SEE exposure to Greece: Much ado about nothing or a serious threat?

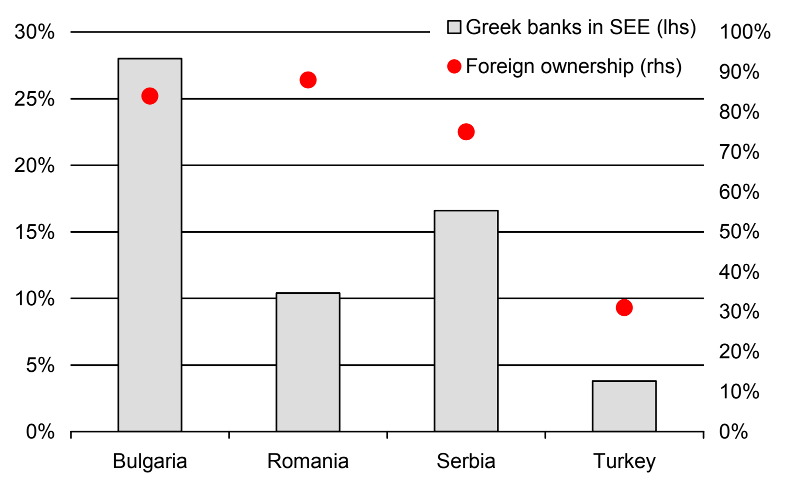
- Since Greece announced that its budget deficit for 2009 was close to 13%, concerns on the sustainability of Greek debt have mounted. We believe a default is unlikely, but the saga could continue to create turbulence and directly impact Greek economic growth, and thus the strategy of Greek companies abroad.

- A slowdown of Greece could in principle have an impact on the open and small South Eastern European economies. Bulgaria is the most exposed as Greece is one of the top-3 export destinations (almost 10% of exports) and Greek FDI in the country is significant. Greek FDI in Serbia is notable as well. However, all in all, we think spill-over effects *via* real links, even if not negligible, should not be considered a major source of concern: #1 trade links are not so important as to be able to affect significantly economic growth, even for Bulgaria; #2 FDI has peaked over the past few years and will not be a driver of growth.

- In contrast, Greek banks provide a more relevant transmission channel for SEE, where Greek banks have a significant role: there are 4 Greek-controlled banks among the top-10 in Bulgaria, 3 in Serbia, 2 in Romania and one in Turkey.

- Market concern on a possible delay of Euro adoption seems to us sensibly overestimated: first, it's a long term process, and second, when entering the Eurozone, CEE countries will be in a better shape than EMU peripheries in terms of fiscal performance.

ROLE OF GREEK BANKS IN SEE COUNTRIES (% OF TOTAL ASSETS)



Source: UniCredit CEE Strategic Analysis

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Greek spillovers to South Eastern Europe

A Greek tragedy?

Since Greece announced that its budget deficit for 2009 was close to 13%, concerns on the sustainability of Greek debt have mounted. We believe a default is unlikely, but the saga could continue to create turbulence and directly impact Greek economic growth, and thus the strategy of Greek companies abroad, especially banks. Can the Greek problems have a significant impact on the SEE economies which are in a relatively fragile situation following a difficult 2009?

Spill-overs to CEE countries have been contained for the moment

The biggest transmission mechanism for the CEE region would come through influence on the South Eastern European (SEE) countries. For now, negative financial spill-overs to Emerging Europe have remained limited: country risk (in terms of CDS) of EMU peripheries and Eastern Europe, for instance, has been moving in opposite directions for several weeks. The whole spectrum of EEMEA CDS premia (except Ukraine and Latvia) now trades inside Greece.

The main transmission channels

In this piece we provide an overview of the possible Greek spill-over effects for the SEE countries, focusing on the following transmission channels:

- Trade flows: Greece and SEE economies are open and highly integrated;
- FDI: Greek companies are active players on SEE markets in various markets
- Presence of Greek banks in the region
- Possibility that the Euro adoption process of Eastern European countries could be negatively affected

The channel of trade and FDI

Greek influence in SEE is not negligible…

…Bulgaria the most exposed

The EUR 240bn Greek economy is 1/10th of the German economy and 1/6th of the Italian economy (Germany and Italy are the main trading partners of CEE). Even so, any slowdown of the Greek economy could have a significant impact on the small open economies of the SEE region. Regarding trade flows, Bulgaria looks to be most exposed, given that imports to Greece account for almost 10% of total Bulgarian export, and less than 2.5% of total exports of Romania, Serbia and Turkey.

In terms of FDI stock, Greek companies have invested significant amounts in various sectors of the Serbian economy, from banking and telecommunications to food processing, cement production and tourism: there are around 200 Greek companies operating in Serbia (and 200 more Serbian-Greek companies) and Greece is the number two source of foreign direct investment in Serbia (with around 14% of total FDI stock). Greece is among the top investors in Bulgaria as well (number four, more than 8% of total stock). In Romania too around 8,000 Greek companies are registered, with estimates of the FDI stock standing at 8% of total. In contrast, Croatia has no such economic ties (negligible role of trade with Greece and FDI).

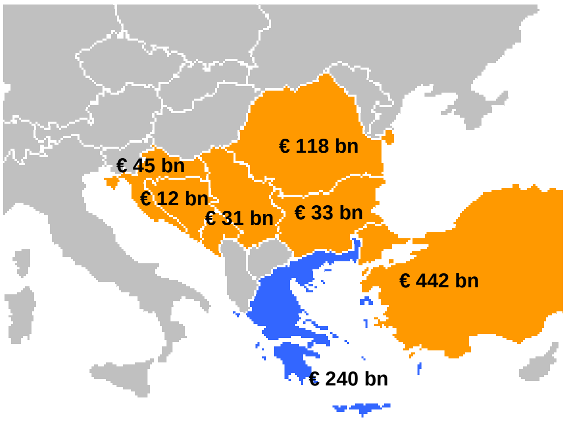
Greece is a significant importer of Bulgarian goods in different sectors (rank)

Electricity	#1
Basic metals	#3
Other non-metallic minerals	#2
Chemicals	#4
Paper products	#2
Wood products	#1
Textile	#3
Food, beverages tobacco	#1
Agriculture	#3

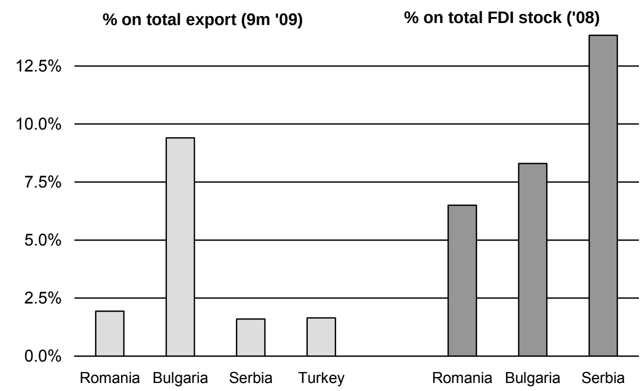
Despite the relatively large share of exports and FDI we think the direct consequences of a Greek slowdown should not be dramatic for SEE countries: #1 trade links are not so important as to be able to affect significantly economic growth: Bulgarian trade represents slightly more than 30% of GDP, and the Greek share is less than 10% of this, as mentioned; hence, a possible impact on Bulgarian growth should be limited to a few decimals; #2 FDI has peaked in the past few years and will not be a major driver of growth this year as in the past, irrespective of the strategy of Greek companies.

GREEK AND SOUTH EASTERN EUROPE

2009 GDP of South Eastern European countries, EUR bn



Export to Greece and Greek FDI in the countries



Source: UniCredit Research

Recovery on the horizon for SEE, but growth prospects are relatively poor if compared to other CEE countries

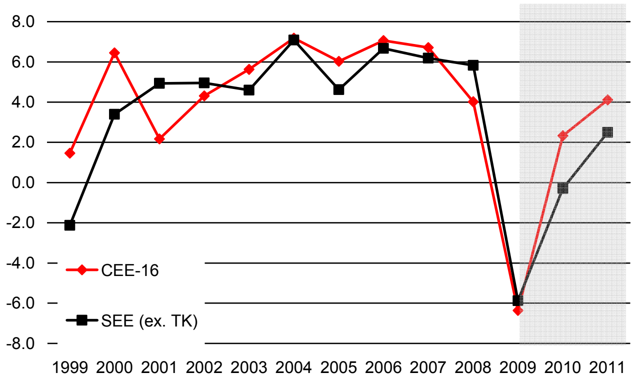
In the period 2002-08 growth in the SEE region was in line with the average growth of Emerging Europe, with the size of the drop in 2009 being similar too. However, recovery prospects appear different, with SEE economies needing more time to recover in comparison to the rest of the CEE. The region has more difficulty leveraging off an export-led recovery *via* the exchange rate adjustments (FX in Bulgaria and Bosnia are pegged, while Croatia is keeping the HRK stable), with Turkey being a notable exception.

The banking sector of these countries was also under pressure during 2009: the estimated peak of NPL could reach two or three times the pre-crisis level. Cost of risk (in terms of provisions to loans ratio) is probably going to exceed 3% in 2010 (less than 2% in Central Europe)[1]. Credit growth in 2009 in SEE was close to zero or negative and the outlook for the banking sector remains challenging, with ongoing deterioration in credit quality and low volumes growth. However, the IMF programs, where present (Bosnia, Serbia, Romania have programs worth EUR 1.5bn, EUR 3.5bn and EUR 26bn) are an important source of stability.

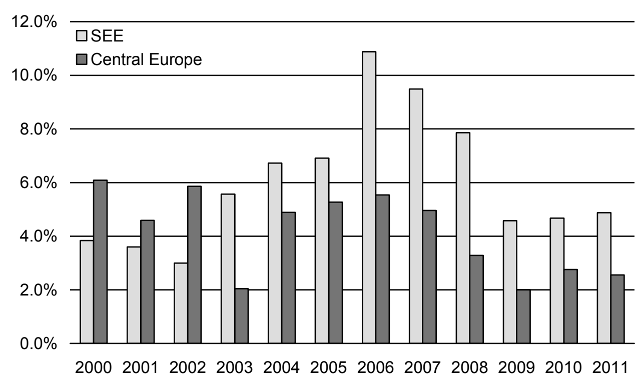
[1] See UniCredit Group CEE Strategic Analysis, "CEE Banking Outlook", November 2009 (http://www.bankaustria.at/en/open.html?opencf=/en/17764.html)

RECOVERY IN SEE IS DELAYED VERSUS OTHER CENTRAL EASTERN EUROPEAN COUNTRIES

GDP Growth in SEE (excluding Turkey) and CEE



Foreign direct investments (% on GDP)



Source: UniCredit Research estimates

Greek banks in South Eastern Europe

Greek banks have an important role in SEE economies

The most pertinent transmission channel from Greece to South Eastern Europe is undoubtedly represented by the activity of Greek banks. There are 4 Greek-controlled banks among the top-10 in Bulgaria, 3 in Serbia, 2 in Romania and 1 in Turkey (no Greek banks in Croatia). The National Bank of Greece, EFG Eurobank, Pireus and Alpha bank are major players in the region, with assets close to EUR 70bn. These banks represent a large share of local banking sectors: Greek banks account for almost 30% of total assets in Bulgaria and more than 15% in Serbia. At the same time SEE represents a large share of their assets, up to one fourth of total assets for EFG Eurobank, which has an extensive presence in most of SEE countries and more than 20% for Alpha Bank and National Bank of Greece.

BANKING PLAYERS IN SEE COUNTRIES (NAME OF THE BANK AND OWER)

Rank	Bulgaria		Romania		Serbia		Turkey	
# 1	UniCredit	Unicredit Group	BCR	Erste	Banca Intesa	IntesaSP	Ziraat	State
# 2	DSK	OTP	BRD	SocGen	Komercijalna	State	Is Bankasi	Is Bank fund
# 3	UnBulgBnk	NB of Greece	Volksbank	Volksbank Intl	Raiffeisen	RZB	Garanti	GE Capital
# 4	Raiffeisen	RZB	Raiffeisen	RZB	Eurobank EFG	Eurobank EFG	Akbank	Citi
# 5	Eurobank EFG	Eurobank EFG	Alpha Bank	Alpha Group	Hypo Alpe	BayernLB	Yapi Kredi	Unicredit Group
# 6	FirstInvestBank	Private	UniCredit	Unicredit Group	UniCredit	Unicredit Group	Vakifbank	State
# 7	Piraeus	Piraeus	B. Transilvania	Local private	Vojvodjanska	NB of Greece	Halk Bank	State
# 8	SG Expressbank	SocGen	Banc Post	Eurobank EFG	AIK	ATEbank Greece	Finansbank	NB of Greece
# 9	Alpha Bank	Alpha Group	CEC	State	SocGen	SocGen	Denizbank	Dexia
# 10	CrpCommBnk	Local private	ING	ING	ProCredit	ProCredit	ING	ING

NOTE: Background is in grey for the Greek banks. Source: UniCredit CEE Strategic Analysis

While the presence of Greek banks in SEE does not represent a problem *per se*, a more inward-looking strategy (i.e. less focus on foreign countries) could be expected. On one side, Greek banks participated in the "Vienna initiatives" (i.e. the commitment by international banks to grant support to their foreign affiliates; this was associated to the IMF programs in Bosnia, Serbia and Romania among SEE countries) and are expected to broadly maintain their exposure to the countries. Expansion plans will depend on funding, and that in its turn is related to funding conditions for Greece as a whole. CDS for Greek banks operating in SEE are now similar (Alpha, National Bank of Greece) or even significantly higher (EFG Eurobank) than Greek sovereign[2]. SEE banking markets have a generally high loans to deposit ratio - between 120% and 130% for all the SEE countries except Turkey - and the funding gap is financed through foreign funding: the era of cheap foreign funding is over. The loans/deposits ratio is generally higher than average for some foreign affiliates of Greek banks. Deposits represent only a 51% of banks' liabilities in SEE (55% in Central Europe), while foreign funding represent 24% (18% on average in Central Europe).

Greek banks in Bulgaria are more exposed in terms of credit quality

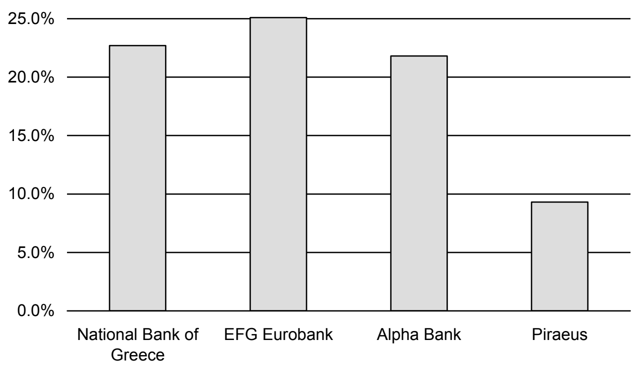
Regarding the specific case of Bulgaria, where Greek banks have a large presence, NPLs reached 6.1% at the end of 2009, up from 3.2% at the end of 2008. Likewise, accounted impairment on the income statement of the banking system as a whole increased more than three-fold compared to 2008, reaching over BGN 1bn, whereas the impairment of Greek banks rose more than four-fold. Thereby, Greek banks' share of impairments in 2009 rose by 10% to 39%, while their share of banking assets stood at 28% at the end of 2009.

Lending channel is more relevant

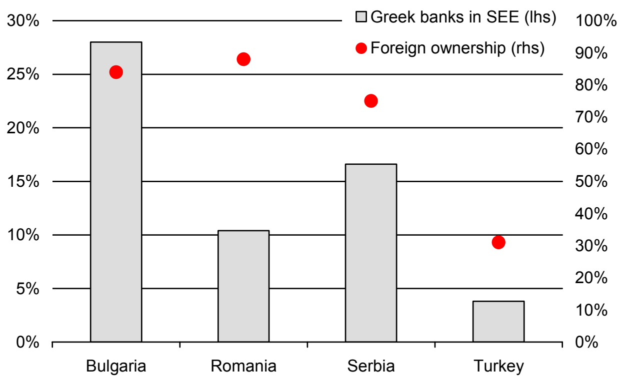
All in all, we believe the presence of Greek banks – among the various transmission channels (trade, FDI, risk of delaying Euro adoption) - is the most relevant for SEE, namely for Bulgaria and Serbia. Unless financing conditions for Greek banks improve (*via* improved markets conditions of the Greek sovereign risk), they will remain extremely cautious regarding the focus on their foreign affiliates. As a result, this element will further contribute to the relatively poor credit growth outlook in SEE.

GREEK BANKS IN SEE

SEE exposure of Greek banks (% of total assets)



Role of Greek Banks in SEE countries (% of total assets)



Source: UniCredit CEE Strategic Analysis

TOP GREEK BANKS

bn euro	NBG	EFG Eurobank	Alpha Bank	Piraeus Bank
Market capitalization (EUR bn, 29 Jan 2010)	12.9	4.5	4.8	2.8
Total assets (EUR bn)	110.5	84	74	54
Customer loans (gross)	75.6	56.4	52.2	38.3
Total equity	9.1	5.7	4.9	3.6
Attributable net profit	0.39	0.17	0.17	0.13
Cost/income ratio	43%	49%	47%	54%
Tier-1 ratio	12.2%	10.9%	9.7%	9.3%

[2] The Greek government was active in supporting its banking sector during the crisis: the support plan for the banking sector was EUR 5bn of capital injections, EUR 8bn of liquidity injections (trough the issuance of special bonds) and EUR 15bn of state guarantee. Piraeus, NBG and Eurobank issued preference shares to the Greek state (EUR 350mn, 950mn, 370mn respectively); NBG and Eurobank issued EUR 1 bn and EUR 500 mn of government guaranteed bonds. See UniCredit Group CEE Strategic Analysis "CEE Banking Outlook", November 2009.

ROE	24%	7.3%	16%	9.0%
Loans/deposits ratio	94%	126%	109%	107%
NPL ratio (IFRS7)	5.10%	5.90%	4.80%	4.50%
Total Assets in SEE (EUR bn)	25.1	21.1	16.1	5

Source: UniCredit CEE Strategic Analysis

Financial contagion still dangerous for SEE, but the fiscal position is very different

Spill-overs could affect high debt-high deficit countries

… but fiscal metrics is sensibly different

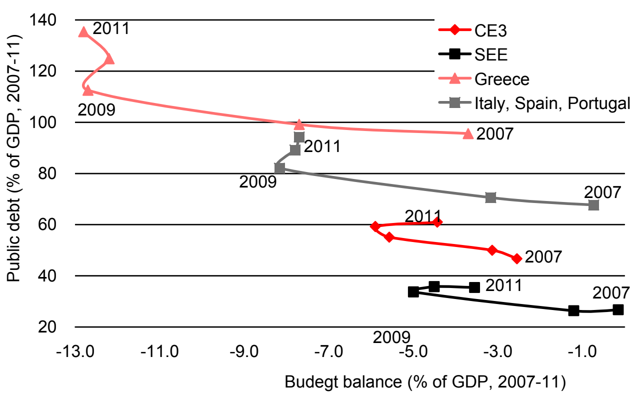
The ongoing Greek saga will continue to add some volatility to sovereign risk across Europe, at least during 1H10. Principal focus will be on the fiscal positions: in this respect countries with high debt would be most affected, and Hungary stands out in this respect. Whereas the SEE countries look relatively sound, given that their positions are sensibly better than EMU peripheries in terms of public debt (all SEE countries have debt-GDP ratio under 60%) and public deficit (most of the countries under 5%, except for Romania). Markets have been able to discern the different fiscal situations over the last few months and contagion remained limited. Contagion could be particularly harsh if and only if the Greek situation sensibly affects global risk appetite.

EU *fatigue*: will Euro adoption become more difficult?

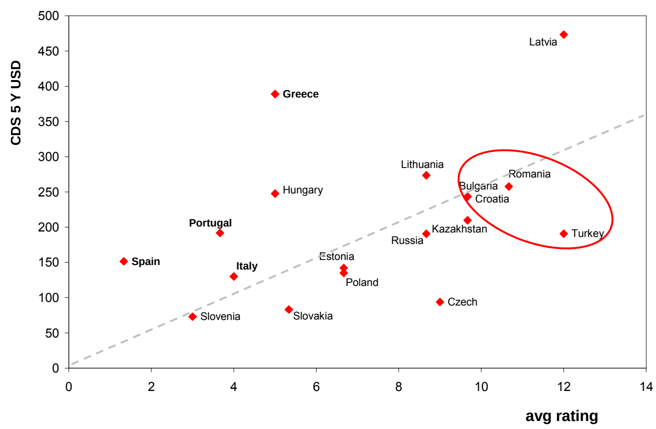
Last but not least, Greek problems could put in to question the role of EMU as the optimal currency area and limit further "enlargement". Market concern on a possible delay of Euro adoption seems to us sensibly overestimated: #1 it's a long term process and not something that will materialize in the coming months. At the moment the Baltic countries are the most committed to adopt the common currency as soon as possible (2011-13). Bulgaria, Romania and Hungary are expected to join the Eurozone in 2013-14, Poland and the Czech Republic in 2015-18; #2 it's a process that has fairly clear rules, despite also being a clear political decision; #3 when entering the Eurozone, CEE countries will be in a better shape than EMU peripheries in terms of fulfillment of the Maastricht Criteria (especially on fiscal metrics). If EMU convergence will not be significantly affected, the same is true for EU convergence: Croatia will join the EU soon, while the rest of the countries (Bosnia, Serbia, Turkey) are still some years away from membership.

FISCAL POSITION OF EMEA COUNTRIES LOOKS BETTER

Fiscal position of EMU and EMEA countries



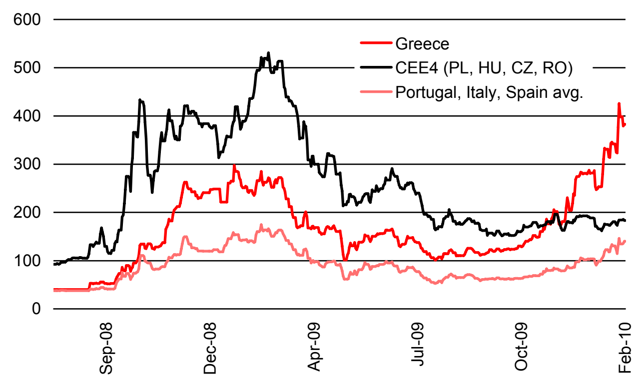
Current CDS (USD 5Y) and average rating



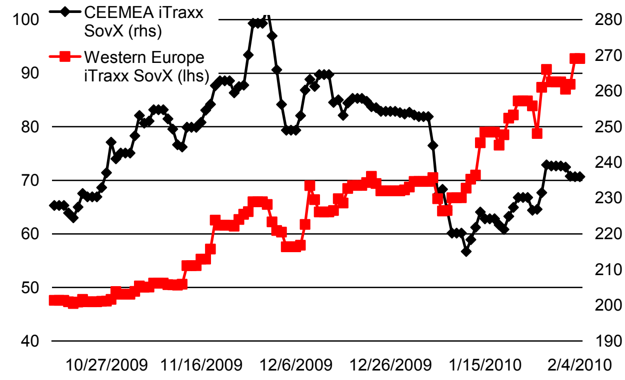
Note: CE3 is the simple average of Poland, Czech and Hungary; South Eastern Europe (SEE) is the average of Turkey, Romania, Bulgaria. Average rating is calculated as an average of Moody's, S&P's and Fitch. Source: Bloomberg, EU Commission, UniCredit Research estimates

CEE CREDIT LOOKS FAVORABLE

CEE Credit outperforming



But east-west spreads have already tightened



Source: UniCredit Research estimates

Appendix: Which Bulgarian industries could be seriously affected?

Export, FDI, tourism

We feel that the Bulgarian economy is most exposed to Greek problems: firstly through variation in export volumes from Bulgaria to Greece (Greece accounts for over 9% of Bulgarian export), including such by Greek companies which have settled production bases in Bulgaria in order also to serve the market in Greece; second, through changes in investment and spending by Greek companies and citizens in Bulgaria reflected in weaker FDI inflows, as well as tourism revenue (Greek FDI stock is close to 8% of total FDI Bulgarian stock).

The **first group of sectors that is likely to be hit includes agriculture, food and beverage goods**, for which Greece is among the top export destinations. Such sectors are likely to be relatively stable, as the Greek economy will continue to import more resilient (in terms of demand) non-discretionary goods, which are produced at lower cost in Bulgaria.

Service sectors will feel the effects

The **second group is comprised of services sectors like finance, real estate, trade, communications, transportation, travel and leisure.** This group will be the most affected in terms of lower investments and spending by Greek companies and individuals. In fact, the drop in FDI flows from Greece in 2009 was largely due to significant decreases in financial intermediation (FDI flow in the sector decreased by EUR 249mn yoy in January-September 2009), real estate and business services (FDI flow deceased by EUR 57mn yoy in January-September 2009), and transport and communications sectors (a drop of EUR 46mn). Greek FDI slowed down more significantly than those of the other countries: the overall drop in the FDI flows from Greece to Bulgaria in January-September 2009 versus the corresponding period of the previous year was EUR 383mn, with total flows down 93% yoy, compared to a decrease of total FDI flows from all countries of 54% during the same period. Notably, the FDI flow decline has so far not led to significant underperformance of Greek banks in terms of loan book growth, as they registered a 3.8% increase yoy at the end of September 2009, while the banking system as a whole was up by 5.8% during the same period.

Greek FDI affected more than average

Considering tourism revenue, the beginning of the year has been difficult for the winter resorts in Bulgaria, due also to organized protests by Greek farmers blocking the entry points at the border, and thus restricting Greek tourist flows. Estimated losses for the whole Bulgarian economy from Greek farmer protests has already reached EUR 40mn (according to estimates by the Ministry of Agriculture and Food report published on 27 January), as besides tourism, transportation and trade activities have also been affected.

Bulgarian manufacturing export not immune

In the **third group, sectors exporting manufactured goods, primarily related to construction and equipment manufacturing sectors in Greece are likely to be impacted from an eventual sharp drop of investments in infrastructure,** in addition to the already depressed levels of building construction in Bulgaria and in Europe. Such sectors, in which Greece has been a top export destination, include production of basic metals, non-metallic minerals, wood products, chemicals and machinery. Importantly, this comes on top of a very significant drop of activity in the constructions sector in Bulgaria as well, which does not bode well for investment outlays in this group of sectors in the mid-term.

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