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Eastern European Outlook

Warsaw, October 2010

Agenda

- The global outlook
- Short summary of the EEO
- The Baltic states
- Poland
- Russia
- Ukraine

Slowing global economy

GDP, percentage change

	2009	2010	2011	2012
United States	-2.6	2.6	2.2	2.9
Euro zone	-4.1	1.6	1.3	1.5
The world	-0.6	4.4	3.8	4.3
Oil, USD/barrel	61.9	76.2	80.0	80.0
EUR/USD, Dec.	1.43	1.40	1.43	1.30

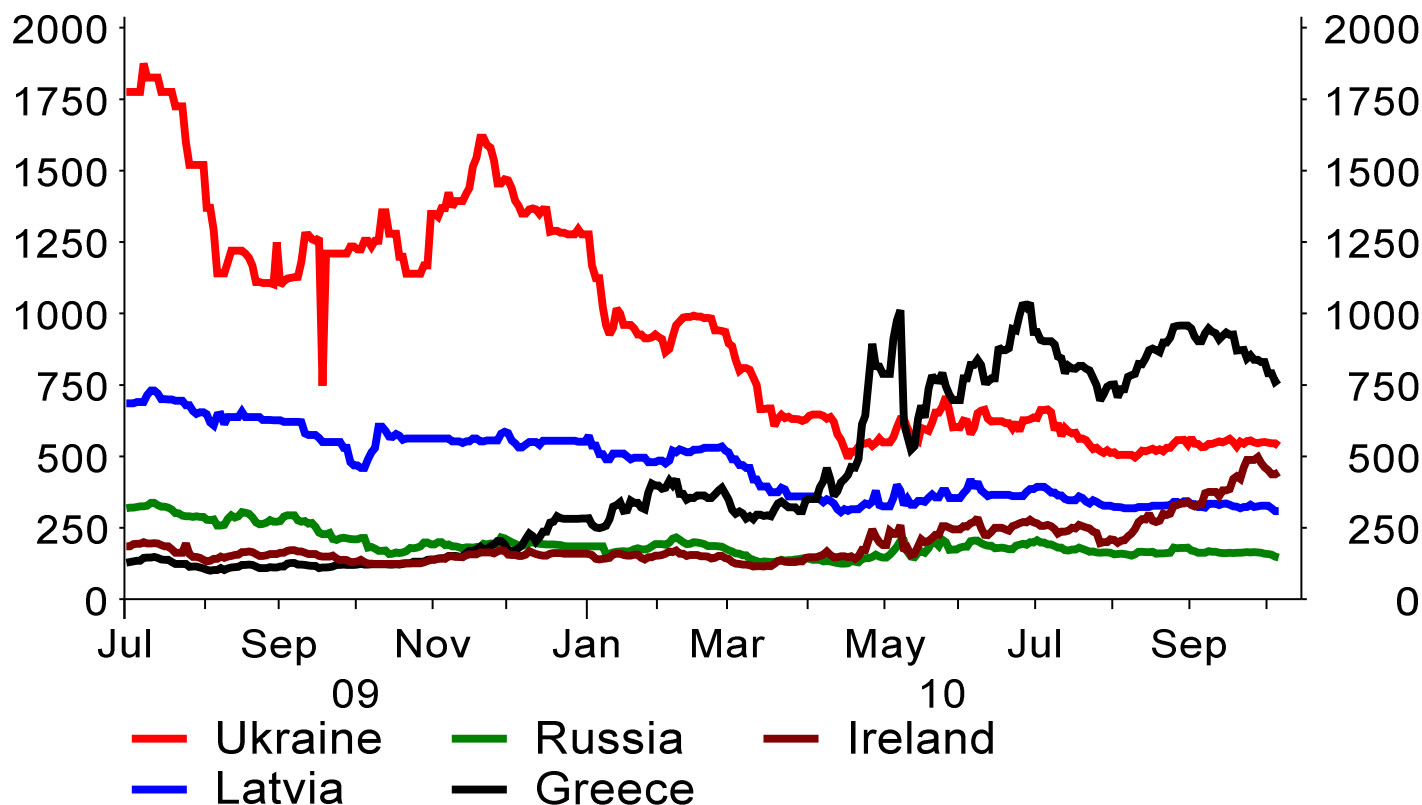
EEO, October 2010: Renewed domestic demand but moderate GDP growth

- Eastern Europe was hardest hit by the global crisis and recession
- Relatively strong export-led turnaround in the past year – now entering mature phase
- Domestic demand is awakening
- Structural obstacles to growth
- Inflation gradually rising from historically low levels
- Large budget deficits are shrinking. Public sector debts are low or moderate
- Theme: Internal devaluations in the Baltics: Pay adjustments ending soon
- **GDP forecasts for 2010-2012 – not the lively growth seen before the crisis**
- **Poland** in the best shape – growth will continue to accelerate, reaching its potential rate of 4.0-4.5%
- **Russia** will achieve a decent 5% growth rate – but ought to perform better
- **Ukraine** will decelerate from a solid 5.2% this year to 4.2% in 2012
- Coming out of the Baltic crash: **Estonia** 2.3%, 4.0% and 4.0%. **Latvia** -1.5%, 4.0% and 5.0%. **Lithuania** 1.0%, 4.0% and 4.5%

Eastern Europe is remaining steady amid turbulence surrounding Greece and Ireland

Reduced risk of sovereign default

Five-year CDS contracts, basis points

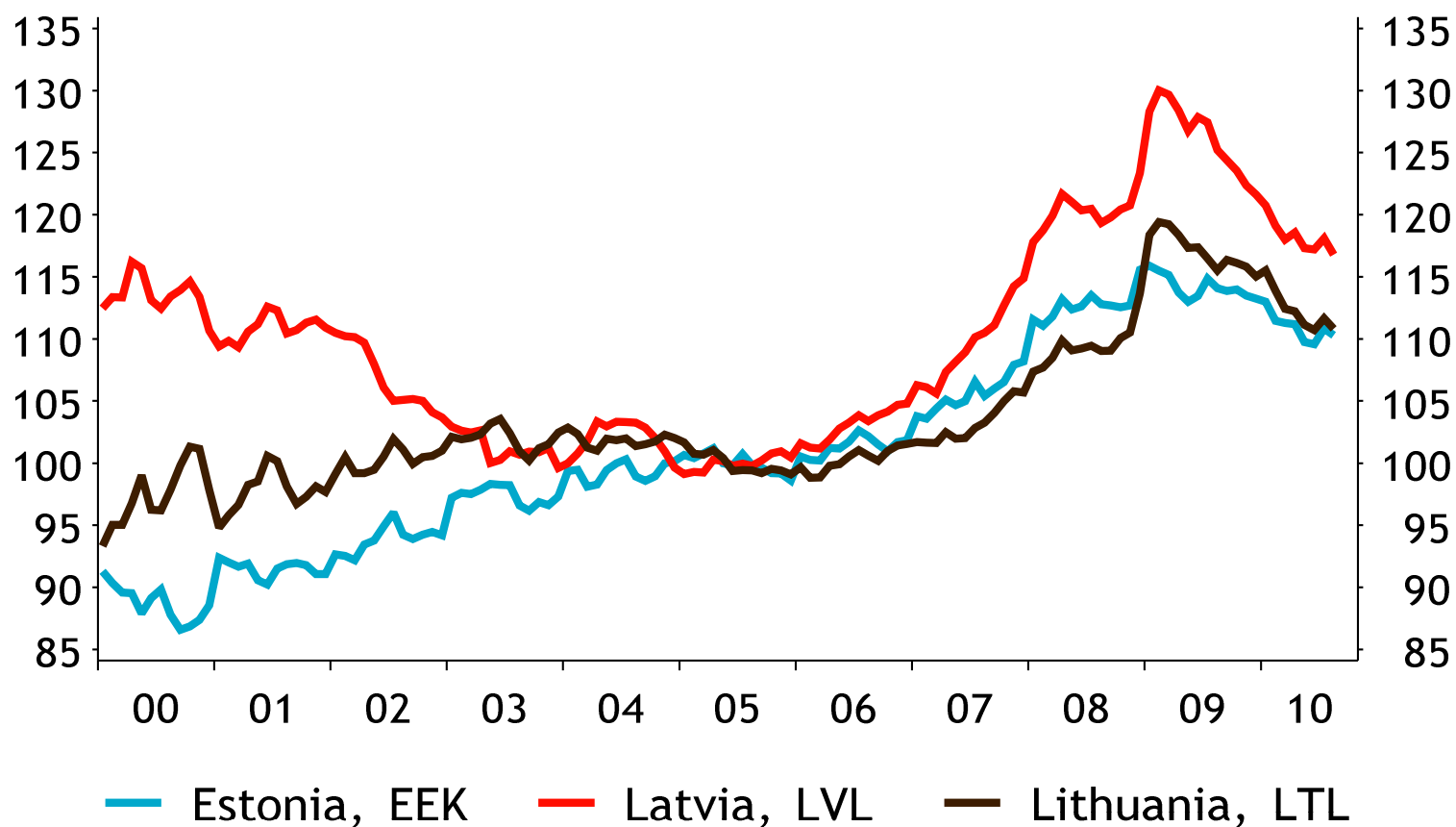


Source: Reuters EcoWin

Competitiveness is returning

Real effective exchange rates

Index 100 = 2005



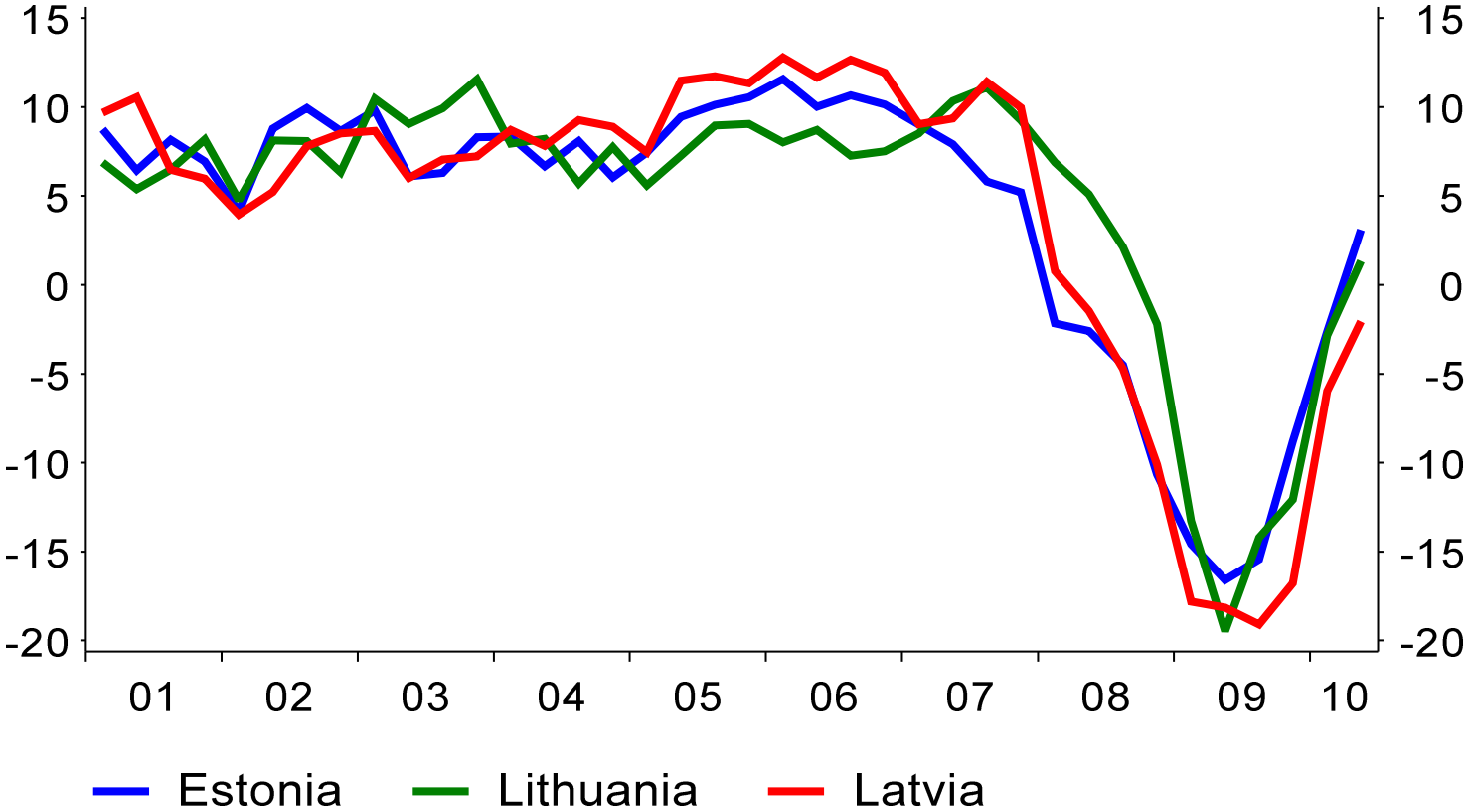
Source: BIS

Growth is returning



GDP

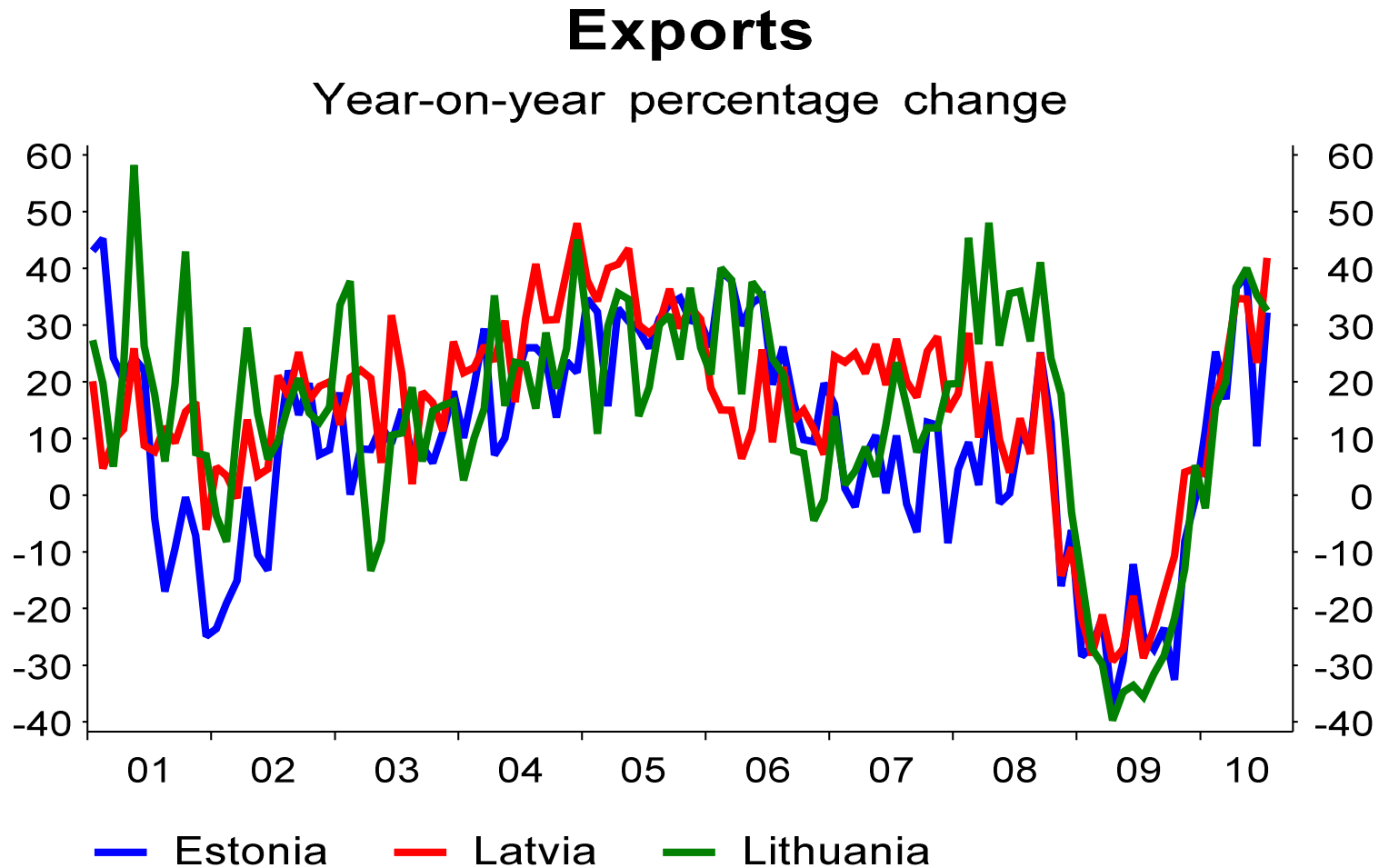
Year-on-year percentage change



Source: Reuters EcoWin



The export boom is culminating...



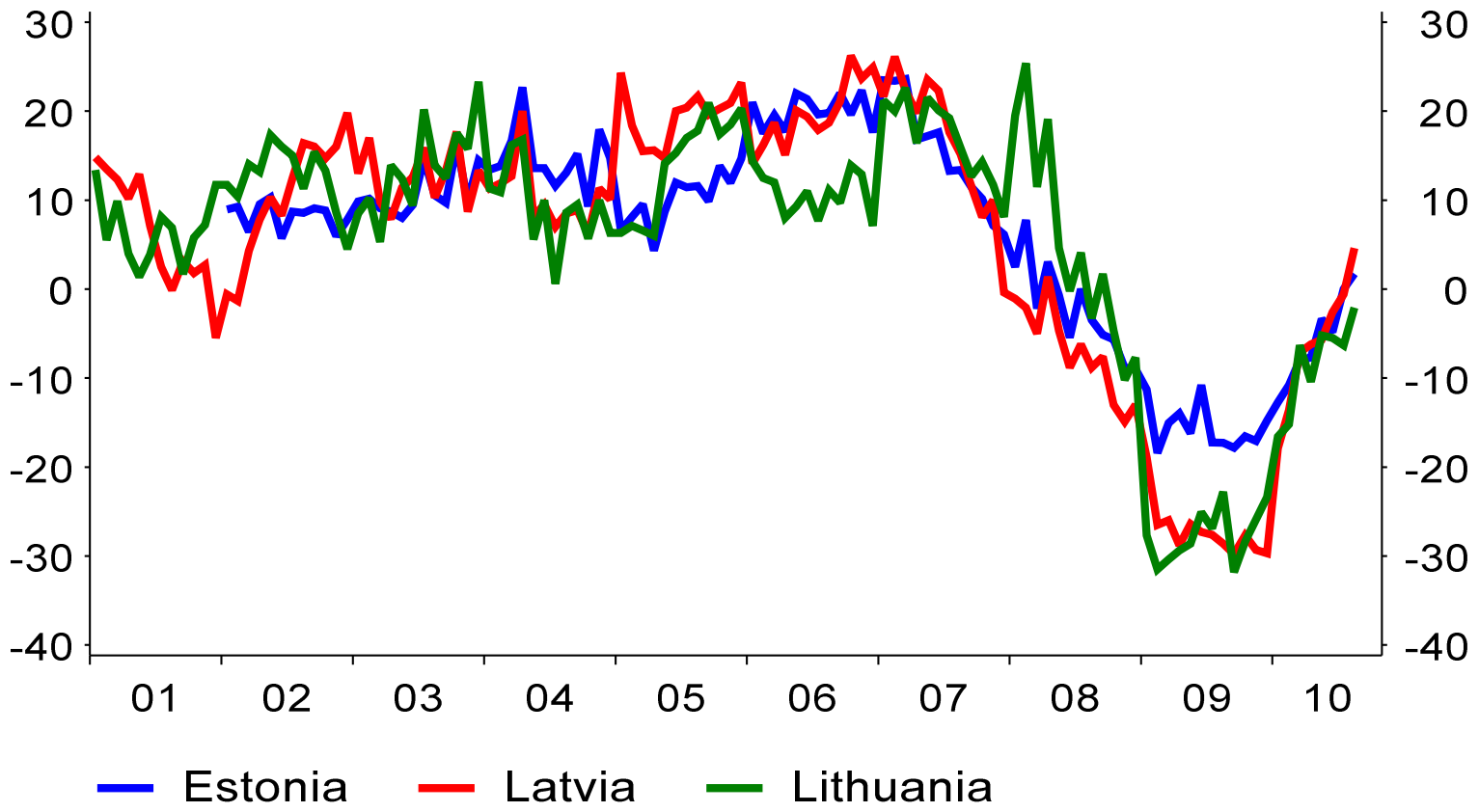
Source: Reuters EcoWin

...consumption is slowly rebounding



Retail sales

Year-on-year percentage change



Source: Reuters EcoWin

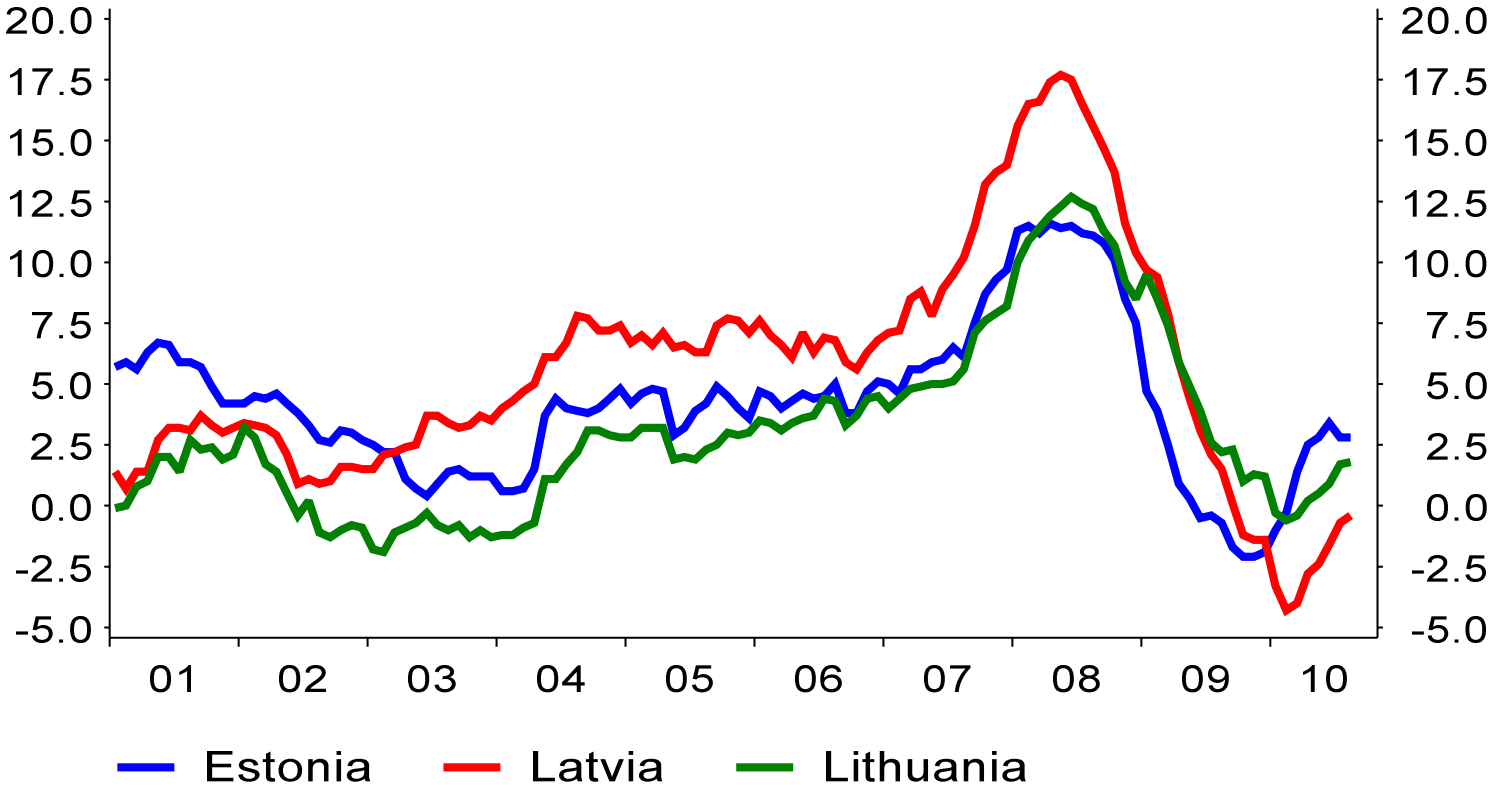


Deflation pressure has ended



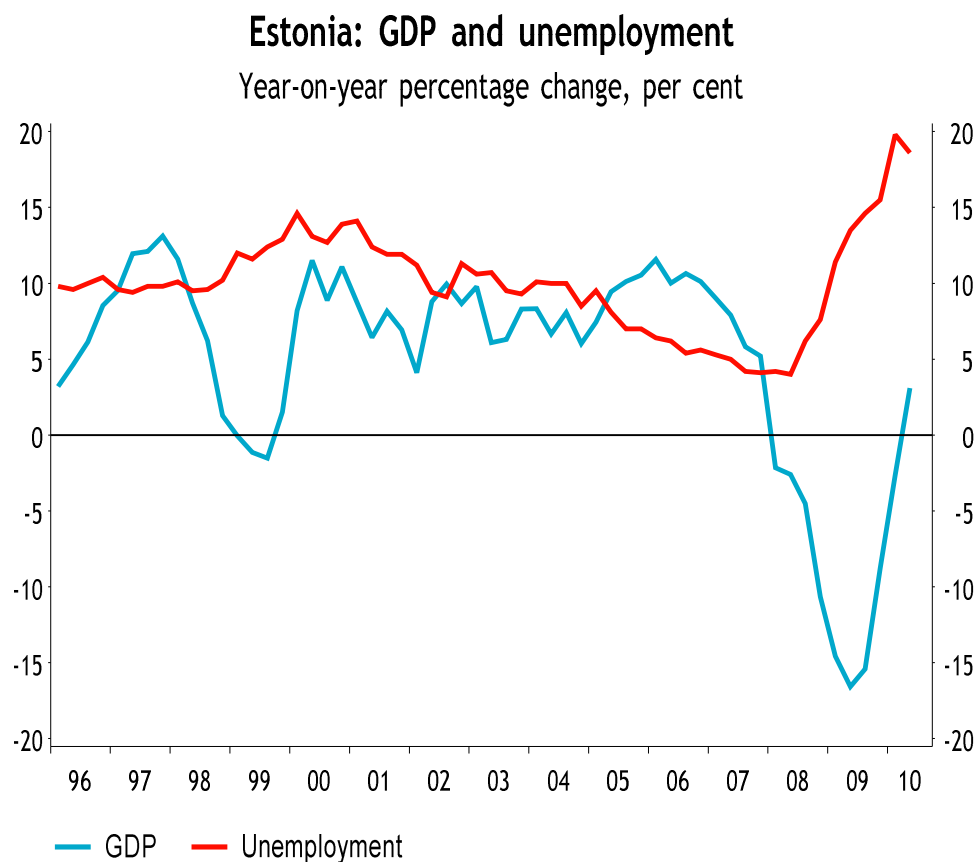
Inflation (HICP)

Year-on-year percentage change



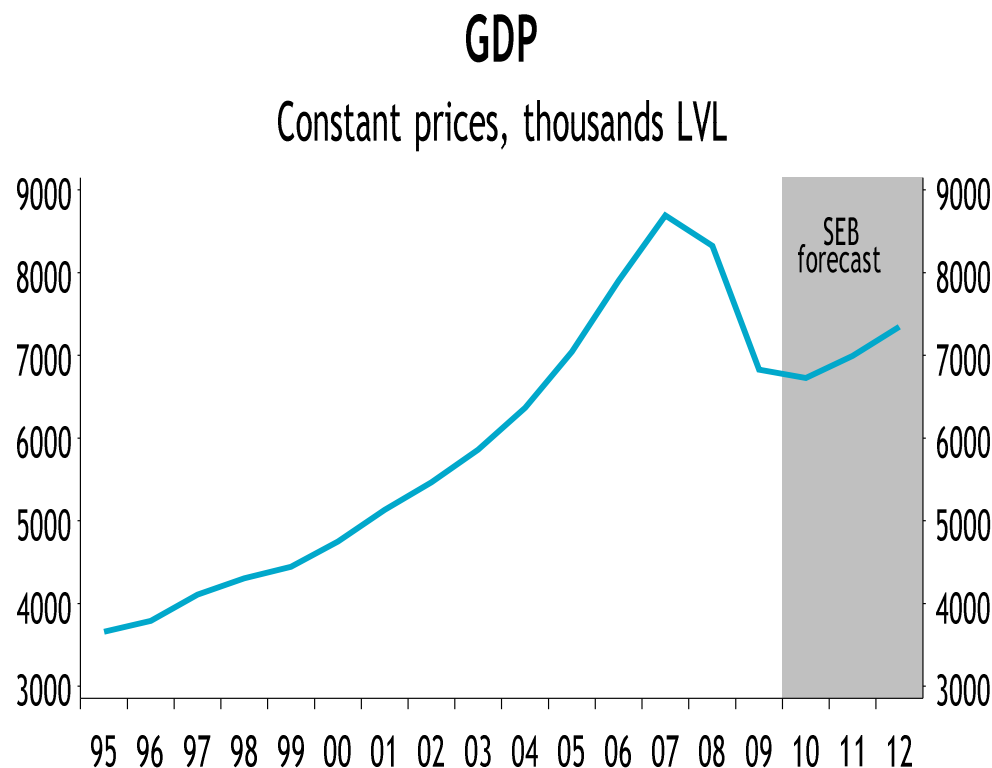
Source: Reuters EcoWin

Estonia: Imbalanced recovery



- Export- and inventory-driven recovery
- Export firms benefit from global upturn, more difficult for firms dependent on domestic demand
- Unemployment is down, but more sluggishly than expected
- Moderate inflation
- Budget under control. Tight fiscal policy will be eased
- EMU-membership January 1st 2011
- GDP +2.3% in 2010, +4% in 2011 and 2012

Latvia: On a shaky path to growth



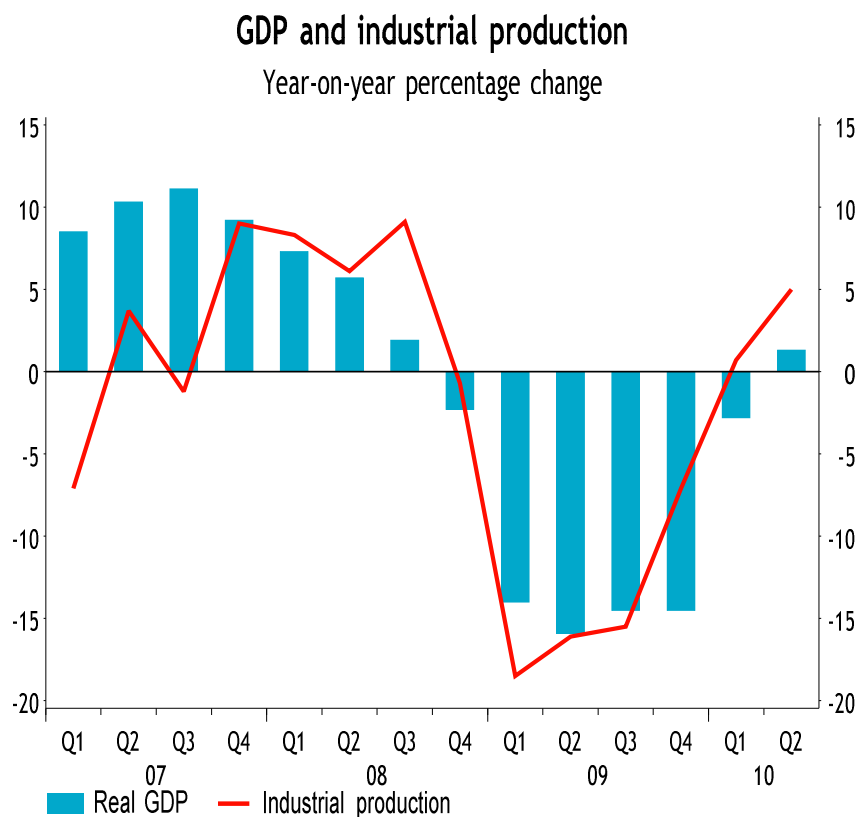
Source: Central Statistical Bureau, Latvia, SEB

- GDP down 23%, 2008-2010
- Growth is returning but long-term growth a challenge
- Unemployment declining sluggishly from its 21% peak
- Housing prices have stabilised (in all Baltic countries)
- Deflation ends later part of 2010
- Budget deficit 8% of GDP this year. Continued austerity in 2011
- GDP -1.5% in 2010, +4.0% in 2011, +5% in 2012

Latvia: Increased political stability

- Unexpected election outcome
- The ruling coalition (*Unity, Union of Green and Farmers and Everything for Latvia/For Fatherland and Freedom*) strengthens the position: now majority
- Budget consolidation and path towards euro adoption will now continue as planned

Lithuania: Growth is back but emigration is a challenge

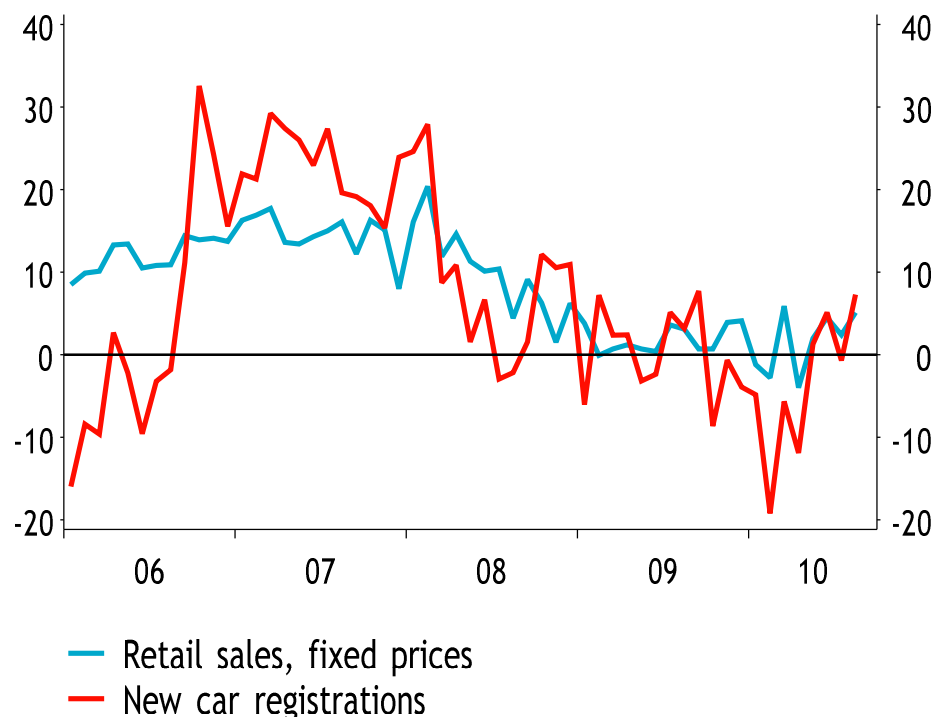


- Improvement in exports: nearby countries also providing support
- Domestic demand will slowly rise
- Labour market problems....
- ... and more acute emigration problems
- Moderate inflation
- Weak public sector finances but improvement in the budget deficit
- No further fiscal tightening in 2011
- GDP +1% 2010, +4% 2011, +4.5% 2012

Poland: Continued upturn despite fiscal austerity

Mild slump in retail sales during the crisis

Year-on-year percentage change



Source: Central Statistical Office Poland, ACEA

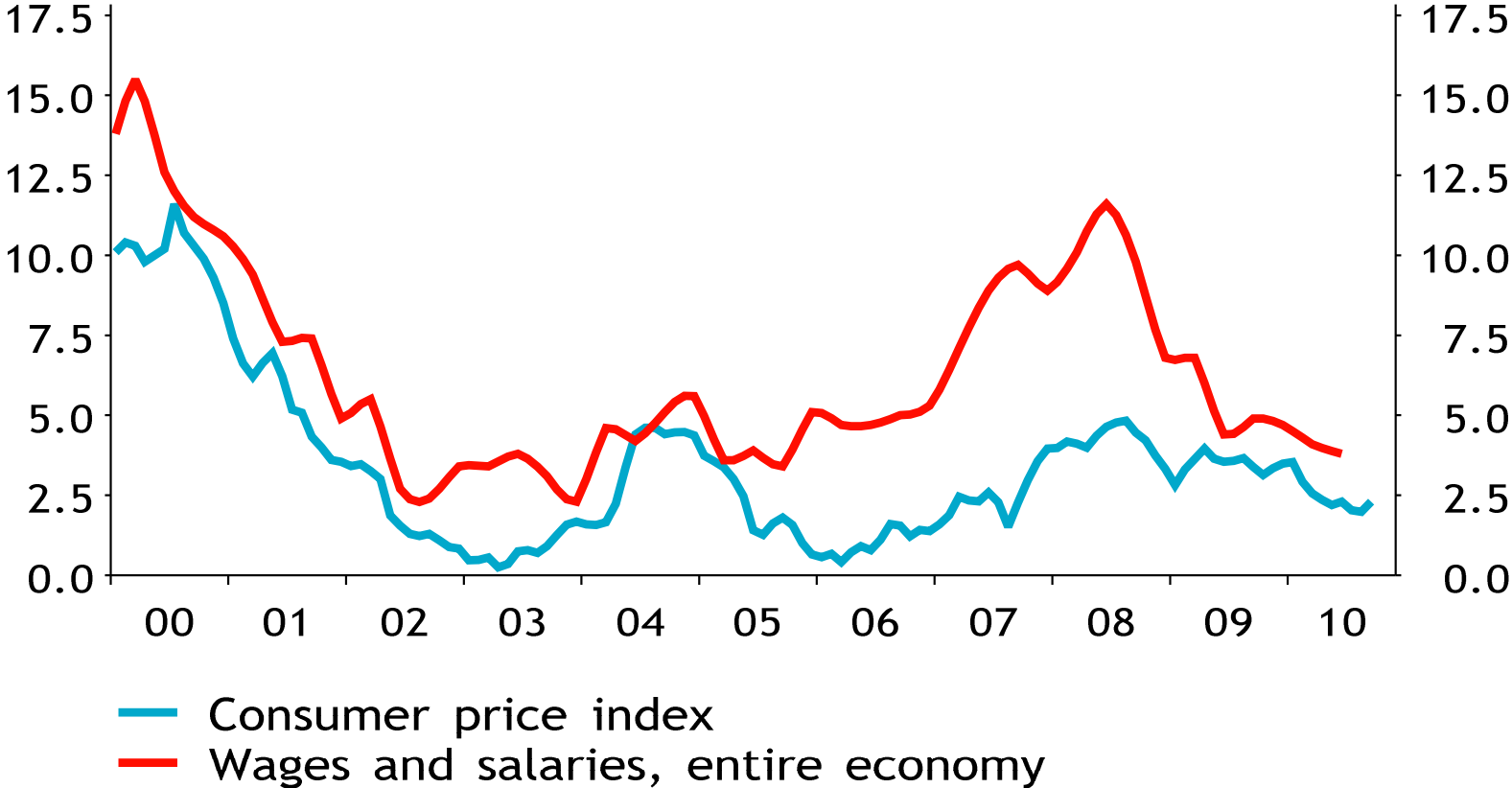
- The only EU country with positive GDP growth in 2009
- Moderate private debt, little foreign currency loan exposure, competitive exports
- Resilient households
- Substantial investment potential
- Increased public sector debt will require some fiscal tightening
- GDP +3.5% 2010, +4.0% 2011, +4.5% 2012

Poland: Calmer pay hikes and inflation



Wages and inflation

Year-on-year percentage change



Source: Central Statistical Office, Poland

Poland: Neutrally valued zloty will strengthen further **SEB**

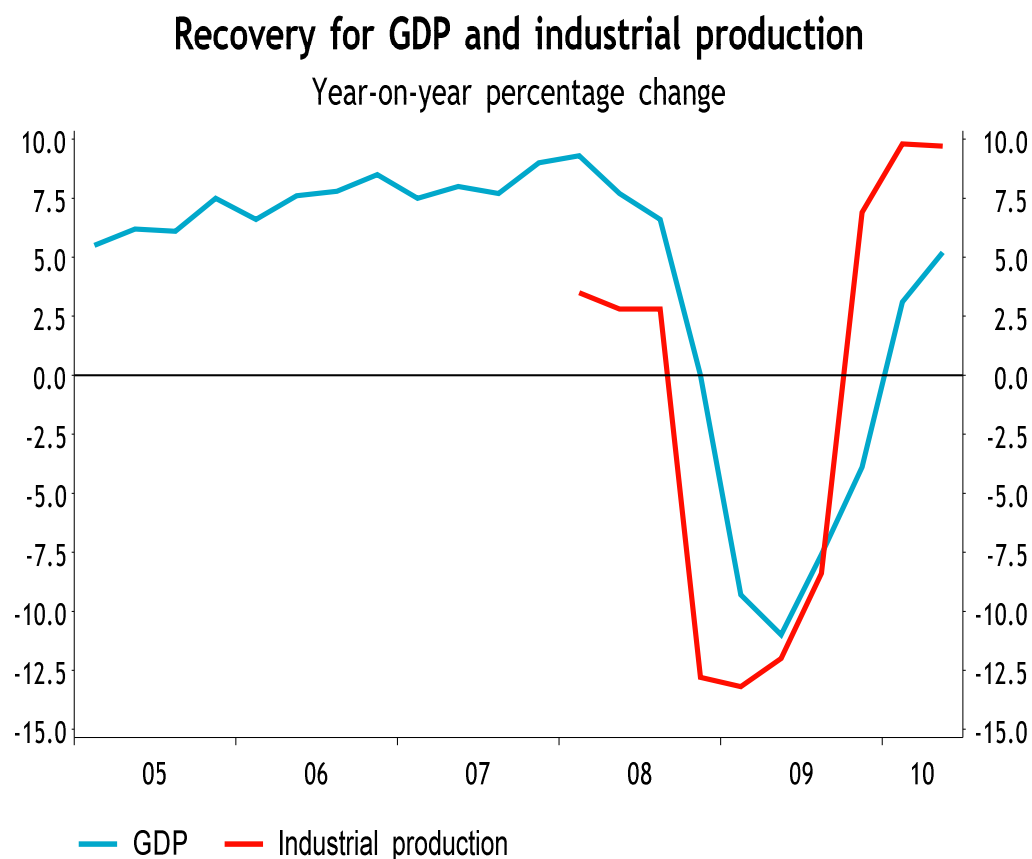
Zloty is appreciating

Index 100=2005 and EUR/PLN, monthly data



EUR/PLN (LHS)
Real effective exchange rate, compared to 58 countries (RHS)
Source: Reuters EcoWin, BIS

Russia: Domestic demand rising

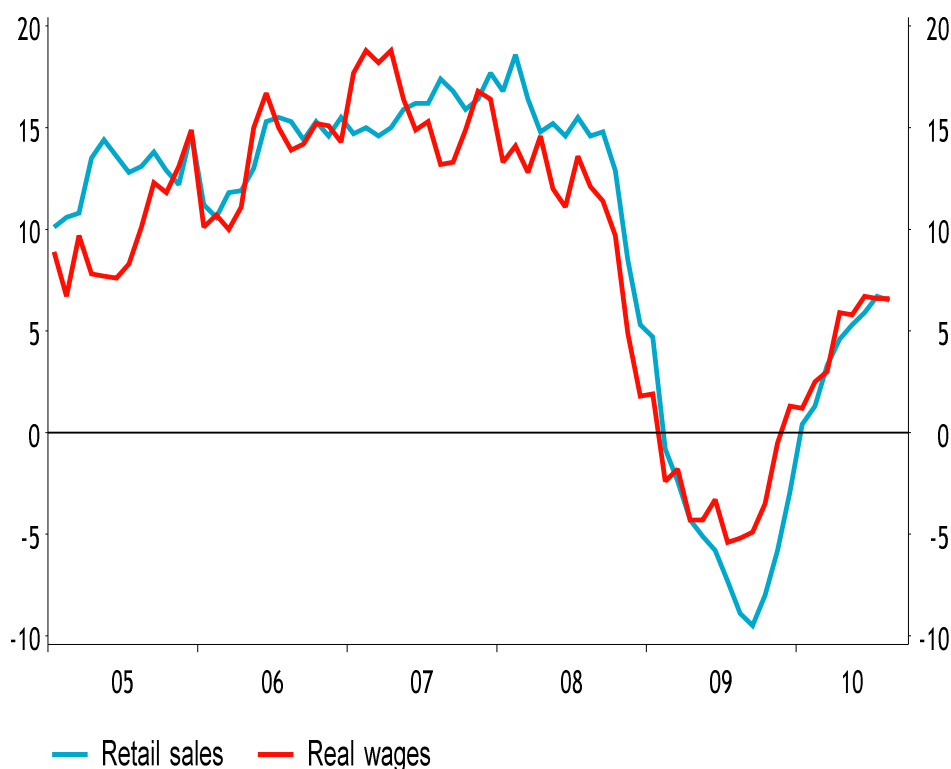


Source: Federal State Statistics Service

- Good first half 2010 recovery, based on higher commodity prices but also thanks to retail sales, industrial production and expansionary fiscal policy
- More sedate export growth and less expansionary fiscal policy, along with good domestic demand sums up to slower growth ahead
- Extreme weather had a major impact on agricultural output: but the total effect on GDP will be small and temporary
- GDP +4.6% in 2010, +4.5% in 2011, +4.8% in 2012

Russia: Brighter labour market and real wage growth

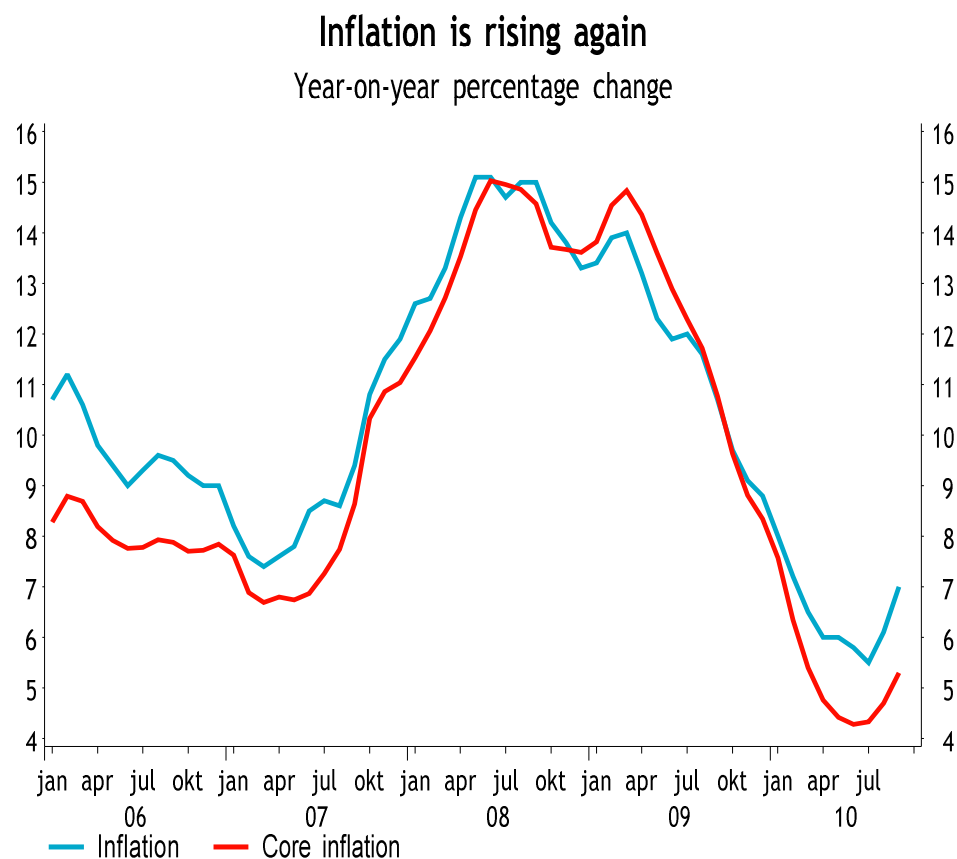
Real wages and retail sales are rising
Year-on-year percentage change



Source: Ministry for Economic Development of the Russian Federation

- The labour market has continued to improve: falling jobless rate and rising employment
- Real wages have climbed by about 6% year-on-year in recent months
- The labour market improvement will continue to invigorate retail sales
- Consumption is also being stimulated by low household debt but is being restrained by slow credit growth

Russia: Inflation at a record low but will gradually rebound



- Inflation was record-low in July (5.5%) but climbed in August and September, partly due to rising grain prices
- We expect the inflation rate to continue rising, but it will not reach pre-crisis levels
- There are signs that the central bank has begun preparing to introduce an inflation target and floating exchange rates
- The rouble has continued to strengthen during 2010, and its real exchange rate is now at about the same level as before the crisis

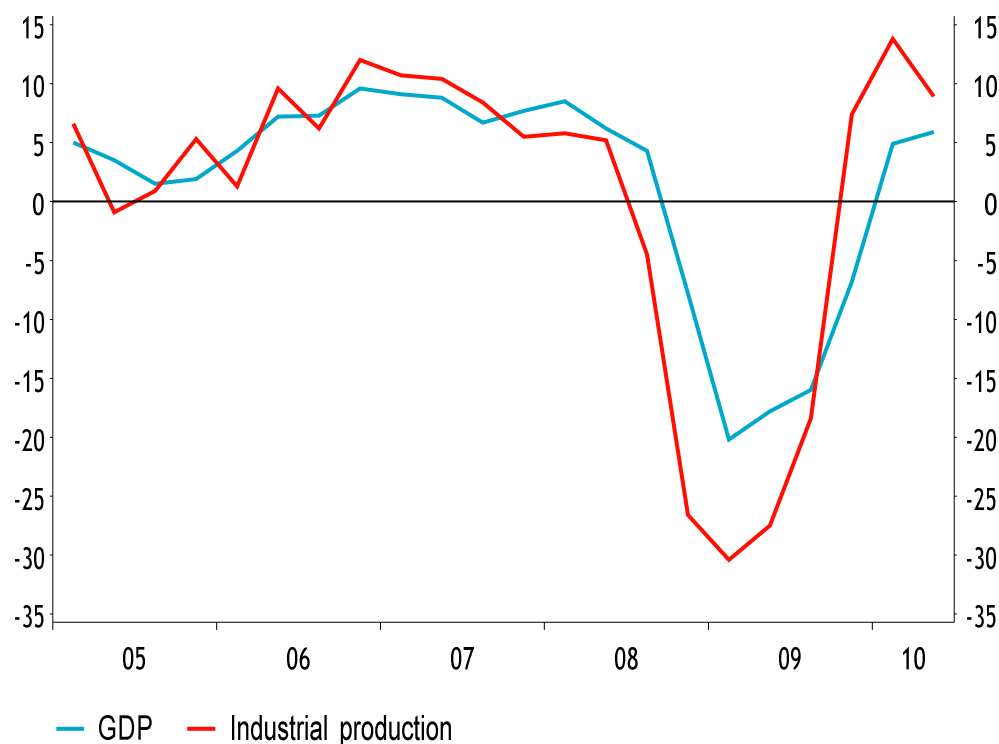
Russia: Stable domestic politics but weak reforms

- Strong support for Vladimir Putin/Dmitry Medvedev
- Improved relations with Poland and Ukraine
- Low short-term risk of instability
- Very large reform needs, but a weak desire for reform
- As long as reforms are delayed, Russia will have to be content with an economic growth rate below its potential



Ukraine: IMF stand-by loan is providing stability but also restraining growth

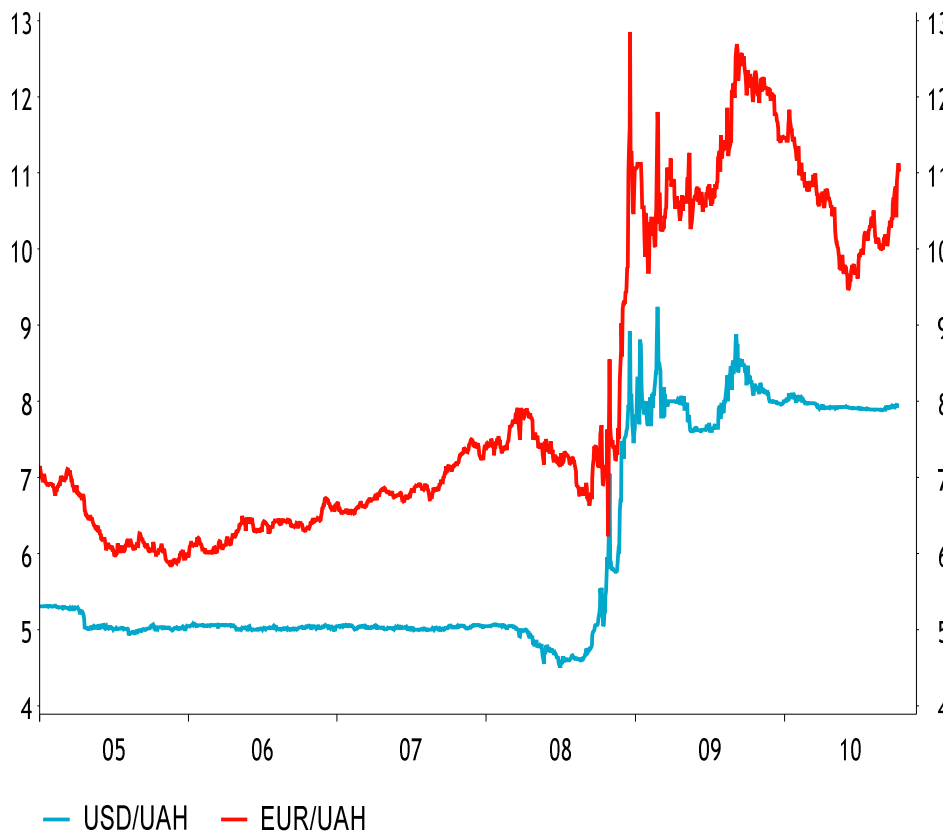
Industrial production driving GDP
Year-on-year percentage change



- GDP fell by 15% in 2009, among the most dramatic such declines in the world
- The rapid first half 2010 recovery will slow down
- The deceleration in global recovery will affect the steel sector
- IMF stand-by loan, with accompanying budget tightening and reform requirements
- Ukraine's historically low inflation will rebound
- GDP +5.2% in 2010, +4.4% in 2011, +4.2% in 2012

Ukraine: The hryvnia has stabilised

The hryvnia has stabilised

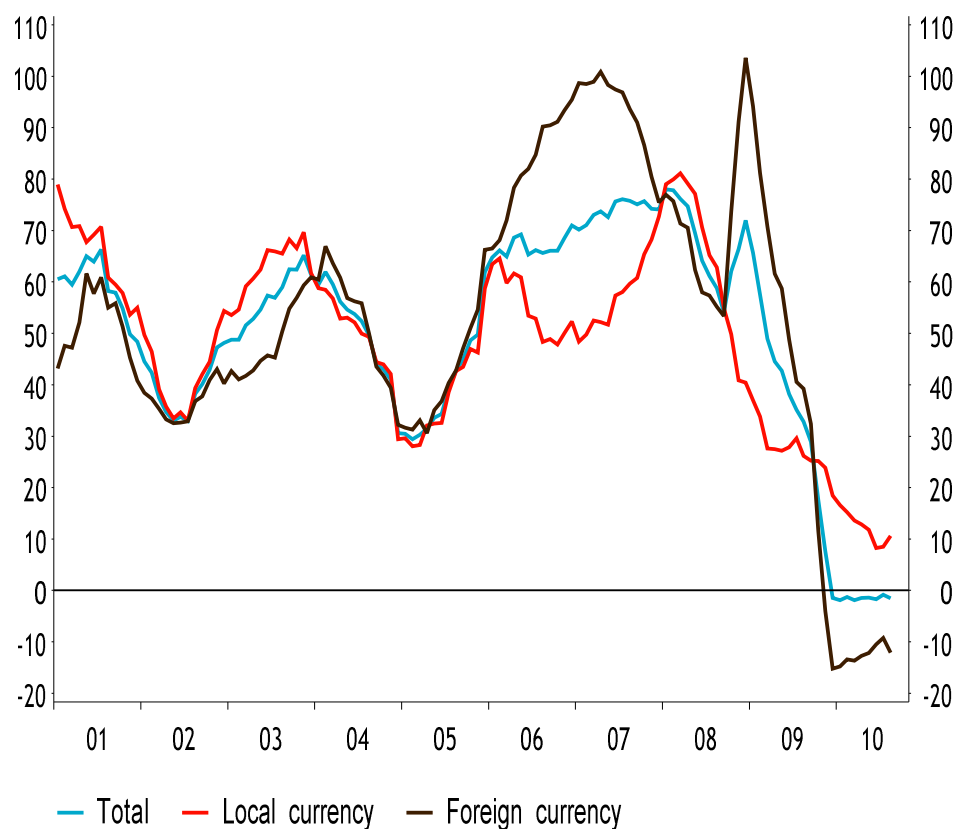


Source: Reuters EcoWin

- The hryvnia has been trading at around UAH 8 per USD and somewhat above UAH 10 per EUR
- The central bank has intervened to defend the currency...
- ...but the IMF wants a more flexible currency policy
- Exports have recovered and are expected to grow at a moderate pace
- The trade deficit will increase
- No more key interest rate cuts during 2010

Ukraine: Banking sector is still fragile but IMF loan is providing support

Credit expansion is stabilising
Year-on-year percentage change



- Stress tests show a continued need for capital injections at many banks
- The IMF is requiring recapitalisation and stricter banking sector oversight
- Low lending volume has hampered corporate capital spending and household demand
- But recently there are signs of stabilisation in bank lending

Source: National Bank of Ukraine

Ukraine: More stable domestic politics



- President Viktor Yanukovich has established a parliamentary majority coalition
- Improved relations with Russia and a desire to move closer to the EU
- Yanukovich has unveiled a reform package. Implementation?
- Local elections in October 31, Presidential election in September 2012
- The opposition, headed by Yulia Tymoshenko, is divided

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