Czech Republic Country Report

July 2014

Back to convergence

- Recession overcome, balanced growth ahead
- Inflation to slowly pick-up
- FX intervention regime to stay until H2 2015
- Stock market dominated by financial equities

Raiffeisen RESEARCH

Explanation:

e ... estimate
f ... forecast
p ... preliminary figures

Abbreviations

Currencies and Countries

ALL	Albanian lek
BAM	Bosnian marka
BGN	Bulgarian lev
BYR	Belarusian roubel
CZK	Czech koruna
EKK	Estonian kroon
HUF	Hungarian forint
HRK	Croatian kuna
LTL	Lithuanian litas
LVL	Latvian lats
PLN	Polish zloty
RON	Romanian leu
RSD	Serbian dinar
RUB	Russian rouble
SIT	Slovenian tolar
SKK	Slovak koruna
TRY	Turkish lira
UAH	Ukrainian hryvnia

Economic abbreviations

%-chg	Percentage change (not in percentage points)
avg	average
bp	basis points
C/A	Current Account
CPI	Consumer Price Index
FDI	Foreign Direct Investments
FX	Foreign Exchange
FY	Full year
GDP	Gross Domestic Product
LCY	Local Currency
mmav	month moving average
mom	month on month
pp	percentage points
PPI	Producer Price Index
qoq	quarter on quarter
T/B	Trade Balance
ULC	Unit Labour Costs
yoy	year on year
ytd	year-to-date

Stock Exchange Indices

BELEX15	Serbian stock index
BET	Romanian stock index
BUX	Hungarian stock index
CROBEX10	Croatian stock index
PX	Czech stock index
MICEX	Russian stock index
SASX-10	Bosnian stock index
WIG 20	Polish stock index

Equity related

DY	Dividend yield
EG	Earnings growth
LTG	Long term (earnings) growth
P/E	Price earnings ratio
RS	Recommendation suspended
UR	Under Revision
Euro area	*Austria, Belgium, Cyprus, Estonia, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Malta, Netherlands, Portugal, Slovenia, Slovakia, Spain*
CE	*Central European countries - Poland, Hungary, Czech Republic, Slovakia, Slovenia*
SEE	*South East European countries - Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Romania, Serbia*
CIS	*European CIS (Commonwealth of Independent States) countries - Russia, Ukraine, Belarus*
CEE	*Central and Eastern Europe (CE + SEE + CIS)*

Please note the risk notifications and explanations at the end of this document

Highlights – Back to convergence

Up until Q1 2013 the Czech economy was caught up in a prolonged recession. A restrictive fiscal policy stance, as well as sluggish external demand, contributed to this development. As the economic situation in the euro area improved, however, the small and open Czech economy regained strength, driven by both external and internal demand. Nowadays internal demand also profits from a more supportive fiscal policy stance. Most recent GDP data indicate a return towards decent and balanced growth. Going forward the Czech economy is projected to outgrow the euro area by one percentage point annually, underlining the remaining convergence potential of the Czech economy. The solid growth outlook is supported by an overall low degree of leverage in the public and private sector (i.e. there is no debt overhang compared to some euro area economies). But the growth rates seen before the crisis with an average outperformance of the euro area by some 3 percentage points will remain a thing of the past.
At the same time the political situation, often a source of ambiguity in the past, seems to have stabilised somewhat with the current government. But this political stability comes more from a lack of alternatives within the political spectrum. Nevertheless, similar to the past where markets have only shown limited reaction to politics, currently other topics are at the centre of interest. One of these main topics not only in the Czech Republic, but throughout the CE region, is the absence of inflationary pressure. Faced with sluggish growth and the threat of a deflationary scenario, the Czech Central Bank (CNB) opted for a use of unconventional monetary policy tools in November 2013: the implementation of an FX intervention level. Interest rates, the standard conventional monetary policy tool, had already been lowered towards technical zero (0.05%) before and therefore the next available monetary policy tool was the exchange rate. Ever since this step was taken, market participants have been speculating on the duration of this policy. The CPI path in the coming months (where we are looking for an uptrend as we expect CPI inflation at 1.7% yoy by the end of 2014) will be a key parameter (CNB's inflation goal remains at 2%), but the exit is likely to remain a conundrum.

All in all, we see the Czech economy on a sustainable convergence towards the euro area, albeit at a slower pace than before the financial crisis. That said an exit from unconventional monetary policy measures seems likely over the next 12 months or so (i.e. in H2 2015), while a tightening of the domestic interest rate environment is likely to follow afterwards, but most likely not in 2015.

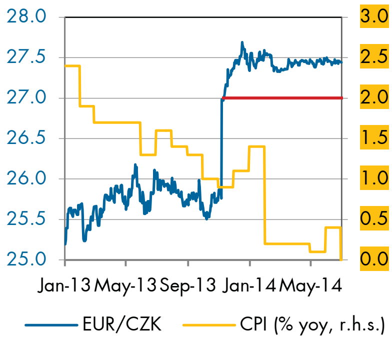
Financial analyst: Wolfgang Ernst (+431 71707 2500), RBI Vienna

Key economic figures: Czech Republic

	2009	2010	2011	2012	2013	2014e	2015f
Nominal GDP (EUR bn)	142.4	150.0	155.6	153.1	149.5	147.3	154.0
Real GDP (% yoy)	-4.4	2.3	1.8	-0.9	-0.9	2.6	2.4
Industrial output (% yoy)	-13.4	10.1	6.9	-1.2	0.5	6.0	3.9
Unemployment rate (avg, %)	6.2	7.0	6.7	6.8	7.7	7.5	7.4
Nominal industrial wages (% yoy)	3.5	3.8	3.4	3.4	0.9	2.1	3.5
Producer prices (avg, % yoy)	-3.1	1.2	5.6	2.1	0.8	-0.1	1.7
Consumer prices (avg, % yoy)	1.0	1.5	1.9	3.3	1.4	0.8	2.2
Consumer prices (eop, % yoy)	1.0	2.3	2.4	2.4	1.4	1.7	1.8
General budget balance (% of GDP)	-5.8	-4.7	-3.2	-4.2	-1.5	-1.5	-2.5
Public debt (% of GDP)	34.5	38.4	41.4	46.2	46.0	45.7	46.5
Current account balance (% of GDP)	-2.4	-3.9	-2.7	-1.3	-1.4	0.4	0.3
Official FX reserves (EUR bn)	28.9	31.8	31.1	34.0	40.8	42.0	43.4
Gross foreign debt (% of GDP)	43.5	47.6	49.0	50.9	54.2	55.6	53.9
EUR/CZK (avg)	26.4	25.3	24.6	25.1	26.0	27.3	27.1
USD/CZK (avg)	19.0	19.1	17.7	19.6	19.6	20.4	21.0

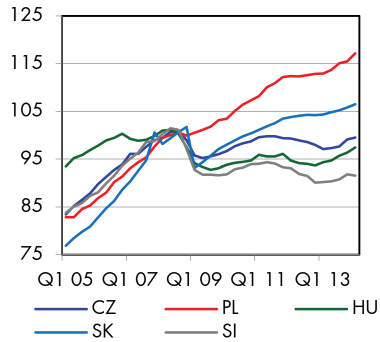
Source: Thomson Reuters, national sources, Raiffeisen RESEARCH

Inflation and FX intervention regime



EUR/CZK 5y high: 27.687; 5y low: 23.994
Source: Bloomberg, Raiffeisen RESEARCH

CE vs. CZ: Long-term GDP trend*



** 2008 = 100*
Source: Datastream, national sources, Raiffeisen RESEARCH

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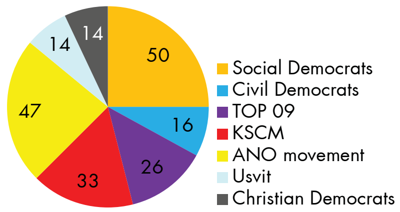
After prolonged stagnation balanced growth on the horizon

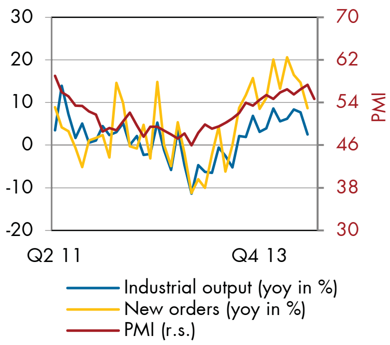
- **Political stability restored, outlook for more political stability ahead**
- **Mild fiscal expansion, following period of overeager fiscal consolidation**
- **Economic recovery driven by external and internal demand**
- **Current strong recovery partially driven by pent-up demand, decent medium-term growth outlook**

Seats in Chamber of Deputies



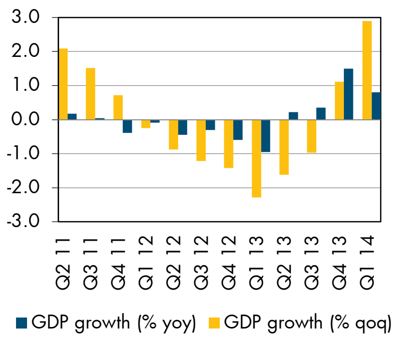
Source: Chamber of Deputies of the Parliament of Czech Republic, Raiffeisen RESEARCH

Production activity



Source: Czech Statistical Office, Bloomberg, Raiffeisen RESEARCH

GDP development



Source: Czech Statistical Office, Raiffeisen RESEARCH

Politics

The Czech Republic now has a coalition government with support in parliament from three parties – the Social Democrats (CSSD), the ANO movement (centrist pro-business party led by Andrej Babis), and the Christian Democrats, whereas the previous government was technocratic appointed by the President with only weak support in parliament. Thus, the political situation "normalised" after half a year of non-standard development. There are internal struggles within the coalition, but their magnitude is minor in comparison to the disputes within the government of Peter Nečas. The main source of troubles is the diverse view of CSSD and ANO on taxation, which make it difficult to compromise. The average duration of Czech governments is just slightly more than 2 years, but this government has a good chance to survive longer. The main assumption here is the lack of feasible alternatives. Early elections would probably result in a similar composition of the Chamber of Deputies as now, and hence, no change. If our prediction of longer lasting political stability is correct, it will be good for the broader economic environment.

Real economy

The Czech economy has been stuck in the longest recession in history (6 quarters from Q4 2011 to Q1 2013). The recession was caused by a decline in external demand and was amplified by the restrictive domestic fiscal policy stance. The economy started recovering from Q2 2013. The recovery was spurred by FX interventions in Q4 when the economy grew by 1.5% qoq. In particular, FX interventions boosted retails sales in a one-off fashion (front loading before expected price increases), and hence a correction was expected in Q1 2014. Nevertheless, the economy still grew by 0.8% qoq. The level of production was 2.9% higher in yoy-terms. Such figures clearly indicate that the recovery is firmly rooted. Despite the current growth momentum, significant threats remain, e.g. sentiment in the euro area deteriorated in H1 2014 as a result of frictions with Russia. Nevertheless, a possible imposition of harsh economic sanctions on Russia even combined with an interruption of gas supply for a couple of months would not trigger another recession in the Czech economy according to our calculations. Based on the performance of Q1 2014 and based on most recent leading indicators, we forecast the Czech economy to grow by +2.6% this year followed by +2.4% in 2015. Worries about a possible overheating of the Czech economy in the near future are very premature. Utilisation of resources remains low, there is a lot of pent-up demand (see also the following Focus on section) and the unemployment rate is still elevated. Potential GDP growth could be reached some time in 2016 or 2017 if the current growth momentum persists. We estimate that the rate of potential growth is 2.4% compared to 1.3% for the euro area. Hence, we believe in renewed convergence of the Czech economy to the euro area average going forward. The current strategy of the Czech government that tries to attract FDI could help to restore convergence.

Fiscal policy

The government approved the introduction of a new lower VAT rate (10%) for selected items (books, child nutrition, drugs). We expect this to pass smoothly through the legislation process and become effective starting from January 2015. Specific taxes for regulated sectors (incl. banking sector) are not on the official agenda for the time being. However, we cannot exclude that once the government starts looking for additional tax income, such measures might be back on the agenda. Overall, changes in the tax system are minor in comparison to the dramatic changes in VAT in 2012 and 2013, and such (fiscal) shocks to the economic system are not expected to be repeated.

The general government deficit will probably stay at 1.5% of GDP this year, far below the Maastricht threshold of 3%. Rapid growth in revenues (almost 10% yoy) will ensure a low deficit, despite the fiscal expansion this year. Moreover, solid budget revenue growth is another indication of the ongoing recovery. The strategy of the new government and of the previous technocratic government is to support the economic recovery by a mildly expansive fiscal policy stance, i.e. there is an end of the over-restrictive fiscal policy of government of P. Necas that prolonged the recession in 2011-2013. At the same time, the government is committed to maintaining the deficit below the 3% Maastricht criterion. Lowering the structural deficit is the secondary goal of the government for the time being. On the other hand, we think it would be appropriate to lower the structural deficit in the medium-term when the economy reaches its potential. In line with this strategy, public investment (especially investment in infrastructure) is set to rise after a couple of years of contraction. This should help the local construction sector that has been in a prolonged depression. The Czech government agreed to raise wages in the public sector by 3.5% in 2015 which will come as a welcome positive contribution to inflation.

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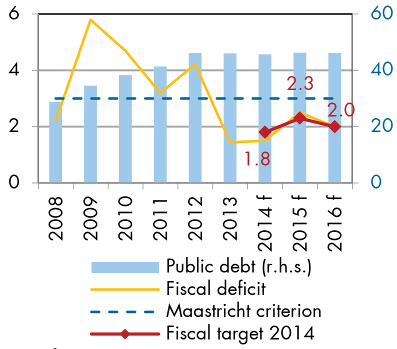
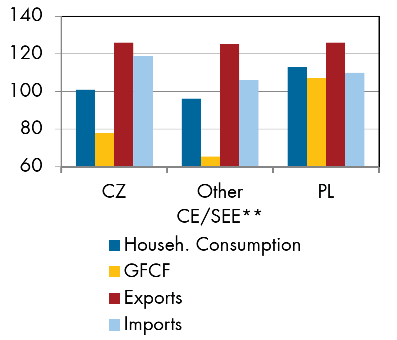
Fiscal deficit and public debt*



* % of GDP
Source: Eurostat, Raiffeisen RESEARCH

CE/SEE vs. CZ: Long-term GDP*



* Current value vs. 2008 (2008 = 100)
** Average Hungary, Slovakia, Slovenia, Romania
Source: Datastream, national sources, Raiffeisen RESEARCH

Focus on: Current recovery of the Czech from a regional perspective

Currently and in line with all the regional CE peers, the Czech economy is experiencing a clear upswing supported by improving domestic and external demand conditions. However, measured in longer-term real GDP trends (e.g. since 2008 and compared to pre-crisis times), the Czech economy is just in the "middle of the pack" compared to other export-oriented CE economies or the export-oriented Romanian economy. On an interesting note, the Slovak economy was also able to significantly outpace the growth performance of the Czech economy in recent years, which can be mostly attributed to somewhat better Slovak export performance as well as much tighter fiscal policies in the Czech Republic (in comparison to Slovakia and Poland, the Czech Republic managed to exit the EU's Excessive Deficit Procedure). That said, in the GDP data there seems no obvious (negative) effect of the Slovak euro-area membership compared to the Czech economy (e.g. in terms of pro-cyclicality or benefits of a flexible exchange rate).

In terms of contributions, headline economic growth in the Czech economy was more or less as one-sided or unbalanced as in other regional peers such as Slovakia and Romania, not to mention Hungary and Slovenia. Pronounced weakness in gross fixed capital formation and domestic consumption was compensated by very strong export growth, a scenario that can be also labelled as "recessionary growth". Therefore, the current growth momentum in the Czech Republic will be only sustainable if there is lasting support from domestic demand. On a positive note, the fiscal consolidation carried out from 2010 until 2013 should now offer some upside for domestic demand as there are no near-term consolidation needs compared to some regional peers. Moreover, the ongoing recovery in the euro area – which our Western team expects to be stronger than current consensus estimates – should continue to support exports. Hence there is a fair chance that the Czech economy, also supported by the modest overall leverage in the corporate and household sector compared to the income position, may improve its relative growth performance compared to regional peers in the years ahead.

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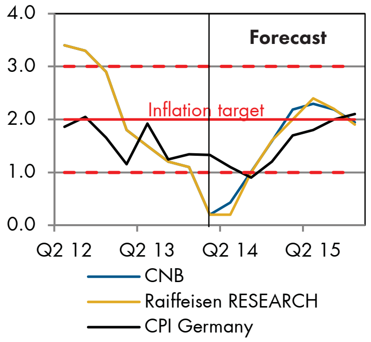
Inflation – where are you?

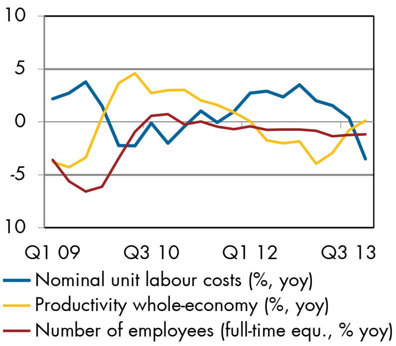
- **In line with broader European and CE trends inflation drops to zero boundary and a 5-year low**
- **Fiscal dominance ties central bankers' hands**
- **Weaker relationship between inflation and unemployment**
- **Economic recovery will slowly spur inflation already in 2014**

Expected inflation path



Source: Czech National Bank, Raiffeisen RESEARCH July 2014

Labour market indicators



Source: Czech National Bank, July 2014, Raiffeisen RESEARCH

Net inflation and unemployment

Net inflation: Consumer price inflation net of administered prices and adjusted for the first-round effects of changes to indirect taxes. Net inflation consists of food price inflation, fuel price inflation and is adjusted. Source: Czech National Bank, ARAD. Based on quaterly figures.
Source: Raiffeisen RESEARCH estimates

The Czech economy has faced the risk of slipping into deflation. Since the Czech National Bank (CNB) reacted pre-emptively with an FX intervention policy in November 2013 (unfortunately, in our view, not soon enough), Czech consumer price inflation did not fall into negative territory as was the case in Poland, Hungary, Bulgaria and Croatia. In our view, anyone who is warning against so-called "debt deflation", as described by the famous economist Irving Fisher, is crying wolf. Although prices are not rising and are even declining in the case of some items (e.g. energy, telecommunication, and computers), and cash-rich companies are reducing their debt, there is no sign of distress in terms of selling assets and an ensuing drop in asset prices. While "debt deflation" does not represent an imminent risk, there is still another kind of deflation (slow, but long lasting and malignant) – "Japan style" – that might threaten the Czech economy.

At the same time, the CNB is facing the so-called fiscal dominance. Via extensive administered price and tax rate adjustments, the government controls a large part of the price basket (administered prices account for almost one fifth of the CPI basket). The CNB is attempting to escape from the trap using FX intervention. The success of this strategy will be evaluated through a sustainable increase in inflation and inflation expectations. Eight months after starting intervention, it is still too early to draw any final conclusions. But we can already see the first signs of pass-through of the weaker currency into Czech inflation.

What are the factors that might make inflation in the Czech Republic visible? First, we can follow specific components of the consumer basket and try to estimate their individual movements. For example, a stronger USD and higher crude oil prices are expected to move fuel prices gradually up. World agriculture commodity prices will translate into higher food prices. Second, we can look at future inflation through the eyes of great economists. For example, the New Keynesian theory represented by Mr. Mankiw considers inflation as a function of economic slack, expectations, and also production costs. Since labour is a key component of production costs, the expected wage growth recovery will boost output prices. However, at the earlier stage of economic growth enhancing productivity is likely to accommodate some acceleration in labour costs (see the graph on the labour market). The increasing pace of economic activity (also supported by currency weakening) and recovering household demand are expected to trigger demand-driven inflation later on. Growth acceleration going forward might move hand in hand with rising production capacity (capacity utilisation still remains below its peak in Q2 2008). And as the declining responsiveness of inflation to the unemployment rate in the Czech Republic indicates (see the so-called Phillip curves in the chart), only a sharp fall in unemployment might stimulate higher inflation at the current stage of the economic cycle. Last but not least, inflation expectations themselves are another factor.

All in all, given the expected economic expansion, we foresee a gradual return of inflation. But without further economic acceleration, inflation will remain very fragile.

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Monetary policy – key instrument is the exchange rate

- **CNB sets FX floor at EUR/CZK 27.0, targeting a "competitive exchange rate"**
- **Exit strategy is difficult to assess, we expect an end to intervention regime in H2 2014**
- **At least one year of almost no CZK appreciation ahead**
- **Key interest rate at 0% expected to remain until 2016**

Monetary policy has been one of the most interesting items on the Czech market since November 2013 when the Czech National Bank (CNB) finally decided to use the controversial FX intervention and set an FX floor at EUR/CZK 27.0. In response, CZK depreciated from EUR/CZK 25.80 to slightly above EUR/CZK 27.0 and then within a couple of weeks the rate settled at a new level close to 27.40.

Although the exit from the current regime is probably far off, the exit strategy is a very hot topic. If there is stronger speculation about CZK appreciation beyond EUR/CZK 27.0 or simply hedging activity by companies, the CNB will have to increase the level of foreign exchange reserves and may suffer potential future losses. Although future CZK appreciation will probably not be as quick as it was in the past and the room for a build-up of foreign exchange stock is huge, we do not think that the exit from the current regime will be more transparent than the entrance. Thus, there will probably be some portion of surprise in terms of timing and possibly also in terms of magnitude in relation to how far the CNB will let the currency appreciate. Another puzzling point might be that if there is, before the exit, a speculation on CZK appreciation, the CNB could accumulate again a large amount of reserves as it did in November 2013. This could create depreciation pressures that could weaken the koruna for a short time even after the end of the intervention. On the other hand, appreciation expectations will probably outweigh this factor relatively quickly.

The key variable for the CNB is inflation and the inflation outlook. By mid-2014 CPI inflation was virtually at 0%. But we can already see the first signs of pass-through of the weaker currency into Czech inflation: higher import prices including food. Food prices grew rapidly in Q1 2014, while fuel prices rose just temporarily by 2013-end. The weaker currency has given support to prices of clothes and shoes in Q2 2014 (by 5% annually). During summer 2014 we expect to see higher-than-usual increases in prices of vacation packages. On the other hand, core inflation remains very low mainly due to the lack of domestic inflationary stimulus. By the end 2014, we foresee CPI inflation at around 1.7%. If the economy continues expanding as we expect, we should see a gradual increase in inflation pushed by demand. By mid-2015 the CPI should be well above the CNB's target of 2% and theoretically allow for an exit. However, as we try to read the CNB's behavior it will keep the currency weaker rather a bit longer, unless the data developments are more positive than expected and cause strong speculation on CZK appreciation. It is probable that the CNB will not start increasing interest rates before it abandons the EUR/CZK 27.0 FX floor. Historically, the exchange rate has functioned well for the CNB within the inflation targeting framework. If the process of real and nominal convergence has not stopped forever the Czech currency will have to appreciate or there has to be a positive inflation differential over euro area inflation (the relevant question of course is how long the ECB will undershoot its inflation target). There is also clearly no rush by politicians to adopt the euro and no inclination to set a desired timing. Such an option has also not been mentioned by any of the CNB board members.

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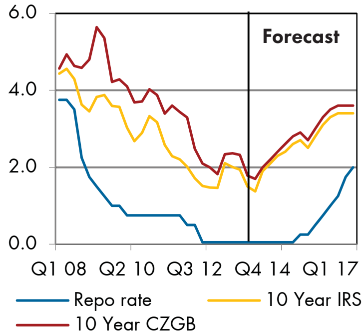
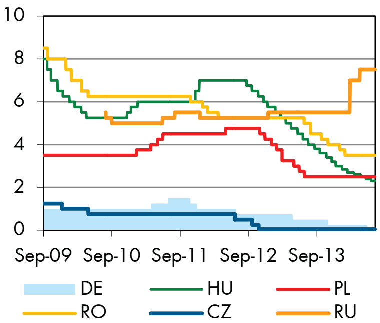
Czech interest rate outlook



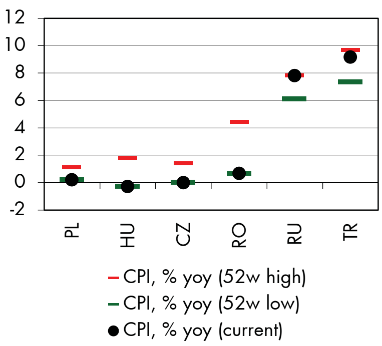
Source: Bloomberg, Raiffeisen RESEARCH

Policy rates in comparison*



** Key rate*
Source: Bloomberg, Raiffeisen RESEARCH

Inflation in comparison



Source: Bloomberg, Raiffeisen RESEARCH

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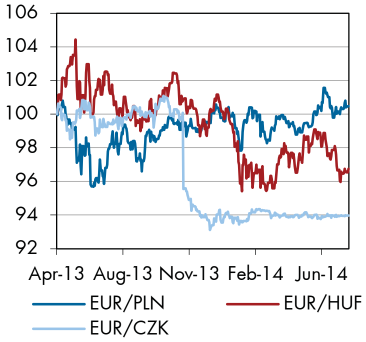
Waiting for the intervention regime to be abolished

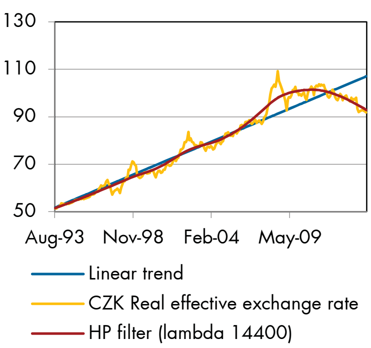
- **CZK seems to be fundamentally undervalued**
- **Central Bank prefers to keep CZK at current levels for longer period**
- **Moderate appreciation trend projected after intervention regime is abolished**
- **External balance is improving, supported by devaluation of CZK**

Comparison CZK to CE peers



Indexed chart: April 2013 = 100
EUR/PLN 5y high: 4.57; 5y low: 3.83
EUR/HUF 5y high: 320.49; 5y low: 261.23
EUR/CZK 5y high: 27.69; 5y low: 23.99
Source: Bloomberg, Raiffeisen RESEARCH

Real effective exchange rate



Source: OECD, Raiffeisen RESEARCH

FX forecast

	curr.*	Sep-14	Dec-14	Jun-15
EUR/CZK (eop)	27.44	27.3	27.2	27.2
USD/CZK (eop)	20.13	20.7	20.9	21.4
EUR/USD (eop)	1.36	1.32	1.30	1.27
Bloomberg median		27.4	27.3	27.1
Consensus**		27.3	27.2	26.9

** data as of 11 July 2014*
*** Foreign exchange consensus forecast June 2014*
Source: Bloomberg, Raiffeisen RESEARCH

Despite improving fundamentals, we now face a weaker-than-expected CZK against EUR. Fundamentally, estimates of the fair EUR/CZK exchange rate are somewhere around EUR/CZK 25-26, i.e. there is undervaluation of 5-10%. While the concepts of equilibrium exchange rates are theoretical, we have already witnessed a rapid improvement in the Czech external balance.

In line with our analysis of monetary policy, we expect that the CNB will let the Czech koruna appreciate across the level of 27.0 in Q4 2015. As we said, CPI inflation is the key variable for the CNB when it comes to a decision to exit the current FX regime. In our view, if spot inflation is lower by 0.1 percentage point compared to our inflation projection, that implies a delay in exiting regime by one month compared to our base case scenario. If the economy and inflation remain on an upward trend, hedging against future appreciation already during 2015 seems reasonable. On the other hand, we see it as quite unlikely that the CNB will exit the intervention regime before mid-2015.

As for the possibility that CZK could depreciate further, we certainly cannot rule this out. But according to its own words the CNB would prefer to keep CZK at current levels for a longer period of time, rather than use this controversial tool again. But if the data worsen again and the threat of deflation returns, the CNB would intervene again, or the market itself would push the exchange rate upward, in anticipation of such a step.

The impact of FX interventions on the external balance of the Czech economy has dropped out of the mainstream discussions on FX intervention consequences. The positive impact of the weaker currency on export performance is well known. Maybe because of a favourable combination of a weaker currency and a global recovery, the Czech trade balance is going to beat all-time highs in 2014 and it is likely do so again in 2015. But what is not mentioned in the usual discussions are the consequences of the weaker currency on the other components of the balance of payments, particularly the income balance. In recent years, the Czech economy was confronted by considerable outflow of investment profits. In Q1 2014, this outflow fell to less than one-half of last year's level. Although this might be partially caused by different timing of some dividends, we believe that this at least partially reflects the impact of the weaker currency which makes profit in euros less attractive. Consequently, profits stay in the Czech Republic and are reinvested here. This might finally support foreign direct investments that have stalled in recent years. We also see renewed interest by foreign investors in the Czech Republic (cf. the recently approved investment of South Korean tyre maker with a volume of EUR 825 mn). In short, the external balance of the Czech economy is very solid and with the devaluation of CZK this will be even magnified.

The CNB's international reserves surged, owing to foreign exchange intervention. At the end of Q1 2014, reserves totalled CZK 1,143.9 billion, representing a quarter-on-quarter increase of almost CZK 26 billion. The CNB's international reserves covered more than 50% of all external debt liabilities of domestic entities at the end of 2013.

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Solid trends in 2013, question of "Banking Union" entry ahead

- **Profitable, well capitalised and compliant with new EU regulatory rules**
- **Independent of foreign funding, thanks to strong deposit collection and low loan-to-deposit ratio**
- **Ready to support forthcoming increase of loan demand**
- **Some domestic regulatory tests, question of voluntary "Banking Union" affiliation remains**

Despite lower-than-expected GDP growth, the banking sector saw positive developments in 2013. The capital position was strengthened and profitability remained decent. However, net interest income decreased slightly for the second consecutive year, a trend that may continue. The overall sector is well prepared for new EU regulatory rules (Tier-1 CAR at 16.8%, compliant with CRD IV/CRR regulations). Nevertheless, the CNB informed four banks that it would require an additional capital reserve of 1% to 3% from them to cover systemic risk. The CNB will demand compliance with the systemic risk buffer – together with the capital conservation buffer pertaining to all banks – as soon as all relevant legislation is adopted in H2 2014. The systemic risk buffer has to be seen in light of a concentrated banking sector (especially in terms of the three largest institutions).
Total banking assets recorded a substantial increase of 9% in 2013, mainly caused by FX intervention as well as a one-off factor (merger of UniCredit entities in CZ and SK). Despite the low rates environment, deposits increased by 6.7% yoy in 2013. Total loans grew by 6.5% yoy in 2013 (up from 2.4% in 2012). In contrast to deposits, where non-financial corporations represented ~30% of the total deposit inflow, private individuals were the main driver of loan growth, thanks primarily to mortgage loans. Due to equal growth of deposits and loans, the loan-to-deposit ratio maintained its pleasing level at ~75% (i.e. the sector is by and large self-funding). The first available data for 2014 point to slowing deposit growth in the corporate segment, which could signal a long-awaited recovery in investments, followed by growing loan demand. In retail, both deposits and loans kept their satisfactory single-digit growth rates in the first months of 2014. Credit risk, expressed by the NPL ratio, decreased slightly to a level of 5.9% in 2013. However, the quality of NPL portfolios continued to deteriorate (the share of the worst category of NPLs – loss loans – grew again in 2013, and the proportion of NPLs more than three months past due exceeded 50%). Hence, additional provisioning might be needed as NPL coverage by provisions has long been flat at ~50% (which does not fully reflect the deterioration in portfolios). Additionally, households still face a difficult situation on the labour market, which could increase their credit risk in case of a rise in interest rates.
Its overall soundness as well as the overall low leverage in the private and public sector makes the Czech banking market one of the few regional banking markets in CEE where leading Western European banks may pursue more active growth strategies going forward (which may also result in some portfolio buying transactions and/or even outright M&A activity). On the one hand, the increasing focus on the Czech market is a positive signal in terms of availability of financing. However, such a situation is likely to result in additional margin pressure. On the regulatory side, the debate about joining the "Banking Union" may gain traction in the months ahead. As things stand, we expect the Czech Republic not to use the "opt-in" clause immediately, although in some other fields of EU policy the country has become more open towards EU demands.

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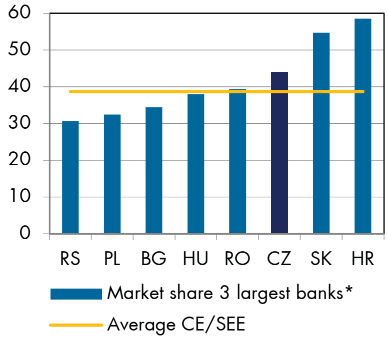
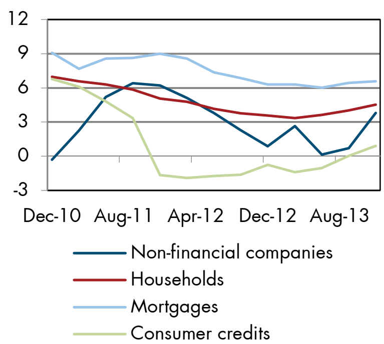
CZ: Banking concentration vs. peers



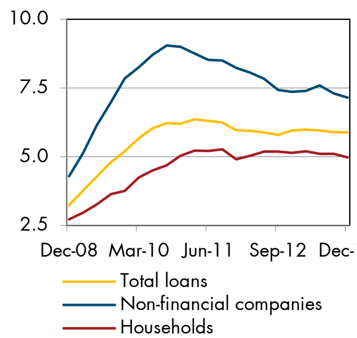
** % of total loans*
Source: national sources, Raiffeisen RESEARCH

Loan growth (% yoy)



Source: CNB, Raiffeisen RESEARCH

NPL ratio to total loans (%)

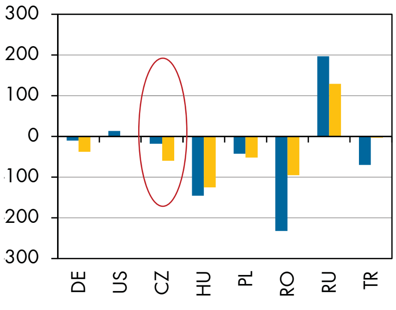


Source: CNB, Raiffeisen RESEARCH

Local currency debt – comfortable financing position

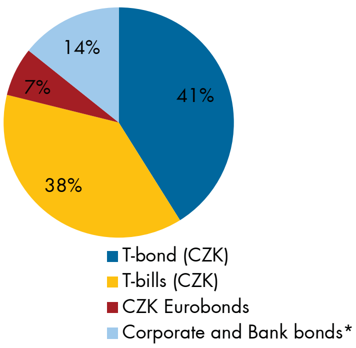
- Local currency government bonds to remain supported, especially in the short-term mainly due to record-low inflation
- However, cyclically rising yields expected later, whilst major upside risk is further MP easing by the ECB
- CZ Eurobonds remain interesting for investors willing to diversify into higher quality CEE debt
- Czech Republic stands a good chance of receiving positive rating outlook in 6-month perspective

12m LCY yield changes (bp)



Source: Bloomberg, Raiffeisenbank RESEARCH

Local currency debt outstanding



** incl. mortgage bonds*
Data as of 15 Jul 2014
Source: Bloomberg, Raiffeisenbank RESEARCH

Yield forecasts

	current[1]	Sep-14	Dec-14	Jun-15
2y T-bond[2]	0.24	0.3	0.3	0.6
Cons.		*0.6*	*0.7*	*0.9*
5y T-bond[2]	0.57	0.7	0.9	1.3
10y T-bond[2]	1.48	1.7	2.0	2.4
Cons.		*2.0*	*2.1*	*2.4*

[1] closing prices as of 11/07/2014 [2] Ask yield
Source: Bloomberg, Raiffeisen RESEARCH

Over the past 12 months, Czech government bonds managed significant gains with the yield curve witnessing an impressive bull flattening. Elsewhere, Bunds for example, saw also the back end outperforming the front end, but regional peers such as Poland also performed similarly in the past 12 months. Although the 10y-10y spread over Bunds has widened slightly in the past few weeks, taking a 12m horizon the spread over German benchmarks tightened by around 30bp.

In terms of local factors, the favourable 12m performance is mainly due to the record-low inflation rates in the Czech economy with CPI inflation at virtually zero in mid-2014 and an inflation outlook which has deteriorated significantly. Accordingly, the likelihood of monetary policy (MP) tightening, which was initially expected for H1 2015, has gradually decreased and we currently project flat rates for all of 2015 in line with our expectations for MP in the euro-area forecasts. Another factor that also contributed to the record-low yield levels was the better-than-expected fiscal performance: the government budget balance closed 2013 with a deficit of only 1.5% of GDP, while the consensus expectation was for 2.8%. The financing position of the government remains very favourable given the faster-than-expected expansion of the Czech economy in H1 2014 and the related boost to the revenue side of the budget balance. Whilst the budget plans for 2014 are based on expectations of only 1.3% GDP growth, our recently raised projection calls for 2.6% for 2014 as a whole.

These favourable developments have clear implications for the refinancing plans of Czech debt managers. Initial estimates were for gross financing requirements of CZK 400 bn, out of which the Finance Ministry planned to collect CZK 121 bn through money market instruments and CZK 185 bn through CZK government bonds. LCY issuance already reached 60% of the plan by mid-2014. Given the favourable year-to-date performance on the fiscal front, gross financing needs for 2014 should be around CZK 60-70 bn lower than the CZK 400 bn outlined by the plan. To what extent this will lower the issuance of CZK bonds is not clear.

For the remainder of 2014, there should be no problems in securing the rest of the borrowing requirements. For 2015 and beyond, the fiscal outlook does not suggest that there could be a major shift in the favourable refinancing position. Although fiscal policy is expected to be slightly more expansionary, the budget deficit should not considerably exceed 2.5% of GDP (including the deduction of the Grippen lease plan which equals 0.5% of GDP according to ESA methodology). All in all, we do not expect that the Czech government bond yield spread over the German benchmarks will change significantly over the next 12 months. Therefore, the key drivers for local currency government bonds will be the overall economic and inflationary developments in the euro area, where we expect a gradual, cyclically driven increase in government bond yields as the year progresses. Apart from the usual risks, the potential for more unconventional easing measures by the ECB is the most prominent upside risk to better-than-anticipated performance of the Czech debt market.

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The Czech Eurobond market remained fairly stable during the turbulent times as the CZ Eurobond spread chiefly mirrored yield fluctuations in the German bond market. The market offers a relatively low-risk low-beta play for international investors who are targeting high quality investment offering a moderate spread pick-up against higher rated euro area debt. In this regard, Czech Eurobonds compete very well against Slovakia despite the fact that the latter is a euro area member. We continue to recommend Czech Eurobonds as stable performers for low-beta risk-averse portfolio investors.

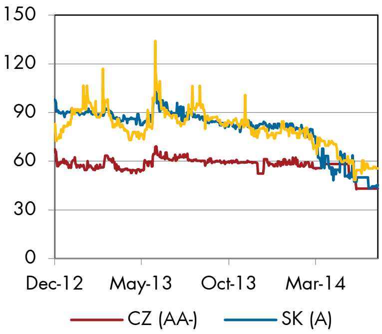
The low level of Czech market risk is underpinned by strong public finances and a smooth debt management policy, which allows the country to retain its high investment grade rating. At present, Czech Republic foreign currency long-term debt is rated at AA-, A1 and A+ by S&P, Moody's and Fitch, respectively. The stable outlook reflects the ability of the government to keep public debt and major budget parameters at sustainable levels. Indeed, the Czech government always maintained a relatively tight fiscal rein, allowing it to successfully eliminate the structural fiscal deficit recently. Despite strong pressure on public finances in CEE during the 2009 financial crisis, the tight fiscal policy of the Czech government helped to limit the growth of public liabilities.

Today, the Czech Republic has one of the lowest debt-to-GDP ratios among the five CE countries and compares well to the developed EU with debt-to-GDP ratio estimated at just 45% of GDP for 2014 vs. 43% for Denmark and 60% for Finland. The portion of short-term debt reaches just 13% of all CZ public liabilities and remains comfortably within a 20% threshold targeted by the government. Foreign debt accounts for slightly less than a quarter of total government liabilities while international Eurobond issues provide for 80% of all international financing. The strong debt position and substantial international liquidity are quite adequate for covering short-term international liabilities and should be a good uplifting factor for the Czech sovereign rating. We believe that the Czech Republic stands a good chance of receiving a single-notch rating upgrade from Fitch and Moody's while the outlook might change from stable to positive in a 6-month perspective.

Despite the 2009 financial crisis pushing Czech Republic to issue more debt in international markets (as was also the case with many other CEE sovereign borrowers), the government never abused this option. As a result, Eurobond issuance accounted for only 28% of all government bond issues. Despite strong investor appetite the government remained reluctant to borrow larger amounts at the expense of local issuance. On 23 June 2014, the redemption of historically the first foreign issue of the Czech Republic denominated in EUR currency in the nominal value of EUR 1.5 bn was carried out. Despite the 2014 financing plan targeting about EUR 3 bn in international borrowing, the government abstained from accessing the international markets in H1. Although we believe the government might issue a EUR Eurobond in Q3-Q4, there is also the possibility of no issue due to the state's stronger fiscal balance position.

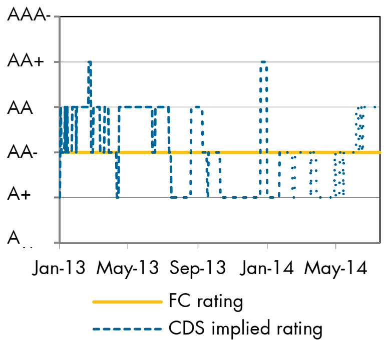
Financial analyst: Gintaras Shlizhyus (+43 1 71707 1343), RBI Vienna

CZ vs. CE peers (CDS) *



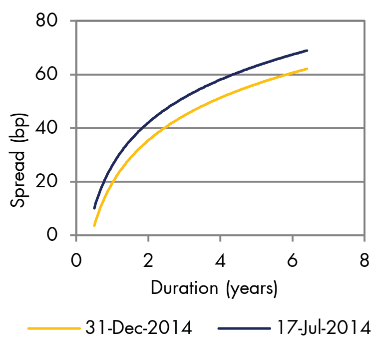
** 5-year CDS spread in basis points, S&P ratings in brackets*
Source: Bloomberg, S&P, Raiffeisen RESEARCH

Czech FC rating vs. CDS implied *



** S&P long-term foreign currency rating, CDS implied - CDS implied rating derived from market signals (CDS)*
Source: S&P, Raiffeisen RESEARCH

CZ sov. Eurobond curve *



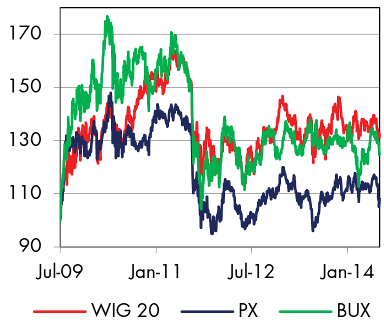
** bp - basis points, spread vs. underlying benchmark German BUND*
Source: Bloomberg, Raiffeisen RESEARCH

Raiffeisen RESEARCH

Reliance on the financial sector represents two sides of one coin

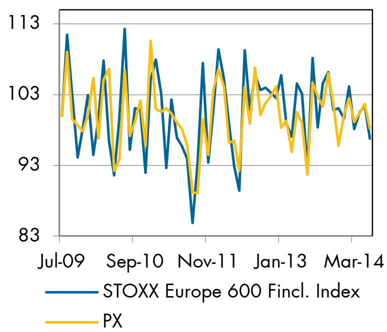
- PX highly correlated to STOXX Europe 600 Financials Index
- Macroeconomic environment currently plays a supporting role
- Aggregated dividend yield of PX equities surpasses government bonds
- Earnings growth still looks promising for 2014 as well as for 2015

Region's core indices



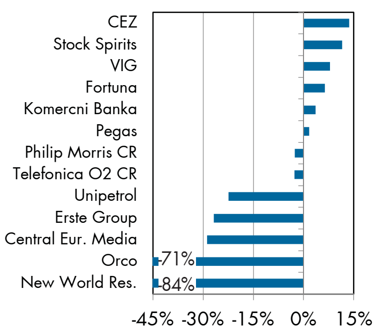
BUX 5y high: 25322.96; 5y low: 14325.71
PX 5y high: 1314.6; 5y low: 843
WIG 20 5y high: 2932.62; 5y low: 1813.14
Source: Thomson Reuters, Raiffeisen RESEARCH

PX and financials highly correlated



Source: Bloomberg, Raiffeisen RESEARCH

Performance YTD of PX members



Source: Thomson Reuters, Raiffeisen RESEARCH

Structure of the Czech stock market

Comparing the market capitalisation of the CE-3 countries, the Czech Republic with EUR 23.4 bn (as of 31 May 2014) ranks ahead of Hungary (EUR 14.3 bn), but well behind Poland (EUR 149.9 bn). When it comes to the number of listed companies, the Czech Republic (25 companies) clearly fails to keep up with Hungary (50) and Poland (460). What is striking, however, is the comparatively large proportion of foreign companies (11 and thus exactly 44% of listed corporations). In 2013, the free float of PSE-listed issuers decreased from EUR 10.6 bn to EUR 7 bn, as institutional investors remain sensitive to debt solvency and default issues. Despite the decrease in free float held by international investors from 70% (as of end-2012) to 40% (as of end-2013), foreign market participants still play an important role in daily trading as well. We cover the PX index, which includes the most liquid shares and currently consists of 13 companies. The driving force here is the financial sector, with Vienna Insurance Group (22.7% index weighting), Komercni Banka (19.8%) and Erste Group (15.7%) followed by the two defensive companies CEZ (23%) and O2 CR (5.7%).

Current situation and outlook

Since the beginning of the year, the leading Czech index PX has suffered one of the highest losses (-2.9% in LCY) compared to its European counterparts. The main reason is its reliance on the financial sector. The yearly returns based on weekly data showed a correlation of 0.83, which represents nearly perfect synchronisation between the PX and the STOXX Europe 600 Financials Index. Accordingly, it is hardly surprising that on the day Erste Group announced its profit warning and dropped more than 16%, the index closed 3.89% lower. In addition to this, the fact that Komercni Banka sees rising risks to its full-year guidance, as borrowing costs in the second quarter continued to fall, also shared responsibility for the negative sentiment on financial equities in the PX.

In contrast to that, the economic environment speaks for a positive development of the PX. GDP expanded by 2.9% in Q1, marking the strongest increase in the last three years. Additionally, we expect the favourable interest rate conditions (key interest rates at 0.05%) to remain at record low levels at least for 2014. The Czech National Bank's decision to embark on a policy of direct FX intervention in November 2013 to keep the CZK exchange rate weaker than 27 versus EUR, should continue to support export-oriented corporate earnings in particular. The most recent CPI declined to a new cyclical low of 0.0% yoy in June and in our view this implies a high probability that the CNB will maintain its intervention well into H2 2015. Furthermore, the current economic recovery in the euro area and the USA is likely to keep Czech export growth on track in 2014 and 2015. With an eye to these aspects, we expect aggregated earnings growth for the companies listed in the PX to be 14.4% in 2014e and 38.1% in 2015f. Beyond that, the dividend yield of 4.5% (2014e: aggregate for the PX) offers a clearly better return than the corresponding government bonds (10y: 2.0%; 5y: 0.9%) making this market interesting for return-oriented investors as well.

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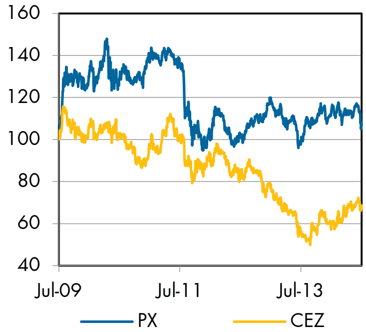
Komercni Banka (Buy, TP CZK 5,250)

Komercni Banka remains a play among CEE banks offering a strong balance sheet (CT1/B3 16.2%, L/D 74%) and a ROE >12% in a relatively stable macro environment, as well as a dividend yield of > 5% for the coming years based on a pay-out ratio of around 70%. The cautious outlook on core revenues (slow loan growth, NIM pressure, negative F&C repricing effects, limited room for further cost-cutting), however, rather points towards a slight bottom-line erosion despite an optimistic outlook for risk costs. In our view, though, this has already been digested by consensus. Management confirmed the core tier 1 target of 15-16% but indicated that there might be a repayment of the excess capital as Komercni Banka is investigating a partial replacement of shareholders' equity with AT1 instruments. In addition, recent statements at Société Générale's Investor Day that target a higher ROE of the Czech segment support this initiative but management does not expect legal certainty before Q4. Although we believe that a bonus dividend might provide some short-term tailwind for the stock, the actual valuation impact is limited due to additional costs for the AT 1 instrument. While reducing our 2014e and 2015e estimates on the back of the cautious guidance lower yields also have a positive valuation effect. In addition, the flagged capital optimisation should be a carrot for shareholders. We have recently lifted our TP to CZK 5,250 accounting for a CZK 200 per share NPV impact from capital optimization and raised our recommendation from HOLD to BUY.

Financial analyst: Stefan Maxian, Raiffeisen Centrobank, Vienna

Komercni Banka vs. PX



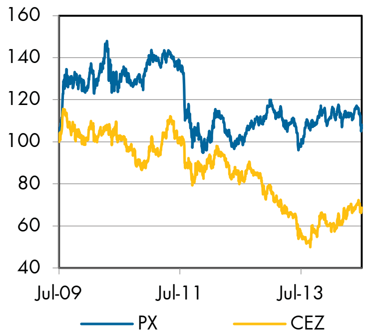
Komercni Banka 5y high: CZK 4875; 5y low: CZK 2742
PX 5y high: 1314.6; 5y low: 843
Source: Thomson Reuters, Raiffeisen RESEARCH

CEZ (Buy, TP CZK 670)

After having impaired a large chunk of its SEE and gas-fired power generation exposure last year and thus boasting a cleaner balance sheet, CEZ made a fresh start into 2014e, which is nevertheless marked by a difficult environment for electricity prices and new challenges. Management decided to abandon the tender for the expansion of the Temelín nuclear power plant given a lack of market and government support. As this move releases quite a bit of cash flow that was earmarked for the enormous capex, management plans to review its growth and dividend strategy by the end of 3Q 14. This became even more important as government representatives voiced appetite for stable dividend payments, which could be financed from operating cash flows despite the electricity price-fuelled decline in earnings. We appreciate that CEZ cancelled most of its growth capex in the current weak market environment, which is additionally burdened by government and EU policies, as well as hostile regulation in SEE. CEZ's substantial cash flow generation potential could thus either benefit shareholders through dividends or could be re-directed towards acquisitions of preferably regulated and stable assets (e.g., heat, renewables, power distribution) in the Czech Republic or in neighbouring countries. Additionally positive is the fact that CEZ settled its dispute with the Albanian government and will recover investment costs until 2018. We consider CEZ an attractive investment given the outlook for a stable dividend boasting a yield of more than 6% in a low rate environment, as well as free cash flows to support growth. CEZ is currently trading at multiples below the sector average and also below Polish names.

Financial analyst: Teresa Schinwald, Raiffeisen Centrobank, Vienna

CEZ vs. PX



CEZ 5y high: CZK 995.6; 5y low: CZK 427.9
PX 5y high: 1314.6; 5y low: 843
Source: Thomson Reuters, Raiffeisen RESEARCH

Real GDP (% yoy)

Countries	2012	2013	2014e	*Konsensus*	2015f	*Konsensus*
Poland	1.9	1.6	3.3	*3.2*	3.3	*3.6*
Hungary	-1.7	1.1	2.7	*2.7*	2.5	*2.3*
Czech Rep.	**-0.9**	**-0.9**	**2.6**	**2.3**	**2.4**	**2.7**
Slovakia	1.8	0.9	2.7	*2.5*	3.0	*3.1*
Slovenia	-2.5	-1.1	1.0	*0.2*	1.0	*1.0*
CE	**0.6**	**0.8**	**2.9**	**2.7**	**2.9**	**3.1**
Croatia	-2.2	-0.9	-0.8	*-0.3*	1.0	*0.8*
Bulgaria	0.6	0.9	2.0	*1.6*	3.5	*2.4*
Romania	0.6	3.5	3.5	*3.0*	3.5	*3.3*
Serbia	-1.5	2.5	0.0	*1.1*	2.0	*2.4*
Bosnia a. H.	-1.1	1.9	0.0	*1.7*	3.5	*2.8*
Albania	1.6	0.4	2.0	*1.7*	3.0	*2.5*
Kosovo	2.5	3.0	3.0	n.a.	4.0	n.a.
SEE	**-0.1**	**2.2**	**2.0**	**2.0**	**2.9**	**2.6**
Russia	3.4	1.3	-0.3	*0.2*	1.0	*1.6*
Ukraine	0.2	0.0	-7.0	*-5.2*	1.5	*0.8*
Belarus	1.7	0.9	0.5	*1.8*	1.5	*2.9*
CIS	**3.1**	**1.2**	**-0.8**	**-0.2**	**1.1**	**1.6**
CEE	**2.1**	**1.2**	**0.5**	**0.8**	**1.7**	**2.1**
Turkey	2.1	4.1	3.5	*2.7*	4.0	*3.6*
Austria	0.9	0.3	1.3	1.4	2.1	1.8
Germany	0.9	0.5	1.8	2.0	2.5	2.0
Euro area	**-0.6**	**-0.4**	**1.2**	**1.1**	**2.0**	**1.5**

Source: Thomson Reuters, Consensus Economics, Raiffeisen RESEARCH

Consumer prices (avg, % yoy)

Countries	2012	2013	2014e	2015f
Poland	3.7	0.9	0.4	2.3
Hungary	5.7	1.7	0.7	3.0
Czech Rep.	**3.3**	**1.4**	**0.8**	**2.2**
Slovakia	3.6	1.4	0.1	1.4
Slovenia	2.6	1.8	1.8	2.0
CE	**3.8**	**1.2**	**0.6**	**2.3**
Croatia	3.4	2.2	0.6	2.0
Bulgaria	3.0	0.9	1.1	3.5
Romania	3.3	4.0	1.9	3.0
Serbia	7.8	7.8	5.5	5.5
Bosnia a. H.	2.1	-0.1	-0.3	2.5
Albania	2.0	1.9	2.3	2.5
Kosovo	2.5	1.8	1.0	2.5
SEE	**3.7**	**3.4**	**1.9**	**3.2**
Russia	5.1	6.8	6.7	5.3
Ukraine	0.6	-0.2	11.3	9.0
Belarus	59.2	18.3	21.0	20.0
CIS	**6.4**	**6.6**	**7.5**	**6.0**
CEE	**5.4**	**4.9**	**5.1**	**4.7**
Turkey	8.9	7.5	8.5	7.4
Austria	2.6	2.1	1.5	1.8
Germany	2.1	1.6	1.0	2.0
Euro area	**2.5**	**1.4**	**0.8**	**1.3**

Source: Thomson Reuters, Raiffeisen RESEARCH

Current account balance (% of GDP)

Countries	2012	2013	2014e	2015f
Poland	-3.5	-1.3	-1.1	-2.1
Hungary	1.8	3.0	3.4	3.5
Czech Rep.	**-1.3**	**-1.4**	**0.4**	**0.3**
Slovakia	2.2	2.2	1.7	1.4
Slovenia	3.3	6.5	6.4	5.0
CE	**-1.5**	**0.0**	**0.4**	**-0.3**
Croatia	-0.1	1.3	1.2	0.7
Bulgaria	-0.8	1.9	0.7	-0.5
Romania	-4.4	-1.1	-2.0	-2.5
Serbia	-10.7	-4.9	-5.3	-6.2
Bosnia a. H.	-9.8	-5.9	-8.1	-11.1
Albania	-9.3	-10.4	-10.3	-11.0
Kosovo	-8.0	-7.0	-7.7	-7.8
SEE	**-4.4**	**-1.4**	**-2.2**	**-2.9**
Russia	3.6	1.6	2.3	2.0
Ukraine	-8.5	-9.1	-3.0	-3.1
Belarus	-2.9	-10.2	-5.5	-6.1
CIS	**2.5**	**0.4**	**1.7**	**1.4**
CEE	**0.7**	**0.1**	**0.9**	**0.4**
Turkey	-6.2	-7.8	-6.3	-6.0
Austria	2.4	2.7	2.9	2.4
Germany	7.4	7.5	7.0	6.5
Euro area	**1.4**	**2.4**	**2.5**	**2.0**

Source: Thomson Reuters, Raiffeisen RESEARCH

General budget balance (% of GDP)

Countries	2012	2013	2014e	2015f
Poland	-3.9	-4.3	-3.3	-2.9
Hungary	-1.9	-2.3	-2.8	-2.9
Czech Rep.	**-4.2**	**-1.5**	**-1.5**	**-2.5**
Slovakia	-4.4	-2.8	-2.6	-2.5
Slovenia	-3.8	-7.0	-5.0	-4.0
CE	**-3.7**	**-3.4**	**-2.9**	**-2.8**
Croatia	-5.0	-4.9	-4.8	-4.5
Bulgaria	-0.4	-1.9	-1.8	-1.3
Romania	-3.0	-2.3	-2.5	-2.3
Serbia	-6.4	-4.8	-7.2	-6.3
Bosnia a. H.	-2.0	-1.5	-1.5	-1.8
Albania	-3.4	-6.0	-6.6	-4.5
Kosovo	-2.7	-2.7	-2.0	-2.0
SEE	**-3.3**	**-3.0**	**-3.4**	**-3.0**
Russia	0.4	-1.0	-0.5	-0.4
Ukraine	-5.5	-6.5	-7.0	-4.5
Belarus	0.5	0.2	0.0	0.0
CIS	**0.0**	**-1.4**	**-1.0**	**-0.7**
CEE	**-1.4**	**-2.1**	**-1.7**	**-1.5**
Turkey	-2.4	-2.2	-2.5	-2.5
Austria	-2.6	-1.5	-2.6	-1.2
Germany	0.1	0.0	0.0	0.0
Euro area	**-3.7**	**-3.0**	**-2.5**	**-2.3**

Source: Thomson Reuters, Raiffeisen RESEARCH

Public debt (% of GDP)

Countries	2012	2013	2014e	2015f
Poland	55.6	57.0	50.7	50.4
Hungary	80.2	79.2	81.5	81.0
Czech Rep.	**46.2**	**46.0**	**45.7**	**46.5**
Slovakia	52.2	55.4	55.2	56.2
Slovenia	54.0	73.0	75.0	75.0
CE	**56.5**	**58.3**	**55.3**	**55.4**
Croatia	56.2	67.4	70.8	73.2
Bulgaria	18.5	19.0	22.0	20.0
Romania	38.0	38.4	38.5	38.2
Serbia	59.9	61.0	67.1	69.3
Bosnia a. H.	39.7	41.5	42.5	41.5
Albania	61.5	68.0	72.0	70.0
Kosovo	18.0	20.0	22.0	22.0
SEE	**41.1**	**43.5**	**45.4**	**45.4**
Russia	10.5	11.3	11.5	12.0
Ukraine	36.8	40.3	54.0	54.5
Belarus	31.3	32.5	34.4	36.0
CIS	**13.1**	**14.1**	**15.4**	**15.9**
CEE	**27.5**	**28.9**	**29.1**	**29.4**
Turkey	39.7	39.4	38.5	38.0
Austria	74.4	74.5	80.5	78.8
Germany	81.0	78.4	77.3	74.5
Euro area	**90.7**	**92.6**	**93.7**	**93.1**

Source: Thomson Reuters, Raiffeisen RESEARCH

Gross foreign debt (% of GDP)

Countries	2012	2013	2014e	2015f
Poland	72.7	70.8	69.2	68.0
Hungary	131.1	123.5	118.2	112.6
Czech Rep.	**50.9**	**54.2**	**55.6**	**53.9**
Slovakia	71.5	82.7	84.6	86.7
Slovenia	115.6	113.3	114.0	115.3
CE	**77.7**	**77.6**	**76.5**	**74.8**
Croatia	103.1	105.8	106.6	104.2
Bulgaria	94.3	93.5	89.1	82.4
Romania	75.7	67.5	62.8	61.3
Serbia	86.9	78.9	79.6	78.7
Bosnia a. H.	63.3	62.2	63.5	62.5
Albania	25.8	28.2	28.9	30.8
Kosovo	14.8	14.4	13.9	13.4
SEE	**80.6**	**75.7**	**72.7**	**70.4**
Russia	31.4	34.1	39.0	39.3
Ukraine	74.4	78.9	106.8	98.0
Belarus	51.9	52.7	56.1	54.0
CIS	**35.4**	**38.1**	**43.8**	**43.7**
CEE	**51.3**	**52.4**	**56.2**	**55.5**
Turkey	42.0	45.0	52.5	48.4
Austria	n.v.	n.v.	n.v.	n.v.
Germany	n.v.	n.v.	n.v.	n.v.
Euro area	**n.v.**	**n.v.**	**n.v.**	**n.v.**

Source: Thomson Reuters, Raiffeisen RESEARCH

Exchange rate EUR/LCY (avg)

Countries	2012	2013	2014e	2015f
Poland	4.18	4.20	4.16	4.04
Hungary	289	297	308	319
Czech Rep.	**25.1**	**26.0**	**27.3**	**27.1**
Slovakia	Euro	Euro	Euro	Euro
Slovenia	Euro	Euro	Euro	Euro
Croatia	7.52	7.58	7.63	7.65
Bulgaria	1.96	1.96	1.96	1.96
Romania	4.46	4.42	4.45	4.44
Serbia	113	113	116	119
Bosnia a. H.	1.96	1.96	1.96	1.96
Albania	139	140	140	140
Kosovo	Euro	Euro	Euro	Euro
Russia	39.9	42.3	47.7	48.6
Ukraine	10.4	10.8	14.7	14.8
Belarus	10,748	11,828	14,107	15,899
Turkey	2.31	2.53	2.85	2.70
Austria	Euro	Euro	Euro	Euro
Germany	Euro	Euro	Euro	Euro
USA	**1.29**	**1.33**	**1.34**	**1.29**

Source: Thomson Reuters, Raiffeisen RESEARCH

Ratings[1]

Countries	S&P	Moody's	Fitch
Poland	A-	A2	A-
Hungary	BB	Ba1	BB+
Czech Rep.	**AA-**	**A1**	**A+**
Slovakia	A	A2	A+
Slovenia	A-	Ba1	BBB+
Croatia	BB	Ba1	BB+
Bulgaria	BBB-	Baa2	BBB-
Romania	BBB-	Baa3	BBB-
Serbia	BB-	B1	B+
Bosnia a. H.	B	B3	not rated
Albania	B	B1	not rated
Kosovo	not rated	not rated	not rated
Russia	BBB-	Baa1	BBB
Ukraine	CCC	Caa3	CCC
Belarus	B-	B3	not rated
Turkey	BB+	Baa3	BBB-
Austria	AA+	Aaa	AAA
Germany	AAA	Aaa	AAA

[1] for FCY, long-term debt
Source: Bloomberg, Raiffeisen RESEARCH

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Bonds

Recommendation horizon: 12 months

	Eurobonds		LCY Bonds		FX to EUR
	EUR	USD	2y	10y	
Bulgaria	N	–	–	–	–
Croatia	H	H	–	–	N
Czech Rep.	N	–	N	N	N
Hungary	B	N	N	S	S
Poland	B	B	N	N	B
Romania	N	B	B	H	N
Russia	–	N	H	H	S
Serbia	–	N	–	–	S
Slovakia	N	N	–	–	–
Slovenia	B	B	–	–	–
Turkey	N	N	B	B	B
Ukraine	S	S	–	–	N
Belarus	–	N			

MARKET STRATEGY (horizon: Jun-15; B: buy, N: neutral, S: sell)
Recommendations based on absolute expected performance: LCY bonds: absolute performance in LCY; Eurobonds: based on expected spread change; FX: expected performance against EUR
Source: Raiffeisen RESEARCH

Stock markets

Komercni Banka:
5y high: CZK 4875 (07/04/2014), 5y low: CZK 2742 (23/07/2009)
Start of Coverage: 01/02/2002

Recommendation history

Date	Rating	Target Price	Prev. day's close	Upside
10.06.2014	Buy	5,250.00	4,616.00	13.7%
09.12.2013	Hold	4,800.00	4,340.00	10.6%
13.08.2013	Hold	4,400.00	4,300.00	2.3%
10.06.2013	Buy	4,400.00	3,732.00	17.9%
03.12.2012	Hold	4,200.00	3,871.00	8.5%
03.08.2012	Hold	3,950.00	3,585.00	10.2%

CEZ:
5y high: CZK 995.6 (05/08/2009), 5y low: CZK 427.9 (04/09/2013)
Start of Coverage: 01/02/2002

Recommendation history

Date	Rating	Target Price	Prev. day's close	Upside
11.04.2014	Buy	670	562	19.2%
24.03.2014	Buy	630	542	16.3%
20.02.2014	Buy	640	555	15.3%
30.10.2013	Buy	640	545	17.4%
27.03.2013	Buy	670	566	18.4%
21.02.2013	Hold	670	605	10.7%
19.09.2012	Hold	830	730	13.7%

PX: 5y high: 1314.6, 5y low: 843

Coverage universe recommendation overview

	buy	hold	reduce	sell	suspended	UR
Universe	54	55	9	5	10	6
Universe %	39%	40%	6%	4%	7%	4%
Investment banking services	14	13	0	0	2	2
Investment banking services %	45%	42%	0%	0%	6%	6%

Source: Raiffeisen Centrobank, rounding differences may occur

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