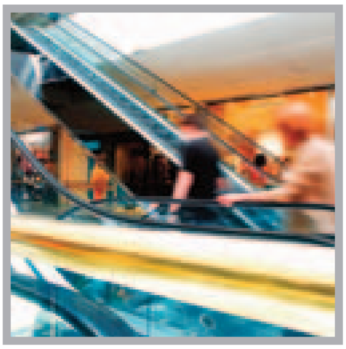
UniCredit Group

CEE Households' Wealth and Debt Monitor



"CEE Households Facing Financial Constraints"

January 2009

In cooperation with

PIONEER Investments®

Imprint

Published by UniCredit Bank Austria AG
http://www.bankaustria.at

Edited by CEE Research Department (cee.economic.research@unicreditgroup.at)
Bernhard Sinhuber, Phone: +43 (0)50505-41964

Produced by Bank Austria Identity & Communications, Editorial Desk, (pub@unicreditgroup.at),
Phone: +43 (0)50505-52826

Printed by Bösmüller

Layout: Horvath Grafik-Design

Closing date: 9th January 2009

Index

Global overview

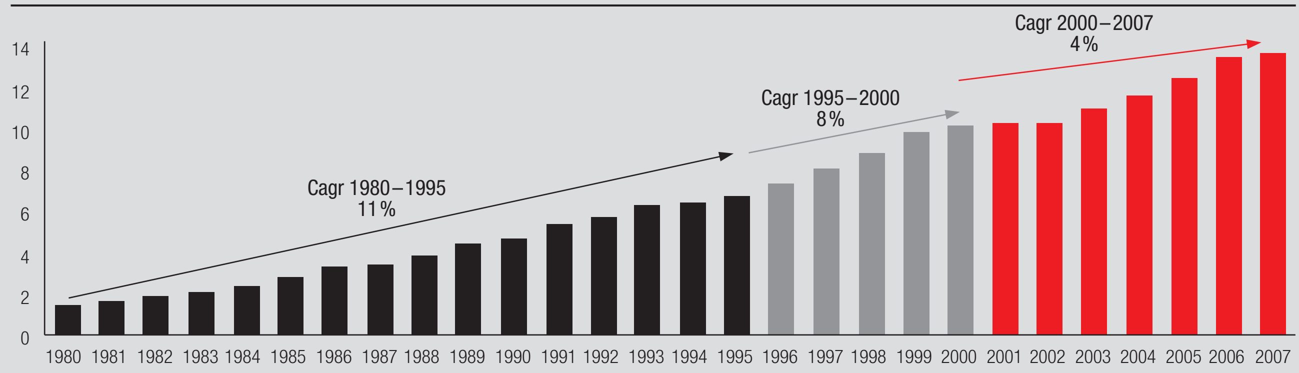
Global household wealth trends in the midst of a crisis

Daniele Fano, Laura Marzorati, Teresa Sbano and Georgieva Milena

It is certainly very difficult to comment on the structure and trends of household wealth in the midst of a crisis that is so widespread, exerts such a deep impact on the liquidity of financial systems and a broad array of securities, and results in such heavy losses on the equity markets.

From 1979 to 2000 financial markets and household wealth benefited from an exceptional period of growth. The end of the dotcom bubble marked the beginning of a new and uncertain period, the consequences of which we are dramatically experiencing.

Household Financial Assets Growth in Main European Countries (€ tn)



Source: Pioneer Strategy Unit

Some lessons from past experience may help us predict future developments.

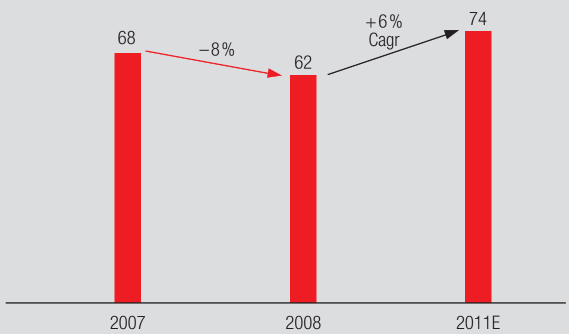
Risk aversion will be strong for a long time to come. Usually, investors cohorts exposed to heavy market downturns tend to avoid relevant exposure to equities for their lifetime. To date, returns on the equity markets over a 10 years time are negative and therefore the scar will not heal easily. Protecting the real value of household wealth will, therefore, represent a daunting challenge for distributors, asset managers and regulators in the years to come.

On the other hand, the sheer extent of public intervention raises prospective inflationary risks, while low liquidity and price corrections in the real estate sector mark the end of yet another myth: housing as a "safe haven".

We forecast that even in difficult times households will continue saving in order to stabilise their lifetime income objectives. Moreover, governments will barely have the resources needed to cover all of the labour market uncertainty and longevity risks. Thus the need for medium to long-term savings programmes will not only remain but probably gain in importance.

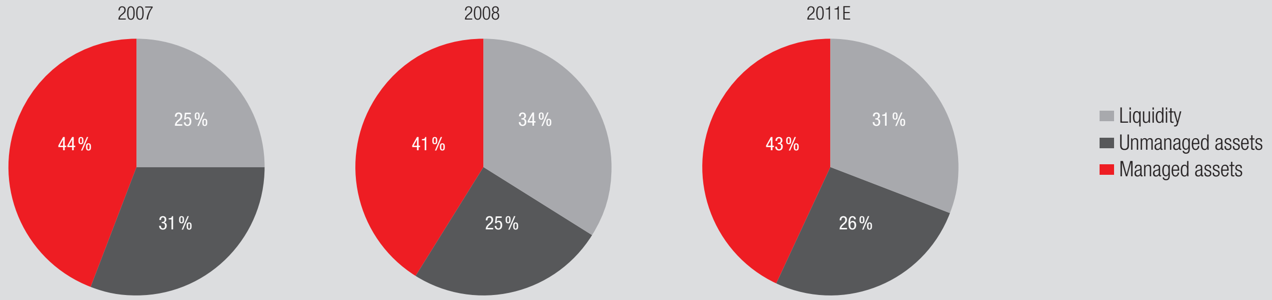
Regulators, asset managers and distributors will need to consolidate trust with final investors. What is needed, in our opinion, is a new range of simple, low-risk but highly diversified products, in an environment dominated by enhanced public supervision.

Global Household Financial Assets (€ tn)



Source: Pioneer Strategy Unit
Global wealth includes North America, Japan, Australia, Western Europe, CEE.

Household Financial Assets Mix*



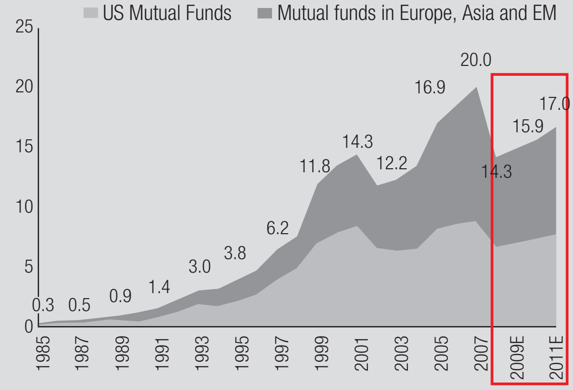
*) Liquidity: currency and deposits; unmanaged assets: shares and securities; managed assets: life insurance, pension and mutual funds.
Source: Pioneer Strategy Unit
Global wealth includes North America, Japan, Australia, Western Europe, CEE.

After reaching record levels of EUR 68 tn in 2007, global household financial assets are estimated to have dropped by 8 % in 2008 down to EUR 62 tn. As we write, the outcome of this crisis is still unknown. Once the deleveraging of the financial system has been accomplished and the economic cycle has rebounded somewhat, many of the losses registered in household wealth will be recovered. It is hard to predict a timeline; however, we estimate that in 3-years' time household assets will recover, reaching EUR 74 tn, which implies a 6 % CAGR in 2008–11.

Managed assets should be among the hardest hit by the turmoil. We estimate that their share in household financial assets could fall from 44 % at end-2007 to 41 % in 2008, as a result of the negative market performance and the massive redemptions as investors flew to safety.

The return of confidence in the Retail market will not be rapid as the bulk of risk-averse clients will shy away from equities for years. For 2011 we still expect over 30 % of household assets to be invested in liquid instruments, with some recovery of managed assets, especially instruments with a long-term focus. We estimate that the share of managed assets in 2011 could return to 43 %.

Mutual Fund Assets (€ tn)



Source: Pioneer Strategy Unit

Mutual fund assets, one of the hardest hit instruments, are down to EUR 14 tn globally in 2008 from the record level of EUR 20 tn in 2007, due to the negative performance effect and strong outflows. In 2011 AUM are expected to reach EUR 17 tn as the potential recovery in market performance restores stability to flows.

Regional overview
CEE Households Facing Financial Constraints

Fabio Mucci

Following years of rapid improvement in household financial conditions, 2008 marked a clear deterioration. Cooling income growth, coupled with negative wealth effects and still unchanged consumer spending led to only marginal growth in household gross financial assets at the regional level. Demand for credit remained high through the year, keeping growth in household debt in double digit figures. The impact of the crisis in terms of the credit squeeze, however, has taken its toll since last October, with banks' offer increasingly switching to short-term and unsecured lending. Bearing in mind the historically low savings capacity of the household sector, especially in some SEE and CIS countries, the less supportive macroeconomic environment and tightening lending requirements anticipated are likely to result in a further stretch of households financial positions in 2009.

Persistent volatility and a only gradual recovery in the performance of the capital markets are likely to continue pushing households toward more traditional saving products such as bank deposits, in the context of still high demand for cash. Accumulation into long-term instruments, such as pension funds, will continue to play a supportive role in most of the countries.

With slowing economic growth and upside risks of a recession in some countries, the debt burden for the households sector is likely to rise, increasing the chance that a number of households may begin to face payment difficulties. Households sector exposure to FX risks, mostly due to rising FX mortgage debt burden, also remains an issue to monitor.

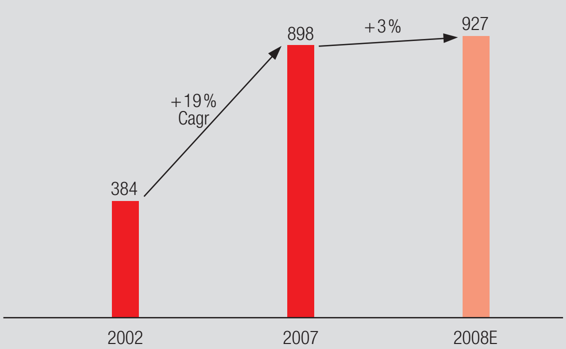
Less supportive macroeconomic environment and negative wealth effects forcing households to retrench

Over the last 5 years the household sector has benefited most from the economic upswing, enjoying a period of stable rising income, improving labour market conditions and easier access to credit. A structural upwards shift in living standards has resulted in buoyant consumption growth (above 8.0 % in real terms per annum). Rapid development in real estate markets also contributed to an increase in the willingness of households to borrow. In the context of a historically low households saving capacity, the robust expansion in CEE[1] household debt (+ 44 % per annum in the 2003 – 2007 period) has been accompanied by a stable downward trend in the accumulation of net financial wealth. Although not keeping up with the pace of indebtedness, gross financial wealth in CEE countries has been rapidly increasing, posting double-digit growth for the fourth year in a row in 2007 (+ 22 % yoy), with soaring prices in domestic financial markets providing a boost to wealth creation.

Still at the beginning of 2008 the financial crisis affecting international markets seemed rather remote to most CEE markets and was completely disregarded by the households sector, as proved by quite strong posting in standard sentiment indicators. In the last months of 2008, however, the feared transmission channel, passing through lower capital inflows or even rapid capital outflows, strong correction in equity and debt markets, as well as internationally induced credit squeeze started to operate. The resulting deterioration

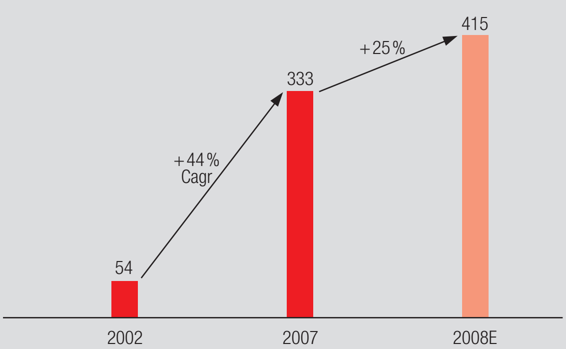
1) Hereinafter, the CEE aggregate includes new EU members (w/o Slovenia and the Baltic states), Russia and Turkey unless otherwise stated

CEE Household Financial Assets (€ bn)*



*) CEE: including new EU members (w/o Slovenia and Baltic states) + Russia and Turkey
Source: UniCredit Group CEE Research Network

CEE Household Debt (€ bn)*



*) CEE: including new EU members (w/o Slovenia and Baltic states) + Russia and Turkey
Source: UniCredit Group CEE Research Network

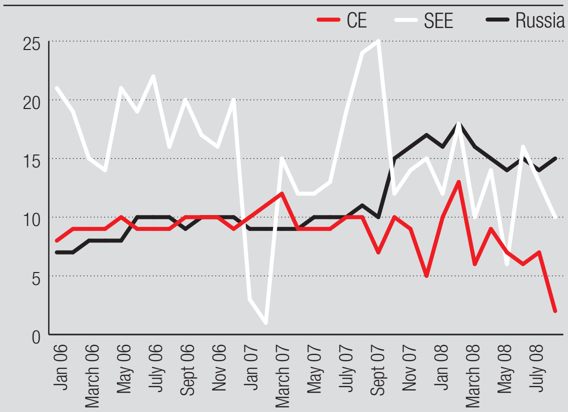
in the macroeconomic environment and the expected slower income growth are now clearly having an impact on households' behaviour across the region, breaking the climate of booming consumption and fast leveraging we have become accustomed to in the recent past.

Despite still good economic performance, the accumulation of financial assets in 2008 has been affected by a strongly negative performance effect, as stock markets throughout the CEE region all tumbled by more than 50 % from the beginning of the year. Assets held in the form of listed shares and mutual funds have been hit the most by falling prices, forcing massive redemptions. The impact of capital market losses on wealth has been particularly strong for Croatian, Polish, Bulgarian, Romanian and Hungarian households, given the relatively higher weight of those asset classes in their portfolio compared to the rest of the region. Overall, household financial asset growth at regional level is anticipated to have recorded a significant deceleration in 2008, up by a marginal +3 % on average (–0.1 % excluding Russia) to reach 37 % of GDP (down from 41 % in 2007).

We expect just a marginal recovery in the accumulation of financial wealth in 2009, with a gradual return of confidence in the financial markets set to provide some support. As risk aversion will continue to dominate, traditional and safer savings products like bank deposits and securities are set to gain further ground, while we predict only very moderate inflows into mutual funds and shares, especially this year. Overall, growth in CEE gross financial wealth is expected to average 14 % in 2009–2010 (12 % excluding Russia) topping out at 39 % of GDP by the end of 2010 (totalling EUR 1.2 bn) still below the level recorded before the crisis.

Compared to other Western European countries, CEE households kept on spending during 2008. In most of the region the first 9 m of last year were marked by persistently good growth in wages and favourable labour market conditions. Worsening economic prospects, however, have exerted an impact in the last part of 2008, forcing households to retrench consumer spending throughout the CEE region. Signs of cooling in consumption growth have been mounting since H2 last year, with retail sales slowing particularly in Central and South Eastern Europe, and growth even turning negative in Hungary, Croatia and the Czech Republic on the back of falling demand for durables.

Retail Sales (yoy % growth, real terms)*



*) CE: Czech Republic, Hungary, Poland and Slovakia; SEE: Bulgaria, Croatia and Romania
Source: UniCredit Group CEE Research Network

The effect of slower growth in household disposable income will be compounded by the significant tightening in credit market conditions registered since the turbulences of last September. Indeed, October was probably a turning point for lending activity in most of the region, with signs of a marked deceleration becoming more visible, especially in Russia, Romania and Bulgaria, as a result of a liquidity drought and rising cost of risk. Despite the slower growth in the last quarter of the year, the increase in household indebtedness throughout the region should have remained in double figures last year, increasing by 25 % (21 % excluding Russia), down from more than 44 % recorded in 2007 (41 % excluding Russia).

Overall, the impact of the crisis in terms of the credit squeeze is expected to be stronger this year with growth in household indebtedness forecasted to slow further to around 14 % yoy on average in the region (10 % excluding Russia). Some re-acceleration in growth might take place from 2010, subject to a return in confidence and an improvement in liquidity conditions at global level. Tighter credit conditions and lower appetite for debt are expected to limit both supply and demand this year, especially in South-Eastern Europe and Russia. Further stabilisation in the real estate market will lead banks to increasingly focus on short-term and unsecured lending, keeping growth in mortgages subdued relative to other forms of financing. A moderation in household debt is also anticipated in Central Europe driven by a general slowdown in economic activity and still tight lending requirements.

Clearly, there are differences across countries in terms of households financial position. The accumulation of net financial wealth is anticipated to remain subdued particularly in South-Eastern Europe, where following the huge deterioration in net financial inflows recorded last year, on the back of dynamic growth in indebtedness and sluggish growth in financial assets, new inflows of net financial assets relative to GDP (a proxy for the household financial savings ratio) is set to recover marginally, increasing by roughly 2 % in 2009 compared to an anticipated drop of 5.7 % last year. The gradual recovery in the capital market performance coupled with slower domestic economic growth and decreasing salary rates are likely to lead to a milder re-acceleration in household financial savings in Central Europe too, with net financial wealth as a share of GDP reaching 35 % this year compared to the 33 % projected for last year, still below the 44 % recorded in 2007.

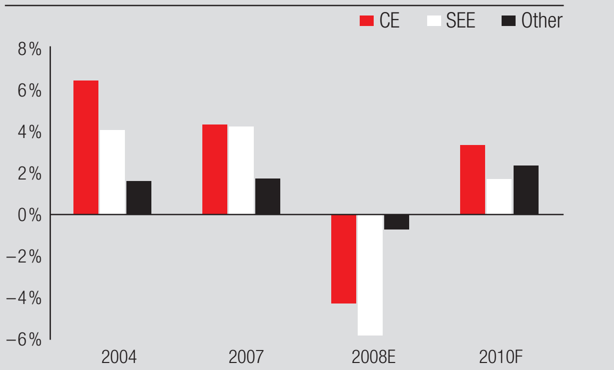
Structural indicators of household sector*

Country	Year	Financial Assets % GDP	Financial Liabilities % GDP	Net Financial Assets % GDP	Fin. Liab. % of Assets	Per capita Fin. Assets	Per capita Fin. liabilities	Per capita Net Fin. Assets
Bulgaria	2007	59.5	25.9	33.5	43.6	2,249	981	1,268
	2008E	50.0	29.7	20.3	59.5	2,243	1,334	909
	2010F	52.7	33.3	19.3	63.3	2,900	1,836	1,064
Croatia	2007	99.4	42.3	57.1	42.6	8,414	3,580	4,833
	2008E	86.3	42.6	43.7	49.3	8,083	3,987	4,096
	2010F	90.8	44.0	46.8	48.5	9,692	4,697	4,994
Czech R.	2007	65.2	24.5	40.7	37.6	8,427	3,167	5,260
	2008E	64.8	27.3	37.5	42.1	9,133	3,848	5,284
	2010F	67.4	31.5	35.8	46.8	11,172	5,227	5,945
Hungary	2007	66.7	28.9	37.8	43.3	6,641	2,875	3,766
	2008E	61.9	31.4	30.5	50.7	6,550	3,324	3,227
	2010F	66.9	34.7	32.2	51.8	7,755	4,020	3,735
Poland	2007	66.7	21.8	44.8	32.7	5,737	1,878	3,859
	2008E	59.6	26.1	33.5	43.8	5,616	2,460	3,156
	2010F	63.6	27.2	36.4	42.8	6,639	2,839	3,799
Romania	2007	32.7	19.5	13.3	59.4	1,705	1,013	692
	2008E	27.0	20.4	6.6	75.6	1,670	1,262	407
	2010F	27.8	20.8	7.0	74.9	2,187	1,637	549
Russia	2007	23.7	9.8	13.9	41.3	1,534	634	900
	2008E	21.6	10.5	11.1	48.4	1,751	848	903
	2010F	23.4	12.4	11.0	52.9	2,465	1,305	1,160
Slovakia	2007	52.6	17.0	35.5	32.4	5,363	1,737	3,627
	2008E	51.0	18.4	32.6	36.1	6,433	2,323	4,110
	2010F	54.6	20.5	34.1	37.6	7,992	3,002	4,990
Turkey	2007	37.7	11.1	26.6	29.4	2,658	781	1,877
	2008E	38.0	12.6	25.3	33.3	2,564	853	1,711
	2010F	40.5	14.8	25.6	36.7	3,569	1,309	2,260
CEE	2007	40.8	15.1	25.7	37.0	2,896	1,074	1,823
	2008E	36.9	16.5	20.4	44.7	2,994	1,340	1,654
	2010F	38.8	18.2	20.6	46.9	3,892	1,830	2,062

*) To ensure consistency, total financial wealth excludes assets invested in unquoted shares and other equities. Other accounts receivable are also excluded. Data on household liabilities also includes loans granted by non-bank financial institutions.
Source: UniCredit Group CEE Research Network

CEE Household Net Financial Assets

(yearly change as a share of GDP)*



*) CE: Czech Republic, Hungary, Poland and Slovakia; SEE: Bulgaria, Croatia and Romania; Other: Russia and Turkey
Source: UniCredit Group CEE Research Network

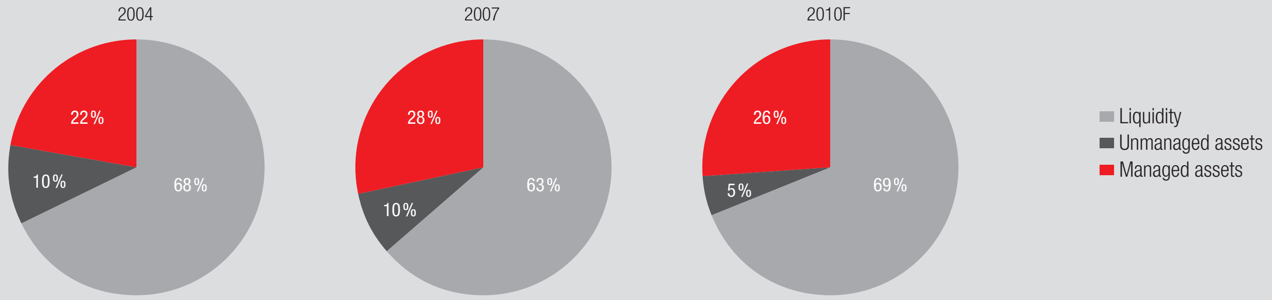
On the assets side, risk aversion and ill winds on financial markets drive flight to quality

Before the global turmoil, the CEE region enjoyed a period of increasing portfolio diversification from traditional investments in favour of alternative assets, including investment funds and listed shares. Soaring market prices and record high market capitalisation driven by peaking economic growth and lively IPO activity played a key role in supporting this process, with bank deposits still accounting for the lion's share, particularly in SEE, Russia and Turkey. The launch of pension reforms boosted the process further, increasing the relevance of long-term instruments, which was also stimulated by the introduction of tax incentives for supplementary pension schemes.

Since the summer of 2007 the world's financial landscape has changed dramatically. With risk aversion dominating investors, the stock markets throughout the CEE region have all tumbled, outstripping the declines in Western European indices. Fixed income markets have been similarly hit, with benchmark sovereign bond yields surging to between 300 and 400 bps in countries like Hungary, Russia and Romania. The impact of falling equity prices on the accumulation of household wealth has been particularly strong in the case of Romania, Poland and Croatia, where equity investments accounted for 10 to 30 % of total wealth at the end of 2007.

Investment into mutual funds also took a beating through 2008. Nervous investors all over the region ran for cover from volatile markets, leaving fund managers facing floods of redemptions, particularly in Poland and Croatia, where in the first 9 months the domestic

CEE Household Financial Assets Mix 1), 2)



1) CEE: including new EU members (w/o Slovenia and Baltic states) + Russia and Turkey; 2) Liquidity: currency and deposits; unmanaged assets: listed shares and securities; managed assets: mutual funds, insurance technical reserves and pension funds
Source: UniCredit Group CEE Research Network

fund industries lost 32% and roughly 50% of their values respectively. Other markets, such as Slovakia, Hungary and Romania, have shown better resilience, although the market mood has changed drastically since last summer when investment fund markets recorded large sell-offs, particularly in the latter two countries. This is also the case in Russia where net redemptions hit a record EUR 0.2 bn in the third quarter of last year.

In response to the collapsing financial markets and mounting uncertainty, households reallocated a major share of their assets to bank deposits, which serve as a safe haven during turbulent times on financial markets. The move was also motivated by supply, as competition for traditional funding among banks intensified. Growth in household deposits has been strong, especially in SEE countries, topping 20% in Romania for the first 9 m of 2008. Growth rates above 10% were also recorded in Turkey and Slovakia, while growth remained more subdued in Hungary (increasing by a marginal 3%) due to the still unfavourable economic conditions.

Along with the critical results of the asset management industry observed up to October/November, we expect the shift from mutual funds and equities into safer instruments to have been re-confirmed in the last part of 2008 as well, despite evidence of temporarily deposit withdrawals in some countries as the crisis spread out in the region in October. Despite some volatility expected in the short term, bank deposits will continue to play a dominant role in the accumulation of wealth all over the region, increasing their share in total wealth to around 61% by 2010 from the 59% projected in 2008.

The trend for a shift towards safer assets will only slow down slightly when equity markets show some signs of stabilisation. Indeed, following the massive losses recorded last year it will take some time before public confidence is restored, and hence we predict only moderate inflows into mutual funds and equities in 2009, with new inflows into investment funds expected to remain below potential, particularly in less-developed markets like Romania and Bulgaria.

At the same time, long-term savings instruments such as pension funds and life insurance should continue to play a crucial role. Despite falling investment returns, accumulation into both instruments remained pretty resilient to the crisis compared to other asset classes, with the combined share in total wealth projected to have increased to 18% at the end of 2008 from 17% in 2007. Slower income dynamics might, however, reduce the pace of this development going forward, with the relative share expected to stabilise at

CEE Household Financial Assets (LC CAGR 2008–2010)*

	Bulgaria	Croatia	Czech R.	Hungary	Poland	Romania	Russia	Slovakia	Turkey	CEE
Currency	10.5%	–3.3%	7.6%	3.5%	6.6%	12.5%	1.1%	10.8%	8.0%	6.2%
Bank deposits	14.5%	9.7%	7.1%	5.9%	6.8%	17.7%	20.9%	9%	17.4%	15.2%
Securities	–30.1%	12.5%	14.8%	10.3%	7.1%	4.3%	–	–	10.0%	11.3%
Listed shares	11.0%	12.5%	9.7%	6.9%	16.0%	11.2%	–	–	13.5%	13.3%
Mutual funds	13.0%	–4.2%	11.1%	5.2%	13.8%	11.6%	16.4%	8.1%	8.7%	12.1%
Insurance reserves	12.0%	13.4%	10.3%	9.8%	12.2%	16.3%	15.4%	9.7%	13.7%	12.6%
Pension funds	9.0%	24.9%	15.3%	12.4%	15.1%	85.4%	16.0%	28.1%	17.8%	16.3%
Tot. financial assets	**13.1%**	**9.3%**	**8.6%**	**7.4%**	**10.1%**	**16.4%**	**18.7%**	**11.4%**	**15.6%**	**14.0%**
Net financial assets	7.6%	10.2%	4.2%	6.2%	11.1%	18.1%	13.4%	10.1%	12.6%	11.6%

*) Bank deposits in Croatia, Czech Republic and Slovakia also include household savings
Source: UniCredit Group CEE Research Network

around 18 % in the next two years. The pension funds industry in particular remains promising in Romania, where starting from the beginning of 2008 a fully-funded mandatory pension system was launched in addition to the voluntary pension scheme. Pension funds constitute a small but dynamic market in Turkey too, with growth expected to average roughly 18 % in 2009 – 2010, very much in line with growth anticipated last year. Government support in stimulating investment in pension schemes is anticipated to remain strong in Russia, resulting in average yearly growth of around 16 % in the same period.

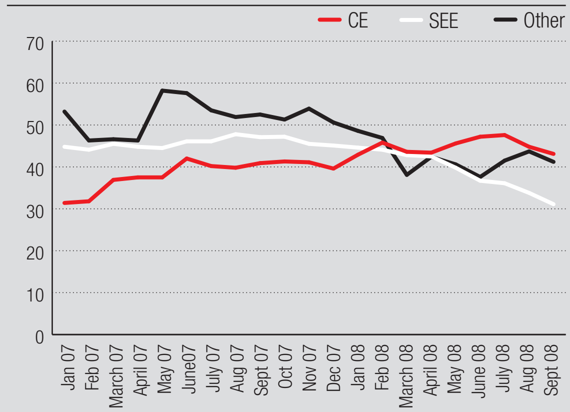
Credit squeeze winds blow over CEE

Over the past 7 years there has been a significant increase in household debt throughout the region. In the context of high international liquidity and low cost of risk, banks have supplied households in CEE with new mortgage and consumer credit products to allow a quick convergence of their living standards toward those of their wealthier western neighbours. Household demand for loans has also been high, closely accompanying rising consumer spending.

The speed and the extent of the lending boom have, however, generated concern over recent years. Spurred by the financial penetration gap and the long-term economic catch-up process, growth in household indebtedness has been particularly fast in Bulgaria, Romania and Croatia, where loans as a percentage of GDP increased between 3.5 and 5 % on an annual basis in the 2004 – 2007 period.

Following the disruption caused by the US subprime crisis in mid-2007 global liquidity conditions changed dramatically, triggering a general increase in the costs of refinancing for banks in combination with growing risk aversion. However, with the exception of the Baltic states where tightening lending requirements have already resulted in rapid deleveraging since the end of 2007, growth in household debt remained lively throughout the CEE region in the first half of last year, increasing by around 16 % (compared to end-2007)[2]. Although slowing from a very high level, household lending growth still came in around 10 to 15 % (ytd) at the end of June in Poland, the Czech Republic and Slovakia, and above 20 % in Russia and Romania.

Bank Loans to Household Sector (yoy % growth)*



*) CE: Czech Republic, Hungary, Poland and Slovakia; SEE: Bulgaria, Croatia and Romania; Other: Russia and Turkey
Source: UniCredit Group CEE Research Network

Signs of a more visible slowdown started to emerge only last summer, following the gradual decline in consumer confidence and a general tightening in monetary conditions and cost of risk (particularly in SEE and Russia). October has then marked the real turning point, leading to an anticipated year-end growth of 25 % throughout CEE (from 44 % in 2007). The gradual squeeze in credit has been particularly visible in the mortgage segment, also on the back of some stabilisation emerging in the real estate market.

Although the CEE real estate markets are generally characterised by a quantitative and qualitative gap in supply, house prices have been growing ever more slowly from the end of 2007. The change in trends is evident and, above all, unsettling for developers and other investors that have poured money into the market in recent years. In addition to the Baltic states and Kazakhstan where the bubble is already bursting, clear-cut signals of a softening in real estate activity were observed in Poland, Romania and Hungary, especially in the capital cities. According to real estate agencies, growth in apartment prices even moved into negative territory in Bucharest and Budapest, falling by – 0.5 and – 6.0 % in the first 10m of last year. A visible deceleration was also registered in overheated Bulgarian locations on the Black Sea, such as Varna (where prices fell by – 0.4 % qoq in Q3), mainly on the back of cooling demand from abroad. Sales have decelerated considerably in most residential projects and the burgeoning financial crisis may seriously contribute to a deeper slowdown this year.

Residential Real Estate Prices (Q3 2008)[1]

Country	RE Price Market (07/08)	YTD Δ price – country [2]	YTD Δ price – capital [2]	Price x sqm in Country, EUR	Price x sqm in Capital, EUR
Russia	↑↑	–	46.0 %	–	4,333
Czech Rep.	↑↑	22.0 %	19.0 %	1,164	2,150
Bulgaria	↑	16.6 %	17.0 %	725	1,263
Slovakia	↑	10.9 %	7.1 %	1,531	1,977
Croatia	→	5.2 %	5.7 %	1,847	2,061
Poland	→	1.5 %	5.8 %	2,271	2,716
Romania	→	–	– 0.5 %	–	2,311
Hungary	↓↓	– 11.2 %	– 6.0 %	882	1,310
Estonia	↓	– 1.5 %	– 7.5 %	1,259	1,566
Kazakhstan	↓↓	– 17.5 %	– 31.7 %	629	1,068

1) As of June for Croatia, Poland and Ukraine; October for Hungary and Romania;
2) Expressed in local currency, changes compared to Dec last year
Source: UniCredit Group CEE Research Network, Analytical Centre IRN.RU

The impact of the crisis in terms of the credit squeeze is expected to take its toll in 2009 especially, with only a gradual recovery starting from 2010. A moderation in the growth of household debt is anticipated particularly in SEE countries and Russia, where the banking sector has been increasingly financing lending growth from abroad.

2) Figures refer to growth in bank loans to the household sector, excluding debt granted by non-banks

All over the region, slower growth is expected in the mortgage segment in particular, as further stabilisation in the residential real estate market and lower income growth could prevent a major recovery on the demand side, while banks might continue to take a more selective approach to financing. As a result, the yearly growth rate for mortgages is set to dive from an anticipated 27 % in 2008 to 13 % in 2009 at the regional level. Despite a less supportive scenario in the short term, opportunities in the mortgage segment remain in the long term, particularly in less penetrated markets such as Romania, Turkey and Russia, where low mortgage loan-to-GDP ratios (at 4 % for the first two countries and 2 % for Russia in 2007) relative to the regional average (8.0 %[3]) indicate room for growth in the mid to long term.

The financing of household appliances is also anticipated to slow down but to a lower extent, especially this year, as banks increasingly switch their focus toward short-term and unsecured lending. In line with a strong decrease in new cars sold, financial leasing is also expected to be badly affected by the crisis with average growth projected at 10 % in 2009–2010 in the CEE region, marginally up from an anticipated 7 % last year.

At the regional level, risks for household sector solvency remain skewed on the upside, especially when referring to some of the well-known vulnerabilities of CEE markets. In a number of countries in the region (i.e. Croatia, Hungary, Poland and Romania), foreign currency loans were increasingly popular, particularly using the euro and the Swiss franc. Although eligibility criteria for new loans have been tightened and lending in foreign currencies in some instances has been cancelled in reaction to the deepening crisis, the household sector (particularly in countries with flexible exchange rate regimes) still remains exposed to FX risks connected to un-hedged currency positions. The recent depreciation of local currencies is also leading to an increase in debt-servicing costs, which combined with the much gloomier prospects on income and a seasoning credit portfolio (i.e. an increasing share of maturing loans) might contribute to a major fall in credit quality, especially this year.

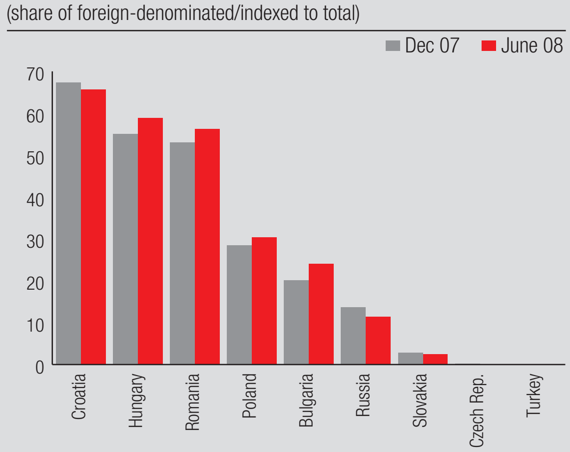
3) Excluding Russia

CEE Household Financial Liabilities (LC CAGR 2008–2010)*

	Bulgaria	Croatia	Czech R.	Hungary	Poland	Romania	Russia	Slovakia	Turkey	CEE
Mortgage loans	19.1 %	8.0 %	15.4 %	6.2 %	8.6 %	15.1 %	30.5 %	8.8 %	20.0 %	16.3 %
Personal loans	14.0 %	7.2 %	12.5 %	11.4 %	8.8 %	16.4 %	21.9 %	6.8 %	5.8 %	15.9 %
- granted by banks	13.0 %	7.2 %	13.0 %	11.7 %	8.8 %	16.5 %	21.9 %	5.5 %	3.5 %	16.0 %
- granted by non-banks	25.4 %	–	11.6 %	–4.2 %	–	14.5 %	–	9.2 %	13.0 %	13.4 %
Overdraft	19.8 %	8.6 %	14.7 %	15.5 %	6.5 %	–	–	16.8 %	–	10.0 %
Other loans	15.0 %	–	15.1 %	7.2 %	3.5 %	–	–	24.4 %	26.5 %	26.0 %
Credit cards	12.5 %	17.5 %	14.3 %	–	18.3 %	–	–	19.3 %	20.0 %	21.5 %
Financial leasing	14.0 %	23.8 %	12.2 %	6.8 %	4.4 %	9.2 %	–	9.9 %	18.0 %	10.4 %
Total liabilities	**16.7 %**	**8.3 %**	**14.5 %**	**8.5 %**	**8.8 %**	**15.9 %**	**24.1 %**	**13.6 %**	**21.4 %**	**16.8 %**

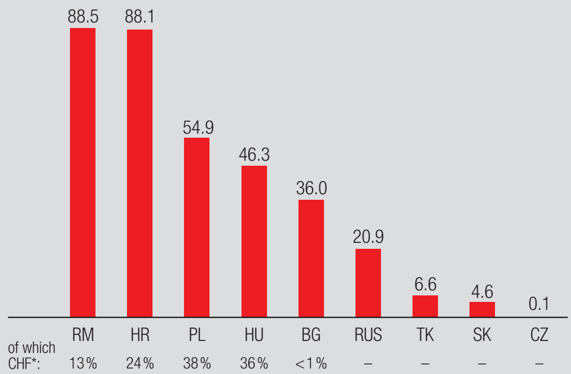
Source: UniCredit Group CEE Research Network

Bank Loans to Household Sector
(share of foreign-denominated/indexed to total)



Source: UniCredit Group CEE Research Network

Structure of Housing Loans
(% denominated / indexed in FX, 2007)



Source: UniCredit Group CEE Research Network

One third of CEE households spend more than 20 % of income to repay debts

By Martin Mayr and Ketevan Bitskinashvili

During the summer of 2008 Bank Austria Market Research conducted a region-wide market research study together with CEE Research to investigate planned household investments in consumer goods and the ways of financing these investments.

At least 1000 interviews were conducted in each of 13 countries in the region (Russia, Poland, Czech and Slovak Republics, Hungary, Romania, Bulgaria, the former Yugoslav Republics of Slovenia, Croatia, Bosnia and Herzegovina and Serbia, and finally, Ukraine and Turkey). The samples were representative for the population aged 15 years and older. All the interviews were conducted as face-to face interviews by BA's long-term partner agencies (GfK, RmPlus, TNS and PENTOR).

The results concerning the level of indebtedness across CEE countries are particularly interesting. These tend to confirm that the increasing debt burden connected to tightening lending requirements may be an issue in some countries given the relatively higher leverage among lower-income classes.

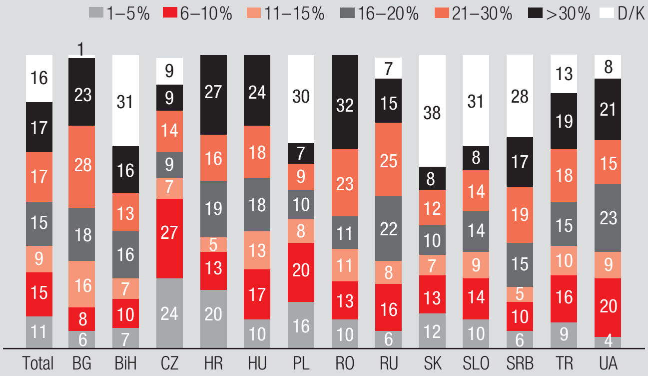
All respondents who currently have loans (i.e. consumer loans, mortgages, car loans, etc.) were asked to evaluate what proportion of the family income has to be used to repay debts.

More than one third (34 %) claimed that loan instalments cover more than 20 % of the family's budget. Another 25 % have to put aside 11 – 20 % of the household's income, while another 26 % of borrowers spend less than 10 % of their monthly household earnings. 16 % refused to answer the question or simply didn't know.

The number of people who have to spend more than 20 % of household income to repay loans is the highest in Bulgaria and Romania: 55 % of Romanians and 51 % of Bulgarian borrowers suffer from such financial burdens.

It seems, on the other hand, that the household budgets of Polish, Croatian, Hungarian and Czech borrowers are least burdened with loan instalments.

Amount of household income used for repayments

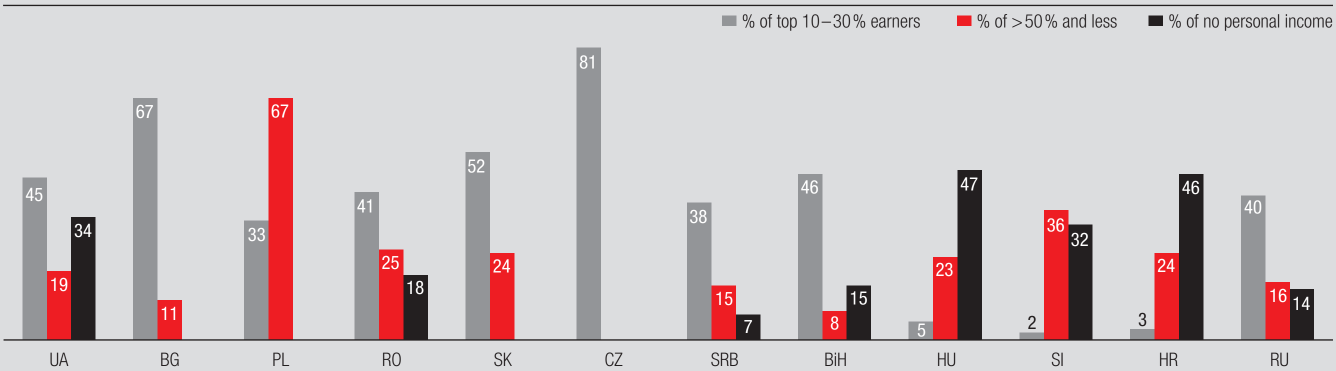


Source: Bank Austria Market Research

However, taking a debt burden of more than 30 % of personal monthly income as a benchmark and comparing within income classes we arrive at the following result:

- Ukraine, Romania, Bosnia, Hungary, Slovenia and Croatia emerge with a relatively high level of indebtedness for no-income individuals. The same holds in Poland for lower income classes
- The relatively high weighting of the top 10 – 30 % earners among those using more than 30 % of income for debt repayments could indicate that access to the credit market is still fairly limited for lower income classes.

Weight of highly leveraged individuals by income class (debt burden exceeding 30 % of monthly income)



Source: Bank Austria Market Research and UniCredit Group CEE Economic Research

Focus

Credit crisis drives investors' exodus from mutual funds market

Annalisa Aleati, Stephan Maier and Fabio Mucci

One year after the international financial turmoil began, high volatility and uncertainty persist at the global level showing no signs of abating. The European fund management industry has suffered unprecedented outflows of assets, amplified in September by the bankruptcy of Lehman Brothers, as investors seek refuge from the ongoing global credit squeeze. The hit has been widespread with the crisis spreading quickly to emerging markets too.

Investment funds outflows intensified in Western Europe …

For the first nine months of 2008 net sales of European investment funds recorded total net outflows of close to EUR 150 billion, compared to net inflows of EUR 164 billion in 2007 as a whole, and net inflows of EUR 425 billion in 2006.

In Austria, Germany and Italy the situation was not very different to that at European level. In Austria, accumulated net sales up to November were EUR 16.8 billion in the red while mutual fund stocks declined by 23 % compared to last year, with equity funds contracting strongly in particular. In Germany, net outflows for publicly-offered mutual funds amounted to EUR 38 billion up to October and assets declined by 20 %, while so far this year the market of institutional funds has been a stabilising force for the investment funds industry, as assets managed for institutional investors decreased by just 2.6 % to September and net sales were positive in the period totalling EUR 11 billion. Finally, the market in Italy was one of the hardest hit in Europe in terms of net outflows with investors redeeming a net sum of EUR 131 billion to November and stocks declining by 32 %. Italians mainly disposed of bond funds but equity suffered from strong outflows too.

Mutual fund markets

Austria

Mutual and institutional funds of Austrian fund management companies under Austrian law* (€ bn)

Total Market	Jan – Dec 07	Jan – Nov '08		% ch on Dec '07	Asset mix %	
	Net sales	Stock	Net sales	Stock	Dec '07	Nov '08
Equity	–	12.1	–	–58.1	17.4	9.5
Balanced	–	44.2	–	–3.0	27.5	34.7
Bond	–	58.3	–	–14.1	41.0	45.7
Liquidity	–	8.4	–	–30.8	7.4	6.6
Alternative	–	2.8	–	–70.2	5.6	2.2
Real estate	0.3	1.8	–0.1	–3.2	1.1	1.4
Total	**–2.7**	**127.5**	**–16.8**	**–23.0**	**100.0**	**100.0**

*) stocks for single fund categories not fully comparable due to reclassification in April 2008
Source: VöIG

Total market Germany

Publicly-offered mutual funds (incl. foreign companies' distribution in Germany)* (€ bn)

Total Market	Jan – Dec 07	Jan – Oct '08		% ch on Dec '07	Asset mix %	
	Net sales	Stock	Net sales	Stock	Dec '07	Oct '08
Equity	–14.6	137.3	–9.5	–40.4	31.6	23.5
Balanced	10.3	52.3	–0.4	–11.4	8.1	8.9
Bond	–18.8	144.9	–25.1	–1.8	20.2	24.8
Liquidity	24.6	86.2	–13.9	–14.7	13.8	14.7
Others	20.9	80.3	10.6	–26.3	14.9	13.7
Real estate	6.3	84.3	–0.2	1.1	11.4	14.4
Total publicly-offered	**28.7**	**585.4**	**–38.3**	**–19.9**	**100.0**	**100.0**

*) stocks for single fund categories not fully comparable due to reclassification in January 2008
Source: BVI

Italy

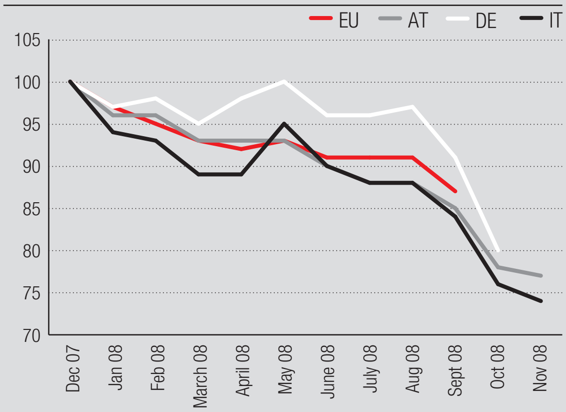
Mutual funds and SICAV under Italian and foreign law* (€ mn)

Total Market	Jan–Dec 07 Net sales	Jan–Nov '08 Stock	Jan–Nov '08 Net sales	% ch on Dec '07 Stock	Asset mix % Dec '07	Asset mix % Nov '08
Equity	–23,569	73,046	–29,018		23.7	17.3
Balanced	–7,093	19,312	–8,485		5.9	4.6
Bond	–46,331	162,567	–62,812		35.8	38.5
Liquidity	7,591	88,408	–8,943		16.5	21.0
Flexible	10,349	53,374	–15,712		11.7	12.7
Hedge	5,865	25,072	–6,165		6.4	5.9
Total	**–53,190**				**100.0**	**100.0**
Total new perimeter	**–**	**421,779**	**–131,135**	**–31.8**		

*) 2007 and 2008 stocks and net sales not fully comparable due to change in Assogestioni perimeter
Source: Assogestioni

In terms of single-asset categories, while the strongly negative net sales of equity funds are deeply rooted in the evolution of stock prices, the strong contraction in the sales of bond funds is more difficult to explain as long-term interest rates have decreased sharply in recent months. Bond funds have suffered from a general loss of confidence in mutual funds as well, and from the crisis in the money markets and credit markets. Liquidity funds too have suffered from the drying-up of liquidity in the money markets and contagion from the difficulties of US money market funds following the Lehman default. Their strong outflows were amplified by a substantial increase in the remuneration of bank deposits and as well by banks issuing debt securities at rates exceeding money market fund yields, as they try to cope with the liquidity crisis.

Dynamics of mutual fund stocks in 2008 (Dec '07 = 100)



Source: Assogestioni, VÖIG, BVI, EFAMA

One of the main factors for the decline in the asset management industry in all countries is clearly the strong contraction on the equity markets, paired with elevated levels of market volatility. Equity markets in Austria, Germany and Italy declined between 42 % and 62 % up to mid-December. In addition to the negative trend set by the equity markets, the fund industry was probably further undermined by the financial system's liquidity problems, which triggered a stronger recourse to funding through deposits and a further loss of investor confidence in financial products (such as mutual funds).

Equity market performance (ytd % changes)

ytd % ch	Q1'08	Q2'08	Q3'08	Q4'08*
ATX	–16.6	–12.6	–38.7	–62.3
DAX	–19.0	–20.4	–27.7	–42.2
S&P/MIB	–18.0	–23.9	–33.8	–50.3
MSCI Europe	–14.5	–18.9	–28.4	–41.9

*) 12/12/2008
Source: Thomson Financial

Still, there are some significant differences found at country level. In Germany, the mutual funds industry is generally more resilient to stock market losses, partly due to the large weight of institutional investors on the market (about 50 %). However, in 2008 the impact of the crisis has been particularly severe, driving investors from mutual funds to bank deposits. This was likely, on the one hand, due to the government guarantee provided for bank deposits to counter the risk of a general loss of trust in the banking system and, on the other hand, to the government measure announced regarding higher taxation on liquidity funds and short-term bond funds (which alone contributed EUR 30 billion to total mutual fund outflows in October).

Looking at Italy, while the financial market turbulence has clearly impacted strongly on the Italian asset management industry, the sheer size of the outflows and the comparison with mutual fund flows in other countries suggests that the severity of the crisis in Italy is more structural in nature, going beyond the distress caused by the current credit turmoil. Indeed, the disaffection of Italian investors with mutual funds can be interpreted as part of a longer term trend which started as early as the previous crisis in 2001. On the demand side, factors which could have alienated investors from mutual funds included, among others, the poor stock market performance together with the comparatively high stock market volatility, the lack of trust in the stock market, relatively high asset management fees and poor financial literacy. On the supply side, the product offering policies of financial intermediaries seem to have favoured investments in structured bonds issued by banks at the expense of mutual funds during the last few years.

All these factors have resulted in a progressively declining trend in the share held by Italian households of financial assets employed in the mutual funds market, which fell from 16 % in 2000 to 7 % in 2007, a trend confirmed in 2008 (5.9 % in H1 2008). In Germany, by contrast, the share of mutual funds in total household financial assets has remained broadly stable over the last decade (11.6 % in 2006 and 11.9 % in 2007), though it did register a slight decline to 11.7 % at the end of the first half of 2008.

… with exodus spreading also in CEE

With risk being the dominant emotion, stock markets throughout the CEE region have all tumbled by more than 50 percent since the beginning of last year (the most visible drop being observed in Russia, Romania, Croatia and Bulgaria), outstripping the declines in western indices such as the STOXX 50 and S&P 500. The CEE investment fund industry has suffered to a similar extent.

Net assets of CEE investment funds industry1)

	2007		H1 2008		Q3 2008	
	€ mn	Yoy % change	€ mn	Ytd % change	€ mn	Ytd % change
Poland	37,553	45.5	29,117	−22.5	25,730	−31.5
Turkey 2)	18,018	69.7	15,443	−14.3	17,287	−4.1
Russia	21,326	76.2	21,961	3.0	20,234	−5.1
Croatia	4,099	87.9	2,621	−36.1	2,092	−49.0
Bulgaria	1,177	137.2	1,010	−12.6	858	−27.1
Czech Republic 3)	6,120	14.2	6,352	3.8	5,853	−4.4
Hungary	11,124	21.5	11,016	−1.0	10,568	−5.0
Romania	267	42.6	246	−8.0	244	−8.6
Slovakia	4,721	24.3	5,275	11.7	4,976	5.4
CEE	**104,405**	**49.8**	**93,042**	**−10.9**	**87,844**	**−15.9**

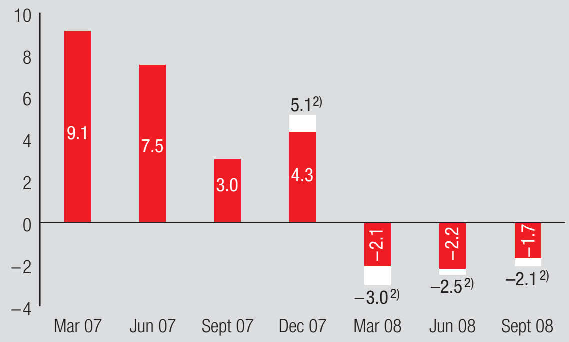
Source: UniCredit Group CEE Research Network
1) @ eop FX rates; 2) Open-end investment funds (Type A+B) and pension funds; 3) Only funds of AKAT's members (excl. foreign funds and other funds domiciled abroad)

Despite sturdy resilience until the last quarter of 2007, the exodus from the CEE fund industry picked up pace in Q1 2008, when a total of EUR 2.1 bn (EUR 3 bn incl. Croatia and the Czech Republic) was withdrawn from the market. The second quarter also saw record outflows of a further EUR 2.2 bn* on the back of ongoing deleveraging at global level. The sell-off wave continued in the third quarter, pushing total assets down to EUR 87.8 bn in September from EUR 104 bn at the end of last year (equivalent to a year-to-date drop of 16 %). The biggest falls were recorded in Croatia, Poland and Bulgaria, with total net assets down by 25 % to 50 % in the January – September period.

Net redemptions have been particularly severe in the case of Poland, where total net outflows topped roughly EUR 5.7 bn in H1 2008 and a further EUR 2.0 bn in Q3, compared to net inflows slightly above EUR 8.1 bn for the whole of 2007. Sharper reductions were recorded in January and July this year. Apart from the very adverse effects of redemptions, the negative performance of the stock markets made a significant contribution too, given the high weight of equity and balanced funds in the asset mix (around 70 percent), with the WIG index going down by 26 % in H1 and a further 9.0 % in Q3 last year.

*) The aggregate refers to Hungary, Poland, Romania, Slovakia, Turkey and Russia.

Net sales in selected CEE countries (€ bn)1)

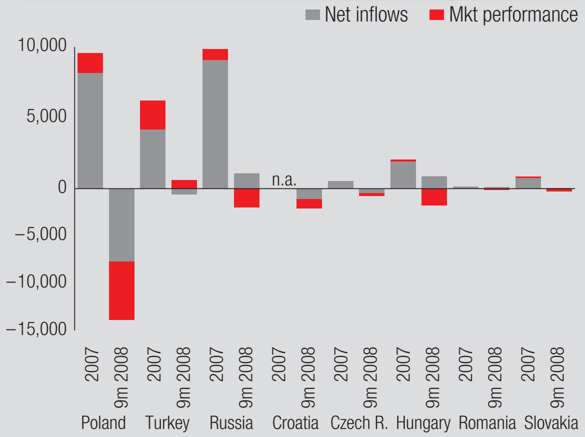


Source: UniCredit Group CEE Research Network
1) Incl. Poland, Hungary, Romania, Slovakia, Russia and Turkey;
2) Incl. net sales in Croatia and the Czech R.

Even Croatia, previously one of the region's bright spots, witnessed net outflows of EUR 1.1 bn in the first 9 m of last year, with the domestic fund industry losing almost 50 % of its asset value. In other CEE markets, investment funds remained in net positions until June this year. This is the case for Slovakia, Hungary and Romania, which have kept their heads above water even in the context of very negative performances on domestic equity markets (mainly in the latter two countries with 28 % and 57 % drops in the first 9 m), outstripping developed Europe. The market mood has changed drastically from H1 onward, especially in Russia, where both the equity and investment funds markets have seen dramatic sell-offs since the summer when first of all political concerns over its invasion of Georgia and then worries about the health of its banks prompted investors to flee the market. The result was a drop of more than 40 % in Russia's equity markets and net redemptions hitting a record EUR 0.2 bn in Q3.

The relevance of equity funds has been increasing steadily in the last couple of years, with the only exception being Russia (whose share decreased from 58 % in 2004 to 41 at the end of last year). The strong domestic stock market – boosted also by a number of IPOs, especially in Croatia and Bulgaria – growing investor awareness and a greater penetration of mutual funds have helped to boost new subscriptions in this category of funds.

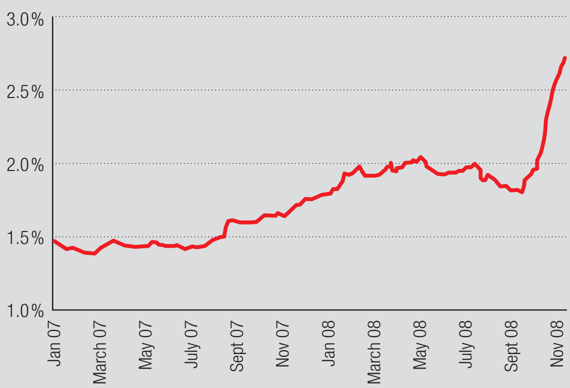
Net sales contribution to investment fund growth (€ mn)*



Source: UniCredit Group CEE Research Network
*) @ avg FX rates

The sentiment toward higher risk asset classes has waned significantly since the disruption caused by the US subprime crisis. The heavy losses endured by CEE stock markets and the loss of investor confidence were the driving forces behind this development. In addition to the slumping equity indexes, the volatility of equity prices has also increased recently. Assuming all other factors remain unchanged, greater equity price volatility could temper the appetite of risk-averse households for equity funds.

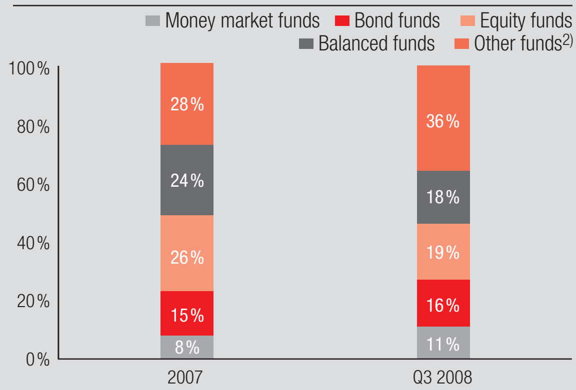
CEE Equity market volatility*



Source: UniCredit Group CEE Research Network, based on Bloomberg
*) Six-month average of intra-day swings in local stock indexes weighted according to daily market cap; swings are calculated as the difference between the intra-day high and low as a percentage of the intra-day low; CEE aggregate incl. Poland, Czech R., Hungary, Slovenia, Bulgaria, Romania, Croatia and Turkey

Given this development the share of equity fund assets fell on average from 26 % at year-end 2007 to 19 % at the end of September 2008. Still, in Russia and Croatia it accounts for around 1 / 3 of total net assets under management and in Bulgaria for more than 70 %, while it remains between 20 % and 25 % in Romania and Poland. Balanced and other funds (i.e. hedge, real estate etc.) made up for most of the difference with a share in total net assets amounting to 55 % at end-September, compared to 51 % at end-2007. The relevance of money market funds remains limited on average – with the only exception being the Czech Republic and Slovakia, where they account for some 45 to 50 % of net assets, and to a lesser extent Croatia (around 1 / 3) – but is clearly rising (due to ongoing risk repricing) reaching a share of 11 % in September last year (up from almost 8 % at the end of 2007).

Structure of CEE investment funds (share in total net assets)[1)]

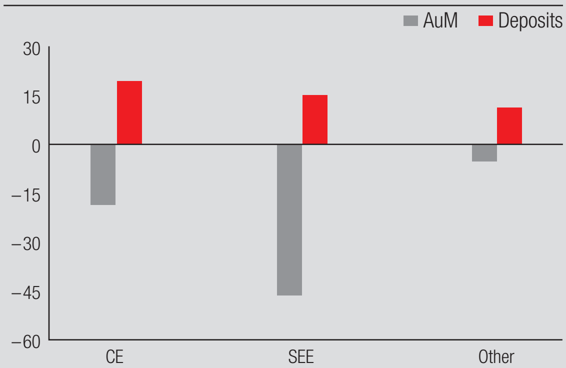


Source: UniCredit Group CEE Research Network
1) CEE including Poland, Russia, Turkey, Czech R., Croatia, Romania, Bulgaria, Hungary and Slovakia; 2) Other funds include real estate, funds of funds, mortgage funds, bank managing funds, direct investment funds, venture funds, hedge total, securitised and reverse repos

Retail investors in CEE markets have arguably been scared most by the financial crisis. Investors in those markets are very much momentum driven given the poor tradition of investing long term and the scant experience of investing in stocks and shares. Following the bad performance of the CEE equity markets and the mounting uncertainty, retail investors have started to reallocate an increasing share of their assets into bank deposits, generally perceived as safer instruments during turbulent times. The strong competition from banks in search of liquidity has also continued to exert an adverse effect on the industry, spurring a switch from investment funds to bank deposits.

CEE household deposits and investment funds

(YTD % change up to September 2008)*



Source: UniCredit Group CEE Research Network
*) CE: Czech R., Hungary, Poland, Slovakia; SEE: Bulgaria, Croatia, Romania; Other: Russia, Turkey

Bulgaria
Households under more strain, despite less appetite for debt

Milen Kassabov and Kristofor Pavlov

- Following years of rapid improvement in household wealth, 2008 is expected to mark a deterioration in net terms on the back of weak performance on the financial markets affecting wealth accumulation and the persistently fast growth in indebtedness. Bearing in mind the historically low saving capacity of the household sector, the less supportive macroeconomic conditions and the tightening lending requirements anticipated, especially this year, the financial position of households will definitely be more stretched.
- The severe volatility experienced on the financial markets is likely to continue pushing households toward traditional savings products such as bank deposits, with pension and insurance products still playing a key role in the accumulation of wealth going forward.
- The appetite for debt has remained high throughout 2008 in line with previous years. The impact of the crisis in terms of the squeeze on credit is, however, expected to have taken its toll since October. Still, the sharp decreases in the number of property deals and the slowdown in new auto sales growth registered lately may indicate a waning appetite for further leveraging.
- Overall, the envisaged trends point toward a marked deceleration in net wealth as a share of GDP, which is expected to fall to 20 % last year from 34 % in 2007, before stabilising at around 19 %.

Table 1: **Household Financial Indicators** (S.14)*

	2006	2007	2008e	2009f	2010f
Financial Assets (% of GDP)	49 %	59 %	50 %	51 %	53 %
Financial Liabilities (% of GDP)	19 %	26 %	30 %	32 %	33 %
Net Wealth (% of GDP)	30 %	34 %	20 %	19 %	19 %
Corrected Net Wealth (% of GDP)	37 %	44 %	32 %	32 %	33 %

*) Corrected net wealth is calculated as gross financial wealth minus the non-mortgage part of household debt
Source: BNB, UniCredit Group CEE Research Network – UniCredit Bulbank Research

The first 9 months of 2008 have been marked by persistently good growth in wages and favourable labour market conditions, keeping household spending on the upside. Households have shown only gradual restraint to borrowing, with debt leverage going up by 45 %. However, retail sales data in Q3 indicate some moderation in consumption, with growth down to 4.4 % yoy from 7.7 % in the previous quarter.

Despite the good income dynamics, the accumulation of financial wealth remained subdued through the year growing by just 6 % yoy (January – September) compared to 38 % yoy in 2007, mainly due to the weak performance on the financial markets. Despite the expected deceleration in lending – on the back of ongoing risk re-pricing and pressures on liquidity – no major improvements are anticipated in the accumulation of net wealth through to the end of the year, with net financial assets projected to reach 20 % relative to GDP from 34 % in 2007.

The impact of the crisis is expected to exert a greater effect this year. The gradual recovery in the capital market performance, coupled with slower domestic economic growth and decreasing salary growth rates are likely to lead to milder growth in household wealth over the forecast period. In addition, lower personal income tax rates introduced in 2008 will not have the same one-off effect on disposable income growth from 2009 onward. The government's plan to sustain the financial conditions of lower income individuals and stimulate savings might lend some support, as 2009 will be an election year. Still, the planned stimulus is likely to have a limited effect on wealth generation as it will most likely result in higher spending on mainly non-discretionary goods and services rather than in higher saving ratios. The cool-down in residential real estate, especially in the second-home segment, and the overall tightening in credit conditions are expected to keep household loan dynamics subdued. Additionally, remittances from abroad may also decrease as economic growth in many Western European countries is expected to slow significantly, contributing to a further cooling of housing demand.

Overall, we reckon the household liabilities / assets ratio will remain relatively unchanged at just above 60 % in the coming years through 2010, with net financial wealth stabilising around 19 % as a percentage of GDP.

In light of the turmoil affecting the world financial markets, the Sofix index declined by almost 75 % at the end of Q3 from its peak in mid-October 2007, causing a significant depletion of household assets through the year. Notably, the value of listed shares owned by individuals decreased by 62 % yoy at the end of Q3 2008. In a similar fashion, although on a smaller scale,

Table 2: **Financial Wealth**

	Stock in 2007 € mn	(% on total)	Yoy % growth (LC) 2007	2008e	2009f	2010f
Currency	1,900	11.1 %	19.3 %	12.5 %	11.0 %	10.0 %
Bank deposit retail	9,645	56.1 %	29.3 %	23.2 %	15.3 %	13.6 %
LC currency	4,164	24.2 %	25.4 %	19.0 %	12.8 %	11.6 %
FX currency	5,481	31.9 %	32.4 %	26.3 %	17.1 %	15.0 %
Securities other than shares	153	0.9 %	–63.7 %	–44.4 %	–34.5 %	–25.4 %
Listed shares	3,232	18.8 %	106.4 %	–74.0 %	10.0 %	12.0 %
Mutual funds	507	2.9 %	117.0 %	–61.4 %	11.7 %	14.2 %
Open-end	228	1.3 %	141.9 %	–62.0 %	12.0 %	15.0 %
Close-end	197	1.1 %	100.7 %	–66.0 %	10.0 %	12.0 %
Registered abroad	82	0.5 %	98.9 %	–49.0 %	14.0 %	16.0 %
Insurance technical reserves	560	3.3 %	31.4 %	19.4 %	12.0 %	12.0 %
Life insurance	175	1.0 %	37.3 %	18.0 %	12.0 %	12.0 %
Non-life insurance	385	2.2 %	28.9 %	20.0 %	12.0 %	12.0 %
Pension funds' assets	1,185	6.9 %	52.8 %	5.0 %	8.0 %	10.0 %
Total	**17,182**	**–**	**37.7 %**	**–0.8 %**	**13.6 %**	**12.7 %**

Source: BNB, UniCredit Group CEE Research Network – UniCredit Bulbank Research

household investments in mutual funds declined to BGN 488 mn from 991 mn at the end of 2007. Overall, total losses for the household sector caused by the collapsing financial markets, including losses of pension and insurance fund investments, are estimated to have reached over BGN 5.2 bn (more than EUR 2.6 bn) at the end of Q3 2008, with the situation deteriorating further in October and November.

Households reallocated a major share of their assets to deposits, which serve as a safe haven during turbulent times on the financial markets. The move was also motivated by supply as competition among banks intensified, resulting in improved conditions for customers. This combined with value depletion in many alternative assets led to a rapid expansion in the share of deposits in total household wealth to 68 % by the end of Q3, up from 56 % in 2007. Looking forward, deposits will continue to play a dominant role in the accumulation of wealth, hovering around 71 % by 2010.

Pension funds have managed to keep their assets flat since the beginning of 2008 thanks to continued strong inflow of new contributions. Declining unemployment, rising wages, and further penetration of voluntary pension schemes all assisted the continually healthy flow of funds, but recent data has started to reveal withdrawals from pension schemes as well.

Life insurance registered growth in gross premiums of 28 % as of Q2 2008, slowing down somewhat from rates above 35 % since 2005. Our forecasts point to a further decline in growth during the forecast period due to adverse employment conditions and gloomy

Table 3: **Financial Liabilities**

	Stock in 2007 € mn	(% on total)	Yoy % growth (LC) 2007	2008e	2009f	2010f
Mortgage loans	2,979	39.8 %	64.7 %	37.3 %	20.4 %	17.8 %
Consumer loans	3,157	42.1 %	47.5 %	31.5 %	16.1 %	12.0 %
Consumer loans of other MFIs	2,971	39.7 %	46.3 %	29.1 %	15.0 %	11.1 %
Consumer loans of OFIs	186	2.5 %	70.0 %	70.0 %	30.0 %	21.0 %
Overdraft	673	9.0 %	60.2 %	52.9 %	22.6 %	17.1 %
Other loans	527	7.0 %	24.0 %	22.7 %	16.7 %	13.2 %
Revolving credit cards*	9	0.1 %	6.3 %	10.0 %	10.0 %	15.0 %
Financial leasing	146	1.9 %	23.4 %	44.0 %	16.0 %	12.0 %
Total	**7,492**	**–**	**52.3 %**	**35.3 %**	**18.5 %**	**15.0 %**

Source: BNB, UniCredit Group CEE Research Network – UniCredit Bulbank Research
*) Includes balances of non-bank financial companies only. Bank-issued credit card loans are included in MFI items.

investment prospects. It should be noted that the domestic life insurance market is very underpenetrated compared to other countries, but the lower disposable income of average households, excluding high net worth individuals, may explain the small market size at present. Deteriorating investment returns have also had a negative impact on life insurance assets recently, albeit to a lower extent given the relatively small size of the industry.

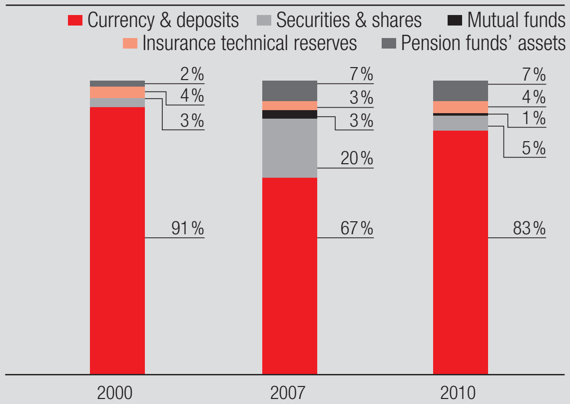
The financial situation of households in terms of liabilities was different, as growth rates remained pretty strong throughout the year (around 30 % ytd in the January – September period). Particularly fast growth was observed in consumer loans, as car purchases, home improvements and other discretionary spending contributed to supporting such growth. Growth in lending has been particularly strong in non-bank financial intermediaries, whose role is growing as the market size of this segment becomes more meaningful.

However, following the re-pricing of risks at global level and the mounting liquidity problems, the situation has very recently begun to change. October is expected to be a turning point with yet more marked moderation in lending to come, leading to a year-end growth rate of 35 % and further deceleration to 19 % this year. The slower growth is expected particularly in the mortgage segment, as the slowdown on the residential real estate market may be felt on the demand side, while financial institutions are showing signs of taking a more selective approach to financing.

Signs of cooling in growth on the residential real estate market were already clear in Q3 last year. House prices in districts such as Shumen, Blagoevgrad, Ruse and Stara Zagora dropped to 2 % – 8 % qoq, with a visible deceleration also registered in overheated locations on the Black Sea coast like Varna (where prices went down by 0.4 % qoq in Q3). Clear-cut signals of a softening in real estate growth were also observed in the capital city of Sofia, where prices went up by a marginal 7 % in the first 9 months of the year compared to the almost 40 % posted in 2007.

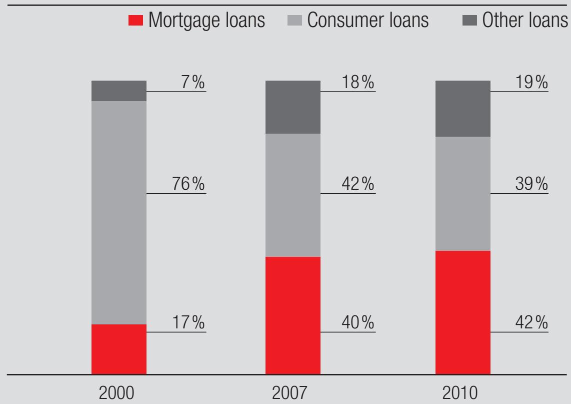
Looking ahead, less supportive macroeconomic conditions together with a tightening in lending requirements and the gradual credit squeeze (especially this year) may result in a fall in the capacity of households to face debt obligations, and an increase in default rates.

Household Financial Assets (% of total)



Sources: BNB, UniCredit Group CEE Research Network – UniCredit Bulbank Research

Household Financial Liabilities (% of total)*



Sources: BNB, UniCredit Group CEE Research Network – UniCredit Bulbank Research
*) Other loans include overdraft, other loans, revolving credit cards and financial leasing

Croatia
Volatile capital markets limit recovery in wealth accumulation

Nenad Golac

- Over the last few years the accumulation of household financial wealth in Croatia has largely benefited from the quick developing capital markets – supported by a number of IPOs – and good macroeconomic conditions, resulting in stable improvement in household financial positions, despite growing indebtedness. For the third consecutive year, net financial wealth showed vigorous growth in 2007 reaching 57 % relative to GDP, up from 36 % in 2003.
- In 2008 due to the global financial crisis and the negative capital market performance, the accumulation of household financial wealth is expected to remain under pressure with an anticipated drop of 4.5 % compared to the previous year. Higher volatility and uncertainty forced individuals to switch to safer financial instruments, i.e. bank deposits and currencies (especially during October in response to the fast development of the banking crisis throughout Europe and the USA).
- Financial liabilities continue to rise, albeit at a slower pace due to the lower growth in car loans and the much slower growth in other consumer loans as a consequence of the current slowdown in retail trade. Looking forward, household indebtedness is expected to continue increasing, but at a slower pace, partly due to the cool-down on the residential real estate market.
- Financial wealth accumulation is expected to recover only gradually. As a result, the net financial wealth of households by the end of 2010 is not likely to reach the level recorded at the end of 2007.

Table 1: **Household Financial Indicators***

	2006	2007	2008e	2009f	2010f
Financial Assets (% of GDP)	86 %	99 %	86 %	88 %	91 %
Financial Liabilities (% of GDP)	39 %	42 %	43 %	43 %	44 %
Net Wealth (% of GDP)	47 %	57 %	44 %	45 %	47 %
Corrected Net Wealth (% of GDP)	63 %	75 %	62 %	63 %	66 %

*) Corrected net wealth is calculated as gross financial wealth minus the non-mortgage part of household debt
Source: CNB, UniCredit Group CEE Research Network –Zagrebacka Banka Research

After years of very fast growth with rates well in excess of 20 % during 2006 and 2007, the accumulation of financial wealth has slowed dramatically during 2008. In fact, we expect total household financial assets to be 4.5 % lower in nominal terms by the end of last year, despite record inflation. The main reason for this development is undoubtedly the global financial crisis and especially its implications on large losses recorded in the capital market. At the moment of writing the Croatian stock exchange index CROBEX is almost 60 % below its value at the end of 2007 and, at the same time, is at its lowest level since the beginning of 2006. The huge negative impact on classes of financial wealth linked to the capital market has been inevitable: the market capitalisation of listed shares held by individuals is expected to drop by the end of this year by at least 39.6 %, and their assets under management in open-end investment funds by almost two thirds, with clear downside risks. It is worth mentioning that far greater falls in assets under management are being recorded in equity and balanced funds, whereas money market funds actually grew until October, when they also experienced major withdrawals as a result of the sudden squeeze in the market. Another class of financial wealth strongly affected by the very unfavourable capital market conditions are assets in pension funds, both compulsory and voluntary ones. The unexpectedly strong growth last year of household currency holdings (26.7 %) and bank deposits (8.7 %), an obvious "safe haven" in hard times, is insufficient to offset the extensive losses mentioned above in wealth classes linked to the capital market, due to the fact that their joint share in total household financial wealth reached almost one third at the end of previous year. Considerable withdrawals from banks were recorded during October in response to the rapid unfolding of the banking crisis throughout Europe and the USA. However, after the government's decision to increase the limit of guaranteed deposits up to HRK 400,000 (more than EUR 55,000) some of the withdrawn money is flowing back into bank deposits again. Assets in closed-end investment funds held by individuals are also falling fast, but this was largely expected due to the withdrawals from the Croatian War Veterans' Fund and the repayment of pensioners' debt from the Pensioners Debt Repayment Fund.

Household consumption growth has so far not been affected as dramatically by increased inflation and the global financial crisis, partly due to the fact that retail loans during the first 9 months still posted double-digit growth rates. Particularly rapid growth in revolving credit card loans has been recorded (20.5 % in the first 9 m of 2008) and the pace of growth in overdrafts is also surprisingly higher than the average retail loan growth rate. Although the

Table 2: **Financial Wealth**

	Stock in 2007 € mn	(% on total)	Yoy % growth (LC) 2007	2008e	2009f	2010f
Currency	4,117	11.0%	8.8%	26.7%	−1.8%	−4.8%
Bank deposit retail	17,796	47.7%	9.9%	8.7%	9.0%	10.5%
LC currency	5,639	15.1%	9.3%	10.7%	11.1%	12.6%
FX currency	12,158	32.6%	10.3%	7.7%	8.0%	9.5%
Housing savings	824	2.2%	4.0%	2.3%	6.2%	9.1%
Securities other than shares	47	0.1%	4.9%	−9.0%	7.6%	17.6%
Listed shares	6,553	17.6%	140.0%	−39.6%	10.0%	15.0%
Mutual funds	3,920	10.5%	52.7%	−57.2%	−10.5%	2.6%
Open-end	2,640	7.1%	117.4%	−64.3%	8.4%	20.9%
Close-end	1,280	3.4%	−5.4%	−42.4%	−34.7%	−36.2%
Registered abroad	–	–	–	–	–	–
Insurance technical reserves	1,087	2.9%	17.2%	5.5%	11.9%	14.9%
Life insurance	1,087	2.9%	17.2%	5.5%	11.9%	14.9%
Non-life insurance	–	–	–	–	–	–
Pension funds assets	2,978	8.0%	33.2%	14.6%	24.0%	25.8%
Total	**37,322**	**–**	**27.5%**	**−4.5%**	**8.1%**	**10.5%**

Source: CNB, Central Depository Agency (SDA), HANFA (Croatian Financial Services Supervisory Agency), Zagreb Stock Exchange (ZSE), UniCredit Group CEE Research Network – Zagrebacka Banka Research

demand for housing loans is still relatively strong, there are some indications that the residential real estate market is cooling down (stagnation of prices, excess supply of new housing, especially in Zagreb). In the first half of last year, house prices went up on average by a marginal 5% ytd (expressed in LC) in the country compared to the 17% yoy increase in H2 2007, with a similar trend observed in the capital city too (6% vs. 12% in H2 2007).

Additionally, combined sales of new and used cars in the first 10m of 2008 are 7.1% lower than in the same period of previous year, resulting in an almost 2% drop in loans for this purpose in comparison with the end of 2007. All in all, the financial liabilities of households are expected to grow considerably slower in 2008 than in previous years, by an estimated 10.7% (in comparison with 18.9% in 2007), mostly as a result of the liquidity squeeze in the banking sector during the last quarter.

As a result of the described dynamics in gross assets and liabilities, net household wealth is expected to drop by almost 15% in 2008 after having increased by as much as 34.6% during 2007. Accordingly, net wealth as a percentage of estimated GDP is expected to fall to 43.7% from the 57.1% recorded in 2007. Corrected net wealth, defined as gross financial wealth minus the non-mortgage part of household debt, is also set to drop from 75.4% to 62.2% of GDP in 2008.

Last year's trends are quite different to those that prevailed during most of 2007; it was a year characterised by huge capital gains generated by a fast growing capital market. A number of IPOs played an important role in the rapid development of the capital market (the CROBEX index rose by 63.2% in 2007 after having risen by 60.2% in 2006). The most important was the IPO of HT (Croatian Telecom), worth approximately HRK 7 bn. Collectively, all

Table 3: **Financial Liabilities**

	Stock in 2007 € mn	(% on total)	Yoy % growth (LC) 2007	2008e	2009f	2010f
Housing loans	6,877	43.3%	22.9%	10.8%	6.7%	9.3%
Consumer loans	7,423	46.7%	14.9%	8.9%	5.7%	8.8%
Consumer loans of other MFIs	7,423	46.7%	14.9%	8.9%	5.7%	8.8%
Consumer loans of OFIs	–	–	–	–	–	–
Overdraft	747	4.7%	13.2%	15.1%	10.3%	6.8%
Other loans	–	–	–	–	–	–
Revolving credit cards	672	4.2%	28.4%	20.0%	18.0%	17.0%
Financial leasing	164	1.0%	41.2%	25.0%	23.3%	24.3%
Total	**15,883**	**–**	**18.9%**	**10.7%**	**7.1%**	**9.6%**

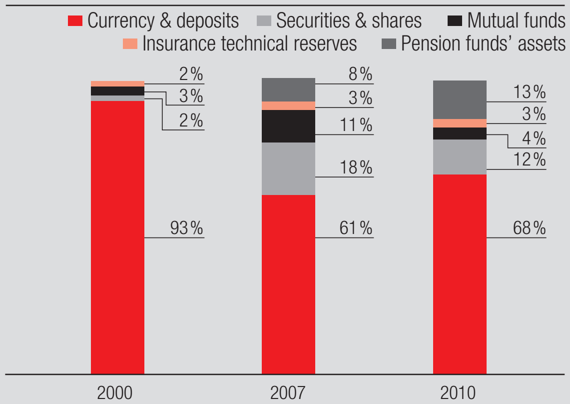
Source: CNB, UniCredit Group CEE Research Network – Zagrebacka Banka Research the IPOs in 2007 totalled HRK 9 bn, bringing new investors to the stock exchange. This development on the stock exchange also fuelled exceptionally fast growth in equity and balanced fund assets under management. AuM held by individuals in open-end investment funds rose by 117.4 %, whereas the estimated market value of listed shares held by individuals rose by 140 %. On the other hand, currency and bank deposits of households grew by just 8.8 % and 9.9 % respectively. Deposits in housing savings banks grew by a mere 4 % due to the fact that the government subsidy for yearly deposits of up to HRK 5,000 was previously reduced from 25 % to 15 %. Pension fund assets grew by 33.2 % in 2007 on the back of a fast developing capital market and rising employment. Life insurance technical reserves recorded somewhat slower growth (16 %). In spite of a 5.4 % decrease in AuM in closed-end funds (due primarily to the repayment of pensioners' debt), 2007 recorded growth of 27.5 % in total household financial assets.

The financial liabilities of households in 2007 grew somewhat more slowly than in 2006 but still posted fast growth (18.9 %), primarily due to the very strong demand for housing loans (22.9 %) and revolving credit card loans (28.4 %). Consumer leasing also grew significantly (41.2 %), which is partly attributable to the low base figure.

Despite the unpredictable global financial and economic circumstances and the slower growth projected in the coming years, we expect a gradual recovery in household financial assets and net financial wealth. A slow and gradual recovery on the capital market and in investor sentiment towards the end of this year should push the growth rates of financial asset classes linked to the stock exchange above 10 % again. Thereafter, pension fund asset growth could again reach 24 %. Together with the expected return of this year's withdrawals, bank deposits should grow by 9 % and make an important contribution to growth of overall household financial assets, as they still account for a dominant share. Consequently, total financial assets are expected to grow by 8.1 % in 2009. The financial liabilities of households this year are set to grow much more slowly than in 2008, i.e. by 7.1 % as a result of the prolonged financing deficit expected in the market. The considerably slower growth in housing loans (6.7 % vs. an estimated 10.8 % in 2008) will reflect cooling residential real estate market conditions and the slower growth in real incomes. Consumer leasing is expected to continue its dynamic growth, largely because of the low base figure. Relatively slow growth is anticipated for car loans.

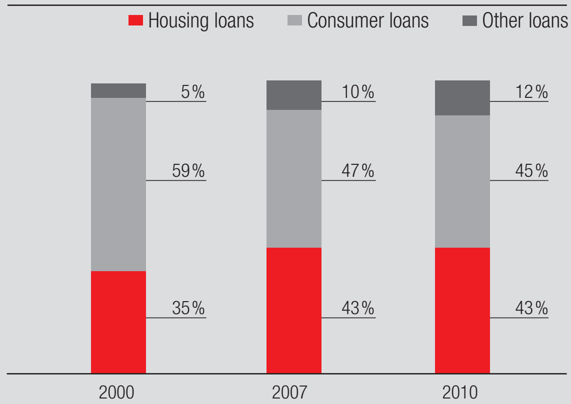
Somewhat better trends are expected in 2010 with higher growth in total financial assets (10.5 %), bearing in mind the gradual recovery expected in the capital market performance. This should result in an increase in net household financial wealth of 9.5 % and 11.8 % in 2009 and 2010 respectively. Corrected net wealth should grow slightly more slowly, at 8.8 % and 11.2 % respectively, due to the declining share of housing loans in total retail loans. By the end of 2010 total financial assets of households should reach almost 91 % of projected GDP and total financial liabilities somewhat more than 44 % of GDP. As a result, the net financial wealth of households should reach almost 47 % of GDP and corrected net wealth around 66 % of GDP, which is still far below the level registered in 2007.

Household Financial Assets (% of total)*



Sources: CNB, Central Depository Agency (SDA), Croatian Securities Commission (CROSEC), Zagreb Stock Exchange (ZSE), Varazdin Stock Exchange (VSE), Insurance Supervision Directorate, HANFA, UniCredit Group CEE Research Network – Zagrebacka Banka Research
*) Currency and deposits include also housing savings

Household Financial Liabilities (% of total)*



Sources: CNB, UniCredit Group CEE Research Network – Zagrebacka Banka Research
*) Other loans include overdraft, revolving credit cards and financial leasing

Czech Republic

Slowdown in net wealth accumulation, but no major risks for households

Pavel Sobisek and Patrik Rozumbersky

- Following years of lively growth in the accumulation of household wealth, supported by good macroeconomic conditions and continual financial deepening, the speed of wealth accumulation is set to slow substantially in 2008 on the back of deteriorating economic growth and the impact of the global financial crisis.
- Mutual fund assets and household property in shares are set to be most severely hit by the financial turmoil, while no massive withdrawals are expected from Czech banks. Hence, the popularity of traditional and more conservative saving instruments is likely to rise again.
- Household indebtedness grew by a third in 2007 driven by loans for housing purposes. However, tax changes affecting housing loans and financial leasing coupled with decreasing consumer confidence should reduce debt growth in 2008 to almost half of previous year's level.
- Looking forward, the accumulation of financial assets is set to recover in the next two years, while growth in household indebtedness is anticipated to cool down further, leading to only a marginal drop in net wealth as a share of GDP by 2010 to 36 %.

Table 1: **Household Financial Indicators** (S.14)[1), 2)]

	2006	2007	2008e	2009f	2010f
Financial Assets (% of GDP)	65 %	65 %	65 %	66 %	67 %
Financial Liabilities (% of GDP)	20 %	25 %	27 %	29 %	32 %
Net Wealth (% of GDP)	45 %	41 %	37 %	37 %	36 %
Corrected Net Wealth (% of GDP)	56 %	55 %	54 %	54 %	55 %

1) Corrected net wealth is calculated as gross financial wealth minus the non-mortgage part of household debt; 2) Sector S.14 according to ESA95 classification; data also include Sector S.15 (NPISHs)
Source: CNB, UniCredit Group CEE Research Network – UniCredit Bank Czech R. Economic Research

The financial position of households deteriorated in 2008 on the back of a slower accumulation of wealth – affected by losses in the financial markets – and persistently lively lending. This really contrasts with trends observed up to 2007 when household financial wealth rose by 11.2 % yoy, maintaining its strong momentum from the previous year and extending its double-digit growth to a third year in a row. However, the share of wealth in GDP in 2007 did not pick up from its 2006 level (65 %) just because of rapid growth in nominal GDP, which exceeded 10 % yoy. The growth in household indebtedness easily outpaced asset growth, bringing the net wealth / GDP ratio down to 41 % from 45 % in 2006. Nevertheless, when deducting the non-mortgage part of the debt from household assets, net wealth over GDP dropped just 1 percent to its long-term average of 55 %.

We anticipate the growth rate of gross wealth to have dropped sharply to 5.6 % last year as the domestic economic slowdown combined with the impact of the global financial turmoil took their toll. Similarly, a significant decline in growth is also expected for liabilities. However, whereas we expect asset growth to claw back some ground in the next two years, the growth of household debt should continue to slow in 2009 followed by a minor recovery in 2010, leading to a marginal drop in the net wealth per GDP ratio by 2010.

The crises have spurred a shift toward more traditional savings products – mainly bank deposits (excluding those in building societies) and cash – that still account for a dominant share in the total wealth of Czechs. What is more, their combined share stopped decreasing and stabilised at 52.7 % in 2007. This was mainly facilitated by rallying deposit growth, which after many years of stagnation picked up to 8.9 % yoy in 2006 and further to 11.5 % yoy in 2007. The renewed interest in bank savings instruments can be attributed to the robust growth of household disposable income coupled with rising interest rates. In addition, the strong rise in bank deposits continued in the first three quarters of 2008, encouraged by money outflows from equities and mutual funds affected by the financial crisis. Some deceleration can be expected from Q4 2008, however, as wage growth abates.

Importantly, we do not expect any massive withdrawals from the banking system in the wake of the global financial crisis. The Czech banking sector has proved to be insulated from the turmoil abroad, with minimal exposure of the most significant players to risky mortgage-backed assets. Moreover, Czech banks are traditionally well capitalised to cover potential risks, sticking to traditional conservative business models.

Unlike bank savings in CZK, deposits in foreign currency declined up to the end of H1 2008 due to CZK appreciation. Apparently, the

Table 2: Financial Wealth

	Stock in 2007 € mn	(% on total)	Yoy % growth (LC) 2007	2008e	2009f	2010f
Currency	9,631	11.1 %	9.8 %	8.0 %	8.0 %	7.1 %
Bank deposit retail	36,218	41.6 %	11.5 %	8.4 %	8.1 %	8.2 %
LC currency	33,940	39.0 %	12.7 %	9.5 %	8.7 %	8.6 %
FX currency	2,278	2.6 %	–4.2 %	–8.7 %	–2.1 %	1.5 %
Housing savings	14,409	16.6 %	6.9 %	5.1 %	4.5 %	4.0 %
Securities other than shares	975	1.1 %	18.0 %	30.2 %	15.2 %	14.5 %
Listed shares	949	1.1 %	10.0 %	–19.0 %	8.4 %	11.0 %
Mutual funds	10,066	11.6 %	15.5 %	–14.3 %	6.3 %	16.0 %
Open-end	5,524	6.4 %	10.6 %	–18.8 %	2.2 %	11.9 %
Close-end	0	–	–	–	–	–
Registered abroad	4,542	5.2 %	22.0 %	–8.9 %	10.7 %	20.2 %
Insurance technical reserves	8,652	9.9 %	8.5 %	8.1 %	10.1 %	10.4 %
Life insurance	7,416	8.5 %	7.9 %	8.4 %	10.6 %	10.8 %
Non-life insurance	1,236	1.4 %	11.8 %	6.4 %	7.1 %	8.0 %
Pension funds' assets	6,090	7.0 %	19.1 %	16.0 %	15.4 %	15.2 %
Total	**86,989**	**–**	**11.2 %**	**5.6 %**	**8.2 %**	**9.1 %**

Source: CNB, CZSO, Ministry of Finance, Czech Capital Market Association, Association of Pension Funds, UniCredit Group CEE Research Network – UniCredit Bank Czech R. Economic Research

higher interest return on foreign currency deposits was not able to compensate for the exchange rate loss, discouraging people from keeping money on FX accounts. In Q3 2008, however, we observed a robust increase in FX deposits, most likely related to a sharp decline in the value of the CZK.

With the interest rate environment becoming more attractive, people started to reduce cash holdings in 2007. After hovering above 11 % yoy in 2005 – 2006, cash growth slowed to below 10 % yoy in 2007 and further to just 3.8 % yoy in September 2008. However, the loss of confidence in the financial system, albeit limited in the Czech case, should stimulate cash holdings in late 2008 and this year.

Deposits in building societies account for the second highest proportion of total household wealth. Nevertheless, the growing saturation and the shifting of savings for construction purposes have been behind the gradually declining growth. In September 2008, the growth in housing savings reached 5 % yoy, down sharply from 14.6 % yoy in late 2005 when their share in total assets peaked (17.5 %). We do not see any reason for a turnaround in this trend in the years to come.

In spite of relatively solid increments over past years, retail holdings of securities and shares remain negligible in comparison with other instruments (both accounted for only 1.1 % of total wealth in 2007). However, while the volume of households' money in securities increased sharply in H1 2008, the collapse of the stock exchange markets has slashed their property held in shares. The PX index of the Prague Stock Exchange lost a third of its value over the first three quarters of 2008, plunging to a three-year low. Hence, the proportion of shares in overall household assets is set to have dropped below 1 % at the end of last year.

Table 3: Financial Liabilities

	Stock in 2007 € mn	(% on total)	Yoy % growth (LC) 2007	2008e	2009f	2010f
Housing loans	19,235	58.8 %	37.6 %	20.8 %	14.6 %	16.1 %
Consumer loans	6,918	21.2 %	24.1 %	18.7 %	11.9 %	13.1 %
Consumer loans of other MFIs	4,321	13.2 %	25.5 %	22.6 %	12.1 %	13.9 %
Consumer loans of OFIs	2,597	7.9 %	21.7 %	12.1 %	11.6 %	11.6 %
Overdraft	440	1.3 %	25.4 %	15.3 %	14.8 %	14.5 %
Other loans	2,715	8.3 %	29.5 %	23.8 %	15.6 %	14.5 %
Revolving credit cards	413	1.3 %	32.9 %	22.9 %	14.8 %	13.9 %
Financial leasing	2,968	9.1 %	37.5 %	–2.6 %	13.0 %	11.5 %
Total	**32,688**	**–**	**33.6 %**	**18.4 %**	**14.0 %**	**15.0 %**

Source: CNB, Czech Association of leasing and consumer finance companies, UniCredit Group CEE Research Network – UniCredit Bank Czech R. Economic Research

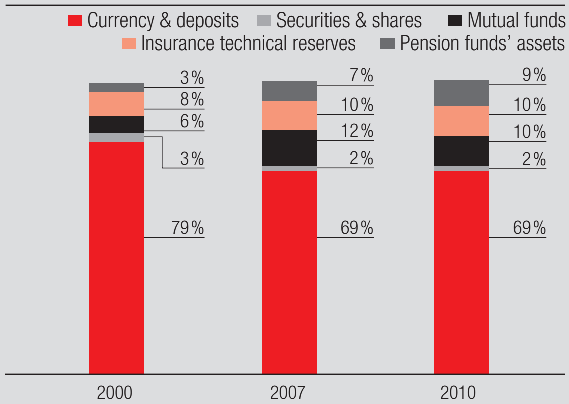
Mutual funds enjoyed a solid 15.5 % yoy inflow of money in 2007. Even though this rate dipped slightly compared with the previous year, their relative share increased by another 0.5 percent to 11.6 % over the year. Nonetheless, the global financial turbulence has resulted in a significant reduction of fund assets since the start of 2008. Over the first three months of the year, household property in mutual funds shrank by 6 %, led by outflows from equity-linked funds. Although the situation stabilised somewhat in Q2 thanks largely to recovering foreign funds, the second wave of outflowing assets hit funds' property in September. Hence, our scenario assumes that mutual fund assets will be down a hefty 14.3 % yoy at the end of 2008. Similar to our prediction for equities, we expect flows into funds to recover in 2009.

The speed of growth in insurance technical reserves dropped to 8.5 % yoy in 2007, its lowest level for the last three years, from 11.6 % in 2006. The slowdown was caused by the life insurance segment, whose rate lagged behind non-life for the first time since 2001. In fact, life insurance represents an alternative to private pension savings given the weaker government support so far for a full reform of the pension system. While the share of pension fund assets in total household wealth has been rising gradually, the share of life insurance reserves has hovered near 8.5 % in the last five years. In 2008 we expect household asset growth related to life insurance to have been partly affected by the poor financial market performance. In the next two years, however, we assume that the growth rate will return to above 10 % yoy.

With annual increases of around 20 %, private pension funds were among the fastest growing forms of savings in past years. Nevertheless, even though the growth looks strong at first sight, it was roughly half that registered throughout the rest of the CEE region. Moreover, the first three quarters of last year saw the growth rate easing to 16.5 % yoy, reflecting the lack of action from the government. Only several amendments to the state's "pay-as-you-go" pillar of the pension system have been implemented so far, while government measures which would support private pensions have yet to be discussed in the parliament. Unfortunately, a cross-party consensus on the basic reform plans has not been reached, making it very unlikely they will be pushed through parliament. Hence, in the near future we do not expect pension funds to sustain their growth of past years.

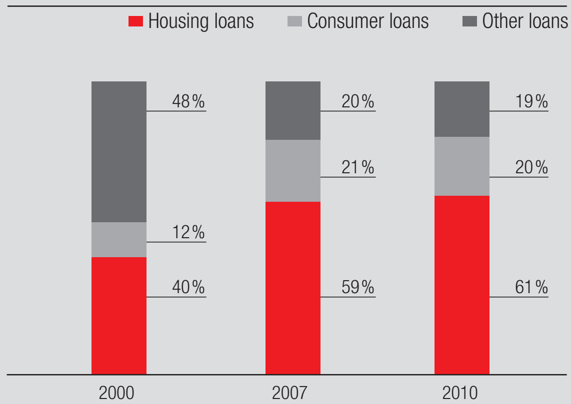
Total retail loans granted by banks and non-banking institutions soared 33.6 % yoy in 2007, the fastest growth rate since 2003. Housing loans and financial leasing drove the overall rate, up 37.6 % yoy and 37.5 % yoy respectively. In addition to the sound macroeconomic environment, tax changes entering into force in January 2008 also contributed to the steep rise in debt related to the above categories in late 2007. However, the adverse effect of these measures combined with the declining economic growth knocked housing lending down to 28.1 % yoy in Q3 2008, and leasing growth to 11.9 % yoy at the end of H1 2008. Unlike all the other categories of retail lending which have been trending downward since the beginning of 2008, consumer credits granted by banks managed to maintain a healthy momentum in the first 9 months of the year. Nevertheless, with consumer confidence gradually declining we reckon that consumer lending is set to weaken too. So far, however, there have not yet been any signs of a significant tightening in credit conditions, as the overall liquidity of domestic banks remains relatively good. On the whole we anticipate the growth in household indebtedness to have eased to 18.4 % yoy in 2008 and to slowdown further to 14 % yoy in 2009.

Household Financial Assets (% of total)*



Sources: CNB, UniCredit Group CEE Research Network – UniCredit Bank Czech R. Economic Research
*) The aggregate currency and deposits also include savings kept in building societies

Household Financial Liabilities (% of total)*



Sources: CNB, Czech Association of leasing and consumer finance companies, UniCredit Group CEE Research Network – UniCredit Bank Czech R. Economic Research
*) The significant increase in the weight of consumer loans between 2000 and 2007 is artificial, as data on consumer loans granted by other financial intermediaries were not available at the beginning of the observation period. Other loans include overdrafts, other loans granted by banks, revolving credit cards and financial leasing

Hungary

Households' saving capacity far from recovering, high risk associated with FX debt

Dániel Frisch, Tamás Nagy and Tibor Nagy

- Household saving potential and private consumption have not yet recovered from the negative impacts of the austerity package, with prospects for income growth and development on the financial markets expected to remain unfavourable in the short term, resulting in marginally negative growth in financial wealth to 62 % of GDP in 2008.
- Previous trends of a gradual switch toward more sophisticated, fund-managed assets have stopped due to the adverse economic conditions and the recent capital market turbulences. Pension fund assets and securities expect to benefit the most from the current climate of uncertainty and high risk aversion.
- The less supportive macroeconomic environment and the higher cost of risk are expected to keep dynamics in household liabilities more subdued this year, with growth decelerating to 7.3 % from an anticipated 16.2 % in 2008. Driven by general-purpose mortgage loans denominated in foreign currency, consumer financing has risen continuously at the expense of housing loans, and this trend should continue in the years to come.

Table 1: **Household Financial Indicators***

	2006	2007	2008e	2009f	2010f
Financial Assets (% of GDP)	64 %	67 %	62 %	65 %	67 %
Financial Liabilities (% of GDP)	25 %	29 %	31 %	33 %	35 %
Net Wealth (% of GDP)	38 %	38 %	30 %	32 %	32 %
Corrected Net Wealth (% of GDP)	50 %	50 %	44 %	45 %	46 %

*) Corrected net wealth is calculated as gross financial wealth minus the non-mortgage part of household debt
Source: NBH, UniCredit Group CEE Research Network – UniCredit Bank Hungary Research

The Hungarian stabilisation programme launched in September 2006 has achieved the planned results concerning the fiscal deficit, but household saving potential and private consumption have not yet recovered from the negative impacts of the austerity package. Despite the global economic environment there was a gradual recovery in Hungarian economic performance in the first half of last year. The increase in global inflationary pressure was only partially compensated by tight monetary conditions and HUF appreciation, with the real disposable income of households barely improving in H1. Prospects for income growth are expected to remain unfavourable in the near future, while further deterioration in the macroeconomic environment is expected to lead to rising unemployment rates, possibly affecting the loan repayment capacity of households. According to an NBH survey, only 12 % of indebted families had any financial savings in 2007, and only 4 % of households with the lowest income have some sort of savings. This means that the majority of indebted households have no reserves to rely on in the event of an income shock.

The latest stage of the global financial crisis reached Hungary in October, resulting in a squeeze to foreign currency financing (mainly CHF) on the interbank market. As funding costs rose sharply, foreign currency reserves dried out and FX loans became more expensive. Some financial institutions have stopped lending in CHF and the structure of FX loans has shifted towards those denominated in EUR. Difficulties in foreign currency lending were not able to push borrowers towards HUF-denominated loans as the National Bank significantly tightened monetary conditions in this context too in response to a speculative attack against the HUF.

Heavy borrowing entails higher household debt, especially among the lower income classes, although overall debt leverage still remains lower in comparison with the average of the Eurozone countries (29 % relative to GDP in 2007). On the other hand, the 43 % ratio of financial liabilities to financial wealth already exceeds the benchmark level. Along with strong borrowing, the debt service burden relative to disposable income increased substantially too, reaching 13 % in 2007 compared to around 10 % in the Eurozone.

After continuously rising in the past few years household financial wealth is expected to fall marginally relative to GDP, ending up at 62 % last year from 67 % in 2007. The net accumulation of financial wealth by Hungarian families is anticipated to have dropped by 14 % yoy in 2008 to reach 30 % of GDP, before gradually recovering from 2009.

Table 2: **Financial Wealth**

	Stock in 2007		Yoy % growth (LC)			
	€ mn	(% on total)	2007	2008e	2009f	2010f
Currency	8,007	12.0 %	11.8 %	1.3 %	3.9 %	3.2 %
Bank deposit retail	25,270	37.8 %	6.8 %	4.4 %	5.8 %	6.0 %
LC currency	21,553	32.2 %	5.9 %	2.4 %	4.6 %	4.4 %
FX currency	3,717	5.6 %	12.1 %	15.8 %	12.1 %	13.5 %
Securities other than shares	4,636	6.9 %	–10.6 %	17.0 %	11.2 %	9.4 %
Listed shares	1,348	2.0 %	10.7 %	–25.0 %	6.0 %	7.9 %
Mutual funds	9,464	14.2 %	29.4 %	–12.5 %	3.0 %	7.5 %
Open-end	7,802	11.7 %	23.9 %	–17.4 %	2.7 %	8.3 %
Close-end	1,662	2.5 %	63.1 %	10.5 %	4.0 %	4.9 %
Registered abroad	–	–	–	–	–	–
Insurance technical reserves	7,030	10.5 %	15.8 %	–4.9 %	8.5 %	11.1 %
Life insurance	5,850	8.8 %	17.1 %	–7.5 %	8.7 %	12.1 %
Non-life insurance	1,180	1.8 %	9.6 %	8.1 %	7.8 %	6.9 %
Pension funds' assets	11,093	16.6 %	19.6 %	–6.5 %	11.0 %	13.8 %
Total	**66,848**	**–**	**11.6 %**	**–0.9 %**	**6.8 %**	**8.0 %**

Source: NBH, UniCredit Group CEE Research Network – UniCredit Bank Hungary Research

In terms of asset allocation, traditional and stable assets like bank deposits have lost ground compared to more complex forms of savings over the past few years. Due to the adverse environment and the recent turmoil on the international markets, this trend has changed radically along with an increase in the importance of less risky and more liquid assets. The share of bank deposits in total wealth declined from 40 % in 2006 to 38 % in 2007, while we anticipate an increase in 2008 due to the high interest rate premium.

After a 29 % increase in 2007 the value of mutual funds fell strongly through last year in line with developments in the equity market. Net sales remained in positive territory up to Q1, with large outflows becoming more visible thereafter. Combined with the negative performance of local stock markets, this resulted in a drop in net assets held in mutual funds of 10 % in the January–September period. Overall, assets accumulated in investment funds are expected to have fallen by 12.5 % by the end of the year. The growth in popular guaranteed funds was less affected, providing an additional survival alternative to riskier assets.

Still, in the long term we expect modest improvements in the value of mutual funds for 2009 and 2010 again, though at a much slower pace than in the past few years.

Life insurance reserves had put in an outstanding performance in the past few years due to the aggressive development of sales agent networks. In 2007 and H1 2008, there was still dynamic growth in new transactions, as for pension fund reserves. Growth in both segments is expected to slow more considerably from Q3, with some recovery emerging next year.

Table 3: **Financial Liabilities**

	Stock in 2007		Yoy % growth (LC)			
	€ mn	(% on total)	2007	2008e	2009f	2010f
Housing loans	12,447	43.0 %	16.2 %	12.0 %	5.0 %	7.5 %
Consumer loans	8,764	30.3 %	38.3 %	24.9 %	10.1 %	12.7 %
Consumer loans of other MFIs	8,480	29.3 %	40.9 %	26.0 %	10.5 %	13.0 %
Consumer loans of OFIs	285	1.0 %	–9.9 %	–9.2 %	–5.8 %	–2.5 %
Overdraft	1,163	4.0 %	41.8 %	31.5 %	13.0 %	18.0 %
Other loans	1,286	4.4 %	1.2 %	12.1 %	6.0 %	8.5 %
Revolving credit cards	–	–	–	–	–	–
Financial leasing	5,282	18.2 %	13.4 %	9.2 %	6.5 %	7.1 %
Total	**28,942**	**–**	**21.6 %**	**16.2 %**	**7.3 %**	**9.7 %**

Source: NBH, UniCredit Group CEE Research Network – UniCredit Bank Hungary Research

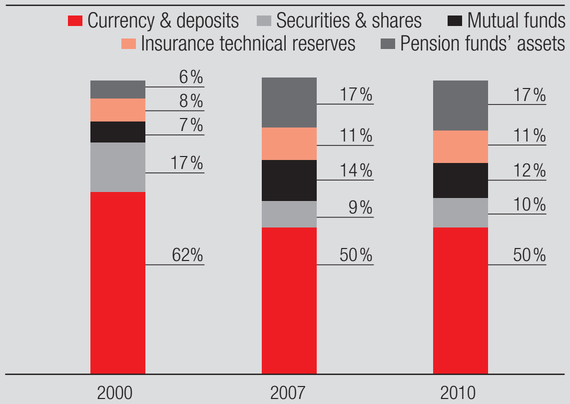
In the wake of the government's austerity measures, growth in total household liabilities accelerated slightly to 21.6 % in 2007 from 20 % in 2006, spurred on by the need of households to maintain living standards. Following the tightening of credit conditions and rising risk aversion, the growth rate has decelerated since the beginning of last year. Overall, household liabilities are expected to have grown by a modest 16.2 % yoy in 2008, while 7.3 % and 9.7 % is pencilled in for 2009 and 2010 respectively. As households were trying to preserve their standard of living, the ratio of consumer financing rose continuously at the expense of housing loans. Corporates and households have tried to sidestep Hungary's high interest rates by borrowing heavily in foreign currency, particularly in CHF and EUR.

The ratio of foreign currency credits within total loans grew at an accelerating rate in past years, particularly thanks to the very attractive pricing of Swiss franc loans compared to those denominated in HUF. At the end of H1 2008, more than half of total bank loans were held in foreign currency. In the case of mortgage loans, the share of FX-denominated ones has overtaken the ratio of local currency loans, reaching 21.6 % of the total. In terms of foreign currency consumer loans we expect 36 % growth in 2008, along with a dramatic 9 % fall in local currency loans – which will most likely be corrected in the coming years. In 2007 and 2008, the fastest growth rate within consumer loans was again delivered by general-purpose mortgage loans, primarily because sales agent networks gained ground and the less favourable forint housing loans were increasingly replaced by general-purpose mortgage loans denominated in CHF.

The growth in general-purpose mortgage loans was accompanied by a fall in loans for goods purchases, while the continued expansion in short-term consumer loans definitely made a significant contribution to the increase in the household debt service ratio. Overall, the quality of the household credit portfolio has deteriorated somewhat, though the ratio of non-performing loans to the total portfolio remains low at 2.7 %.

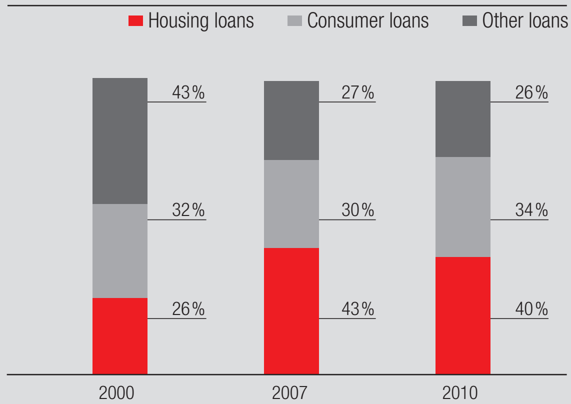
Financial leasing and hire purchasing seems to have peaked and has continuously lost ground since 2004, generating a modest 5 % increase in H1 2008. This form of asset financing is still dominated by vehicle leasing, despite a fast rise in the relevance of real estate. In line with the decrease in new cars sold, approximately 9 % growth can be expected on the leasing market for 2008 along with further possible setbacks in the next few years.

Household Financial Assets (% of total)



Sources: NBH, UniCredit Group CEE Research Network – UniCredit Bank Hungary Research

Household Financial Liabilities (% of total)*



Sources: NBH, UniCredit Group CEE Research Network – UniCredit Bank Hungary Research

*) Other loans include overdraft (since 2003), other loans and financial leasing

Poland

Falling asset prices and rising risk for FX debt put pressure on household solvency

Marcin Mrowiec

- The substantial decline in the dynamics of net wealth in 2008 was primarily the result of very significant losses in the stock market, which in turn lowered the value of listed shares, mutual funds and pension funds. On the other hand, financial liabilities kept increasing for most of the year, contributing to deterioration in the net financial position of households.
- The gloomier growth prospects for 2009 and 2010 along with the moderate increases expected in asset prices will support only a marginal recovery in the accumulation of wealth, while investments into mutual funds and listed shares will regain strength gradually depending on when confidence is restored to the capital markets.
- Important developments are taking place on the loan market, with CHF-denominated loans (which constituted the majority of the increase in mortgage financing in recent quarters) becoming much riskier due to the global CHF liquidity squeeze and the significant zloty weakening. This will clearly have an impact on the dynamics of mortgage loans, especially in the coming years, with the bulk of lending returning to the local currency. Higher interest rates in the domestic currency will in turn mean lower demand for credit, with household indebtedness anticipated to slow down in 2009 and not pick up again until 2010.

Table 1: **Household Financial Indicators***

	2006	2007	2008e	2009f	2010f
Financial Assets (% of GDP)	64 %	67 %	60 %	62 %	64 %
Financial Liabilities (% of GDP)	17 %	22 %	26 %	26 %	27 %
Net Wealth (% of GDP)	46 %	45 %	34 %	35 %	36 %
Corrected Net Wealth (% of GDP)	54 %	55 %	46 %	48 %	50 %

*) Corrected net wealth is calculated as gross financial wealth minus the non-mortgage part of household debt
Source: CSO, NBP, UniCredit Group CEE Research Network – Pekao Research

2008 has been characterised by a reversal of many benign processes in wealth creation that took place in previous years. Strong economic growth in the past supported an improvement in household incomes, lowered the unemployment rate – as a result of both strong domestic payrolls as well as emigration to EU countries that opened their labour markets – and boosted sentiment. With low interest rates and a stronger zloty, this resulted in a boom in retail loans of both the consumer and mortgage variety. Meanwhile, the good financial results of enterprises, low interest rates and the strong demand shown towards mutual funds all drove a significant boom in the stock exchange and real estate market, with house prices in major Polish cities doubling and tripling, and in some cases even quadrupling. The interplay of these factors generated a strong increase in household financial wealth, as gains from the increasing value of real estate and the bullish equity markets pushed up the value of listed shares, mutual funds and pension fund assets.

However, the boom came to an end mainly on the back of the global liquidity crunch and the re-pricing of risks, although for now there has not yet been any sign of a significant slowdown in the real economy, and credit growth to households continued uninterrupted until Q3 last year. The lower pace in the accumulation of financial wealth accompanied by the still faster growth in lending is expected to result in a marked slowdown of net wealth over GDP to 34 %.

As a result of the gloomier macroeconomic outlook and the less dynamic growth in wages, the accumulation of wealth is only expected to recover marginally in 2009 and 2010. However, the significant cooling on the lending side, especially this year, might result in a gradual pick up in the accumulation of net financial wealth, which is forecast to increase marginally to 36 % of GDP by 2010.

The accumulation of financial assets experienced a severe contraction in 2008 as equity prices tumbled worldwide and the value of the domestic stock market index (WIG) halved over the first ten months of 2008. Falling prices were responsible for half of the decline in the value of mutual funds, with the other half coming from redemptions (PLN 32.5 bn was withdrawn from mutual funds in the first ten months of 2008). The situation is expected to have improved towards year-end, but still, after such massive losses, it will take some time for the public to trust the stock market again, and hence we predict only moderate inflows into mutual funds and purchases of listed shares in 2009. The higher interest rate

Table 2: **Financial Wealth**

	Stock in 2007		Yoy % growth (LC)			
	€ mn	(% on total)	2007	2008e	2009f	2010f
Currency	21,541	9.9%	12.2%	10.2%	6.4%	6.8%
Bank deposit retail	77,960	35.6%	10.2%	18.1%	6.8%	6.8%
LC currency	69,645	31.8%	13.6%	20.1%	7.3%	7.4%
FX currency	8,316	3.8%	–12.2%	1.7%	1.1%	0.9%
Securities other than shares	2,990	1.4%	–16.8%	1.8%	7.3%	6.8%
Listed shares	23,808	10.9%	16.5%	–33.4%	14.8%	17.2%
Mutual funds	30,821	14.1%	35.5%	–45.6%	11.7%	16.0%
Open-end	30,821	14.1%	35.5%	–45.6%	11.7%	16.0%
Close-end	–	–	–	–	–	–
Registered abroad	–	–	–	–	–	–
Insurance technical reserves	22,475	10.3%	17.4%	8.3%	12.0%	12.5%
Life insurance	17,929	8.2%	18.7%	7.3%	12.5%	13.4%
Non-life insurance	4,547	2.1%	12.3%	12.0%	10.0%	9.0%
Pension funds' assets	39,093	17.9%	20.1%	–6.7%	16.1%	14.1%
Total	**218,688**	**–**	**16.1%**	**–2.9%**	**9.9%**	**10.4%**

Source: CSO, NBP, ISO, UniCredit Group CEE Research Network – Pekao Research

environment contributed to making bank deposits more appealing for clients. This factor is being strengthened by regulations on liquidity ratios demanded by the supervisory authorities (in force since mid-2008), which demand a higher share of longer-term deposits than was previously the case, forcing banks to increase interest rates paid to depositors. Higher rates (plus a significant decline in the attractiveness of investing in the equity market) pushed growth of deposits close to 24% yoy in October, and even though some deceleration is expected, this year we still see scope for a strong increase in household deposits at banks.

2008 recorded a significant increase in household debt (almost 31% yoy in the first 9 m), especially when taking into account that this came on top of an almost 38% yoy increase in the previous year. The lower availability of mortgages throughout the year did contribute, however, to stabilisation in the demand for flats.

This coincided with an increase in the supply of newly completed apartments which grew by 56% yoy in H1 in the six largest cities. The surge in supply was further driven by the appearance on the market of new flats bought in previous periods for investment purposes. The combination of both factors brought about a stabilisation of house prices, which grew on average by just 0.3% qoq as of June this year on the primary markets, while going down by almost 4% both at the country level and in the capital city on secondary markets.

In 2009, lending growth will slow down markedly as the lower economic growth and the already high levels of indebtedness are likely to curb demand for credit. Serious problems have started to emerge recently following the strong increase in the relevance of CHF loans recorded over past years – with almost 90% of the growth in housing loans in Q1 – Q3 related to the CHF. The signifi-

Table 3: **Financial Liabilities**

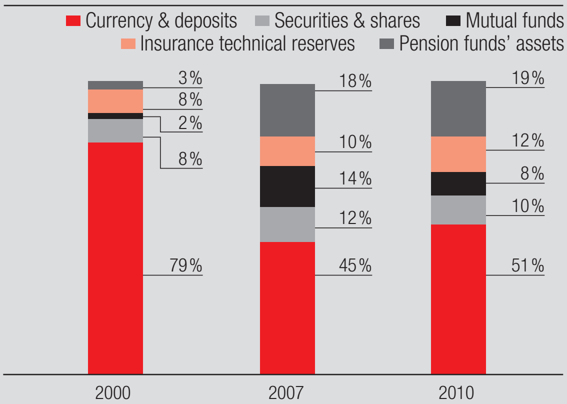
	Stock in 2007		Yoy % growth (LC)			
	€ mn	(% on total)	2007	2008e	2009f	2010f
Housing loans	32,844	45.9%	50.7%	37.0%	7.6%	9.5%
Consumer loans	30,374	42.4%	31.1%	25.1%	5.4%	12.2%
Consumer loans of other MFIs	30,374	42.4%	31.1%	25.1%	5.4%	12.2%
Consumer loans of OFIs	–	–	–	–	–	–
Overdraft	4,959	6.9%	16.4%	18.2%	8.6%	4.4%
Other loans	473	0.7%	–1.1%	–17.3%	0.0%	7.1%
Revolving credit cards	2,489	3.5%	53.0%	31.4%	15.3%	21.5%
Financial leasing	451	0.6%	4.2%	3.9%	4.0%	4.9%
Total	**71,589**	**–**	**38.3%**	**29.9%**	**7.0%**	**10.7%**

Source: NBP, UniCredit Group CEE Research Network – Pekao Research cant liquidity squeeze in the CHF taking place on interbank markets worldwide in recent months and the consequent increase in the cost of borrowing combined with a weakening of the zloty hit the household sector hard. These factors – plus the fact that the domestic Financial Supervisory Authority is likely to tighten regulations on FX lending even further – could hit CHF lending hard, resulting in a marked slowdown especially in the growth of FX mortgages. Loans denominated in zloty remain less appealing to domestic homebuyers than those in Swiss francs, as interest rates are relatively high and in many places, apartment prices have reached such high levels that average (or even above-average) earning families cannot afford to service a loan for a decent flat.

Overall, the growth in mortgage loans is projected to cool down from an anticipated 37 % in 2008 to around 8 % this year.

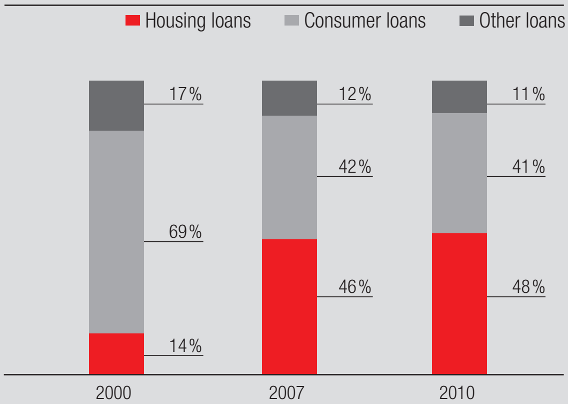
These developments will also affect consumer loans, though to a smaller extent, given the increasing focus of banks on short-term / unsecured lending in a period of unfavourable liquidity conditions and slowing economic growth. Our forecasts point to a slowdown in the growth of personal loans from an anticipated 25 % last year to 5 % in 2009.

Household Financial Assets (% of total)



Sources: CSO, NBP, ISO, UniCredit Group CEE Research Network – Pekao Research

Household Financial Liabilities (% of total)*



Sources: CSO, NBP, ISO, UniCredit Group CEE Research Network – Pekao Research
*) Other loans include overdraft, other loans, revolving credit cards and financial leasing (since 2001)

Romania
Low saving capacity and increasing debt burden affect household solvency

Rozalia Pal

- Despite the booming economy, the accumulation of financial wealth is expected to record a significant deceleration last year, mainly on the back of the negative wealth effect resulting from losses on the financial markets. The less supportive economic growth forecast coupled with the extremely uncertain global environment may allow just a modest recovery in wealth accumulation until 2010. Net wealth over GDP is set to stabilise at around 7 % of GDP in 2009 – 2010.
- Amidst mounting volatility and increasing risk aversion, traditional savings' products are expected to regain popularity to the detriment of investment funds and listed shares, with the newly created pension system providing some support to wealth accumulation.
- The consumption-boom phase led by fast lending growth is coming to an end thanks to tightening in lending requirements and the ongoing re-pricing of risks. The impact of the crisis in terms of the credit squeeze is expected to take its toll this year especially, but lending growth will still remain in double figures. Falling economic growth and the rising debt burden are issues to keep an eye on with the savings cushion of households still low.

Table 1: **Household Financial Indicators***

	2006	2007	2008e	2009f	2010f
Financial Assets (% of GDP)	27 %	33 %	27 %	27 %	28 %
Financial Liabilities (% of GDP)	12 %	19 %	20 %	20 %	21 %
Net Wealth (% of GDP)	14 %	13 %	7 %	7 %	7 %
Corrected Net Wealth (% of GDP)	17 %	17 %	10 %	11 %	11 %

*) Corrected net wealth is calculated as gross financial wealth minus the non-mortgage part of household debt.
Source: UniCredit Group CEE Research Network – UniCredit Romania Economic Research

Following the peak recorded in 2007 the first half of last year has marked a significant deceleration in the accumulation of household financial wealth, with the huge losses reported on the financial markets largely thwarting the positive effect of a still booming economy. While wages continued to past strong growth, assets held in the form of listed shares and mutual funds have been deeply affected by the escalated liquidity squeeze on the global financial market, with massive sell-offs and shrinking stock prices. By contrast, growth in liabilities remained strong in the first three quarters (up by 59 % yoy), contributing to a further deterioration in the net financial position of households.

Credit market conditions have tightened significantly since the turbulences in September and October, and this could be a turning point for lending activity with signs of a marked deceleration becoming more visible.

The forthcoming cooling in wage growth will than allow only a marginal recovery in the accumulation of financial wealth compared to before 2007, with the gradual return of confidence in the financial markets set to provide some support. At the same time, a cooling of wage growth and tighter lending requirements might contribute to lower demand for loans, thus reducing the pace of consumption and resulting in a marginal improvement in household saving ratios.

Demand for real estate investment should be more affected relatively speaking, on the back of changing expectations regarding the future development of house prices given the growing signs of stabilisation, especially in the largest cities.

Following the drop anticipated last year, net financial wealth should be around 7 % of GDP in 2009 – 2010.

The rising risk aversion triggered by the still high volatility on the financial markets meant that households preferred traditional forms of savings during 2008. As a result, bank deposits went up by 20 % in the first 9 months, with growth expected to remain robust in the short term too, stimulated by intensified competition among banks. Overall, the share of deposits in total household financial wealth is projected to reach almost 65 % by 2010.

Household investments in listed shares represented around 30 % of total wealth at the end of 2007, significantly above the less developed mutual funds market. The high exposure to losses recorded on the stock exchange was thus the main driver behind the marked deceleration of overall financial wealth accumulation through the year. The Romanian stock exchange has been one of the most affected by the turmoil, relative to the other CEE markets, with the BET index plummeting 70 % in the first 10 months. The extremely

Table 2: **Financial Wealth**

	Stock in 2007 € mn	(% on total)	Yoy % growth (LC) 2007	2008e	2009f	2010f
Currency	5,464	14.9 %	43.1 %	12.5 %	11.0 %	14.0 %
Bank deposit retail	18,646	50.8 %	52.6 %	28.0%	18.4%	17.0%
LC currency	11,749	32.0%	50.5%	31.0%	18.5%	17.2%
FX currency	6,897	18.8%	56.1%	22.9%	18.2%	16.6%
Securities other than shares	309	0.8%	–6.7%	8.4%	5.9%	2.8%
Listed shares	11,006	30.0%	35.3%	–50.0%	10.5%	12.0%
Mutual funds	163	0.4%	63.7%	–15.2%	5.6%	17.9%
Open-end	110	0.3%	34.4%	–15.3%	4.2%	20.3%
Close-end	52	0.1%	202.3%	–15.1%	8.4%	13.1%
Registered abroad	–	–	–	–	–	–
Insurance technical reserves	1,115	3.0%	35.6%	23.0%	15.8%	16.8%
Life insurance	777	2.1%	28.3%	23.5%	17.0%	18.0%
Non-life insurance	338	0.9%	56.2%	22.0%	13.0%	14.0%
Pension funds' assets*	4	0.01 %	–	7183.7%	142.7%	41.6%
Total	**36,707**	**–**	**44.3%**	**2.6%**	**16.7%**	**16.1%**

*) Newly reformed pension system effective from the beginning of 2008
Source: BNR, UNOPC, UniCredit Group CEE Research Network – UniCredit Romania Economic Research

volatile environment expected over the short term might also impact negatively on net sales of investment funds, which remained in positive territory up to September, outstripping developed Europe.

Investment in insurance products has proved to be a more stable segment. Accumulation in the segment is projected to remain robust, cooling slightly on the back of falling income growth in particular.

The most promising segment is still pension funds. The voluntary pension system was launched in mid-2007 with a maximum contribution set at 15% of gross salaries – subject to partial tax deductibility. The 7 companies present on the voluntary pension market managed RON 14 mn last year from 50,000 participants. As confirmation of the bright prospects ahead, the voluntary pension system had net assets of RON 66 mn in H1 2008, more than doubling the number of contributors to 136,000.

From the beginning of 2008 a fully funded mandatory pension system (2nd pillar) was launched in addition to the voluntary pension scheme. Contributions to the 2nd pension pillar are set at 2% for the first year, increasing by an annual 0.5% to reach 6% in eight years. As of October 2008 the number of participants reached 3.8 mn, while net assets amounted to around RON 0.6 bn. The mandatory pension system currently consists of 14 pension funds. Driven by progressive contribution hikes we expect the assets managed by pension funds (in both the 2nd and 3rd pillars) to reach RON 3.6 bn (around EUR 1 bn) in 2010.

Stimulated by the still booming economy, growth in household debt remained stable in the first 9 months of last year recording a hefty 34% ytd increase. Growth was particularly strong in the segment of housing loans (up by 34% ytd). Personal loans went up as well (by 31% ytd) fuelled by the persistently strong demand for consumption.

Table 3: **Financial Liabilities**

	Stock in 2007 € mn	(% on total)	Yoy % growth (LC) 2007	2008e	2009f	2010f
Housing loans	3,983	18.3%	71.8%	29.9%	14.5%	15.7%
Consumer loans	16,705	76.6%	90.1%	31.5%	16.3%	16.5%
Consumer loans of other MFIs	15,876	72.8%	84.7%	32.2%	16.4%	16.7%
Consumer loans of OFIs	830	3.8%	334.7%	17.0%	15.9%	13.1%
Financial leasing	1,129	5.2%	104.5%	17.2%	8.9%	9.6%
Total	**21,817**	**–**	**87.1%**	**30.5%**	**15.7%**	**16.1%**

Source: BNR, ASLR, Official statements of other financial intermediaries, UniCredit Group CEE Research Network – UniCredit Romania Economic Research

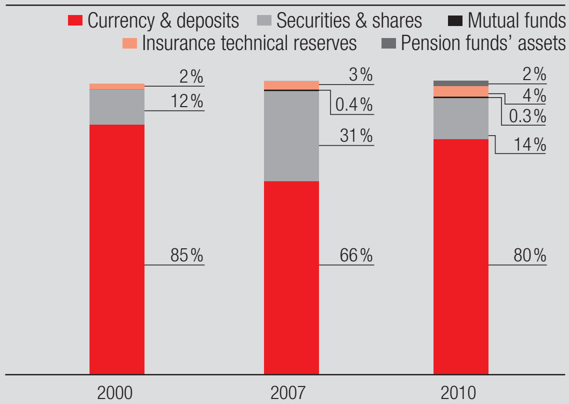
However, the increasing inflationary pressures and mounting risks related to macroeconomic imbalances prompted the Central Bank to tighten monetary conditions further, hiking rates by another 50 bps since June (325 bps since end-2007). The tightening in lending requirements and the growing shortage of liquidity stemming from the global credit crunch were not fully translated into higher borrowing costs up to August, with interest rates on RON-denominated loans going up by around 180 bps and interest rates on EUR-denominated loans remaining relatively stable.

The situation has probably changed significantly in recent months given the clear signs of deceleration in lending especially from Q4. The newly introduced CB regulation effective since October 2008 may also contribute to cooling lending activity. The regulation requires a stress testing of monthly instalments under a worst case scenario – based on the development of key parameters in the last 18 months (i.e. interest rate, commissions and exchange rate risk) – for each customer that is used to calculate lending capacity. As a starting point, each bank can use up to 20 % more than the officially declared income of the previous year.

Growth in lending activity is anticipated to halve in the coming months, with mortgage market particularly affected, as banks shift their focus towards short-term loans in particular and the real estate market continues to cool down, especially in the largest cities. Given the gloomier economic outlook, credit quality may represent a serious challenge going ahead, especially given that the wealth of Romanian households is supported by a low cushion. FX risk also remains an issue to monitor given the relatively high weight of foreign-denominated loans in the household lending portfolio (57 % as of September 2008).

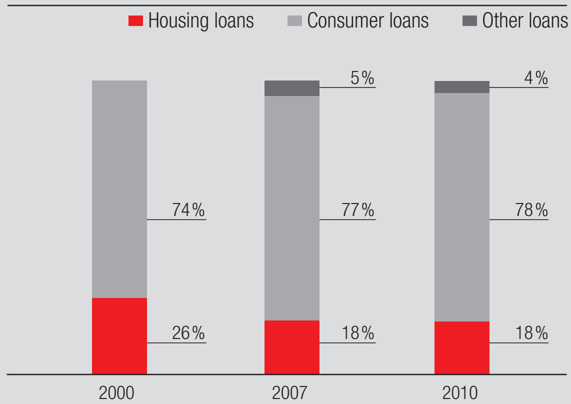
Overall, growth in total household liabilities is projected to slow down from an anticipated 30 % yoy in 2008 to 16 % in 2009.

Household Financial Assets (% of total)



Sources: BNR, UNOPC, UniCredit Group CEE Research Network – UniCredit Romania Economic Research

Household Financial Liabilities (% of total)*



Sources: BNR, ASLR, official statements of other financial intermediaries, UniCredit Group CEE Research Network – UniCredit Romania Economic Research
*) Other loans refer to financial leasing

Russia

Less supportive macroeconomic conditions limit recovery in net wealth accumulation

Nikolay Akimov and Valery Inyushin

- Following years of dynamic growth in household disposable income, the outlook appears much gloomier, with economic growth estimates rapidly revised down as the oil price keeps falling. It is anticipated that the less supportive macro conditions combined with the persistently volatile environment will bring only a marginal recovery in the accumulation of financial wealth, stabilising around 22 / 23% of GDP.
- Owing to the tense world economic situation a sharp drop in household mutual funds' investments was recorded in the second half of last year. The unstable situation in the financial markets and fears of rouble devaluation are expected to encourage an increasing shift into USD cash and bank deposits. Government support to stimulate pension funds should keep investment into these saving schemes lively.
- The tightening of credit market conditions, visible since last September, is expected to further depress lending activity in 2009 with most of the banks mainly focusing on short-term and unsecured loans. This will enable some stabilisation in the accumulation of net financial wealth as a share of GDP to around 11%, while growth in corrected net wealth is anticipated to cool down as mortgages lose their momentum.

Table 1: **Household Financial Indicators** (S.14)*

	2006	2007	2008e	2009f	2010f
Financial Assets (% of GDP)	23 %	24 %	22 %	22 %	23 %
Financial Liabilities (% of GDP)	8 %	10 %	10 %	11 %	12 %
Net Wealth (% of GDP)	15 %	14 %	11 %	11 %	11 %
Corrected Net Wealth (% of GDP)	17 %	16 %	14 %	13 %	14 %

*) Corrected net wealth is calculated as gross financial wealth minus the non-mortgage part of household debt
Sources: Bank of Russia, Rosstat, UCBR, UniCredit Group CEE Research Network

After almost six years of around 25 % growth p.a. in household disposable income (in USD terms), some signs of moderation started to emerge in 2008 on the back of poorer market conditions. Accordingly, growth in household real disposable income decelerated to 7.8 % yoy in the first 9 m compared to 10.4 % yoy for the same period of 2007, with wage growth also slowing down to 12.8 % yoy from 16.2 % yoy in 2007.

Despite the observed softening in income dynamics, the accumulation of financial wealth was sustained in H1 with investments into bank deposits and especially mutual funds still making a positive contribution. The market mood, however, changed drastically from then on, with both equity and investment fund markets recording dramatic sell-offs after the summer, when first of all due to political concerns over the Russian invasion of Georgia and then worries about the health of its banks prompted investors to flee the market. The result was a drop of more than 40 percent in Russia's equity markets and net redemptions of mutual funds hitting a record EUR 0.2 bn in Q3.

Volatility and uncertainty in financial markets are expected to hold at least in the short term, strongly influencing household preferences in favour of long-term saving instruments and deposits with larger banks, together with some evidence of a re-dollarisation process backed by recent CB decisions to speed up the depreciation of the rouble. Overall we anticipate the growth rate of household financial assets to have decreased to 15 % in 2008 as opposed to 27.1 % in 2007. However, a whole range of macro indicators seem to show worrisome trends ahead with growth estimates being rapidly revised down for 2009 as the oil price keeps falling. As a result of the gloomier outlook we envisage there will be only marginal room for recovery in the accumulation of financial wealth next year, with growth in financial assets projected to be 16.2 % yoy. The tightening of credit market conditions, visible since last September, is expected to further depress lending activity in 2009 with most of the banks mainly focusing on short-term and unsecured loans. The deleveraging of households might support some stabilisation in the accumulation of net financial wealth to around 11 % of GDP, while corrected net wealth should shrink as a percentage of GDP with mortgages losing their momentum.

Despite some outflows registered following the financial turmoil since September, bank deposits remain the key household saving vehicle and are expected to increase by 20 % yoy to reach EUR 172 bn by end of 2008. In 2008 the population continued to neglect cash savings in favour of the more profitable retail deposits at banks. Looking ahead, the share of bank deposits in total wealth is projected to increase further from an anticipated 69 % in 2008 to 72 % by 2010.

Table 2: **Financial Wealth**

	Stock in 2007 € mn	(% on total)	Yoy % growth (LC) 2007	2008e	2009f	2010f
Currency	14,647	6.7%	–37.9%	–6.2%	–2.0%	4.4%
Bank deposit retail	145,032	66.6%	35.7%	20.2%	18.0%	24.0%
LC currency	126,492	58.1%	41.6%	24.0%	20.6%	26.6%
FX currency	18,540	8.5%	5.8%	–6.0%	–5.6%	–7.0%
Securities other than shares	–	–	–	–	–	–
Listed shares	–	–	–	–	–	–
Mutual funds	21,291	9.8%	81.9%	–10.0%	13.0%	20.0%
Open-end	3,785	1.7%	49.2%	–31.7%	17.2%	37.1%
Close-end	16,337	7.5%	117.6%	–2.6%	14.4%	17.1%
Interval	1,169	0.5%	–29.6%	–42.6%	–35.4%	20.0%
Insurance technical reserves	12,525	5.7%	25.4%	15.7%	14.6%	16.3%
Life insurance	–	–	–	–	–	–
Non-life insurance	–	–	–	–	–	–
Pension funds' assets	24,345	11.2%	26.5%	21.0%	17.0%	15.0%
Total	**217,841**	**–**	**27.1%**	**15.3%**	**16.2%**	**21.3%**

Sources: Bank of Russia, Rosstat, Analytical Center Investfunds, Federal Service of Insurance Survey, Vnesheconombank statistics, UCBR, UniCredit Group CEE Research Network

The Russian mutual funds industry also recorded stable inflows of funds until Q2 last year. However, the market mood and perceptions changed dramatically from the summer with a huge sell-off wave recorded in the July–September period and net sales topping out at 6.0 bn roubles (EUR 0.2 bn). With risk aversion dominating, stock markets in Russia tumbled by more than 40% in Q3 resulting in a drop of net assets of almost EUR 2.0 bn to 20.2 bn at the end of September. In the months to come, some stabilisation on the financial markets and depressed quotations could stimulate just a gradual recovery in accumulation into investment funds with growth expected to accelerate again to 13.0% this year.

Overall we expect high volatility conditions to persist in the coming years, stimulating a re-dollarisation process in line with trends prevailing in recent months. In October, Russians withdrew 9.2% of their retail deposits from the 32 largest banks, with outflows speeding up compared to September when net retail deposits decreased by 1%. At the same time, deposits in foreign currencies rose by 18.2%, while rouble deposits fell by 22.6%. The outflows from local currency deposits show that confidence in the rouble is falling, fuelled by recent CB decisions to speed up its depreciation. As a result, demand for dollars in October also reached a record high with banks selling over USD 6 bn. Restored confidence in the banking sector should facilitate some stabilisation in the outflows from bank deposits, while demand for cash dollars will remain high in the short term.

The share of insurance in household financial assets has remained quite stable over the last 3 years. This trend is expected to persist resulting in a share in total financial assets of around 5.5 % by 2010. The Russian pension system has undergone a deep reform since 2002. As of 2008 the pension system is still far from being efficient. For some time, the Pension Fund of the Russian Federation has been running at a deficit and has been subsidised by the state. Nevertheless, the government was able to avoid tak-

Table 3: **Financial Liabilities**

	Stock in 2007 € mn	(% on total)	Yoy % growth (LC) 2007	2008e	2009f	2010f
Housing loans	21,083	23.4%	116.3%	45.0%	28.0%	33.0%
Consumer loans	68,945	76.6%	44.9%	32.1%	21.0%	22.7%
Financial leasing	–	–	–	–	–	–
Total	**90,028**	**–**	**57.1%**	**35.1%**	**22.8%**	**25.4%**

Source: Bank of Russia, UCBR, UniCredit Group CEE Research Network ing unpopular action. Government support to stimulate investment into pension funds is anticipated to remain strong in the years to come as well, resulting in average yearly growth of around 18 % in the 2008 – 2010 period.

The volume of retail loans has grown exponentially in recent years. Retail demand was driven by improving household financial conditions, especially among the middle classes. Growth rates remained strong throughout last year until September when signs of a rapid squeeze in credit became more evident following the mounting liquidity problems.

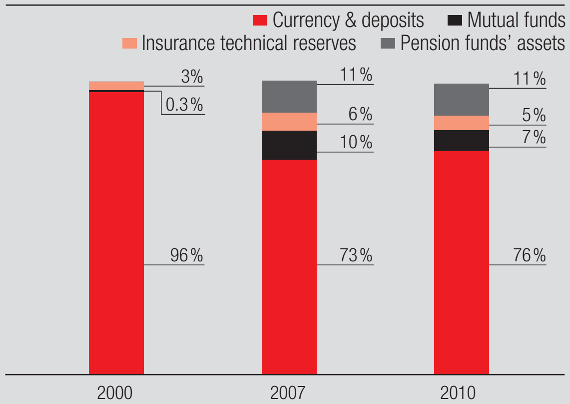
The mortgage market was hit particularly hard – only high quality collateral accepted and based on low LTV and on already finished projects – and banks increasingly switched their focus toward short-term and unsecured lending. As a result, the yearly growth rate for mortgages is expected to dive from 116.3 % in 2007 to 45.0 % in 2008. Looking ahead, the mortgage market may receive some relief from the government injection of funds into the AHML (Agency for Home Mortgage Lending – joint stock company owned by the Russian Government) equivalent to USD 2.5 bn.

Government support will also be crucial for property developers as it might help to unfreeze some important projects, partially avoiding a bust in the real estate market. However, the full recovery in the housing market will very much depend on improved macro conditions and restored confidence. Longer term potential in the segment still remains intact with mortgages representing only 2 % of GDP at the end of 2007, below the regional average of 9 %.

The ongoing crisis and credit squeeze at global level are also badly affecting the car loan business. The financing of household appliances is also anticipated to slow down (most purchases of white goods are still made on a cash basis). Despite a less supportive scenario in the short term, opportunities in the car loan segment remain healthy and bank loans may still play an important role in influencing sales given car affordability, which is still relatively low.

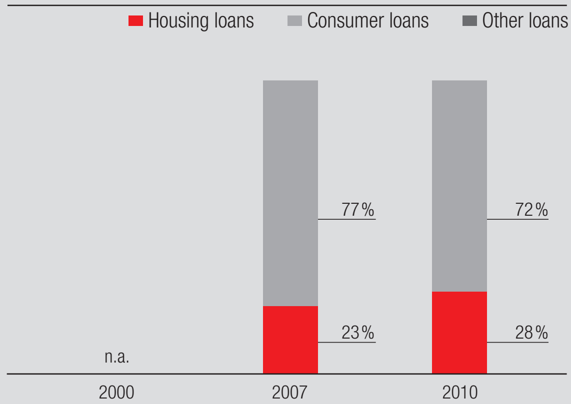
Overall, total retail loan growth is projected to slow down significantly from an estimated 35 % yoy in 2008 to 23 % in 2009, reaching 12 % of GDP by 2010.

Household Financial Assets (% of total)



Sources: Bank of Russia, UCBR, UniCredit Group CEE Research Network

Household Financial Liabilities (% of total)*



Sources: Bank of Russia, UCBR, UniCredit Group CEE Research Network
*) Consumer credits include also credit cards, overdrafts and car loans as they are not split by the Bank of Russia

Slovakia
Euro-related stabiliser effect protects households' finances from the crisis

Lubomir Korsnak

- The accumulation of household financial assets continued last year, driven by dynamic personal income growth and increasing employment. Rising penetration on the asset side was accompanied by even faster expansion in the level of household indebtedness, backed by the strong appetite of households for both consumption and real-estate investments. As a result, the net financial wealth of households remained stable at 36 % of GDP.
- The global financial crises have only had a minor impact on the Slovak economy so far. Some marginal impacts have, however, been noted in the performance of mutual and pension funds, while fundamental growth still remains lively.
- Despite some downside risks, the impact of the ongoing global crisis on Slovakian households is anticipated to have remained limited on the whole. However, some slowdown in the accumulation of both assets and liabilities might have materialised in the last quarters of 2008, with net financial wealth relative to GDP expected to have decreased marginally this year before stabilising around 34 % by 2010

Table 1: **Household Financial Indicators** (S. 14)*

	2006	2007	2008e	2009f	2010f
Financial Assets (% of GDP)	51 %	53 %	51 %	53 %	55 %
Financial Liabilities (% of GDP)	15 %	17 %	18 %	19 %	21 %
Net Wealth (% of GDP)	36 %	36 %	33 %	33 %	34 %
Corrected Net Wealth (% of GDP)	43 %	43 %	41 %	42 %	42 %

*) Corrected net wealth is calculated as gross financial wealth minus the non-mortgage part of household debt
Source: NBS, UniCredit Group CEE Research Network – UniCredit Slovakia Macroeconomics & Market Analysis Dpt.

Spurred on by favourable macroeconomic conditions, the accumulation of household financial assets remained fairly strong last year, rising by a nominal 16 % yoy, in excess of economic growth, to reach 53 % of GDP. The fast expansion of investments into mutual funds and the introduction of the 2nd pension pillar made an important contribution to growth. Growth in assets was accompanied by an even faster increase in household indebtedness, which rose by almost 29 % yoy reaching 17 % of GDP at the end of 2007 (from just above 8.0 % in 2003). As a result, net financial wealth dropped slightly reaching 35.5 % of GDP in 2007.

The ongoing crises affecting the global financial markets only had a limited impact on the accumulation of household financial assets in H1 2008. However, both mutual and pension funds recorded a significant slowdown in growth, with sell-offs from investment funds starting to emerge in October. In terms of lending the dynamic growth continued in H1 too – despite the moderate increase in interest rates. Looking forward, further deceleration in the pace of lending growth should be mainly supply driven. However, some cooling on the demand side is also likely, especially in relation to housing loans, backed by the slower growth in house prices that is forecast following the rally observed in 2007 and H1 2008 in the run-up to euro adoption. Growth in the residential real estate market will remain relatively sound, although some signs of overheating are emerging, especially in specific segments such as buy-to-let properties in and around the capital city.

We still believe the global financial crises may only have a limited impact on the domestic real economy. However, risks are increasing as the global crises deepen and are prolonged (mainly in Eurozone countries). A potential slowdown in the real economy could thus lead to weaker growth in both household assets and liabilities too, bringing some stabilisation to the accumulation of net financial wealth to around 34 % of GDP by 2010.

In terms of asset allocation, Slovak households remain fairly conservative in their approach to investments, with the majority of their assets still kept in low-risk forms of savings – mainly currency and bank deposits. The sudden slump of the currency in 2008 is reflecting the announced adoption of the euro at the beginning of next year. People are putting their money into banks to ease the conversion process, thus stimulating growth in bank deposits (up by 14 % in the first 9 months). The growing trend toward bank deposits will also benefit from mounting risk aversion following the ongoing crisis on the global financial markets. Nonetheless, some of the new euro-driven deposits could melt into currency again in 2009.

Table 2: **Financial Wealth**

	Stock in 2007 € mn	(% on total)	Yoy % growth (LC) 2007	2008e	2009f	2010f
Currency	4,217	14.6%	8.0%	–15.1%	12.7%	8.9%
Bank deposit retail	12,654	43.7%	14.6%	13.8%	11.1%	8.8%
LC currency	11,537	39.8%	16.5%	15.0%	17.9%	8.7%
FX currency	1,117	3.9%	–1.8%	1.9%	–67.5%	12.0%
Housing savings	1,694	5.8%	3.6%	1.0%	1.3%	1.5%
Securities other than shares	–	–	–	–	–	–
Listed shares	–	–	–	–	–	–
Mutual funds	4,748	16.4%	21.1%	–8.6%	5.0%	11.4%
Open-end	4,722	16.3%	21.3%	–8.6%	5.2%	11.8%
Close-end	27	0.1%	–3.7%	–5.1%	–35.3%	–
Registered abroad	–	–	–	–	–	–
Insurance technical reserves	3,374	11.6%	9.2%	13.1%	9.7%	9.7%
Life insurance	2,516	8.7%	12.0%	13.8%	9.1%	8.9%
Non-life insurance	857	3.0%	1.7%	11.1%	11.7%	12.0%
Pension funds' assets	2,280	7.9%	55.0%	45.7%	26.0%	30.3%
Total	**28,968**	**–**	**15.6%**	**7.6%**	**11.3%**	**11.5%**

Source: NBS, Association of Asset Management companies, Ministry of Labour, UniCredit Group CEE Research Network – UniCredit Slovakia Macroeconomics & Market Analysis Dpt.

The deepening of the crises resulted in a sell-off of mutual fund shares, especially from August, following positive net flows recorded in the first part of the year. Looking ahead, the speed investments into open-end funds recover will very much depend on the revival in the financial markets, with livelier growth still expected for money and bond funds, whose share in total net assets will continue to grow (60 % as of September 2008).

Accumulation into pension fund assets has been the main driver for the observed increase in household financial assets over recent years, with participation in the 2nd pillar largely exceeding initial expectations.

Moreover, despite the option given by the new government for all participants to exit the scheme in an effort to reduce the overall burden on public finances, the outflows recorded were not significant. As a result, the assets accumulated in pension funds have been rising steadily. Despite the uncertainty dominating the capital markets we see space for continual growth in pension fund assets in the coming years too, even taking the planned re-opening of the 2nd pillar this year into account.

In the years to come there is scope for a gradual recovery in the growth of household financial assets. Household financial assets should thus record average annual growth of about 11 %, reaching 55 % of GDP by 2010. The growth will be driven mainly by pension funds, still benefiting from the pension system reform. Some recovery is also expected in open-end funds provided that developments in global financial markets stabilise and confidence is restored.

Following the credit boom experienced in recent years, household indebtedness continued to rise in H1 2008. Economic growth remained lively and Slovak households have yet to feel the uncer-

Table 3: **Financial Liabilities**

	Stock in 2007 € mn	(% on total)	Yoy % growth (LC) 2007	2008e	2009f	2010f
Housing loans	4,312	46.0%	22.9%	14.0%	8.8%	8.9%
Consumer loans	2,000	21.3%	23.6%	12.8%	9.5%	4.2%
Consumer loans of other MFIs	1,253	13.4%	15.8%	17.1%	9.6%	1.7%
Consumer loans of OFIs	747	8.0%	39.4%	5.6%	9.4%	9.0%
Overdraft	403	4.3%	11.1%	16.0%	16.9%	16.6%
Other loans	2,324	24.8%	52.3%	38.3%	21.4%	27.5%
Revolving credit cards	137	1.5%	38.0%	28.3%	20.3%	18.3%
Financial leasing	205	2.2%	10.9%	12.0%	10.4%	9.4%
Total	**9,380**	**–**	**28.5%**	**20.0%**	**13.1%**	**14.2%**

Source: NBS, UniCredit Group CEE Research Network – UniCredit Slovakia Macroeconomic & Financial Analysis Dpt.

tainty stemming from the global financial crises. The strong demand for improvement in living standards has continued to support growth in mortgages and other housing loans. Significant growth was also recorded in consumer financing. As a result, bank loans to the household sector went up by 13 % in H1 and further accelerated through October posting an increase of 22 % compared to the end of 2007.

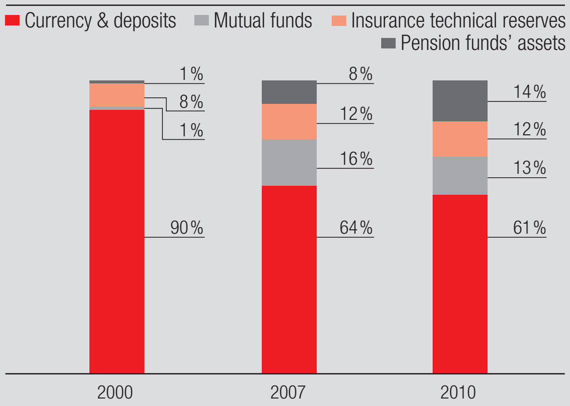
Despite the continued high growth in household indebtedness, the retail loan portfolios of banks remain relatively healthy. The share of non-performing loans increased only slightly, reaching 3.9 % as of September 2008 from 3.4 % in 2007.

Looking ahead, some deceleration is anticipated in the pace of growth in household loans. The real estate market is starting to show initial signs of cooling. Uncertainty and rising interest rates are decreasing demand for housing. Furthermore, banks are starting to be more prudent, e.g. in some regions they do not allow 100 % of real estate to be financed by loans. The demand for housing could recover modestly this year again, supported by the further relaxation of monetary conditions expected in the Eurozone.

House prices recorded dynamic growth at the end of 2007 and the beginning of 2008, also driven by euro speculation. Prices in the capital city went up by 30 % yoy, while in the regions growth was even higher – in some (Zilina, Nitra, Kosice and Banska Bystrica) it exceeded 50 % yoy. In Q3, the residential real estate market started to cool down. Demand decreased dramatically, hence prices corrected themselves – prices fell 1.4 % qoq in Bratislava. However, the correction of prices has only taken place in some of the regions so far (Trencin, Kosice and Banska Bystrica).

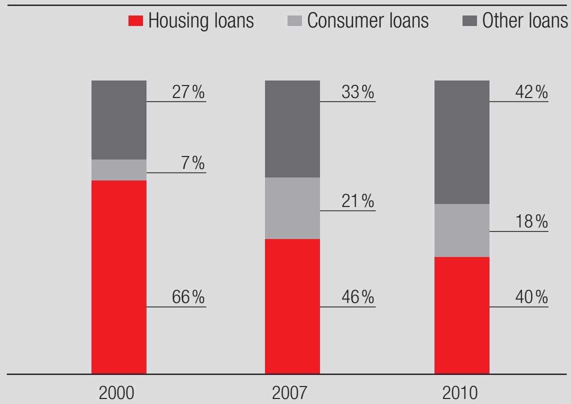
Overall, household financial liabilities are expected to reach around 21 % (relative to GDP) by 2010, recording average annual growth of around 14 % in the next two years. Mortgage as well as consumer loans will remain the key drivers. However, strong growth is also expected in the short-term financing of households, i.e. credit cards. Leasing (still dominated mainly by car leasing) and loans provided by consumer financing companies are expected to suffer the most in the coming years due to strong competition and the more flexible products offered by banks.

Household Financial Assets (% of total)*



Sources: NBS, UniCredit Group CEE Research Network – UniCredit Slovakia Macroeconomic & Financial Analysis Dpt
*) Currency and deposits include savings kept in construction and savings banks

Household Financial Liabilities (% of total)*



Sources: NBS, UniCredit Group CEE Research Network – UniCredit Slovakia Macroeconomic & Financial Analysis Dpt
*) Other loans include overdrafts, other loans granted by banks, revolving credit cards and financial leasing

Turkey
Flight to quality

Cemal Cenk Tarhan

- Decelerating economic growth and fast increase in household debt in the first half of the year resulted in a further decline in net financial wealth as a share of GDP in 2008. Despite the gloomier economic outlook for this year, the accumulation of financial wealth is projected to remain stable supported by an anticipated recovery in financial market performance. This, in combination with some cooling on the lending side, could support a recovery in the dynamics of net financial wealth to around 26 % of GDP.
- Bank deposits are expected to continue playing a dominant role in fostering financial asset accumulation. Mutual funds are not likely to recover quickly given the less favourable macro environment. Pension funds, despite being hit by the financial turmoil towards the end of 2008, are expected to return to sound growth territory in the coming period.
- Following years of booming lending activity there may be some deleveraging, especially this year, on the back of less favourable economic conditions and tighter lending requirements. Mortgages and credit cards should show more resilience, while no major improvement is anticipated in the car loan segment.

Table 1: **Household Financial Indicators** (S.14)*

	2006	2007	2008e	2009f	2010f
Financial Assets (% of GDP)	38 %	38 %	38 %	39 %	40 %
Financial Liabilities (% of GDP)	9 %	11 %	13 %	13 %	15 %
Net Wealth (% of GDP)	29 %	27 %	25 %	26 %	26 %
Corrected Net Wealth (% of GDP)	32 %	30 %	29 %	30 %	30 %

*) Corrected net wealth is calculated as gross financial wealth minus the non-mortgage part of household debt
Source: UniCredit Group CEE Research Network – Yapi Kredi Research

We observed solid financial asset accumulation in the first quarter of 2008, mainly consisting of robust deposit growth. In this period, concerns about a fast deterioration in the global outlook increased, but the overall picture for Turkey was still positive. However, rising political tensions stemming from the court case on the closure of the governing AKP affected financial markets negatively towards the end of the first quarter. Interest rates rose, economic activity started to display signs of weakening, and consumer confidence faded in Q2. This contributed to a slowdown in the growth of mortgages, though overall borrowing appetite remained intact.

Following this period, interest rates in the bond market started to decline in July with stronger expectations of a smooth decision from the Constitutional Court regarding the AKP closure case. Political tensions finally eased with the court decision not to close the AKP, and bond rates settled down at around 19 % for most of the 3rd quarter, roughly 2 % above 2007 year-end levels. However, the improvement in sentiment was not enough to promote economic activity strongly. At the same time, the central bank (CB) raised its short-term rates by a further 50 bps (on top of a 50-bp increase in Q2) keeping deposit rates steady and supporting LC deposit accumulation. Following these developments, the beginning of the fourth quarter was marked by the collapse of the world financial markets and it was impossible for Turkey to stay isolated from the negative effects. Equity prices on the Istanbul stock exchange fell sharply, interest rates soared again, while the willingness of households to borrow at higher interest rates clearly faded. The economic slowdown will probably become more visible in the remainder of the year.

Overall, we anticipate a slight increase in the financial asset/GDP ratio from 37.7 % in 2007 to 38.0 % in 2008. Despite the slowing growth, the ratio of financial liabilities to GDP is likely to rise from 11.1 % to 12.6 %. Consequently, the household net financial wealth / GDP ratio is set to decline in 2008 from 26.6 % in the previouos year to 25.3 %.

The outlook for 2009 remains grim with GDP growth projected to slow down to 2.5 % from an estimated 3.5 % in 2008. Alongside higher interest rates, households are expected to be more risk-averse and therefore less eager to increase their debt under those circumstances. Banks will also be more cautious in extending loans. Accordingly, we expect more moderate growth in household financial liabilities, which will cause the net financial wealth / GDP ratio to increase for the first time since the 2001 crisis, before stabilising around 26 % in 2010.

Table 2: Financial Wealth

	Stock in 2007		Yoy % growth (LC)			
	€ mn	(% on total)	2007	2008e	2009f	2010f
Currency	14,103	7.5 %	2.1 %	12.0 %	9.0 %	7.0 %
Bank deposit retail	125,717	67.0 %	16.3 %	22.0 %	16.6 %	18.3 %
LC currency	80,715	43.0 %	24.8 %	25.0 %	17.0 %	22.0 %
FX currency	45,002	24.0 %	3.6 %	16.6 %	15.8 %	11.1 %
Securities other than shares	9,639	5.1 %	–31.4 %	18.0 %	12.0 %	8.0 %
Listed shares	10,198	5.4 %	11.1 %	–48.5 %	13.0 %	14.0 %
Mutual funds	15,235	8.1 %	18.5 %	–1.1 %	7.8 %	9.6 %
Open-end	15,076	8.0 %	18.2 %	–1.1 %	7.8 %	9.5 %
Close-end	106	0.06 %	90.4 %	–1.1 %	7.8 %	9.5 %
Registered abroad	52	0.03 %	21.8 %	1.3 %	8.0 %	10.0 %
Insurance technical reserves	5,292	2.8 %	9.2 %	19.7 %	15.1 %	12.3 %
Life insurance	2,667	1.4 %	5.6 %	9.7 %	7.0 %	6.0 %
Non-life insurance	2,625	1.4 %	13.2 %	29.8 %	22.0 %	17.0 %
Pension funds' assets	7,462	4.0 %	22.8 %	18.4 %	16.6 %	19.1 %
Total	**187,645**	**–**	**11.1 %**	**15.1 %**	**15.0 %**	**16.2 %**

Source: Central Bank, BRSA, Capital Markets Board, UniCredit Group CEE Research Network – Yapi Kredi Research

Throughout 2008, the share of deposits increased in household portfolios. The higher exchange rates in the last quarter of the year further strengthened this development. Meanwhile, household bond portfolio preferences followed the changes in interest rates throughout the year to a large extent. Residents increased their government bond holdings in the first half of the year when interest rates were rising, while non-resident investors scaled back their bond portfolios. However, the fall in interest rates from July prompted a shift in household preferences: they started to reduce their bond portfolios, probably preferring to cash in their capital gains. Nevertheless, with bond rates starting to increase at the beginning of the last quarter, household bond portfolios started to rise again. On the other hand, the interest of households in mutual funds remained muted once again in 2008 and their share in household portfolios declined. Pension funds constitute a new, small, but dynamic market in Turkey, with significant growth potential. In the first 9 m of 2008 pension fund assets exhibited strong growth. However, the deepening of the financial turmoil from the end of September caused a sharp slowdown in Q4, probably due to mark-to-market losses. Still, we foresee a slight increase in the share of pension funds within total financial assets of households. Obviously, the sharp decline in the prices of equities caused a severe fall in the weight of listed shares in household portfolios.

We expect household financial assets to grow around 15 % and 16 % in 2009 and 2010 respectively, with the share of deposits continuing to increase. Progressively decreasing bond rates will likely cause the share of bond holdings in total financial assets to decline slightly. Mutual funds are not expected to attract strong interest in the very near future either; we think they may start growing robustly under more benign macroeconomic conditions. The possible correction in equity prices will probably not be enough to restore the share of equities in the total financial portfolio to its original level.

Table 3: Financial Liabilities

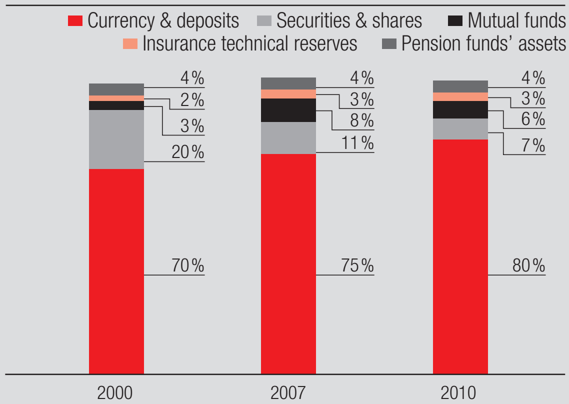
	Stock in 2007		Yoy % growth (LC)			
	€ mn	(% on total)	2007	2008e	2009f	2010f
Housing loans	18,607	33.7 %	39.1 %	27.0 %	17.0 %	23.0 %
Consumer loans	4,379	7.9 %	–11.9 %	2.5 %	4.4 %	7.3 %
Consumer loans of other MFIs	3,420	6.2 %	–7.9 %	0.4 %	2.0 %	5.0 %
Consumer loans of OFIs	959	1.7 %	–23.9 %	10.0 %	12.0 %	14.0 %
Overdraft	–	–	–	–	–	–
Other loans	16,859	30.6 %	64.0 %	43.4 %	23.0 %	30.0 %
Revolving credit cards	15,032	27.3 %	21.5 %	28.3 %	18.0 %	22.0 %
Financial leasing	286	0.5 %	37.5 %	8.9 %	17.0 %	19.0 %
Total	**55,162**	**–**	**33.9 %**	**30.3 %**	**18.5 %**	**24.3 %**

Source: Central Bank, BRSA, Turkish Leasing Association, UniCredit Group CEE Research Network – Yapi Kredi Research

The indebtedness of the household sector increased at quite a strong pace in Q1 2008. In a period when the central bank cut short-term rates by 0.5 % and bond rates hovered mostly around 16 % – 17 %, consumer lending rates encouraged further leveraging. Consequently, we observed quarterly growth rates of around 10 % in mortgages and general purpose consumer loans, while car loans remained flat. The increase in interest rates due to political tensions caused mortgage growth to slow down in Q2. However, personal loans and credit cards were still not badly affected. It was only in Q3 when we saw signs of a reduction in the overall borrowing appetite of households.

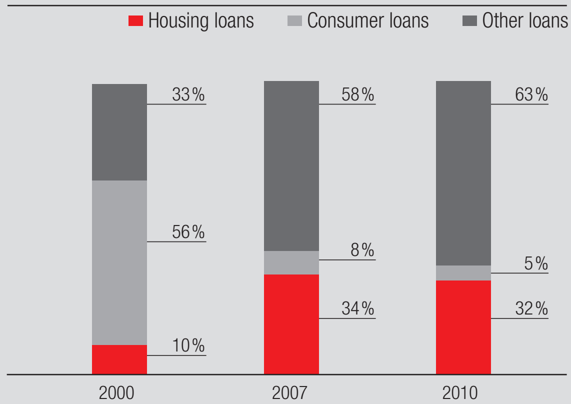
The financial turmoil by the beginning of the last quarter on the other hand caused a surge in lending rates and affected the willingness of households to increase debt markedly; the growth in both mortgages and personal loans weakened substantially. As a result of these developments, we expect the ratio of total financial liabilities to GDP to have reached 12.6 % by the end of 2008, up from 11.1 % in 2007. In 2009 we expect the growth in consumer borrowing to remain subdued. Mortgage growth is expected to slow down to 17 % and no revival is anticipated in car loans. General purpose consumer loans are expected to grow by around 23 %, and consequently the financial liabilities / GDP ratio should rise by only 0.8 %-points to 13.4 %. With a relative improvement in macroeconomic conditions and a gradual decline in interest rates, we can expect a re-acceleration in the pace of lending growth from 2010 with total household financial liabilities likely to rebound to 15 % relative to GDP.

Household Financial Assets (% of total)



Sources: Central Bank, BRSA, Capital Markets Board, UniCredit Group CEE Research Network – Yapi Kredi Research

Household Financial Liabilities (% of total)*



Sources: Central Bank, BRSA, Capital Markets Board, UniCredit Group CEE Research Network – Yapi Kredi Research

*) Other loans include revolving credit cards, other loans and financial leasing

Banking network

UniCredit Group CEE banking network – Headquarters

Azerbaijan

Yapi Kredi Azerbaijan
G28 May Street,5
AZ-1014 Baku, Azerbaijan
Phone: +994 12 497 77 95
E-Mail: yapikredi@yapikredi.com.az

The Baltics

UniCredit Bank Estonia Branch
Liivalaia Street 13/15,
EST-10118 Tallinn
Phone: +372 668 8300
www.unicreditbank.ee

UniCredit Bank Lithuania Branch
Vilniaus Gatve 35/3,
LT-01119 Vilnius
Phone: +370 5 2745 300
www.unicreditbank.lt

UniCredit Bank (Latvia)
Elizabetes Iela 63,
LV-1050 Riga
Phone: +371 708 5500
www.unicreditbank.lv

Bosnia and Herzegovina

UniCredit Bank
Kardinala Stepinca b.b.,
BH-88000 Mostar
Phone: +387 36 312112
E-Mail: unizaba@unizaba.ba
www.unicreditbank.ba

UniCredit Bank Banja Luka
Marije Bursac 7,
BH-78000 Banja Luka
Phone: +387 51 243344
E-Mail: info@novablbanka.com
www.novablbanka.com

Bulgaria

UniCredit Bulbank
Sveta Nedelya Sq. 7,
BG-1000 Sofia
Phone: +359 2 923 2111
www.unicreditbulbank.bg

Croatia

Zagrebačka banka
Paromlinska 2,
HR-10000 Zagreb
Phone: +385 1 6305 250
www.zaba.hr

Czech Republic

UniCredit Bank
Na Príkope 858/20
CZ-11121 Prague
Phone: +420 221 112 111
E-Mail: info@unicreditgroup.cz
www.unicreditbank.cz

Hungary

UniCredit Bank
Szabadság place 5–6,
H-1054 Budapest,
Phone: +36 1 301 12 71
E-Mail: info@unicreditbank.hu
www.unicreditbank.hu

Kazakhstan

ATFBank
100, Furmanov Str.
KZ-050000 Almaty
E-Mail: info@atfbank.kz
Phone: +7 (727) 2 583 111
www.atfbank.kz

Kyrgyzstan

ATFBank Kyrgyzstan
493, Zhibek Zholu Ave.
KG-720070 Bishkek
Phone: +7 312 67-00-47
E-Mail: bank@atfbank.kg
www.atfbank.kg

Macedonia

Bank Austria Representative Office
Dimitrie Cupovski 4–2/6,
MK-1000 Skopje
Phone: +389 2 3215 130
E-Mail: office@ba-ca.com.mk

Montenegro

Bank Austria Representative Office
Hercegovacka 13,
ME-81000 Podgovica
Phone: +382 81 66 7740
E-Mail: ba-ca@cg.yu

Poland

Bank Pekao
ul. Grzybowska 53/57,
PL-00-950 Warsaw
Phone: +48 42 6838 232
www.pekao.com.pl

Romania

UniCredit Tiriac Bank
Ghetarilor Street 23–25,
RO-014106 Bucharest 1,
Phone: +40 21 200 2000
E-Mail: office@unicredittiriac.ro
www.unicredit-tiriac.ro

Russia

UniCredit Bank
Prechistenskaya emb. 9,
RF-19034 Moscow
Phone: +7 095 258 7200
www.unicreditbank.ru

Bank Siberia
11, Pevtsov Str.
RF-644099 Omsk
Phone: +7 3812 24-49-19, 28-98-80
E-Mail: gu@omsk.cbr.ru

Yapi Kredi Moscow
Goncharnaya emb. 2,
RF-115172 Moscow
Phone: +7 495 234 9889
E-Mail: yap@online.ru
www.ykb.ru

Serbia

UniCredit Bank
Rajiceva 27–29,
RS-11000 Belgrade
Phone: +381 11 3204 500
E-Mail: office@unicreditbank.co.yu
www.unicreditbank.co.yu

Slovakia

UniCredit Bank
Šancova 1/A,
SK-813 33 Bratislava,
Phone: +42 1 44 547 6870
www.unicreditbank.sk

Slovenia

UniCredit Bank
Šmartinska cesta 140,
SI-1000 Ljubljana,
Phone: +386 1 5876 600
E-Mail: info@unicreditbank.si
www.unicreditbank.si

Turkey

Yapi Kredi
Yapi Kredi Plaza D Blok, Levent,
TR-80620 Istanbul,
Phone: +90 212 339 70 00
www.yapikredi.com.tr

Ukraine

UniCredit Bank
14, D. Galitsky St.,
UA-43016 Lutsk,
Phone: +380 332 776210
www.unicredit.com.ua

Ukrsotsbank
29 Kovpak Street,
UA-03150 Kiev
Phone:+380 44 230 3203
E-Mail: info@ukrsotsbank.com
www.usb.com.ua

Debora Revoltella
UniCredit Group, CEE Chief Economist
Network Coordinator
Neweuroperesearch@unicreditgroup.eu

UniCredit Group, CEE Economic Research

Carmelina Carluzzo – Matteo Ferrazzi – Hans Holzhacker – Fabio Mucci –
Lisa Perrin – Bernhard Sinhuber – Gerd Stiglitz

UniCredit Bulbank – Economic Research Unit

Kristofor Pavlov, Chief Economist
Milen Kassabov – Katerina Topalova – Stanislava Vrabcheva

Zagrebačka banka – Macroeconomic Research

Goran Saravanja, Chief Economist
Nenad Golac

UniCredit Bank Czech Republic – Economic Research

Pavel Sobisek, Chief Economist
Patrik Rozumbersky – Vaclav Verner

UniCredit Bank Hungary

Márta Szegö Bíróné, Chief Economist
Dániel Frisch – Tamás Nagy – Tibor Nagy

Bank Pekao

Marcin Mrowiec, Head, Market Analyses and Forecasting
Agnieszka Decewicz

UniCredit Tiriac Bank – Economic Research

Rozalia Pal, Senior Economist
Anca Mihaela Stoica

UniCredit Bank Russia – Strategy and Research

Vladimir Osakovskiy – Valery Inyushin – Sergey Borisov – Nikolay Akimov

UniCredit Bank Slovakia – Macroeconomics & Market Analyses

Viliam Patoprsty, Chief Analyst
Lubomir Korsnak

Yapi Kredi Bankası

Cevdet Akcay, Chief Economist
Ahmet Cimenoglu, Head, Strategic Planning and Research
Yelda Yucel – Murat Can Aslak – Eren Ocakverdi – Cenk Tarhan – Muhammet Mercan

Pioneer Investments – PGAM Strategy Unit and Research

Daniele Fano – Laura Marzorati – Teresa Sbano – Georgieva Milena

UniCredit Group

"Your Leading Banking Partner in Central and Eastern Europe"

Bank Austria
UniCredit Group

HypoVereinsbank
UniCredit Group

UniCredit Bank

UniCredit Bank Banja Luka

UniCredit Bulbank

UniCredit Țiriac Bank

Zagrebačka banka
UniCredit Group

BANK PEKAO SA

YapıKredi

ATF Bank
Member of UniCredit Group

UKRSOTSBANK
Member of UniCredit Group