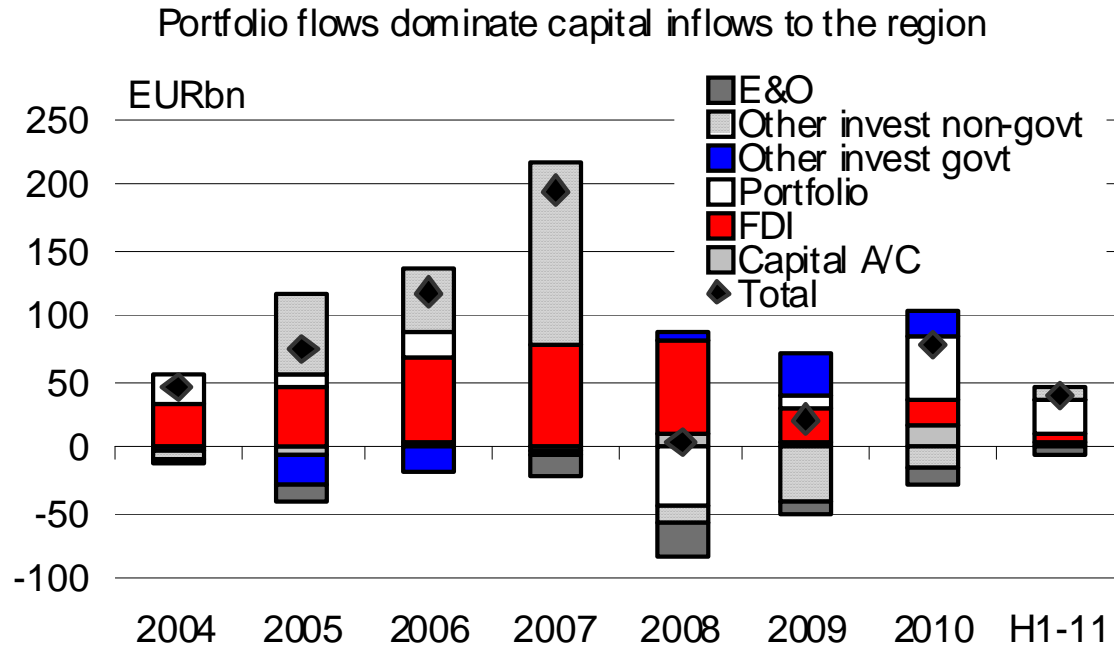

CEE: The virtuous and vicious of capital flows

Gillian Edgeworth, Chief EEMEA economist

The changing composition of capital flows

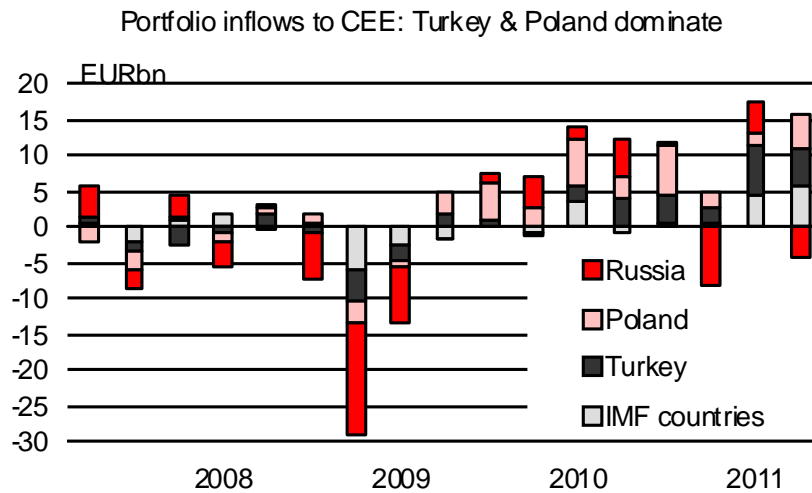
Since the 2008 crisis there has been a shift in the composition of capital flows from long term to short term in nature. Over the 6 quarters to Q2-11, the region saw capital inflows of EUR116bn, EUR72.3bn of which were portfolio flows, primarily to fixed income markets. Longer term forms of investment such as FDI and long term bank borrowing have shown a very limited recovery.



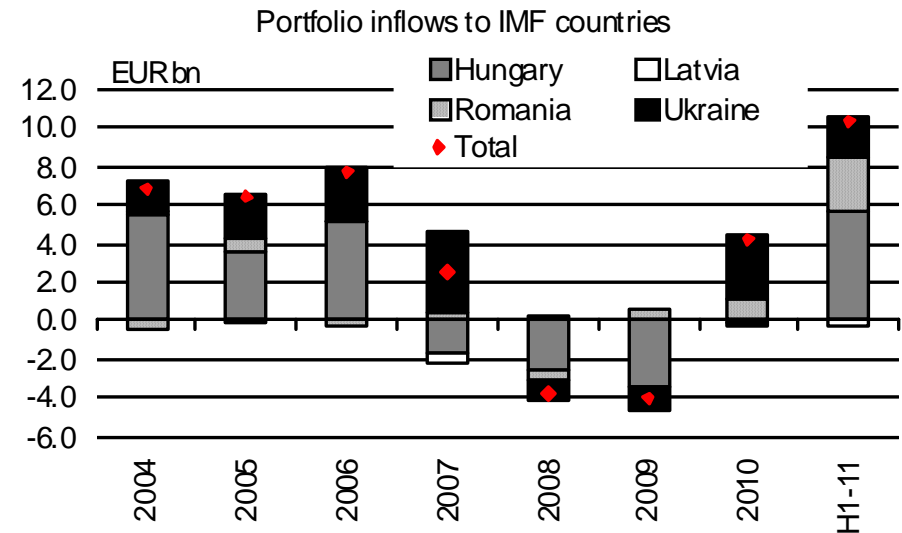
Source: National central banks, UniCredit Research

Decreasing differentiation across countries

Turkey and Poland account for the majority of portfolio inflows since the 2008 crisis. Over the 8 quarters to Q2-11 portfolio inflows to Poland and Turkey amounted to EUR33.4bn and EUR25.1bn respectively. However over the course of recent quarters 'weaker' economies in the region have also benefitted, in particular Hungary, Romania and Ukraine.

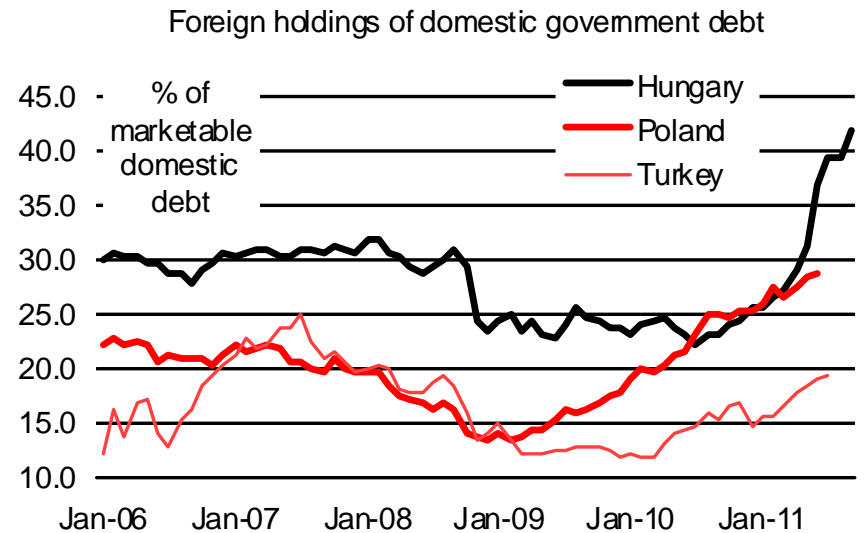
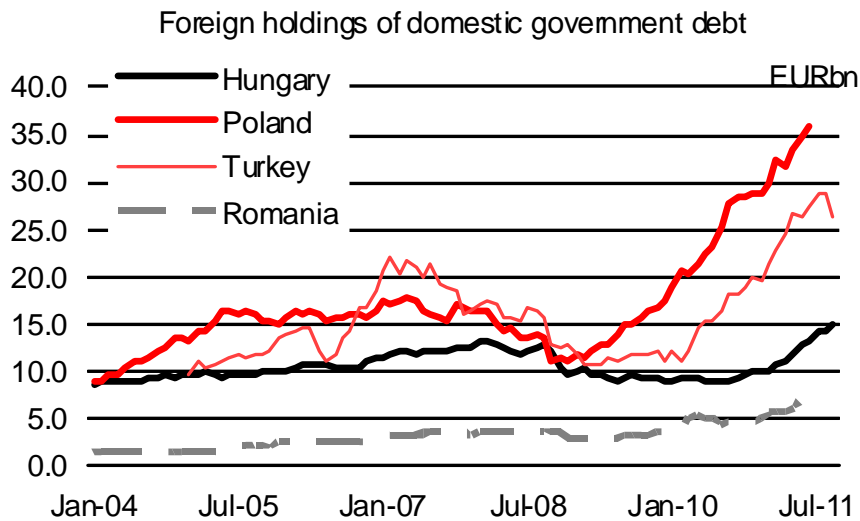


IMF countries refer to the aggregate of inflows to Hungary, Latvia, Romania and Ukraine.



Governments appreciate financing

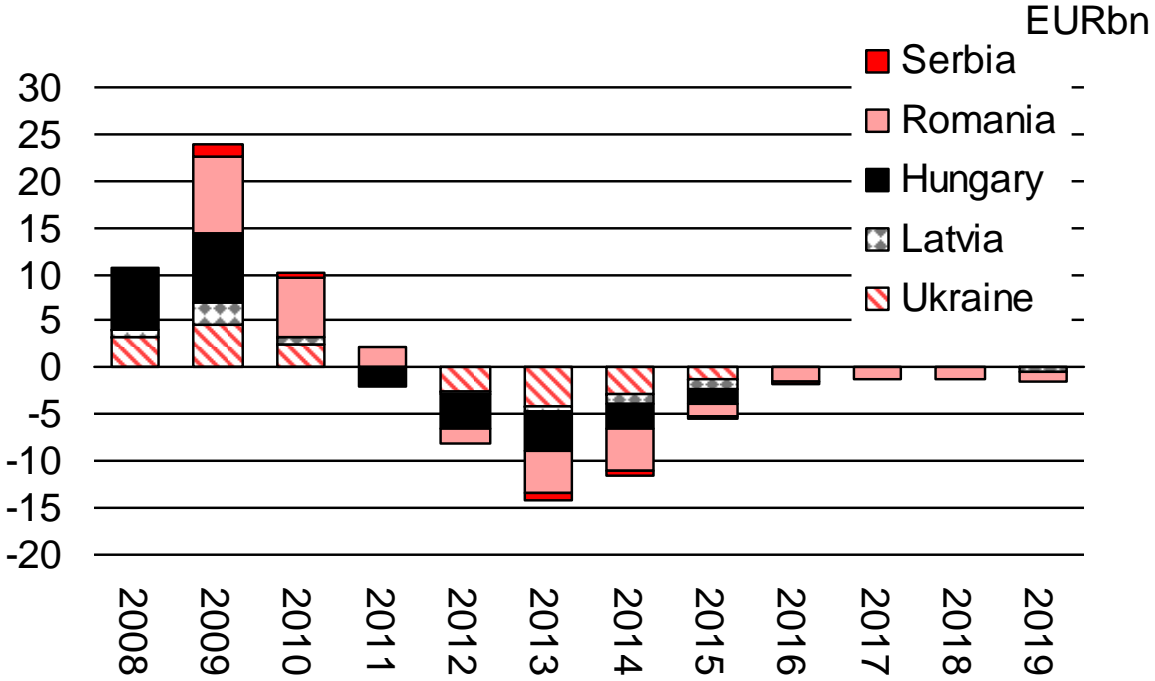
A significant chunk of portfolio flows have found their way to domestic fixed income markets, helping to finance governments and prevent crowding out of the private sector. Foreign holdings as a % of the market stand at record highs in Poland and Hungary.



Source: National central banks, UniCredit Research

IMF support coming to an end

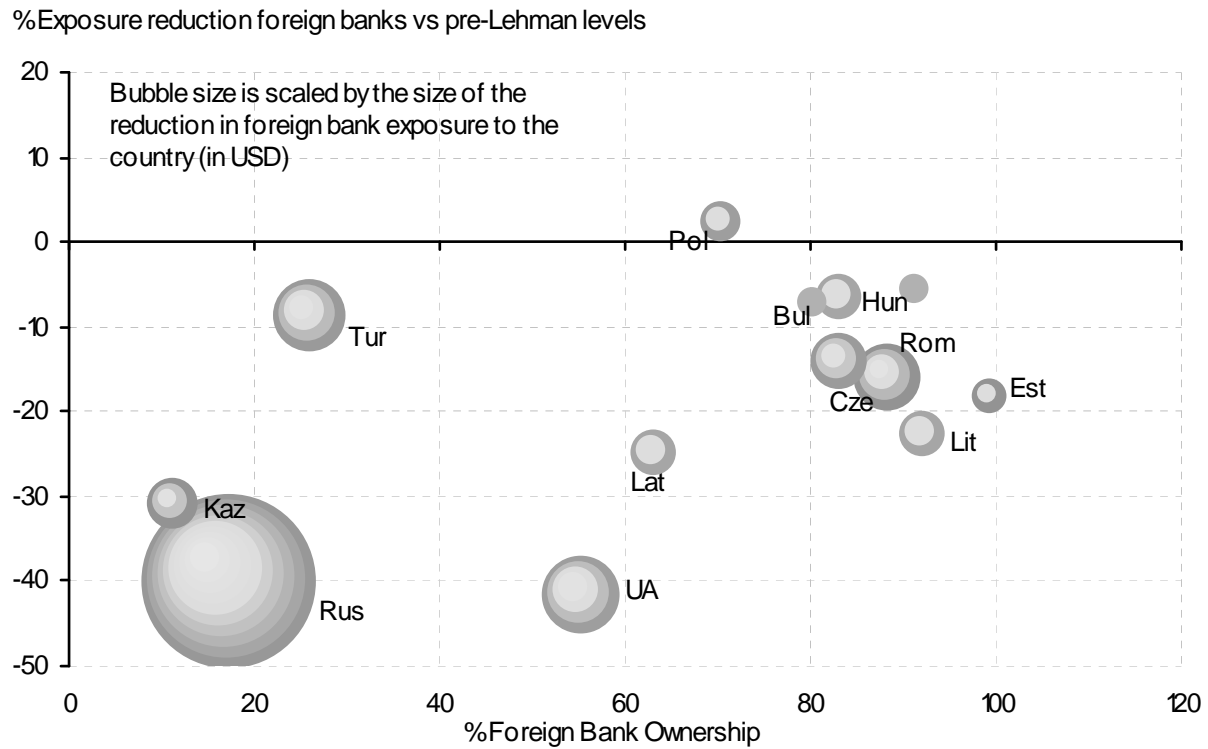
The IMF played a crucial role in the region over 2008/09. The majority of funding at this stage has now been disbursed, with repayments for some countries to begin by the end of this year.



Source: IMF, European Commission, UniCredit Research

Foreign banks differentiate across countries

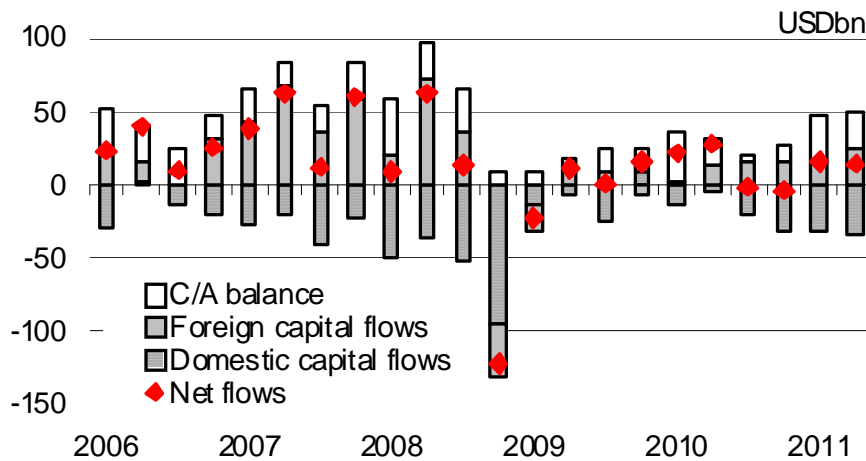
Foreign banks have reduced exposure to some countries much more than others.



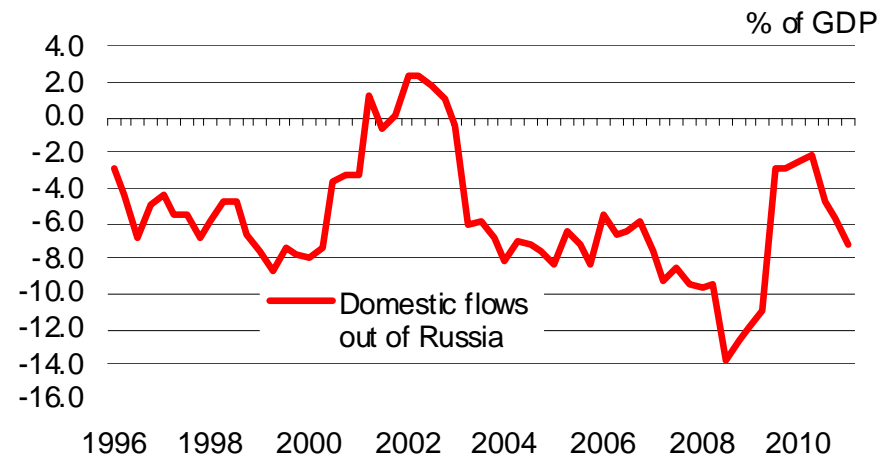
Russia is the exception to the rule

Russia is one of the few emerging markets globally not to see a significant recovery in global capital flows while domestic capital outflows have accelerated.

Any recovery in foreign inflows is being neutralised by domestic outflows

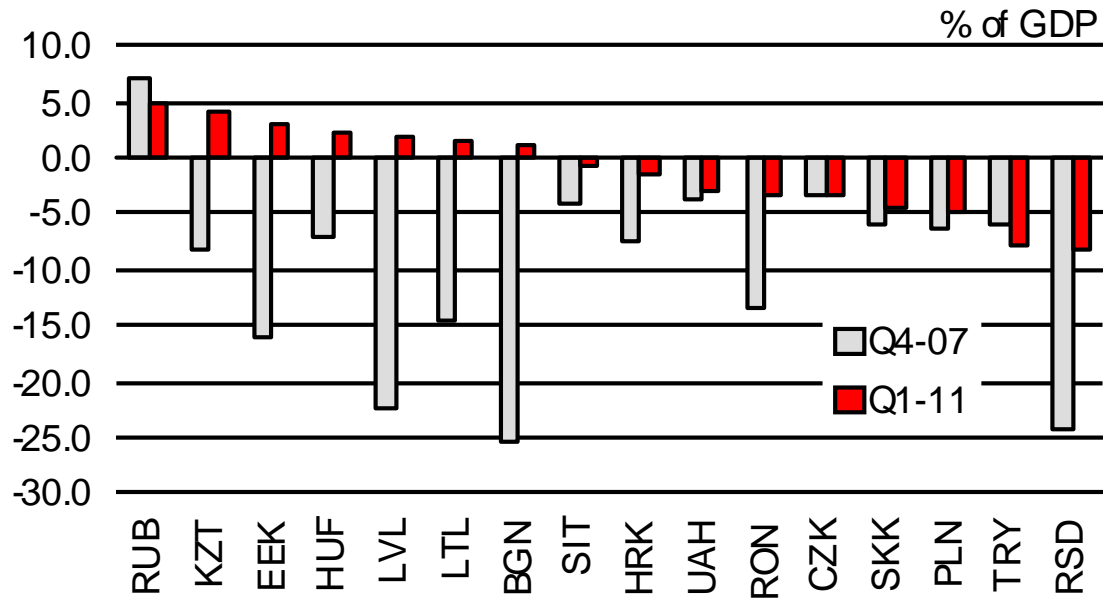


Locals continue to lack trust



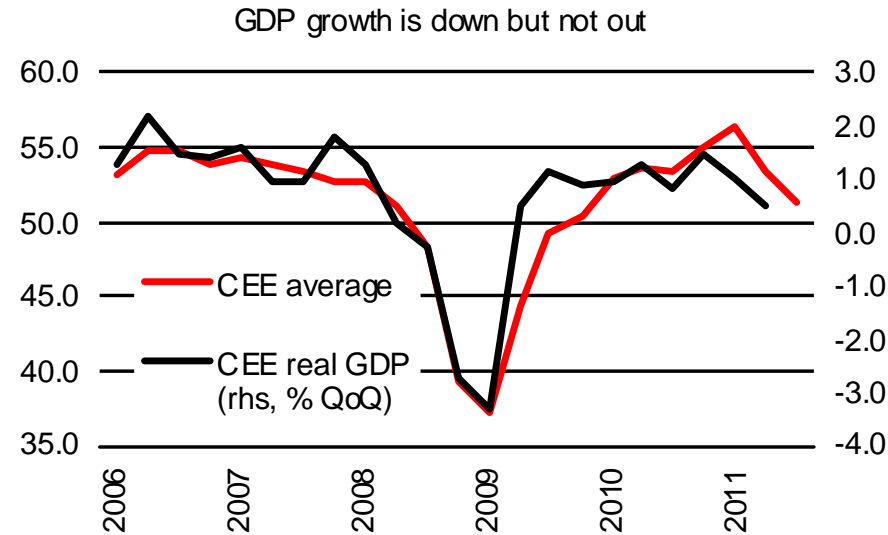
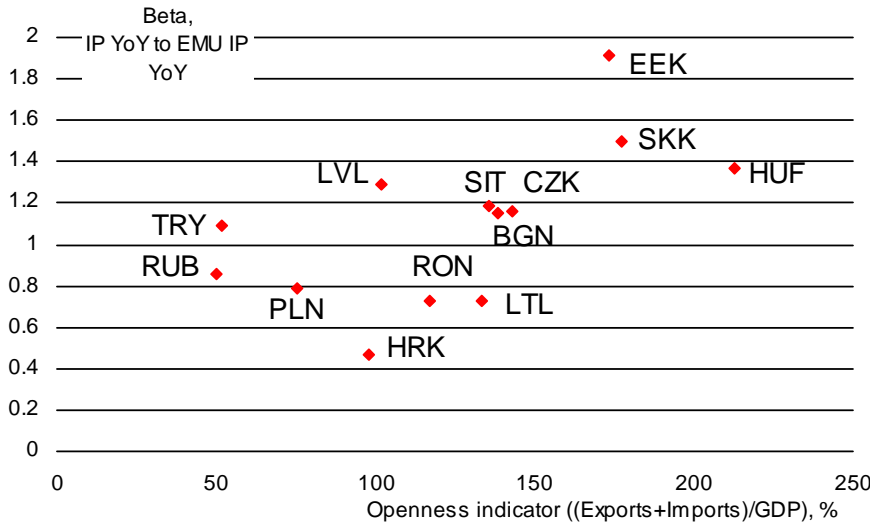
Current account balances in most cases have adjusted

Most countries in the region have seen C/A deficits adjust significantly, limiting adjustment pressures this time around.



CEE is holding its own in terms of growth

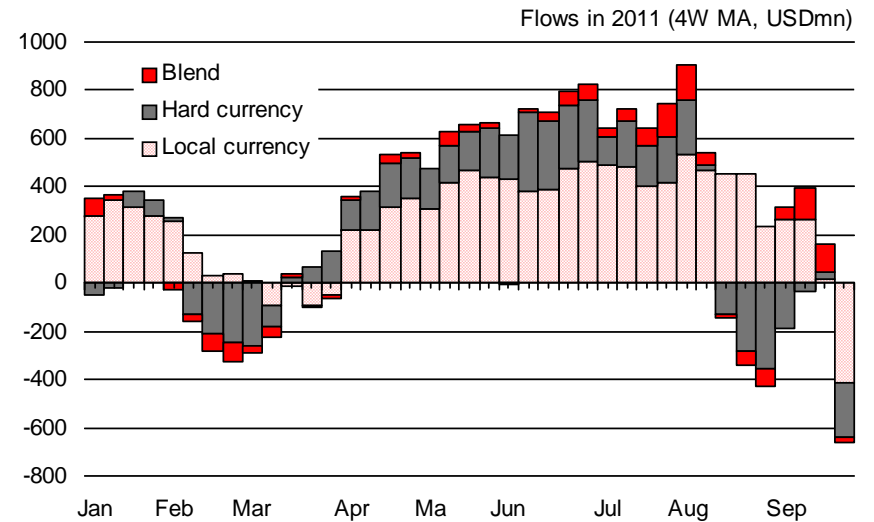
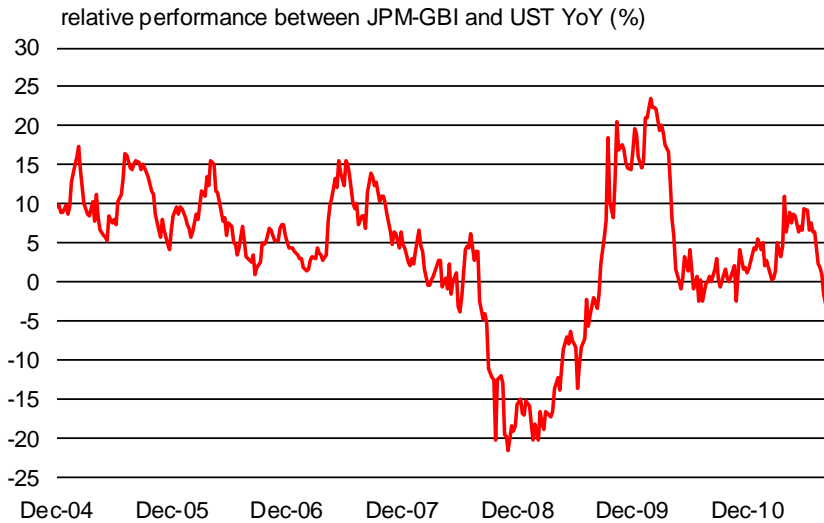
Despite EMU woes, the region is holding its own in terms of economic activity. GDP growth has softened significantly but remains positive while latest indicators for Q3 (including September) point to slowing growth but not recession.



Source: National central banks, UniCredit Research

Capital outflow represents the primary risk

Last week saw the largest outflow on record from emerging market funds, providing clear evidence that EM is no longer a safe haven but is clearly being impacted by weakening global risk appetite.

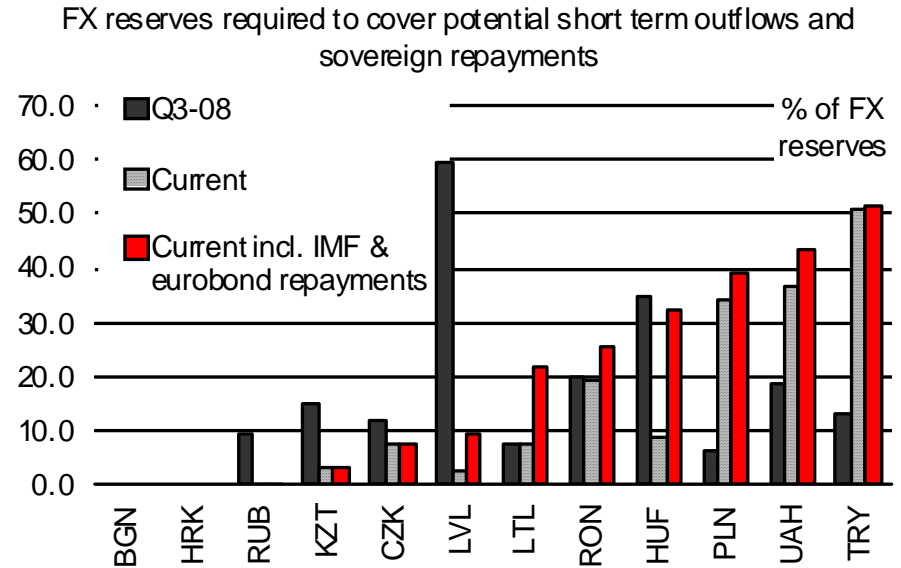


Source: Bloomberg, EPFR, UniCredit Research

CEE: Currency mgt will play more of a role from here

An examination of central bank ability to defend their currencies/smooth capital outflows relative to 2008 re-inforces the need for such insurance.

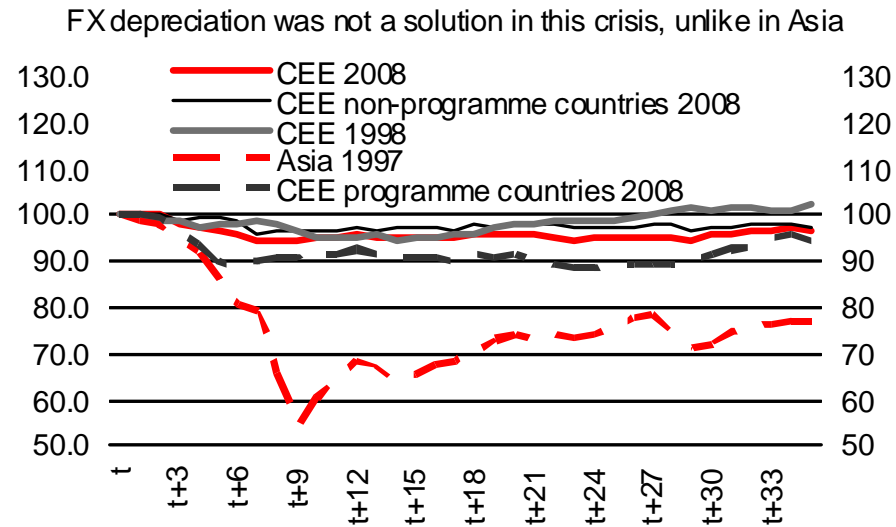
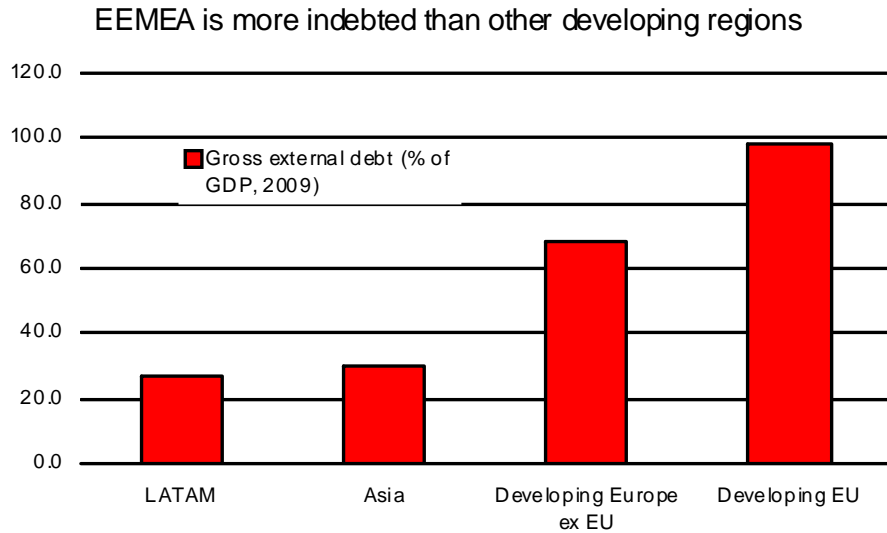
1. We sum portfolio inflows and short term external borrowing (banks, non-bank corporates and governments) between Q1-07 and Q3-08.
2. We then calculate the percentage of these inflows that reversed between Q4-08 and Q2-09, as well as external sovereign debt coming due, all as a % of FX reserves.
3. We repeat step no. 1 for the period Q1-10 to Q2-11 (though for a number of countries Q2 BoP data is still not available). From step 2 we apply the same ratio of outflows to inflows as over Q4-08 – Q2-09. In the event that outflows exceeded 100% of inflows after the 2008 crisis, i.e. all short term borrowing portfolio flows not only fall back to end-06 levels but even further, we capped the outflows at 100%. This is to capture the fact that there has been a more limited time period this time around for accumulate inflows. Finally we add sovereign external debt and IMF repayments coming due until year-end.



Source: National central banks, UniCredit Research

CEE: More work to be done

Against a backdrop where the region remains significantly more indebted than other developing regions and FX has not helped in restoring competitiveness, macro performance will be determined to a large extent by government and central bank policy.



Source: IMF World Bank, BIS, National central banks, UniCredit Research

Disclaimer

This publication is presented to you by:
UniCredit Corporate & Investment Banking
UniCredit Bank AG, Milan Branch
Via Tommaso Grossi, 10 – 20121 Milan – Italy

The information in this publication is based on carefully selected sources believed to be reliable. However we do not make any representation as to its accuracy or completeness. Any opinions herein reflect our judgement at the date hereof and are subject to change without notice. Any investments presented in this report may be unsuitable for the investor depending on his or her specific investment objectives and financial position. Any reports provided herein are provided for general information purposes only and cannot substitute the obtaining of independent financial advice. Private investors should obtain the advice of their banker/broker about any investments concerned prior to making them. Nothing in this publication is intended to create contractual obligations. UniCredit Corporate & Investment Banking consists of Bank Name, UniCredit Bank AG, Munich, UniCredit Bank Austria AG, Vienna, UniCredit CAIB Securities UK Ltd. London, UniCredit S.p.A., Rome and other members of the UniCredit Group. UniCredit Bank AG is regulated by the German Financial Supervisory Authority (BaFin), UniCredit Bank Austria AG is regulated by the Austrian Financial Market Authority (FMA), UniCredit CAIB Securities UK Ltd. is regulated by the Financial Services Authority (FSA), UniCredit Bank AG, Milan Branch, and UniCredit S.p.A. are regulated by both the Banca d'Italia and the Commissione Nazionale per le Società e la Borsa (CONSOB).

Note to UK Residents:

In the United Kingdom, this publication is being communicated on a confidential basis only to clients of UniCredit Corporate & Investment Banking Division (acting through UniCredit Bank AG, London Branch ("HVB London") and/or UniCredit CAIB Securities UK Ltd. who (i) have professional experience in matters relating to investments being investment professionals as defined in Article 19(5) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 ("FPO"); and/or (ii) are falling within Article 49(2) (a) – (d) ("high net worth companies, unincorporated associations etc.") of the FPO (or, to the extent that this publication relates to an unregulated collective scheme, to professional investors as defined in Article 14(5) of the Financial Services and Markets Act 2000 (Promotion of Collective Investment Schemes) (Exemptions) Order 2001 and/or (iii) to whom it may be lawful to communicate it, other than private investors (all such persons being referred to as "Relevant Persons"). This publication is only directed at Relevant Persons and any investment or investment activity to which this publication relates is only available to Relevant Persons or will be engaged in only with Relevant Persons. Solicitations resulting from this publication will only be responded to if the person concerned is a Relevant Person. Other persons should not rely or act upon this publication or any of its contents.

The information provided herein (including any report set out herein) does not constitute a solicitation to buy or an offer to sell any securities. The information in this publication is based on carefully selected sources believed to be reliable but we do not make any representation as to its accuracy or completeness. Any opinions herein reflect our judgement at the date hereof and are subject to change without notice. 9

We and/or any other entity of UniCredit Corporate & Investment Banking may from time to time with respect to securities mentioned in this publication (i) take a long or short position and buy or sell such securities; (ii) act as investment bankers and/or commercial bankers for issuers of such securities; (iii) be represented on the board of any issuers of such securities; (iv) engage in "market making" of such securities; (v) have a consulting relationship with any issuer. Any investments discussed or recommended in any report provided herein may be unsuitable for investors depending on their specific investment objectives and financial position. Any information provided herein is provided for general information purposes only and cannot substitute the obtaining of independent financial advice.

HVB London is regulated by the Financial Services Authority for the conduct of business in the UK as well as by BaFin, Germany. UniCredit CAIB Securities UK Ltd., London, a subsidiary of UniCredit Bank Austria AG, is authorised and regulated by the Financial Services Authority.

Notwithstanding the above, if this publication relates to securities subject to the Prospectus Directive (2005) it is sent to you on the basis that you are a Qualified Investor for the purposes of the directive or any relevant implementing legislation of a European Economic Area ("EEA") Member State which has implemented the Prospectus Directive and it must not be given to any person who is not a Qualified Investor. By being in receipt of this publication you undertake that you will only offer or sell the securities described in this publication in circumstances which do not require the production of a prospectus under Article 3 of the Prospectus Directive or any relevant implementing legislation of an EEA Member State which has implemented the Prospectus Directive.

Note to US Residents:

The information provided herein or contained in any report provided herein is intended solely for institutional clients of UniCredit Corporate & Investment Banking acting through UniCredit Bank AG, New York Branch and UniCredit Capital Markets, Inc. (together "HVB") in the United States, and may not be used or relied upon by any other person for any purpose. It does not constitute a solicitation to buy or an offer to sell any securities under the Securities Act of 1933, as amended, or under any other US federal or state securities laws, rules or regulations. Investments in securities discussed herein may be unsuitable for investors, depending on their specific investment objectives, risk tolerance and financial position.

In jurisdictions where HVB is not registered or licensed to trade in securities, commodities or other financial products, any transaction may be effected only in accordance with applicable laws and legislation, which may vary from jurisdiction to jurisdiction and may require that a transaction be made in accordance with applicable exemptions from registration or licensing requirements.

All information contained herein is based on carefully selected sources believed to be reliable, but HVB makes no representations as to its accuracy or completeness. Any opinions contained herein reflect HVB's judgement as of the original date of publication, without regard to the date on which you may receive such information, and are subject to change without notice.

HVB may have issued other reports that are inconsistent with, and reach different conclusions from, the information presented in any report provided herein. Those reports reflect the different assumptions, views and analytical methods of the analysts who prepared them. Past performance should not be taken as an indication or guarantee of further performance, and no representation or warranty, express or implied, is made regarding future performance.

HVB and/or any other entity of UniCredit Corporate & Investment Banking may from time to time, with respect to any securities discussed herein: (i) take a long or short position and buy or sell such securities; (ii) act as investment and/or commercial bankers for issuers of such securities; (iii) be represented on the board of such issuers; (iv) engage in "market-making" of such securities; and (v) act as a paid consultant or adviser to any issuer.

The information contained in any report provided herein may include forward-looking statements within the meaning of US federal securities laws that are subject to risks and uncertainties. Factors that could cause a company's actual results and financial condition to differ from its expectations include, without limitation: Political uncertainty, changes in economic conditions that adversely affect the level of demand for the company's products or services, changes in foreign exchange markets, changes in international and domestic financial markets, competitive environments and other factors relating to the foregoing. All forward-looking statements contained in this report are qualified in their entirety by this cautionary statement.

UniCredit Corporate & Investment Banking
as of 14 November 2011