, a unit of Raiffeisen Bank International AG (RBI), states referring to his team's newly revised 2012 growth forecasts for Central and Eastern Europe (CEE)¹. Raiffeisen Research expects the CEE region as a whole to post an average GDP growth of 2.0 per cent for 2012. “The rather muted growth that we forecast for CEE this year must be seen in comparison to the recession of -1.0 per cent that we are expecting for the eurozone,” Brezinschek adds.

Raiffeisen Research's analysts anticipate that the negative effects due to strong foreign trade ties with the eurozone will be most pronounced in Central Europe (CE), whose regional GDP they expect to grow by 0.5 per cent, and Southeastern Europe (SEE), which they see posting a growth rate of 0.4 per cent. With regard to the countries of the Commonwealth of Independent States (CIS), Raiffeisen Research has left its existing 2012 GDP growth forecast of 3.1 per cent unchanged. With the notable exception of Poland (expected GDP growth of 2.2 per cent), Raiffeisen Research's analysts forecast GDP declines in all of the countries in Central Europe, including Austria (-0.5 per cent). Brezinschek expects that the regional economies' strong focus towards the German economy, necessary budget consolidation measures, and cautious lending are likely to be the main factors leading to a weak first half in 2012. However, Brezinschek is more optimistic about the second half of the year: “A closer look at our GDP forecast for CEE makes clear that the negative trend for the first half of 2012 should be compensated by a better development in the second half of the year. This outlook is in line with the eurozone's expected performance,” says Brezinschek.

Inflation: Most CEE countries already past the peak

According to Raiffeisen Research, the inflationary peak appears to have already been reached in most of the CEE region's economies. “We forecast higher inflation rates only for Hungary, the Czech Republic and Ukraine in 2012, due to the fiscal measures being implemented in these countries,” Brezinschek adds. The interest rate cuts that the European Central Bank is expected to make, as well as the large volumes of liquidity assistance that are likely, may push the shorter-term Euribor rates below the key interest rate in the first half of 2012. In the case of waning inflation rates, this might also lead to interest rate cuts in most all of the markets stretching from Poland to Romania. “Hungary is the only country where we expect the central bank to stabilise the fragile exchange rate by maintaining high key interest rates,” explains Brezinschek.

CEE currencies under pressure in the first quarter of 2012

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.

The renewed tension emanating from the sovereign debt crisis should place additional pressure on the CEE currencies in the first quarter of 2012. "Only once the economic and financial market situation has improved in the second half of the year do we expect the CEE currencies to appreciate gradually," believes Brezinschek. "This also applies to the Russian rouble, which has traditionally been weak compared to the USD during the first half of the year."

CEE equity markets: new lows to be tested in the first quarter of 2012

"The negative development of the CEE equity markets in 2011 was in the hefty double-digit range. While the markets that were still doing better at the beginning of 2011 lost a substantial amount of ground in the fourth quarter, the ones that had posted the weakest performance early in 2011 stabilised later on," Brezinschek analyses. He sees great potential for declines in the beginning of 2012, particularly on the stock exchanges in Hungary, the Czech Republic and in the Balkan markets. The relatively good fundamental situation in Poland and Russia should also be reflected in lower price losses. Brezinschek's cautious assessment for the emerging markets extends through the middle of the year, although he believes that the expected revival in economic sentiment will be accompanied by a strong share price recovery in the second half of 2012. "The basic assumption is that a clear progress in solving the debt problem will be acknowledged," he adds.

Market recovery to follow first quarter's temporary weakness

The sovereign debt crisis, continuing discussions over capital requirements of domestic banks and the specific composition of the leading index – the ATX is dominated by cyclical and financial companies – altogether weighed heavily on the Austrian equity market in 2011. In addition to that, the domestic economy is expected to have retreated in the fourth quarter 2011, with Raiffeisen Centrobank's analysts estimating a return to positive growth rates only in the third quarter. For the full year 2012 their forecast thus shows a 0.5 decline.

As a result, further dips on the Austrian equity market cannot be ruled out over the months to come. "Even if Austrian companies continue to feature solid fundamentals, they are unable to fully detach from the prevailing negative influence such as the sovereign debt crisis", as Birgit Kuras, Chief Analyst at Raiffeisen Centrobank, explains. This leaves the ATX with some room for decline in the first quarter 2012, whereas the remaining year – particularly the second half – may allow for double-digit gains. According to Kuras, the ATX has potential to climb up to 2,200 points by year-end.

Valuation levels appear attractive upon share prices decline

As far as profit growth is concerned, Raiffeisen Centrobank's research considers the slightly positive trend to continue. In spite of enormously negative effects resulting from burdens such as the foreign exchange rates, the analysts foresee an adjusted profit growth of 13 per cent in 2012. Thanks to a relatively benign share price development, valuation has come back to quite attractive levels recently: based on aggregated growth estimates, the price/earnings ratio for 2012 currently amounts to 9, and the price/book value ratio has remained at a moderate 0.7.

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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 60,000 employees service about 13.7 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.

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