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Sectoral Analyses

"Recovery back on track but challenges remain"

Outlook 2011

This is a product of CEE Strategic Analysis
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2011 CEE sectoral outlook – Sustainable recovery underway led by cyclical sectors but challenges remain

Regional outlook 2011 (best, stable and worst sectors)

		BEST	STABLE	WORST
Agriculture		BG, HR, KZ	PL, SK, HU, CZ, RO, UA, RU	
Mining[1]		RU, KZ	UA, HU, CZ, HR, BG	PL, SK, RO
Manufacturing				
Consumer goods	Food and Beverages	RU, KZ, UA	PL, SK, HU, CZ, RO, BG, HR	
	Tobacco Products		PL, CZ, BG, HR, UA, RU, KZ	HU, RO
	Textiles		HR	PL, SK, CZ, BG, HU,RO, UA, RU, KZ
	Wearing Apparel[2]		BG	PL, SK, CZ, HR, HU, RO, UA, RU, KZ
	Leather Footwear		HU, HR, UA	PL, SK, CZ, RO, BG, RU, KZ
	Wood Products (excl. furniture)[3]	RO	SK, HU, CZ, BG, HR, UA, RU, KZ	PL
	Paper and Pulp	PL, BG, HR	SK, HU, CZ, RO, UA, RU	KZ
	Printing and Publishing		PL, SK, HU, CZ, BG, HR, UA, RU	RO, KZ
Intermediate goods	Refined Petroleum, Coke and Nuclear	RU, KZ	PL, SK, HU, RO, BG, HR, UA,	CZ
	Chemicals[4]	HU, BG, RU	CZ, HR, UA, KZ, PL, SK, RO	
	Rubber and Plastics Products	SK, HU, CZ, RO	PL, BG, HR, UA, RU, KZ	
	Mineral-based Products (non-metalic)	KZ	PL, SK, HU, UA, RU	CZ, RO, BG, HR
	Manufacture of basic metals[5]	SK, CZ, RO, BG, UA, RU, KZ	HU, HR, UA	PL
	Fabricated Metal Products[5]	CZ, BG, KZ	SK, HU, RO, UA, RU	PL, HR
Investment goods	Machinery, Equipment, Appliances	HU, CZ, BG	PL, SK, RO, HR, RU, KZ	UA
	Computers and Office Machinery	PL, SK, CZ, BG	HU, RO, HR, RU	UA, KZ
	Electrical Machinery	PL, CZ, RO,	SK, HU, BG, HR, RU, KZ	UA
	Communications Equipment including Semi-Conductors and TVs	PL, SK, CZ	HU, RO, BG, HR, RU, KZ	UA
	Medical, Precision and Optical	PL, HU, CZ, BG	SK, RO, HR, RU, KZ	UA
	Motor Vehicles, Trailers and Parts[6]	SK, HU, CZ, RO, RU, KZ	PL, BG, HR, UA	
	Transport Equipment (excluding Motor Vehicles)[6]	HU, CZ, RU, KZ	SK, UA	PL, RO, BG, HR
	Furniture, Jewelry, Toys, Musical, Other Goods [7]		SK, HU, RO, HR, RU, KZ	PL, CZ, BG, UA
	Recycling	HU, BG, KZ	PL, SK, RO, HR, RU	UA, CZ
Non-manufacturing and network industries	Utilities	SK, RO, RU, KZ	PL, HU, CZ, BG, HR,	UA
	Construction[8]		PL, UA	SK, HU, CZ, RO, BG, HR, RU, KZ
	Wholesale and Retail Trade[9]		PL, SK, HU, CZ, HR, UA, RU, KZ	RO, BG
	Hotels and Restaurants	HR	PL, RO, BG, UA, RU	SK, HU, CZ, KZ
	Transport, Storage and Telecommunication[10]	KZ, SK, HR	PL, HU, CZ, RO, BG, UA, RU, SK, HR	SK
	Real Estate and Business Activities		PL, CZ, RU	SK, HU, RO, BG, HR, UA, KZ

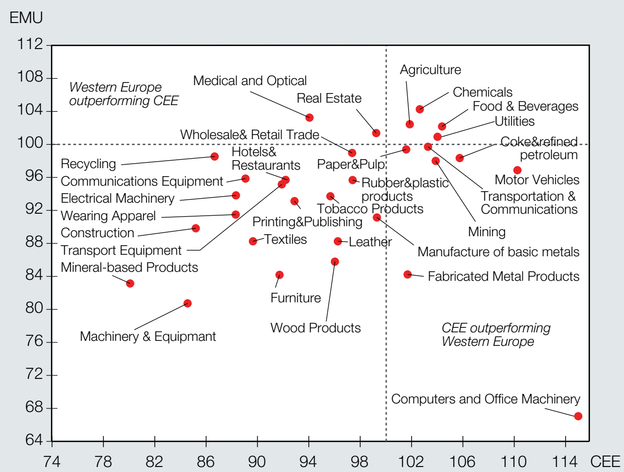
Note:
1) For Romania, extraction of crude petroleum and natural gas with stable outlook; in Czech R., the outlook for quarrying is worst, while for the rest of mining is stable; in Croatia, other mining and quarrying with worst outlook; in Bulgaria, quarrying with worst outlook.
2) In Bulgaria, longer term prospects more questionable (worst);
3) Longer term outlook for Poland more stable;
4) In Poland, outlook for basic chemical is worst; pharmaceuticals segment with best outlook in Romania and Slovakia;
5) In Poland, prospects for the sector in the long run are more stable;
6) For Russia, rising imports competition might constrain longer term growth (stable outlook);
7) For Poland and Bulgaria, longer term outlook is stable;
8) In Kazakhstan, large infrastructure projects showing good opportunities for growth (best);
9) In Romania, sub-segments such as pharma and fuel retail have more stable outlook;
10) In Slovakia, transport sector ranked as worst, storage as stable and telecommunication as best; for Croatia, telecommunication ranked with best outlook; in Hungary, transport and logistics are among servicing activities with brighter prospects in the longer term (best outlook)

Source: UniCredit CEE Strategic Analysis

Following the deep downturn recorded in both 2008 and 2009, the global economy has been gradually recovering during 2010. The "double dip" scenario has not materialised, but growth remains fragile and uneven among countries and regions. In Europe, fiscal consolidation and austerity packages will weigh heavily on 2011 GDP growth. Moreover, large disparities in countries´ growth (acceleration in Germany vs. depression in the fiscally-strained periphery) complicate monetary policy and make it less potent in supporting Eurozone growth. Demand in Western Europe will remain significantly below pre-crisis levels, but is already recovering from previous lows, with chemical and communication equipment in the best position to recover (due in part to improved demand from Asia). At the same time, the machinery sector is still suffering from a limited willingness to invest (still high spare capacity), while automotive is affected by the fading out of scrap incentives and structural global overcapacity.

The CEE region has also been recovering from the slump, expanding by an estimated 3.6% last year. However, the recovery pattern has diverged substantially among countries and segments. Recovery to date has been driven by industry and inventories supported by the rebound in export demand. Countries most open to the global trade cycle and with tighter links to Germany have reaped the greatest benefits, with Turkey experiencing the strongest momentum and Central Europe generally back on track. Countries which faced the strongest pre-crisis imbalances and require a deeper structural transformation (mainly Latvia, Lithuania, Croatia, Romania and Bulgaria) are still lagging both in terms of momentum and levels. The euro debt crisis is definitely not helping, creating an environment of uncertainty and higher cost of country risk, which also reflects in higher funding costs for these economies. 2011 will see some consolidation in the recovery path, with growth projected to accelerate to some 3.8% yoy supported by a stable export dynamic and some pickup in private consumption in most CEE economies, despite persisting weaknesses mainly in countries with harsh austerity packages.

Value added by sector in Western Europe and CEE
(2011 vs 2008, level)



Source: UniCredit CEE Strategic Analysis, Global Insight

The export-driven recovery scenario favours intermediate and investment goods. Also, as is typical in the early stages of a recovery, cyclical sectors have been performing better recently: motor vehicles, electrical equipment, chemicals and basic metals have seen the strongest growth over 2009–2010. These sectors are expected to outperform in 2011 as well, also joined by investment goods sectors.

Among the sectors with a more positive outlook, the **chemical** industry has already rebounded strongly in 2009–2010 and retains good prospects for 2011 and beyond, driven by demand from other manufacturing sectors, stable demand from agriculture and growing external demand. Prospects look particularly favourable in Bulgaria, supported by the generally lower level of indebtedness relative to other sectors and in Russia, backed by a general drive toward deeper domestic processing of mineral base. The **pharmaceuticals** and **fertilisers** sub-segments are expected to perform strongly and help to compensate for meagre demand for other chemicals in countries such as Romania, the Czech Republic and Slovakia. Producers of basic chemicals are instead expected to underperform in Poland due to persistent problems connected to underinvestment, chronic lack of production assets (particularly for polymers) and general limited access to key resources, which erodes their competitiveness against low-cost producers. Overall, the sector has already recovered from the crisis, with 2011 value added expected to be above the pre-crisis level.

The outlook for **basic metals and metal products** is generally also good, supported by demand from machinery and equipment (including automotive) and from China. CIS countries should outperform the rest of the region as they are expected to continue benefiting from massive comparative advantages justified by their ample natural resource endowment and above-average Asian economic growth. In Russia, for 2011 we expect an additional impulse to the stock cycle despite some uncertainty related to price developments. In Ukraine, the sector will also benefit from the expected increase in demand from preparations for the Euro-2012 football championship. In Kazakhstan, the sector provides a significant contribution to the economy, accounting for roughly 6% of value added and 2% of the total workforce. As one of the largest exporters historically, the sector has also been resilient during the crisis both in Romania and Bulgaria. Romania's good positioning (the country ranks 13th in steel production among EU members) and some announced investment projects by large aluminium producers (e.g. Alro) supports its ranking among the country's best performing sectors. Similar arguments also apply to Bulgaria, where despite some shutdown of important capacity in the production of ferrous metals, the recent expansion into new export markets and opportunities related to the use of domestic scrap as input, support our optimistic outlook for this sector.

As a pro-cyclical sector, **machinery, equipment and appliances** has been recovering recently, helped by orders from Germany, and we maintain a stable outlook in 2011 for most of the CEE region. However, the sector is showing an excess of production capacity overall, with the level of value added considerably below the pre-crisis level, mainly due to Russia and Romania. In countries such as Bulgaria, the more positive outlook is supported by the relatively low level of sector indebtedness and an adequate supply of domestic metals with particularly strong positioning in the segment of military-related equipment. Investment-driven demand should also be particularly supportive in countries such as the Czech Republic and Hungary, although in the latter there is a risk that uncertainty could lead to a decline in FDI. The medium-term outlook is generally supportive due to a strong FDI presence in the sector, cost advantages and resource base. In CIS countries, however, FDI has been lacking, making it harder for them to maintain competitiveness in the longer term.

Computers, office machinery, communications, electrical and medical equipment are also cyclical sectors with generally good prospects, supported by a revival of exports and investment activity. In recent years EU members have benefited from strong FDI inflows and the relocation of production capacities from Western Europe. Prospects look more favourable for most Central European economies relative to the rest of the region. Among them, Poland and Slovakia are two success stories related to the spectacular development of the electronic and electrical equipment industry. These countries have recently attracted numerous foreign investments in medium/high-tech industries (Poland for segments such as consumer electronics, office and telecommunication equipment, Slovakia mainly in LCD production) and have become a popular destination of production relocation by multinational companies. This was less the case for CIS countries, where poor protection of intellectual property rights hinders sector development.

Automotive, one of the most important manufacturing sectors for many CEE economies has seen a rebound in 2009–2010, helped to a large extent by car scrapping schemes in Europe and ongoing relocation of production toward Eastern Europe. Overall, value added should reach 110% of pre-crisis level this year. Despite the sharp drop in domestic demand, the crisis has not affected – and even intensified – the process of erosion of Western Europe's share in total production in favour of CEE countries, although with a two-track development (with Central European countries more favoured relative to CIS). In just one decade, the share of motor vehicles (passenger cars and commercial vehicles) produced in CEE almost tripled at the end of 2009 to reach 24% of total European production[1]. Looking ahead, the automotive sector in CEE countries could continue to fare better than Western Europe as they are still considered an efficient production basis. However, the relatively positive view on the production side will not be matched by a quick recovery in CEE markets on the demand side. Households will remain particularly prudent and car registrations will not quickly reach pre-crisis levels. Other transport equipment (ships, wagons, etc.) has been more heavily affected during the crisis and has weaker near-term potential; in many cases it is inefficient, with obsolete plants and lack of FDI. Furthermore, Croatian and Polish shipyards have been affected by EU regulations banning them from subsidising the industry.

Some industries have been suffering structural changes in the last couple of years with no clear recovery prospects in the near future. These are industries struggling with many structural problems such as underinvestment, high indebtedness, overemployment, declining or definitive loss of competitive advantages.

Mining has been losing significance in recent years in a range of CEE countries and has weak near-term prospects due to its heavy dependence on the construction industry, which still remains in limbo. Mining has been a declining industry all over the region even prior to the crisis and today value added is set at 104% of the pre-crisis level. Low productivity and low comparative advantage are among the drivers of the above-mentioned trends. The only exception are CIS countries (Kazakhstan, Ukraine, Russia) where oil and other extraction industries play a dominant role in the economies and are already seeing a rebound due to rising world commodity prices and reviving internal demand.

Highly labour-intensive light industries such as **textiles, wearing apparel** and **leather footwear** were in decline in the majority of CEE countries even before the crisis as they were consistently losing the competitive race with low-cost producers from Asia. Following the deep contraction in value added recorded at the peak of the crisis and a slight rebound recorded last year, those industries may also see some modest recovery in 2011, but their medium-term prospects remain bleak. Only some narrow highly specialised segments have a more stable outlook, such as leather products for world brand fashion houses, production of leather seats for the car industry or shoe production (as is the case in Poland). Those textile companies which have outsourced manufacturing of their own brand products to low-cost countries and thus concentrate only on effective marketing on the domestic and nearby markets are also in better shape.

Construction is among the sectors most hit by the crisis, and it should also remain under pressure this year, thus justifying a continued negative outlook in most of the countries. The poor state of company and household finances, combined with still tight credit conditions, will constrain sector development. Moreover, in some countries the sector's weight in the total economy had substantially overshot a long-term equilibrium, calling for a structural rebalancing of the economy. There are, however, some countries and subsegments with better outlooks: in Ukraine and Poland, preparations for the Euro-2012 football championship will provide some support to the sector. In Kazakhstan, the large government programmes should help to boost infrastructure construction with roughly KZT 708 bn (EUR 3.5 bn) expected to be disbursed for transport modernisation (e.g. the Western Europe – Western China corridor) including railroads upgrade, particularly terminal and rolling stock. Infrastructure-oriented investments managed by the government and supported by the EU funding scheme will also be important drivers of construction sector growth in the rest of CEE countries with transport infrastructure (e.g. roads and highways) among the top priority projects. Together with construction, **real estate** suffered severely during the crisis and is still under pressure. Many countries still have a substantial oversupply of residential and commercial objects. Other Business Activities have better prospects as industry recovers.

By contrast, defensive sectors (Food & Beverages, Telecoms, Utilities) have been more stable throughout the crisis, but are also not going to show rapid growth looking ahead.

1 Including Russia and Ukraine, production reached 28% of the total in 2009

Food and beverages weathered the crisis well and is going to see steady growth in 2011. Russia, Ukraine and Kazakhstan are going to outperform the rest of the region due to large domestic markets and with still considerable gaps to fill in terms of infrastructure and processing capacities.

Utilities is a stable sector with good prospects and it will benefit from the recovery in the industry in 2011. Government tariff regulations and the crisis tax should weigh on the sector's performance in some countries (Hungary, Ukraine). Reconstruction and modernisation programmes have been in place in many countries, often within the framework of EU initiatives, but inefficiencies still remain (notably in Romania, Croatia, Ukraine). We expect particularly positive developments in countries such as Kazakhstan and Russia, supported by huge power station and grid (re)construction programmes and robust growth in energy demand from recovering industries.

We assign a generally stable outlook also for traditional sectors such as **agriculture**. The sector has shown resilience during the crisis and is expected to perform well going forward. Its near-term performance has been hampered by the 2010 bad weather conditions, but this is unlikely to have a lasting effect. The sector has potentially very strong medium to long-term prospects due to rich agricultural resource endowments in CEE countries, however realisation of this potential hinges on the implementation of structural reforms that would help raise sector efficiency. We expect a more positive outlook for the sector in Croatia, Bulgaria and Kazakhstan. In Croatia, the positive outlook is based on the ongoing recovery in exports especially for fishing and an expected acceleration in domestic demand. In Bulgaria, grain production has been the major growth driver, benefiting from favourable pricing levels and from considerable EU-funding, and sector fundamentals remain strong as unutilised farm land still offers significant potential. Kazakhstan also possesses good comparative advantages in agriculture (and is among the world's ten largest wheat exporters) despite the strong need for upgrading technologies, facilities and procedures. We also assign a stable outlook for the sector in Russia where the adverse impact of severe droughts should fade in both 2011 and 2012.

We generally forecast a stable pattern of growth for **wholesale trade**, while the outlook remains more uncertain for **retail trade** especially in Bulgaria and Romania as consumer spending may remain soft due to persistently high unemployment, low income growth and meaningful indebtedness levels. **Transport, storage and telecommunications** depend to a large extent on the rest of the economy and, therefore, should perform relatively well in 2011 on the wave of industrial and trade recovery. Telecoms may see sluggish growth due to still weak household demand.

The recent economic crisis triggered a strong debate concerning the sustainability of CEE growth prospects and the type of 'growth model' that is appropriate for the region.

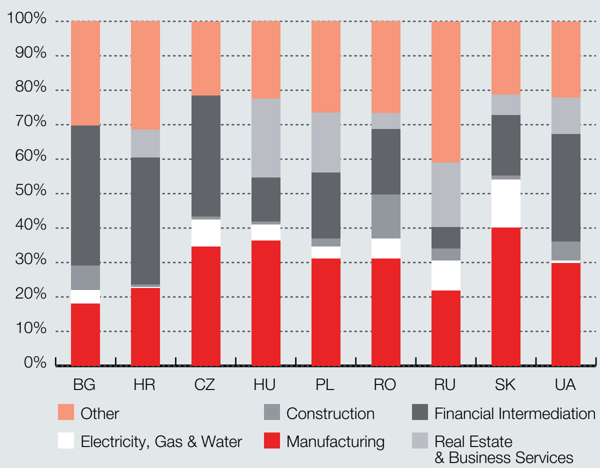
In the short term, sector developments throughout the region will continue to be shaped by further deleveraging (particularly for highly indebted sectors), a deteriorating public debt situation, increased pressure to reform public expenditure programmes, and net capital imports below pre-crisis levels. Improved absorption of EU funds could definitely provide some boost to the ongoing recovery process.

The crisis did not change CEE's long-term potential. Before the crisis, growth in the region benefited from a 'catching-up' process based on a high degree of trade liberalisation, capital movements, financial integration and the prospect of either accession to or a strong association with the EU. Capital inflows, however, largely targeted non-tradable sectors (e.g. real estate) contributing much less toward the build-up of a competitive and sufficiently sized manufacturing sector. There was, however considerable variation within the region regarding the allocation of foreign direct investment across different sectors of the economy. In the medium to long run, we do believe the 'old' growth model continues to apply. However, CEE countries should pursue it with more caution, emphasising the development of better economic diversification and further modernisation (particularly true for CIS countries).

Central European economies have a share of FDI stock in manufacturing – a sector with a high trade share – which is above or close to 40%; in most of the Baltic and SEE economies it is substantially below that. On the other hand, FDI shares are particularly high in a number of the SEE and Baltic economies in financial intermediation and in real estate. Hence there is a significant difference in the roles which FDI played in the different groups of economies in supporting the build-up of industrial capacities and resilience to the crisis and in its focus on tradable vs. non-tradable sectors.

Once the crisis has passed, most of these trends will remain in place, but the changing global framework will imply a higher cost of international liquidity and risk, meaning a more balanced 'integration model'. Overall, long-term potential growth will be slower than before the downturn, as all the convergence drivers are intact

FDI stock by activities (2009, shares in %)



Source: UniCredit CEE Strategic Analysis, WIIW but are less strong than in the past. The uncertain global outlook, growing competition from Asia and some rebalancing from non-tradable toward tradable sectors will shape the region's growth pattern.

More generally, improvements in the overall business environment and investment into higher value added sectors and more innovation remain among the key challenges for the CEE region. Over the last decade, important progress has been made in making the business environment more investment-friendly with five out of the ten CEE countries analysed in this report ranking among the top 60 in the World Bank's ranking of ease of doing business. Despite the crisis, CEE countries have also succeeded in maintaining a strong role in total global exports, with only some stabilisation observed during 2010 in the context of a still decreasing share of Western Europe and strong competition from a rapidly growing Chinese economy.

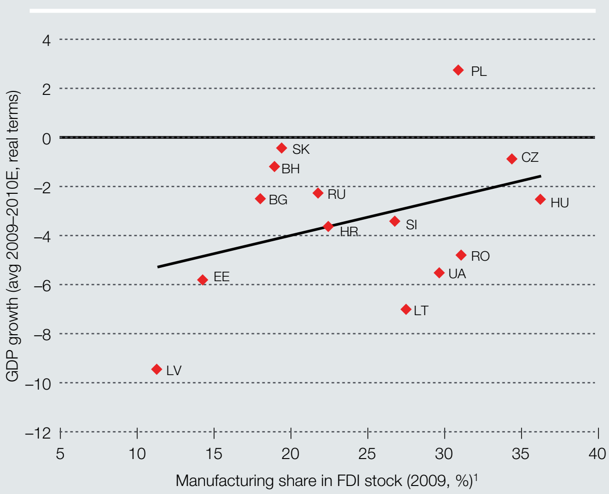
However, important obstacles to business still remain. According to the latest EBRD Transition report, skills availability, corruption and tax administration emerge as the top three business environment constraints in many CEE economies.

Competitiveness structural indicators (2010)

	WORLD BANK – EASE OF DOING BUSINESS						EBRD – TRANSITIONS INDICATORS		
	Overall Rank	Starting Business	Protecting Investors	Trading Across Borders	Enforcing Contract	Closing Business reform	Overall Infra-structure	Competition policiy	Trade and exchange system
Top performers									
Singapore	1	4	2	1	13	2	–	–	–
Hong Kong SAR, China	2	6	3	2	2	15	–	–	–
New Zealand	3	1	1	28	9	16	–	–	–
CEE countries									
Slovakia	41	68	109	102	71	33	3+	3+	4+
Hungary	46	35	120	73	22	62	4–	3+	4+
Bulgaria	51	43	44	108	87	83	3	3	4+
Romania	56	44	44	47	54	102	3+	3	4+
Kazakhstan	59	47	44	181	36	48	3–	2	4–
Czech Republic	63	130	93	62	78	32	n.a	n.a	n.a
Poland	70	113	44	49	77	81	3+	3+	4+
Croatia	84	56	132	98	47	89	3	3	4+
Russia	123	108	93	162	18	103	3–	2+	3+
Ukraine	145	118	109	139	43	150	2+	2+	4

Source: World Bank, EBRD

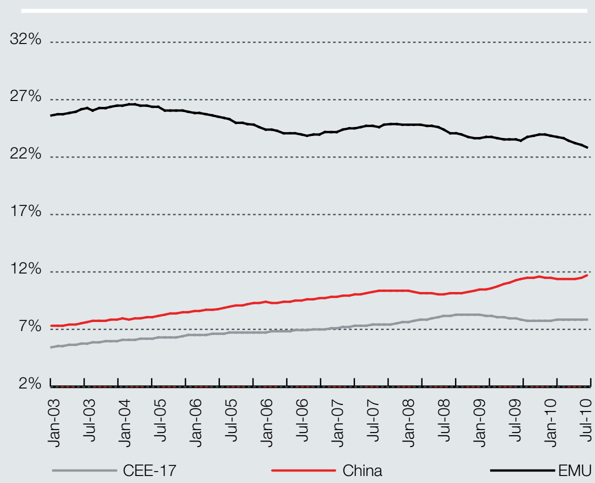
FDI and economic activity



Note: 1) 2007 for SI; 2008 for BH

Source: UniCredit CEE Strategic Analysis

Share of CEE countries in global exports



Source: IMF DOTS

Focus 1 – CIS Oil & Gas: seeking new markets

Russian oil production reached its all-time high in 2010 and is likely to retain these gains in 2011 despite core producing regions' natural decline and maturity of certain key fields. The Russian current daily production rate exceeds 10.1mn bpd, however in our view further small gains are lined up for 2011. Recent positive production profile revisions from a number of the country's key upstream players, including Rosneft, TNK-BP, Gazprom Neft and Bashneft, lend support to our view of the Russian upstream as still evolving and not yet at the peak of its potential.

Russia's gas industry reflected the global economic downturn of 2008-2009 to a much greater extent than the oil sector. Production dropped by 12.1% in 2009 and its gradual recovery in 2010 is yet to bring the output rate to its historical highs. In addition, an abnormally cold winter of 2009/2010 led to a large outflow of the natural gas in the country's underground gas storage facilities, which are utilised in times of peak demand to balance the load on the key natural gas producing fields and the country's gas distribution network. As a result, 2010 year-to-date gas production recovery appears skewed by the restoration of the underground inventory. This trend stimulates the output but does not directly translate into earnings until the gas is called up by the consumers.

Russian oil industry remains a low cost, low yield operation, with per-barrel earnings depressed by significant non-income taxes burden and other non-controllable costs such as transportation. The upcoming reforms to the sector envision a shift away from revenue-linked taxes toward a more balanced windfall profit tax approach. The government's efforts to design a proper tax scheme were reinvigorated in 2H10. Alhough market reaction remains muted due to great uncertainty surrounding the issue and significantly lower expectations of the potential direct benefits for the companies, in our view the newsflow surrounding the revisions to the O&G tax regime is likely to remain a key driver for the sector's performance in the next twelve months.

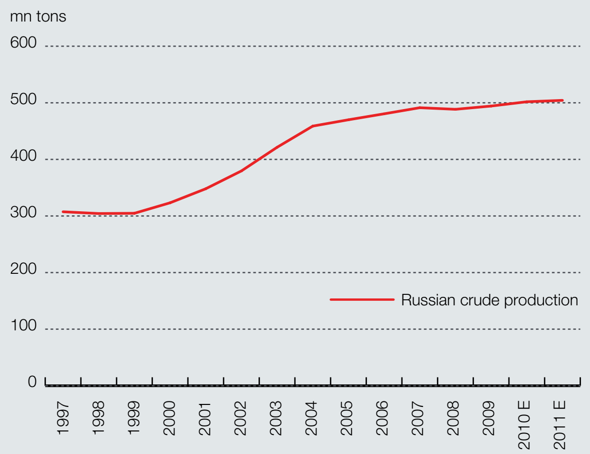
Russian downstream, meanwhile, enjoyed fairly strong netbacks throughout 2010, helped as usual by the low domestic crude price and world-level oil product prices. The government is on the verge of reducing its export duty rates for light oil products on the way to eventual convergence to the level of 60% of the crude export tax rate. By our estimates, this change is likely to help domestic integrated companies, in particular those which are long in refining cover vs. their respective upstream business segments. We note Gazprom Neft, Alliance Oil and Bashneft are among the most likely beneficiaries from the proposed downstream taxation changes.

Kazakhstan is rapidly developing into a key regional oil player, with production levels more than tripling since 1997 and large output gains lined up on the immediate near-term horizon. The country's production is driven mostly by the output increases in the large PSA projects, in particular the large Tengiz field (developed primarily by Chevron and ExxonMobile with local NC Kazmunaigaz and LUKoil's Kazakhstan arm on board as minority investors). Production at Tengiz is up 18% yoy and is expected to rise further.

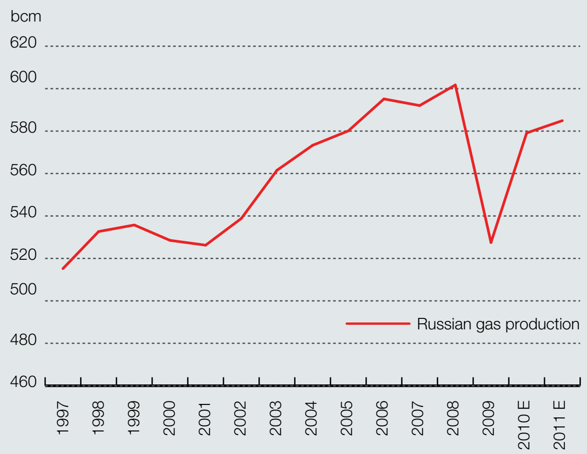
OPEC expects Kazakhstan to become a major contributor to the marginal additional barrels produced by non-OPEC countries as demand for crude oil picks up in 2011–2012. The country's giant Kashagan project is forecasted to produce over 1.5 mn bpd of crude, contributing nearly 47% to the country's total projected crude production. Delayed a number of times, the field's launch is now scheduled for 2013.

Russian crude production at all-time high while gas output recovery is far from certain

Russian crude output at record high as prices & investments grew



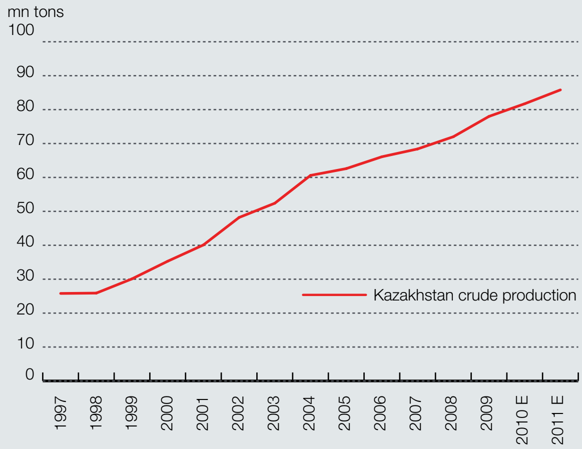
Gas output reflects market glut & demand decline in 2008–2009



Source: BP, MinTOP, UniCredit Research estimates

At the same time, the government's budgetary concerns have led to a reintroduction of an export rent tax, currently charged at USD 20/ton beginning August 2010. In 2011, the duty rate will double to USD 40/ton, and though still significantly below the Russian corresponding tax, the ongoing tweaking of the tax regime and enforcement of the new tax rules upon previously granted 'grandfathered' contracts (historically considered to be unchangeable) has led to a visible lag in the development of the sector.

Kaz oil production doubled in ten years, driven by large psa projects



Source: BP, MinTOP, UniCredit Research estimates

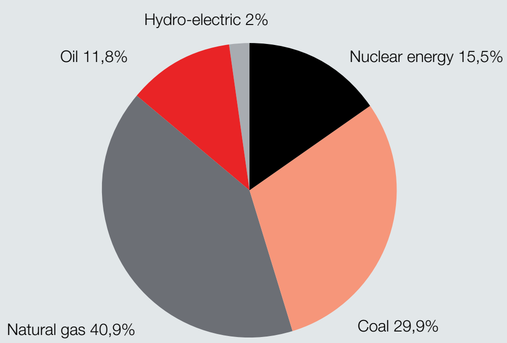
Ukraine's position in the ex-CIS energy space is vastly different from its neighbours due to the country's net energy importer status. Local crude and gas production do not cover even a third of the domestic hydrocarbon needs. Ukraine is thus Gazprom's largest customer among the monopoly's European clients; its annual import volumes recently ranged between 27bcm and 50bcm in the past five years.

Ukraine's primary energy demands are geared heavily toward natural gas, which is the source of nearly 41% of total primary energy generation. The government's 2030 Energy Strategy envisions a reduction in the country's dependency upon foreign energy suppliers, namely Gazprom as the current sole natural gas importer into the country. The government plan calls for a multi-tiered approach to this task: along with stimulation of the local producers through the rising gas prices, further hydrocarbon permits distribution, and support of the healthy operating margins realised by local O&G businesses; the country also plans to diversify its sources of natural gas through construction of an LNG regasification facility on the Black Sea coast near Odessa (a long-term project with significant variations in the cost estimates and unclear logistics).

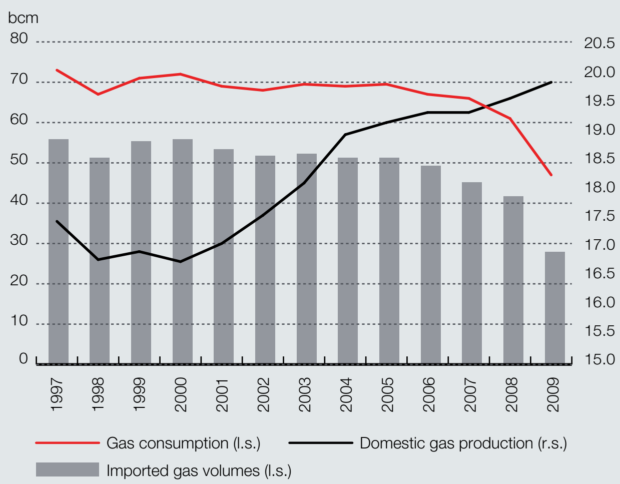
In our view, the newsflow surrounding Ukraine's natural gas affairs will remain the key market moving factor. We note that a number of the independent public O&G companies are already present in the local market place. Gazprom's efforts in establishing an arms-length relationship business model with its Ukrainian counterparties have led to a significant increase in domestic gas tariffs, and as the result, a reinvigorated interest in the local hydrocarbon producing properties. Among the public companies already operating in the region are JKX O&G, Regal Petroleum and Cadogan Petroleum. Although the success of their operations varies to a wide degree, with gas prices expected to remain generally stable we believe more companies are likely to come on the market.

Ukraine's net energy importer status calls for a reduction in dependency upon sole key supplier

UKR primary energy generation geared toward nat gas consumption



Rising local output reduced but not eliminated dependency on GAZP



Source: BP, IMF, UniCredit Research estimates

Focus 2 – Automotive in CEE

The automotive sector was among those most affected by the financial crisis. Although the worst is probably over, the environment remains very challenging for the sector. Indeed, despite a significantly better economic environment this year, the fading out of scrap incentives in various countries, which sustained automotive sales during 2009 (especially in large markets such as Italy and Germany), is hampering market recovery.

Following three consecutive years of a reduction in new vehicles registrations in Europe, last year the two major markets, Italy and Germany, are estimated to have recorded further significant reduction in new car sales (see chart). This drop was driven by the end of scrap incentives and by the uncertainties related to the pace of recovery (mainly export driven, while consumer spending is still subdued). Many CEE countries – such as Bulgaria, Hungary and Romania, whose economies are still under pressure – were also showing a significant contraction of new car sales according to available statistics (until October 2010).

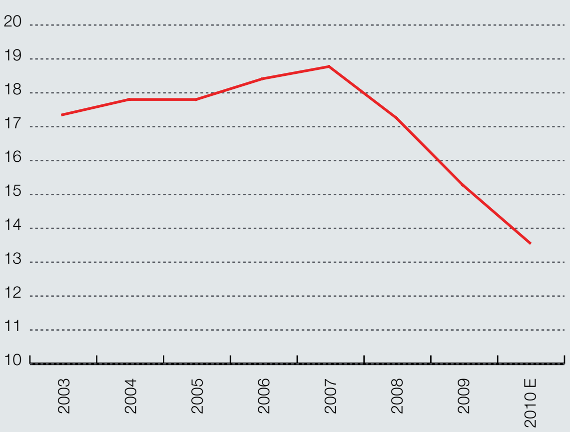
During the financial crisis, the sector experienced the continuation of some global trends already in place in the sector: 1) US producers continued to be the worst hit; 2) well-known structural problems of overcapacity, saturation and weak demand continued, and were even exacerbated; 3) increased sensitivity to global warming and greenhouse emissions has continued to push customers to change their preference in favour of smaller and more fuel-efficient vehicles during the past years – the effects of the economic crisis were moving in the same direction, in favour of smaller cars; 4) acquisitions and partnerships were among the strategies implemented by the OEMs (Original Equipment Manufacturers i.e. car producers) to survive the tough environment; 5) the role of emerging markets continued to develop, driven by the stellar performance of Chinese production (+48%, from 9.3 mn to 13.8 mn vehicles in 2009). Emerging markets have already contributed to an impressive production increase of 19.5 mn vehicles during the past decade (1999–2009), 12 mn of which are attributed to China. The year 2009 marked the first year in which emerging markets production overtook production from North America, Japan and Western Europe (it was slightly higher than 20% a decade ago and is now at 55%); and 6) for the first time in its history, China surpassed Japan as the first-ranked global producer of motor vehicles.

The automotive sector is the most important manufacturing sector for most of the Central Eastern European (CEE) economies. For Slovakia, the Czech Republic, Poland and Hungary the sector represents a large share of manufacturing value added and export (more than 20% of Slovakian manufacturing exports, for example, and around 15% for the other CEE countries).

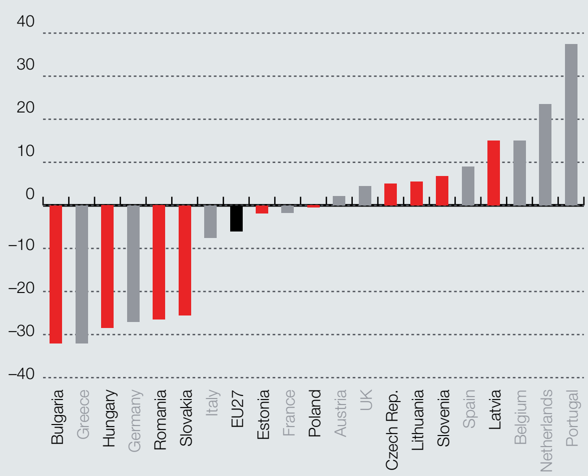
Regarding the performance of the sector in CEE on the production side, two main pieces of information must be considered: 1) the region's economies were among those most affected during the global financial crisis of 2009, and local demand dropped

European demand is still weak

European demand (new registrations in Europe, mn)



New passenger cars registration (yoy % change, Jan-Oct 2010)



Source: OICA, Acea, UniCredit

sharply; and 2) despite this, during 2009 CEE countries continued to erode the share of vehicle production of Western European countries. In one decade the share of motor vehicles (passenger car and commercial vehicles) produced in CEE out of the total European production jumped from 9% (in 1999) to 22.4% in 2008 and moved further to 24% in 2009. If Russia and Ukraine are included, production beyond the former "iron curtain" reached 28% of the total in 2009. Among the world's countries with the best performance in 2009 – in the midst of the crisis – were Romania, Slovenia, the Czech Republic (all three with positive growth in terms of production), Poland and Serbia. Russia and Ukraine were an exception, given their economies were more affected by the crisis – production of motor vehicles more than halved. The collapse amounted to a drop in production of 1.5 mn units to only 800,000 vehicles.

In summary, the automotive sector of CEE countries could continue to fare better than Western Europe. The East-West substitution of production clearly continued during the crisis, despite that a two-track development could clearly be seen: on one side, the strength of Central European countries, on the other, the weakness of the sector in Ukraine and Russia.

The performance of CEE countries will remain in place in the next years: 1) optimisation of production by OEMs will continue (production in the East is more efficient and hence there is an incentive to reduce production in Western Europe rather than in Eastern Europe); 2) all of the top ten automotive players in the world – they represent around 80% of global production, as the sector is very concentrated – already have plants in CEE and are still betting on this area for their future development. We believe the above factors will remain in place, at least partially, and this will bode well for the role of automotive production in the region.

Paradoxically, on the one hand, the automotive sector is characterised by huge and increased spare capacity at the global level; on the other, many OEMs are still expanding their production capacity in Eastern Europe. Among the most relevant examples: 1) the Italian Fiat in Serbia, which established a joint venture with the Serbian government (in a few years, Fiat exports from Serbia will likely represent one-fifth of total Serbian exports); 2) Mercedes invested EUR 800 mn in a new plant in Kecskemét (Hungary). The company is building the factory and in 2011–12 is to start production of Class A and Class B models: the annual production capacity is to reach 100,000 compact Mercedes cars in 2012 and 150,000 units in 2013; 3) in Slovakia, Volkswagen is to produce a new line of small-sized family cars in 2011. Production capacity will be expanded up to 400,000 vehicles after the production line is put into full operation – in 2009, around 188,000 vehicles were produced; 4) Bosch is closing its plant in Glamorgan (Wales) in summer 2011 and is moving to Hungary; 5) Toyota is shifting back the production of the new Corolla model vehicle to Turkey in 2012 and 6) Renault chose its Bursa plant in Turkey as the main production hub for its Clio model. Renault plans to produce 280,000 units of the model annually from 2013.

These trends confirm that CEE will further increase its role as Western Europe's production arm in the automotive sector. The "borderless economy" of Central Europe – in particular, Czech Republic, Slovakia, Hungary – will remain one of the most important clusters for the main OEMs and their suppliers, not only from Western Europe but also from Asia (Toyota, Suzuki, KIA, Hyunday, Honda have factories in CEE).

In summary, if the sector continues to suffer the effects of the crisis and the fading out of the scrap incentives, CEE countries can be considered more protected as they are still regarded as an efficient production basis. However, the relatively positive view on production (supply side), especially versus the Western European performance, will not be matched by a quick recovery of CEE markets (demand side). Households will remain particularly prudent and car registrations will not quickly reach pre-crisis levels in Central Eastern European countries.

Production of motor vehicles in regions

	PRODUCTION (mn units) 2009	VARIATION (mn units) past decade (1999–2009)	last year (2008–09)
Emerging markets	**32,510**	**19,510**	**922**
China	13,791	11,961	4,446
India	2,633	1,815	318
Emerging Asia (Other)	5,658	1,796	–857
Central Eastern Europe	3,887	2,152	–534
CIS	910	–324	–1,512
Latin America	5,253	2,047	–756
South Africa	380	63	–183
Developed countries	**27,453**	**–15,888**	**–10,210**
US and Canada	7,201	–8,882	–3,581
Japan	7,935	–1,961	–3,629
Western Europe	12,317	–5,045	–3,000

Source: OICA, UniCredit Research

Bulgaria – Tradable sectors at the front end of recovery

2011 Best, Stable and Worst sectors

Best		Stable		Worst	
Agriculture	High productivity & subsidies; good liquidity in grains; profit squeeze in livestock and milk	Mining	Stable outlook for mining, natural gas and coal production.	Quarrying	Influenced by long-term supply shortages globally and cyclicality of the sector
Paper and Pulp	Solid growth, significant raw material base but elevated debt	Food and Beverages	Good resilience during the crisis but very high indebted sector, import competition	Textiles	Strong traditions; low labour cost; proximity to EU; low debt
Chemicals	Cyclicality; low debt; significant investment activity; construction-related weakness in some segments; export strength	Tobacco Products	Export strength but import competition, higher excise tax and decreasing consumption growth	Leather Footwear	Low labour cost and proximity to EU export markets but overall poor competitiveness
Manufacture of basic metals	Resilience during crisis due to shift to higher VA production and new export markets; investments in cleaner technologies; high FDI opportunities in domestic scrap as input	Wearing Apparel	Short-term outlook (stable) supported by strong traditions, low labour cost, proximity to EU markets and specialisation in short lead time	Mineral-based Products (non-metalic)	Dependent on construction and real estate; significant raw materials base; strong investment; high FDI; high transport cost
Fabricated Metal Products	Expansion to new export markets; machinery driven demand; vast opportunities in domestic scrap as input	Wood Products (exclude furniture)	Export strength, significant raw material base, low labor cost, strong FDI presence but elevated debt and dependence on construction and furniture	Transport Equipment (excluding Motor Vehicles)	High debt; oversupply in ships; low competitiveness; significant metals base
Machinery, Equipment, Appliances	Investment driven demand, low debt and FDI presence; good supply of domestic metals; strong in military-equipment	Printing and Publishing	Stability during recession; saturation in some segments and lower marketing budgets	Furniture, Jewelry, Toys, Musical, Other Goods	High correlation with construction and real estate, weak domestic demand and high debt but solid export, significant raw materials base and low labour cost
Computers and Office Machinery	Cyclical sector characterised by low debt, low energy intensity, solid export, FDI and high profitability	Refined Petroleum, Coke and Nuclear	Strong export activity; low debt investments in higher ecological standards; high FDI presence; high dependence on external resources	Construction	High debt; oversupply in residential, office, leisure, retail; infrastructure related activity to pick up
Medical, Precision and Optical	Cyclical sector, low debt, low energy intensity and high profitability	Rubber and Plastics Products	High debt, cyclicality and construction-related weakness	Wholesale and Retail Trade	High debt; oversupply; consolidation underway in favor of larger chains but high FDI presence and investments in modern logistics
Recycling	High potential in scrap metals and waste management; new investments with EU, government funding	Electrical Machinery	Cyclical; low debt; low energy intensity; solid export growth; FDI; high profitability; construction-related; support from new renewable energy projects; renovation of power network	Real Estate and Business Activities	Oversupply in residential, office, leisure, retail real estate; high debt in real estate; low debt in business services; solid growth in outsourcing business services; resilient software segment
		Communications Equipment including Semi-Conductors and TVs	Cyclical sector characterised by low debt, low energy intensity, solid export growth, FDI presence and high profitability		

Best	Stable		Worst
	Motor Vehicles, Trailers and Parts	Solid investments in auto part facilities; high FDI; new auto plant to begin operations; elevated debt	
	Utilities	Electricity export pick up but poor domestic demand, lack of competition and need for network upgrades; renewable energy projects boom due to subsidies, water and waste management projects financed by government and EU	
	Hotels and Restaurants	High debt; oversupply; poor infrastructure; fast food formats progress	
	Transport, Storage and Tele communication	Low debt; cyclicality in transport; pick up in foreign trade; poor domestic activity; saturation in communications; transport network expansion, modernisation; diverse transport alternatives	
	Public Administration and Defense	–	
	Education, Health and Social Services, Social and Personal Services	Low debt; vast new investment potential; government financing issues; EU funding opportunities	
	Private Household Services	Higher resilience of non discretionary services during crisis; low purchasing power	

Source: UniCredit Bulbank

After a sharp fall in 2009, GDP growth stabilised early last year and moved into positive territory in 2Q10 (up by 0.5% qoq), marking the end of Bulgarian recession. Looking at the details, recovery has clearly started from export and changes in inventories. Improved utilisation of EU funds and restocking of inventories have also been among the most relevant growth drivers. More recently economic data flow relevant to fixed investments has likewise started to improve, suggesting that recovery is set to broaden also in terms of drivers, as investments are likely to provide a positive contribution in 2011. At the same time, contraction in household consumption expenditures has shown little sign of abatement, highlighting the slow and uneven nature of Bulgaria's economic recovery.

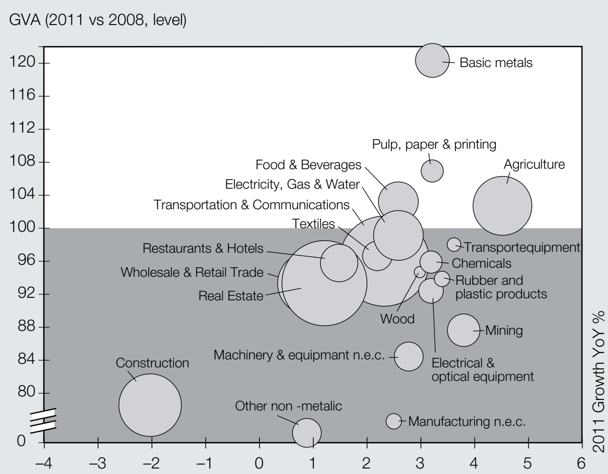
Solid but still below potential GDP growth of around 2.8% yoy is expected for this year. Despite a somewhat weaker dynamic relative to 2010, export growth is set to remain solid in 2011. The positive push from restocking seems not over, particularly given its limited contribution to growth posted so far when compared with other CEE markets. More progress in EU funds and restart of some investments which were put on hold during the most difficult times of the crisis, are expected to contribute positively to growth dynamics in 2011. The big challenge for the Bulgarian economy however lies in the success of a structural transformation of the economy, with strengthening of competitive advantages and export potential, away from non-tradable sectors which accounted for roughly 90% of value added growth and two-thirds of pre-crisis investment activities.

The tradable sectors are likely to outperform others, building on strength from 2010. Cyclical sectors with high potential to benefit include paper manufacturing, chemicals and pharmaceuticals, basic metals and fabricated metal products, machinery and electronic equipment. **Paper manufacturing** has benefited from the cyclical upturn in demand and favourable pricing levels, and provides good opportunities for further growth, with untapped potential for leveraging on domestic raw materials. Currently, import still dominates considerably over export, which could be reversed going forward, also due to advantages based on lower cost production in the country.

Chemicals and pharmaceuticals have traditionally been strong export drivers for Bulgaria and are also ranked among the sectors with the "best" outlook. Due to cyclical demand growth in 2010, the sector has outperformed and is likely to continue to do so into 2011. In addition, lower indebtedness levels compared to other sectors are supportive. Still, state- regulated gas prices (gas is a major energy source) remain an obstacle. Along with basic chemicals, pharmaceuticals and fertilizers have been among the strongest segments, with new investment likely to lead to more robust output growth going forward.

Basic metals is also ranked among the "best" performing sectors. As one of the largest exporters historically, the sector has been resilient during the crisis, due to expansion into new export markets and increased capacity in higher value added production. Ferrous

Value added by sector (real terms)[1]



Note: 1) Size of the ball = value added in billion USD

Source: UniCredit Bulbank, Statistical Office metals capacity has decreased due to a shut down of important capacity, caused by financing difficulties and the real estate slump, while non-ferrous metals have performed better and compensated for the ferrous metals declines. Investments in improved efficiency, lower pollution and modern capacity substituting obsolete technologies are likely to improve the profile of the sector further.

Among the best performing sectors, **agriculture** is likely to be supported by favourable demand-supply dynamics going forward. Grains have been the major growth driver, benefiting from favourable pricing levels due to supply shortages and from considerable EU-funding. On the other hand, the livestock segment has suffered due to lack of financing, and slow development of large modern farming. External financing to farming activity in general is reportedly hard to secure, as traditionally the sector is not very attractive for financial institutions. This may lead to below potential growth in crops despite strong profits in 2010. In addition, EU funding plays a crucial role for farmers, and any delays in distribution of such funds usually lead to lower planting activity. Looking ahead, sector fundamentals remain strong, as a favourable climate and unutilised farm land offer significant potential, in light of stable growth in demand.

Infrastructure oriented investments managed by the government and crucially supported by EU funding schemes are also likely to be important growth drivers. Among top priority projects appear to be major cross country roads and highways, as well as underground train networks in the capital. Others such as water and waste management are also likely to benefit, while there are initial signs of health care equipment investments, funded by EU programmes, finally likely to go live. Overall, the EU funding frame in the 2007–2013 period is worth EUR 9.4 bn, with an additional contribution of up to EUR 2.0 bn from the Bulgarian government. However, out of the total amount only a mere 11% has actually been paid on projects at present.

Non-tradable sectors are likely to lag behind the rest of the economy in line with 2010. Consumer spending may remain soft due to persistently high unemployment, low income growth, and meaningful debt levels thus, influencing trends in sectors such as **wholesale and retail trade**. The sector is characterised by the highest share of bank debt, particularly short-term debt, as the previous decade's rapid economic growth stimulated debt expansion. Sub-segments such as high-end shopping malls might be characterised by some overcapacity, while others (e.g. discounters) still look relatively underpenetrated. Overall, the retail market remains quite fragmented and consolidation is likely to progress further, led by expansion plans of retail chains and penetration of new players (the sector has been one of the most attractive for FDI). On the other hand, reviving international trade is likely to continue to stimulate wholesale trade activity. **Construction** and **real estate** activities, except for infrastructure projects, are also likely to remain among the "worst" performing sectors. Vast supply in segments including residential, office, retail, and leisure during the past several years has been significantly outpacing demand growth, potentially leading to much lower levels of activity in the medium term. High indebtedness built up in a very short time frame also bodes ill for the sectors, while vacancy rates are meaningful and building up further due to ongoing completion of already started projects.

Among the sectors with a stable outlook, **electricity** is a traditionally important sector for the government. The sector remains under-liberalised (state-set prices), with no competition among final providers, and state dominance in generation activities. At the same time overdue investment in the power grid remains an issue due to low profitability of companies which operate the network.

Operation programs funded by the Structural Funds (ths euro)

	EU	National	Total	Paid as of Sep 2010	% of total
Transport	1,624,480	379,002	2,003,481	90,969	4.5
Environment	1,466,425	334,323	1,800,748	92,452	5.1
Regional Development	1,361,084	240,191	1,601,275	110,754	6.9
Competitiveness	987,883	174,332	1,162,216	219,679	18.9
Human Resources	1,031,789	182,080	1,213,870	85,291	7.0
Administration Capacity	153,671	27,118	180,789	41,903	23.2
Technical Support	48,297	8,523	56,819	5,687	10.0
All Operational Programs	6,673,628	1,345,569	8,019,197	646,734	8.1

Sectoral programs not funded by the Structural funds

	EU	National	Total	Paid as of Sep 2010	% of total
Agriculture	2,609,099	632,840	3,241,938	562,287	21.5
Fisheries	80,010	26,670	106,680	n.a	n.a
Total	2,689,108	659,510	3,348,618	n.a	n.a
TOTAL	9,362,737	2,005,079	11,367,815	1,209,021	10.6*

Note: *) Excluding Fisheries

Source: UniCredit Bulbank

Bulgaria – Structural indicators (2009 unless otherwise stated)

SECTOR	MARKET STRUCTURE	
	Number of enterprises[1]	Number of SME[2]
TOTAL	**1,446,084**	**259,081**
Agriculture, Hunting, Forestry, Fishing	**163,395**	**7,317**
Mining & Quarrying	**860**	**226**
M&Q of energy producing materials	169	34
M&Q except of energy producing materials	691	192
Manufacturing	**100,278**	**26,390**
Food products, beverages and tobacco	24,417	5,980
Textiles and textile products	18,116	4,456
Leather and leather products	1,720	450
Wood and wood products	7,877	1,662
Pulp, paper & paper products; publishing & printing	6,530	1,751
Coke, refined petrolium products & nuclear fuel	56	17
Chemicals, chemical products and man-made fibers	1,923	597
Rubber and plastic products	4,261	1,321
Other non-metalic mineral products	3,079	879
Basic metals and fabricated metal products	11,164	3,210
Machinery and equipment n.e.c.	4,699	1,623
Electrical and optical equipment	5,397	1,751
Transport equipment	1,899	414
Manufacturing n.e.c.	9,140	2,279
Electricity, Gas & Water	**1,619**	**299**
Construction	**50,878**	**13,006**
Wholesale & Retail Trade, Restaurants & Hotels	**682,447**	**139,842**
Wholesale & Retail Trade	599,534	121,811
Restaurants & Hotels	82,913	18,031
Transportation & Communications	**109,205**	**16,183**
Transportation & Storages	107,310	15,524
Communication	1,895	659
Finance, Insurance, Real Estate & Business Services	**194,550**	**30,839**
Financial Institutions	6,008	1,127
Insurance	10,982	435
Real Estate, Dwellings & Busienss Services	177,560	29,276
Community, Social & Personal Services	**142,852**	**24,979**

Note: 1) 2007; 2) 2008

SECTORAL DETAILS				COMPETITIVENESS			CONSTRAINS	
Share in Total VA,%	Share in Total FDI,%	Capital Intensity[1] %	FDI Attractiveness %	RCA[2], %	Wage adjusted Labour Productivity Indicator[2]	Average Wage Indicator[2]	Total Indebteness[1], %	Bank Indebteness[1], %
100.0	**100.0**	**59.2**	**100.0**	**100.0**	**100.0**	**100.0**	**60.9**	**11.6**
6.0	**0.4**	**22.2**	**7.5**	**348.6**	**375.5**	**73.3**	**59.2**	**13.8**
1.8	**0.5**	**39.1**	**28.6**	**5.3**	**114.6**	**166.8**	**43.5**	**4.4**
0.7	–0.1	37.7	–12.1	0.2	85.5	165.9	63.9	n.a
1.1	0.6	39.7	55.7	26.6	142.1	167.7	35.4	n.a
15.3	**18.1**	**61.9**	**118.7**	**120.8**	**65.4**	**90.4**	**57.9**	**13.0**
3.3	2.0	75.1	60.2	118.1	84.0	88.5	66.2	20.6
2.1	2.1	30.0	98.7	213.4	57.1	60.4	52.9	9.5
n.a	0.0	n.a	n.a	149.3	n.a	55.3	n.a	n.a
0.3	0.3	81.5	104.8	104.0	54.3	72.9	58.2	13.5
0.8	0.5	81.7	60.2	60.6	69.9	97.8	57.9	13.5
n.a	3.4	n.a	n.a	360.6	n.a	305.1	n.a	n.a
0.9	1.4	71.6	153.4	98.2	86.0	126.6	38.8	10.0
0.5	0.2	116.3	38.0	57.9	73.4	68.1	68.4	17.6
1.3	1.6	60.3	123.6	119.1	125.8	109.8	49.4	13.9
1.7	3.9	82.1	227.3	195.7	40.8	115.6	61.1	12.1
1.6	1.6	47.7	104.3	76.5	48.1	116.1	52.3	7.7
1.1	0.8	27.8	72.3	78.2	68.6	104.0	51.8	8.4
0.4	0.1	n.a	21.0	25.0	44.6	133.3	55.7	9.0
0.6	0.2	62.7	36.2	108.5	78.7	65.8	63.1	14.9
4.7	**3.9**	**100.9**	**82.0**	**10,807.1**	**122.9**	**173.2**	**40.8**	**11.4**
8.6	**7.1**	**95.8**	**82.2**	**n.a**	**125.1**	**85.2**	**73.6**	**10.3**
12.5	**15.2**	**79.5**	**122.3**	**n.a**	**80.1**	**71.5**	**70.1**	**14.6**
9.6	13.7	81.7	143.1	n.a	73.2	74.0	71.2	13.7
2.9	1.6	71.4	54.2	n.a	112.1	62.0	63.8	20.1
10.4	**12.4**	**57.7**	**119.3**	**n.a**	**124.8**	**125.1**	**57.3**	**7.5**
6.2	1.1	n.a	17.1	n.a	115.6	117.3	51.9	7.8
4.2	11.3	n.a	270.6	n.a	145.9	149.2	62.8	7.3
24.6	**40.7**	**58.1**	**165.2**	**26.8**	**189.0**	**139.2**	**n.a**	**n.a**
7.8	18.1	20.3	231.2	n.a	168.7	234.5	76.4	45.1
n.a	n.a	n.a	n.a	n.a	n.a	250.7	30.8	4.9
16.8	22.5	75.7	134.4	26.8	202.6	110.4	59.6	10.2
16.2	**1.7**	**27.1**	**10.7**	**623.0**	**60.0**	**113.4**	**49.8**	**6.4**

Source: Statistical Office, UniCredit Bulbank

Croatia – Budget constraints to influence key sectors

2011 Best, Stable and Worst sectors

Best		Stable		Worst	
Agriculture	Recovery of exports, especially fishing; gradual recovery of domestic demand	Mining	Generally stable outlook	Quarrying	Further drop in domestic demand, especially from construction industry
Paper and Pulp	Stronger external demand from countries in the region; recovery of domestic intermediate demand	Food and Beverages	Growth more likely to be driven by external demand	Wearing Apparel	Limited domestic demand with low competitiveness and lack of new investments and management leadership
Hotels and Restaurants	Expected good tourist season; gradual upgrading of quality, better flight connections with EU	Tobacco Products	–	Mineral-based Products (non-metalic)	Connected with construction, meaning there is no room for growth
Transport, Storage and Telecommunication	Stable transport and storage due to stagnating retail trade; spreading of new services (especially IPTV) support better outlook for telecommunication	Textiles	Recovery of both domestic and external demand; firms which survived likely to show gradual recovery in the next years	Fabricated Metal Products	Among sectors which are mostly lagging behind general recovery after the crisis; low domestic demand and very slow recovery of exports
		Leather Footwear	Production of leather seats for car industry and production of footwear gradually reviving; gradual recovery of external demand	Transport Equipment (excluding Motor Vehicles)	Shipbuilding industry: lack of new orders, at risk of losing probably half of its capacity (due to restructuring terms agreed with EU Commission)
		Wood Products (exclude furniture)	Growth driven by intermediate demand of gradually reviving furniture industry as well as external demand	Construction	Stopping of all government-led infrastructural projects; very low demand for new dwellings; very low demand for business investments
		Printing and Publishing	–	Real Estate and Business Activities	Low demand for new dwellings; low business demand (new offices, warehouses etc.) partly due to the lack of FDI
		Refined Petroleum, Coke and Nuclear	Benefit from modernisation of refineries in Rijeka and Sisak		
		Chemicals	Mostly driven by growing external demand		
		Rubber and Plastics Products	Gradual recovery of external demand		
		Manufacture of basic metals	Expected considerable growth of steel exports from restruc-tured Sisak factory owned by US firm		
		Machinery, Equip-ment, Appliances	Well below its potential, but expected gradual recovery of production and exports		
		Computers and Office Machinery	–		
		Electrical Machinery	Gradual recovery driven mostly by external demand		
		Communications Equipment including Semi-Conductors and TVs	–		

Best	Stable		Worst
	Medical, Precision and Optical	Gradual recovery driven mostly by external demand	
	Motor Vehicles, Trailers and Parts	–	
	Furniture, Jewelry, Toys, Musical, Other Goods	Stable outlook with further recovery expected during the next year, mainly driven by exports and new investments in design (supported by government)	
	Recycling	–	
	Utilities	In need of new investments; growth driven by new distribution channels for gas	
	Wholesale and Retail Trade	Gradual recovery mainly driven by slow recovery of domestic demand	

Source: Zagrebačka banka Research, UniCredit CEE Strategic Analysis

Croatia's economy at the end of 2010 according to available data has stabilised, but still there is little evidence of a sustained recovery. Exports are slightly higher, but there are no signs of a substantial pickup in domestic demand. The pattern of growth based on public spending on infrastructure projects extensively used in the past is not possible in the near future with foreign debt approaching 100% of GDP and the fiscal deficit over 5% of GDP. As domestic demand will no longer be able to contribute to growth as much as in the past, partly because private sector investment spending is likely to recover only in the medium term, exports will have to play a greater role.

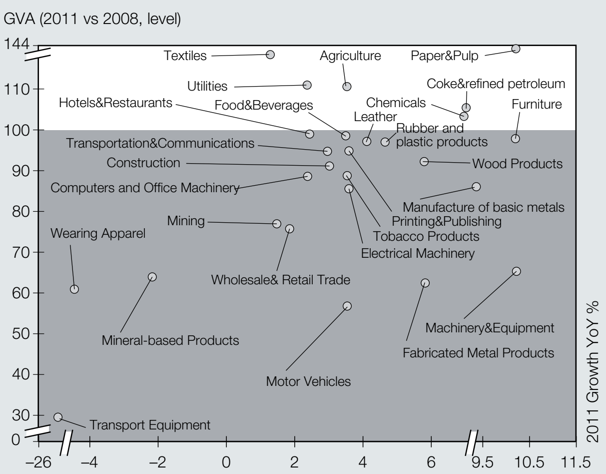
The prospect of completing EU accession talks in the first half of 2011 remains the main policy anchor in the country as general elections are nearing (expected in late 2011). In such circumstances, the fiscal deficit is not likely to narrow (needed cuts in public spending will be postponed to the post-election period). Inflation pressures are expected to remain relatively low and the currency stable as the current account deficit remains low due to weak domestic demand.

The most important drivers of growth in 2011 remain export-oriented manufacturing industries, and especially export-led services sectors (tourism, transport). We do foresee another good touristic season which in the context of gradual upgrading of infrastructure quality and better flight connections with EU supports our positive view for the **hotels and restaurants** sector. Important contributions will also originate from other well performing sectors such as **agriculture, forestry and fishing**, as well as **telecommunications**. The excellent performance of the agricultural sector in Croatia is fostered by the recovery of exports and domestic demand, in particular for the fishing market. As regards the very positive dynamic in Telecommunications, it is spurred by the spreading of new services, in particular IPTV and other similar sectors.

The **paper** industry is also expected to make a notable contribution to growth in 2011. The stimuli comes again largely from abroad, thanks to strong external demand in the region, although there is also vibrant domestic intermediate demand, mostly for packing purposes.

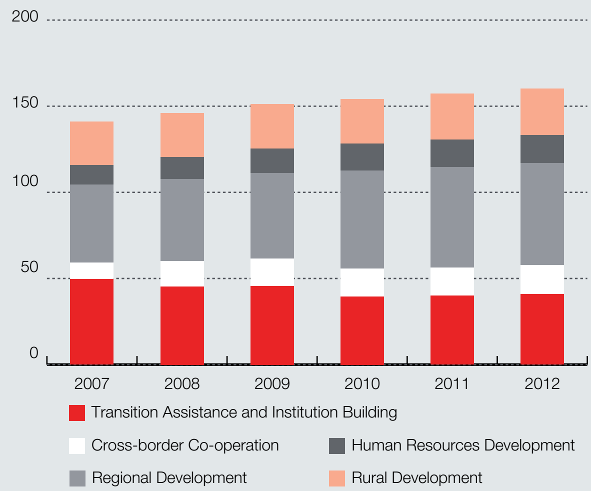
EU accession funds will be also an important factor of support, because some EUR157 mn could be withdrawn in 2011, mostly for projects in regional development, institution building and rural development. However, budget constraints will force a change in the pattern of infrastructure projects. For example, the completion of the last part of the motorway from Zagreb to the southern port of Ploče has been delayed until the end of 2012 reflecting budget constraints. Unlike in the past,

Value added by sector (real terms)[1]



Source: Zagrebačka banka Research, UniCredit CEE Strategic Analysis

EU pre-accession funds (EUR mn)



Source: European Commission

government policy is now more in favour of attracting private sector participation when undertaking infrastructure investments.

The focus of future infrastructure activity will be mainly on building gas pipelines, freight railway capacities, ports and airports. Government projects in terms of energy policy have a medium- to long-term horizon, so that 2011 and 2012 will most likely represent a period of preparation for larger projects to come. Despite the more stable prospects for infrastructure investments, the overall outlook for the construction sector remains negative. The main determinants of this classification are the virtual stop of all the government-led infrastructure projects, the low demand of new dwelling and the very scarce demand for business investments.

Among the worst performing sectors, development in the **real estate** industry remains constrained by low demand both in the residential and business segments. The outlook for **quarrying and other mining** suffers a lot from the drop in domestic demand, induced by the bad performance of the construction industry. Those weaknesses are also one of the main determinants of the negative outlook for **mineral-based** and **fabricated metal products.** **Wearing apparel** is also expected to perform relatively weakly

Croatia – Structural indicators (according to NACE 1. 1, 2009 unless otherwise stated)[1]

SECTOR	MARKET STRUCTURE	
	Number of Enterprises	Number of SME
TOTAL	**91,316**	**91,069**
Fishing and agriculture	**2,312**	**2,307**
Mining and quarrying	**248**	**242**
Manufacturing	**10,939**	**10,869**
Food products	1,327	1,309
Beverages	224	219
Tobacco products	3	2
Textiles	217	217
Wearing apparel	555	553
Leather products	132	131
Wood and wood products	845	845
Paper and paper products	173	171
Printing	876	876
Refined petroleum products	8	6
Chemicals and chemical products	263	260
Pharmaceutical products	32	29
Rubber and plastic products	671	670
Other non-metallic mineral products	613	608
Basic metals	119	117
Fabricated metal products	1,835	1,832
Computers. electronic and optical products	509	505
Electrical equipment	257	251
Machinery and equipment	566	565
Motor vehicles. trailera ans semi-trailers	74	72
Other transport equipment	285	279
Furniture	571	570
Other manufacturing	299	299
Repair and installation of machinery	485	483
Electricity, gas and steam	**191**	**182**
Water supply, waste management	**515**	**513**
Construction	**12,151**	**12,127**
Wholesale and retail trade	**27,262**	**27,176**
Transport and storage	**3,522**	**3,508**
Hotels and restaurants	**4,833**	**4,829**
Information and comunications	**3,576**	**3,565**
Financial activities	**674**	**670**
Real estate	**4,134**	**4,133**
Professional, scientific and technical activities	**12,926**	**12,918**
Administrative and auxiliray service activities	**3,264**	**3,262**
Public services; compulsory social insurance	**37**	**37**
Education	**828**	**828**
Health and social activities	**917**	**917**
Art, entertainment and recreation	**791**	**790**
Other service activities	**2,194**	**2,194**
Households as employers	**2**	**2**

Note: 1) Number of SME is the number of enterprises with turnover up to HRK 300 mn (approximately up to EUR 41 mn).

because of the increased competition from emerging Asia and lack of new investments and management leadership.

Among the stable sectors, **food and beverages** industry is still depressed due to low domestic demand, but is likely to benefit in 2011 from expected gradual increase in external demand. Parts of **textiles** industry which survived are prepared to profit from favourable conditions on the foreign markets this year and gradually increase its production. **Leather** industry on the back of gradual recovery of footwear production may also slightly improve its position during 2011. **Chemical** as well as **pharmaceutical** industry has also stabilised in 2010 and is preparing for new investments in current year. Production of **machinery and equipment** is likely to increase its exports in 2011 on the back of recent considerable growth of new orders from foreign markets, but is still suffering on the domestic market.

Generally, expected completion of EU accession talks during the first half of 2011 would boost investor sentiment toward Croatia and likely lead to a quicker recovery in investment activity as country risk falls and credit spreads tighten. More projects in the future should be carried out with the support of EU funds which will be available to Croatia upon entry into the European Union (expected in the beginning of 2013).

SECTORAL DETAILS				COMPETITIVENESS			CONSTRAINTS	
Share in VA %	Share in FDI, %	FDI Attractiveness	Capital Intensity	RCA	Labour productivity	Average Personnel Costs	Total Indebted-ness	Bank Indebted-ness
100.0	**100.0**	**100.0**	**0.5**	**100.0**	**118.9**	**107.4**	**49.72**	**33.94**
3.2	**0.3**	**8.8**	**0.3**	**147.0**	**118.7**	**106.6**	**58.09**	**49.58**
1.8	**3.8**	**209.8**	**1.2**	**29.8**	**270.3**	**163.3**	**30.86**	**20.28**
23.9	**22.6**	**94.5**	**0.2**	**108.0**	**100.0**	**100.0**	**44.09**	**38.41**
4.3	1.6	37.9	0.2	107.4	102.5	98.9	45.79	41.73
1.3	n.a	n.a	0.3	201.0	218.8	143.5	31.73	19.31
0.6	-0.1	-16.7	0.0	449.5	779.3	177.5	0.00	0.00
0.2	0.4	175.2	0.1	52.3	47.1	60.7	45.93	37.32
0.9	0.2	22.7	0.1	161.8	46.7	57.2	43.66	35.01
0.3	0.3	101.8	0.2	159.5	36.4	57.9	29.01	27.45
0.7	0.1	20.7	0.2	272.9	55.0	61.6	52.34	42.16
0.3	0.2	63.5	0.2	65.5	67.1	82.1	60.05	50.10
0.6	0.4	70.6	0.3	95.2	111.0	101.4	46.94	38.60
2.0	6.6	320.3	0.0	277.8	208.6	184.0	46.08	46.08
0.7	6.6	943.7	0.4	80.7	94.5	117.7	43.06	40.61
0.8	n.a	n.a	0.1	86.0	175.1	210.3	28.70	25.10
0.7	0.5	67.2	0.2	43.3	96.2	84.6	48.94	38.68
1.7	3.4	197.9	0.3	179.2	133.5	109.1	41.41	31.27
0.2	0.1	41.7	1.1	51.0	32.8	82.8	31.70	24.03
2.3	0.4	19.7	0.1	129.7	89.5	90.5	40.87	32.00
1.0	1.1	107.4	0.1	56.2	146.7	144.7	41.55	33.91
1.5	n.a	n.a	0.1	197.3	144.6	135.7	28.66	24.00
1.0	0.4	35.9	0.2	64.0	90.5	99.6	34.00	30.17
0.3	0.3	78.3	0.1	32.2	88.6	87.3	49.98	44.75
1.3	-0.1	-5.7	0.3	309.9	90.6	114.3	54.16	52.09
0.6	0.3	44.0	0.1	153.4	55.7	64.1	38.07	30.48
0.1	n.a	n.a	0.1	40.9	87.2	90.4	42.70	26.27
0.6	n.a	n.a	0.1	n.a	87.8	102.9	69.30	51.50
3.4	**0.2**	**5.2**	**0.5**	**32.2**	**204.2**	**144.8**	**14.78**	**14.21**
2.1	**0.6**	**27.8**	**0.5**	**1,837.5**	**123.2**	**112.7**	**57.26**	**47.96**
9.9	**0.8**	**7.7**	**0.7**	**n.a**	**101.7**	**92.9**	**65.07**	**34.19**
20.0	**16.6**	**83.0**	**0.2**	**n.a**	**107.0**	**97.9**	**43.92**	**25.28**
7.5	**0.7**	**10.0**	**0.3**	**n.a**	**124.4**	**125.6**	**55.88**	**46.59**
3.8	**2.5**	**67.4**	**0.6**	**n.a**	**94.6**	**94.4**	**68.04**	**50.71**
7.7	**n.a**	**n.a**	**0.3**	**124.7**	**262.3**	**170.4**	**31.57**	**20.08**
1.5	**36.9**	**2,524.1**	**2.6**	**n.a**	**214.1**	**138.5**	**39.22**	**24.94**
3.0	**8.0**	**268.8**	**0.8**	**n.a**	**199.5**	**152.9**	**58.98**	**35.71**
7.7	**0.7**	**n.a**	**0.4**	**3,487.8**	**176.2**	**142.7**	**55.94**	**45.24**
1.9	**n.a**	**38.1**	**0.3**	**n.a**	**64.2**	**77.3**	**49.96**	**26.72**
0.2	**n.a**	**n.a**	**28.7**	**n.a**	**470.9**	**176.0**	**75.00**	**72.91**
0.3	**n.a**	**n.a**	**1.3**	**n.a**	**74.0**	**92.0**	**44.82**	**22.77**
0.7	**n.a**	**n.a**	**1.1**	**n.a**	**104.6**	**114.8**	**58.43**	**42.33**
1.0	**n.a**	**n.a**	**0.4**	**113.4**	**107.0**	**99.8**	**62.46**	**38.96**
0.5	**n.a**	**n.a**	**0.2**	**n.a**	**76.1**	**88.9**	**45.62**	**23.72**
0.0	**n.a**	**n.a**	**n.a**	**n.a**	**223.7**	**108.4**	**66.44**	**19.20**

Source: Zagrebačka banka Research, UniCredit CEE Strategic Analysis

Czech R. – Cyclical sectors to continue driving the recovery

2011 Best, Stable and Worst sectors

Best		Stable		Worst	
Rubber and Plastics Products	Solid demand from automotive industry; feeble demand from construction	Agriculture	Heavily subsidised sector	Textiles	Challenge from cheap imports, production transfer eastward
Manufacture of basic metals	Cyclical upturn	Mining	Mostly vertically integrated into energy production complex	Quarrying	Outlook for quarrying dampened by poor construction activities
Fabricated Metal Products	Revival of investments, domestic as well as abroad	Food and Beverages	Domestically oriented, but competitive challenges from Poland and Slovakia	Wearing Apparel	Challenge from cheap imports, production transfer eastward
Machinery, Equipment, Appliances	Revival of investments, domestic as well as abroad	Tobacco Products	Oligopoly	Leather Footwear	Challenges from cheap imports and production transfer eastward
Computers and Office Machinery	Cyclical upturn	Wood Products (exclude furniture)	Exporter of commodity (of domestic origin), heavy state involvement	Refined Petroleum, Coke and Nuclear	Lack of predictability in the sector represented by just a couple of the companies, with most of them being horizontally interconnected with other sectors
Electrical Machinery	Revival of investments, domestic as well as abroad	Paper and Pulp	Cyclically driven	Mineral-based Products (non-metalic)	Negatively influenced by depressed construction activity and weak household demand for housing
Communications Equipment including Semi-Conductors and TVs	Revival of investments, domestic as well as abroad	Printing and Publishing	Squeezing due to internet competition	Furniture, Jewelry, Toys, Musical, Other Goods	Depressed by poor construction activity and subdued households consumption
Medical, Precision and Optical	Revival of investments, domestic as well as abroad	Chemicals	Benefits from demand from other manufacturing sectors; stable demand from agriculture; rising demand for pharmaceuticals	Recycling	State's "green frenzy"
Motor Vehicles, Trailers and Parts	Benefits from Hyundai strategy for growth at the EU level	Utilities	Benefits from demand from industry	Construction	Standstill in residential projects; structural construction dragged by state budget cuts
Transport Equipment (excluding Motor Vehicles)	Revival of investments, domestic as well as abroad	Wholesale and Retail Trade	Partially non-cyclical (retail) and partially driven by recovery in the industry	Hotels and Restaurants	Capacity oversupply in Prague
		Transport, Storage and Telecommunication	Benefits from industry and export revival		
		Real Estate and Business Activities	Standstill in new projects and NPL on a downward trend in real estate, revival of demand for business services		

Source: UCB CZ

After having gained momentum last year, supported by a combination of both domestic and external factors, moderate recovery is set to continue in the Czech economy also throughout 2011. Manufacturing will be supported externally by impressive economic growth in Germany and internally by higher corporate capital spending on machinery and transport equipment. Higher business confidence may also keep boosting the level of inventories and FDI inflows. The improved macroeconomic conditions during 2010 already marked a significant reversal in the trend, with inward FDI inflow nearly doubling on a yearly basis in 1H 2010 to reach CZK 80.2 bn, mostly directed toward the financial sector. Overall the Czech economy is likely to continue to profit from its comparative advantages at the European level, remaining a production hub for Europe in medium-high technological sectors.

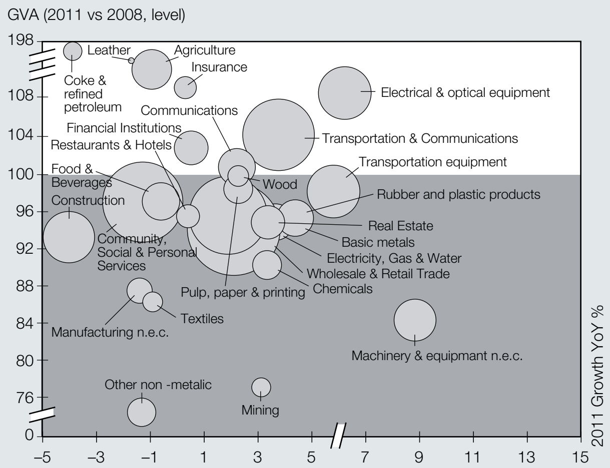
Major headwinds are instead set to be attached to the government's fiscal restrictions. These should be felt in lower social transfers, inhibiting the potential of private consumption to expand. Secondly, public investments are likely to be cut short. From the production side, the structure of demand might prove to be supportive for engineering sectors, while construction and other related sectors are anticipated to underperform.

EU funds could contribute to further boost the ongoing recovery process. The Czech Republic is entitled to receive about EUR 27 bn from the EU in the budgeting period 2007–2013. In the period to come, efforts will be made to finalise road and railway projects which are currently underway and co-financed with EU money. No big new projects are set to start any time soon, as the budget of the State Fund of Transport Infrastructure will shrink by CZK 30 bn in 2011 versus the record high of 2010. In 2011, EU funds will provide approx. CZK 18 bn for transport infrastructure investments (vs. CZK 36 bn in 2010), while the local co-financing should amount to CZK 10 bn (vs. CZK 12 bn in 2010). Outside the investments into transport infrastructure, major environmental projects (such as water processing plants, sewage systems etc.) are being co-financed by municipalities or directly by the Ministry of Environment. These projects could drain another CZK 25 bn from EU funds in 2011; the civil engineering construction sub-sector will remain the major beneficiary from the production side.

Among the best performing sectors, the **automotive** industry is expected to maintain the positive trend observed last year. The industry was running double-digit growth in 2010, driven by a suitable product portfolio and rising production by Hyundai. Last year for the first time in history, one million vehicles were produced in the Czech Republic. Demand in the sector is giving a boost to the related sector of **rubber and plastic production** as well as to other engineering sectors. **Machinery and equipment** has been also gaining ground since the middle of 2010. Considering its typical position as a beneficiary in the later stages of the economic cycle and its current solid order books, the machinery and equipment outlook for 2011 looks fairly promising. In contrast to the transport equipment branch, 2011 growth in the the machinery and equipment sector is projected to accelerate into the double-digits area in 2011. Demand from the machinery and equipment branch should also help the **basic metals and fabricated metal products** sector. At the same time, **electrical and optical equipment** should benefit from an expected need of the corporate sector to replace fixed assets.

Within the stable sectors, **wholesale** is set to perform better than retail due to its closer linkages to expanding industrial output. Despite the stable outlook, **retail trade** may instead post meagre growth, as private spending will be dampened by the government's fiscal restrictions in 2011. Overall, the trade sector should post decent growth over the 2011–2012 period. The majority of relevant indicators for the **real estate** sector are currently hovering around their lowest levels since 2005 but the prospect of further deterioration remains generally limited. We expect the commercial real estate segment to return to more normal functioning during the year accompanied by economic recovery gathering pace. Signs of recovery have been also mounting in the industrial and logistics property market. Compared to other segments (e.g. retail, office and residential), the industrial segment appears to be improving a bit faster. **Utilities** could profit from the rising demand for energies by industry and related sectors. The **mining** industry should benefit from an ongoing renaissance in commodity prices. **Chemicals** might do reasonably well, as the anti-cyclical pharmaceutical and fertilizer productions will mitigate meagre demand for other chemicals.

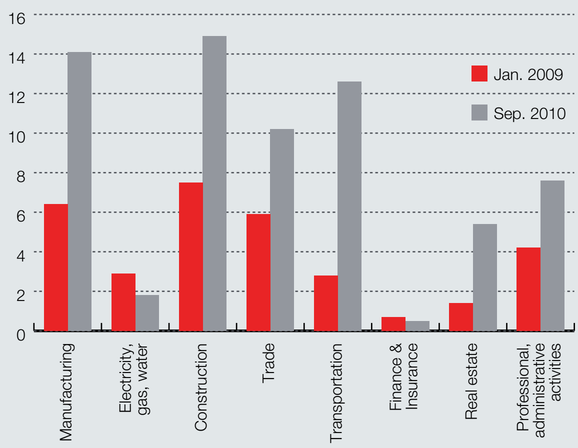
Value added by sector (real terms)[1]



Note: 1) Size of the ball = value added in billion USD

Source: UCB CZ, Statistical Office

Non-performing loans by key industrial sectors



Source: UCB CZ, CNB

After the surprisingly mild drop in **construction** output observed during 2009 (compared to the sharp fall in industrial output), the construction branch accelerated its decline during last year. Measured by the volume of construction works (structural and civil engineering construction combined) the sector dropped by an estimated 8% yoy in 2010. The branch is set to remain under pressure in the foreseeable future thus justifying its rating among the worst performing sectors; lower public funding for infrastructure investment and the cautious approach of private investors support our view that 2011 will likely be the third year in a row with negative growth. Output stabilization may only occur starting from 2012. Subsequently, **non-metallic** production and the production of **furniture** will be suffering as well.

The hotels & food services branch is experiencing difficulties; apparently, tourists (residents & non-residents) travel closer to home, spend less and stay abroad for shorter periods of time. Prague (as the centre of the Czech Republic' tourism) feels capacity oversupply which keeps persistant pressure on margins. A more pronounced recovery can hardly be expected before 2012.

Textile and leather products are set to resume their long-term downside, characterised by low profitability and a reduction of capacities on relocation of production abroad.

Czech Republic – Structural indicators (2009 unless otherwise stated)

SECTORS	MARKET STRUCTURE		SECTORAL DETAILS				COMPETITIVENESS	
	Number of enterprises	Number of employees '000	Share in total VA,%	Share in total FDI, %[1]	FDI attractiveness %	Capital Intensity, %	Labour Productivity (Manufacturing = 100)	Average Personnel Cost (Manufacturing = 100)
TOTAL	**343,832**	**4,254**	**100.0**	**100.0**	**100.0**	**29.6**	**90.7**	**113.3**
Agriculture, Hunting, Forestry, Fishing	**6,466**	**146**	**3.1**	**0.2**	**5.4**	**23.5**	**82.0**	**77.4**
Mining & Quarrying	**354**	**48**	**0.7**	**2.7**	**389.1**	**39.5**	**55.2**	**115.5**
Manufacturing	**36,951**	**1,213**	**31.4**	**34.6**	**110.1**	**17.6**	**100.0**	**100.0**
Food products, beverages and tobacco	n.a	137	2.5	3.4	134.4	17.2	71.7	84.7
Textiles and textile products	n.a	60	0.9	0.6	66.9	13.4	56.4	62.2
Leather and leather products	n.a	7	0.1	0.0	10.2	5.4	53.0	74.4
Wood and wood products	n.a	47	1.0	2.1	212.3	18.9	81.6	71.6
Pulp, paper & paper products; publishing & printing	n.a	57	1.5	n.a	n.a	16.8	103.8	118.1
Coke, refined petroleum products & nuclear fuel	n.a	4	0.7	4.8	655.9	5.7	805.6	137.2
Chemicals, chemical products and man-made fibres	n.a	41	1.7	n.a	n.a	16.0	161.3	122.9
Rubber and plastic products	n.a	81	2.7	n.a	n.a	14.2	129.8	96.9
Other non-metallic mineral products	n.a	63	1.6	3.0	186.6	22.4	98.2	105.4
Basic metals and fabricated metal products	n.a	191	2.7	4.4	162.7	30.9	54.4	97.3
Machinery and equipment n.e.c.	n.a	155	3.6	3.1	86.1	18.4	89.8	106.9
Electrical and optical equipment	n.a	172	5.6	3.8	69.2	11.8	124.9	103.8
Transport equipment	n.a	137	5.6	8.8	158.0	20.3	157.6	123.0
Manufacturing n.e.c.	n.a	62	1.2	0.5	41.6	16.0	72.4	89.2
Electricity, Gas & Water	**3,216**	**57**	**2.7**	**7.8**	**293.5**	**55.3**	**180.1**	**173.3**
Construction	**28,068**	**306**	**5.4**	**1.0**	**19.3**	**18.1**	**67.8**	**100.2**
Wholesale & Retail Trade, Restaurants & Hotels	**131,458**	**691**	**17.8**	**10.4**	**58.6**	**12.4**	**99.4**	**103.3**
Wholesale & Retail Trade	117,598	545	16.7	9.8	58.7	11.3	118.5	110.0
Restaurants & Hotels	13,860	146	1.1	0.6	57.8	29.9	28.1	78.0
Transportation & Communications	**18,924**	**318**	**10.6**	**6.8**	**63.7**	**53.4**	**129.1**	**116.8**
Transportation & Storage	7,946	249	7.8	n.a	n.a	67.1	120.0	112.9
Communications	10,978	69	2.9	n.a	n.a	16.5	162.3	130.8
Finance, Insurance, Real Estate & Business Services	**105,677**	**475**	**15.6**	**35.1**	**224.3**	**49.8**	**127.2**	**152.6**
Financial Institutions	1,936	55	2.3	18.8	820.1	16.6	162.0	223.8
Insurance	n.a	16	1.0	n.a	n.a	5.2	253.5	193.7
Real Estate, Dwellings & Business Services	103,741	404	12.3	16.3	132.0	59.7	117.6	139.4
Community, Social & Personal Services	**11,324**	**1,001**	**12.6**	**1.4**	**11.1**	**38.8**	**48.7**	**122.5**

Note: 1) 2008

Source: Statistical Office, UCB CZ

Hungary – Government policy to have an impact on some industries

2011 Best, Stable and Worst sectors

Best		Stable		Worst	
Chemicals	–	Agriculture	Vast reserves to exploit, but deep farm fragmentation, mass production domination, poor sense of the market, inflexible workforce and influence of political interests	Tobacco Products	Outlook influenced by intensive counter campaigns, increasing excise rates and high penetration of illegal products
Rubber and Plastics Products	–	Mining	Low economic relevance except for stone and gravel	Textiles	Small economic scale; import competition
Machinery, Equipment, Appliances	–	Food and Beverages	Relatively resilient to crisis, but not much rebound; share of import rising constantly; domestic firms slowly accommodating to the more sophisticated EU market	Wearing Apparel	Inward processing dominates => uneven asset utilization, => profit gap; import competition
Medical, Precision and Optical	Profitable and fast growing business activity; growth not halted even during the harshness of the crisis	Leather Footwear	Solid status of inward processing for world brand fashion houses but uneven asset utilisation, sensitivity to FX and import competition	Construction	Weak performance in residential; EU co-financed school renovation projects eased the depression
Motor Vehicles, Trailers and Parts	–	Wood Products (exclude furniture)	One of the two largest processing plants under liquidation; manufacturing of pellet for bioenergetics utilisation has room to develop; prospects in wood carpentry limited by recession construction	Hotels and Restaurants	–
Transport Equipment (excluding Motor Vehicles)	–	Paper and Pulp	–	Real Estate and Business Activities	Sluggish real estate; other business stable with good chance to take advantage of improving business climate
Recycling	Underdeveloped but demand generated by increasingly strict EU environmental standards; high capital returns	Printing and Publishing	Fragmented sector. Small printing firms in weak bargaining position, but must keep up with fast technology obsolescence		
		Refined Petroleum, Coke and Nuclear	MOL with solid market presence, cutting-edge technology, large infrastructure and good access to financial markets; some adverse impact from the crisis tax		
		Mineral-based Products (non-metalic)	Large foreign companies dominate production; depression in construction deteriorated earning ratios but no extreme cases of defaults		
		Manufacture of basic metals, Fabricated Metal Products, Computers and Office Machinery	–		

Best	Stable		Worst
	Electrical Machinery	Poor statistics basically reflect withdrawal of traditional light bulbs from production at GE domestic plants	
	Communications Equipment including Semi-Conductors and TVs	–	
	Furniture, Jewelry, Toys, Musical, Other Goods	Recession in furniture as domestic demand stagnates while import competition and raw material prices have been increasing. Bottoming out phase, however, giving way to moderate recovery for firms that survived	
	Transport, Storage and Telecommunication	In long run, transport and logistics with brighter than average prospects. HUF 61 bn crisis tax strongly impacting telecom firms, esp. T-com.	
	Utilities	Price moratorium for residential services and higher input costs utility weighing on firms' results. Crisis tax of HUF 70 billion on energy firms, many of which already loss making	
	Wholesale and Retail Trade	Retail hit by depressed domestic economy and by crisis tax of HUF 30 bn	
	Education Health and Social Services, Social and Personal Services	–	

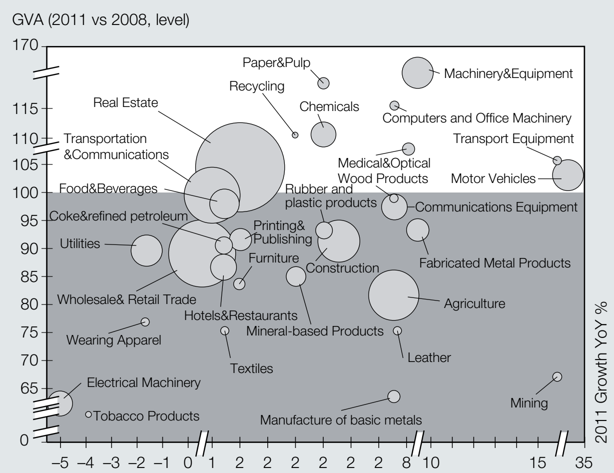
Source: UniCredit Bank HU Research, UniCredit CEE Strategic Analysis

Following the deep contraction observed in 2009, the Hungarian economy gradually stabilised during last year expanding by an estimated 1.2% yoy. Progress was still hampered by depressed domestic consumption resulting from a high debt service ratio to disposable income. Public spending could not generate additional demand as the budget deficit is under tight monitoring by institutional lenders to Hungary. Investment is showing signs of picking up, especially in the business sector, while households will presumably hold back spending on both capital and consumer goods. EU funds could provide some boost to the ongoing recovery process. In the 2007–2013 EU budget, Hungary was granted a total of EUR 28.76 bn for co-financing the framework programmes. Since the implementation of these programmes was launched in 1H 2007, Hungary reached 90% progress -ranking among the top 3 within the new EU member states following Estonia and Lithuania. For the relevant period Hungary has three major EU co-funded framework programmes – New Hungary Development Plan with an EU contribution of EUR 24.92 bn, New Hungary Rural Development Programme with EU funds of EUR 3.81 bn and Fisheries Operational Programme with EU financing of EUR 34 mn. The government has committed itself to maintaining the 2.8% deficit target for 2011 while it is determined to implement one tax rate bracket and family taxation in PIT. In return, it introduced heavy crisis taxes on the financial, energy, retail trade and telecom sectors and suspended contribution payments in intended for private pension funds. Despite streamlined public financing plans and the drastically improving external financing capability of Hungary, high gross external indebtedness, the lack of a new IMF programme and the redemption schedule of EU and IMF loans make Hungary sensitive to potential money market shocks.

Over the past years, the operating environment in Hungary has been generally investment friendly with FDI inflows averaging roughly 5.0% as a share of GDP in the 2004–2008 period. The risk is now that uncertainty will bring a decline in FDI. Moreover, market mistrust is leading to an increase in country risk (lower ratings, higher CDS), meaning a higher cost of funding for the economy.

Among the sectors with better prospects, the **automotive** industry now represents a core part of the Hungarian economy characterised by the dominance of multinationals, the highest labour productivity and FDI share, the fastest capital return, and largest

Value added by sector (real terms)[1]



Note: 1) Size of the ball = value added in billion USD

Source: UniCredit Bank HU Research, UniCredit CEE Strategic Analysis export volumes after electronic machinery. Following the 2009 free-fall, along with resurging export demand, vehicle and spare part manufacturers have awakened extremely quickly from the depression and lined up to expand local capacities. Audi has geared up engine production by 32% in first half of 2010 following a 27% drop in 2009. The firm is planning to double the area of its existing plant with the officially unconfirmed aim to bring complete high-end production. In 2008 Daimler AG initiated an EUR 800 mn project to build a manufacturing plant for the production of the next generation A- and B-Class series from 2012 onward. Opel is going to double its Hungarian capacities by investing EUR 500 mn. From 2010 onward the firm plans to produce 500,000 motor block units a year. In addition to these giant projects several others are underway at Allison, Bosch, Telefunken and many others.

Thanks to massive FDI inflow **rubber manufacturing** has also become a prosperous industry marked with world leading producers such as Continental, Michelin, Bridgestone and Hankook. However, the sector could not escape the headwinds of the crisis and experienced a 23% contraction from the peak in 2008. Over the past year, however, production enlarged by 12% driven by export sales. Prospects for the sector look even more promising, supported by plans of prominent brand owners such as Hankook to boost current tyre production from 5 mn to 12 mn by 2012 after the currently ongoing EUR 230 min worth of investment project has been completed.

Among the stable sectors, **agriculture** still represents one of the key industries for the Hungarian economy. Although natural resources are abundant and perfect for land cultivation transformation, the damages inflicted during the 1990's have not yet been recovered from entirely and the sector is still vulnerable to erratically occurring weather hazards like the one in 2010. Hungary's EU entry brought a great deal of opportunities (especially in development financing) as well as challenges. While the intensity of mechanisation has been rising rapidly since that event, it is still relatively low: engine capacity per hectare measures only 1.9 kw in contrast to the 5.6 kw of the EU average. A ban on foreigners' land purchases prohibit the penetration of up-to-date farming methods and technology, the involvement of desired excess capital and the consolidation of a fragmented land structure. In 2009 the actual disbursement of EUR 2.2 bn within the framework of the Agricultural and Rural Development Programme was twice the amount of the annual target due to crisis rescue measures that allowed higher SAPS payments and increased the contribution from EU funds. Out of the total amount the EU covered 76%, while direct subsidies accounted for EUR 1.16 bn, corresponding to 52% of total disbursement. As to the outlook, although the interim statistics indicate a poor harvest and decreasing earnings for 2010, the sector holds a vast amount of reserves to exploit, and there is also the low base of reference and the rare probability for harsh weather conditions to reoccur one year after another.

Food processing has strong ties to agriculture. In the years after EU entry the export surplus significantly melted away, with import goods making aggressive inroads into the domestic market. The share of imports now appears to be stabilising at below 20%, while Hungarian firms are getting more successful in acquiring new markets abroad. The sector weathered the crisis relatively well but faces much less dynamic progress in the coming years. In the short-term, we maintain a stable outlook for the sector.

Stable prospects are also expected for the **refined petroleum, coke and nuclear** sector. The sector practically consists of one, albeit, regionally prominent firm, MOL. It possesses solid market presence, cutting-age technology, one of the most efficient oil refineries in the region, a vast amount of infrastructure and proximate access to financial markets. The company is supposed to be adversely affected by the crisis tax, but it has the means to offset a part of extra costs with higher prices.

We also maintain a stable outlook for the **wholesale** sector. Prospects are however less positive for the **retail** segment, which has been hard hit by the depressed domestic economy (unemployment, high debt service, credit freeze). The proposed crisis tax in the amount of HUF 30 bn is unlikely to disturb the affected retailers as they can easily pass on the extra cost to customers in marginally higher prices.

The **construction sector** is one of the most adversely affected by the poor financial state of households caught in a debt trap. Construction of residential flats experienced a 32% decline, the number of construction permits fell by almost the same degree. Corporate and public investments could not offset such a vast drop, even more so as the state has its own financial problems.

Currently underway EU co-financed school renovation projects were alone to ease the depression somewhat. Given the anticipated lack of dynamism in the domestic recovery, especially in terms of private consumption and spending sentiment, coupled with the lingering debt-related issues, the sector outlook remains still uncertain.

Similar to construction, the **real estate sector** has also suffered the most over the past one-and-a half years. Though the crisis has bottomed out, sector prospects are not very bright due to the still high indebtedness level. Until the debt service ratio to disposable incomes falls to a more tolerable level no significant resurgence is expected. Outside of real estate, other business activities have had a relatively stable performance and have a good chance to benefit from an improving business climate.

The outlook remains also negative for the **hotels and restaurants** sector. Hungarian EU presidency in 1H 2011 may ease the gloom somewhat but, in our view, will be inadequate to bring about a real turning point. High exposure to unpredictable elements (good/bad weather), similar to the case in agriculture, and higher than average operating leverage (high proportion of fixed costs) is also considered in the poor rating.

Hungary – Structural Indicators (2008, unless otherwise stated)

SECTOR	MARKET STRUCTURE		
	Number of Enterprises	Number of employees	Number of SME[1]
TOTAL	**649,271**	**2,918,500**	**648,326**
Agriculture, Hunting, Forestry, Fishing	**24,181**	**175,800**	**24,149**
Mining & Quarrying	**452**	**8,500**	**450**
M&Q of energy producing materials	58	n.a	57
M&Q except of energy producing materials	394	n.a	393
Manufacturing	**58,209**	**794,600**	**57,759**
Food products, beverages and tobacco	6,339	132,300	6,266
Textiles and textile products	5,409	55,200	5,385
Leather and leather products	632	9,100	622
Wood and wood products	4,281	18,516	4,279
Pulp, paper & paper products; publishing & printing	7,603	37,384	7,581
Coke, refined petroleum products & nuclear fuel	13	6,500	11
Chemicals, chemical products and man-made fibres	676	44,000	660
Rubber and plastic products	2,188	40,968	2,152
Other non-metallic mineral products	2,261	28,332	2,236
Basic metals and fabricated metal products	9,402	96,600	9,374
Machinery and equipment n.e.c.	5,900	45,900	5,861
Electrical and optical equipment	6,809	131,300	6,706
Transport equipment	809	76,500	750
Manufacturing n.e.c.	5,887	72,000	5,876
Electricity, Gas & Water	**772**	**84,100**	**723**
Construction	**68,785**	**293,300**	**68,760**
Wholesale & Retail Trade, Restaurants & Hotels	**182,391**	**702,000**	**182,261**
Wholesale & Retail Trade	150,006	549,200	149,895
Restaurants & Hotels	32,385	152,800	32,366
Transportation & Communications	**34,932**	**345,300**	**34,854**
Transportation & Storage	32,640	254,300	32,573
Communications	2,292	91,000	2,281
Financial Intermediation	**27,141**	**95,500**	**27,113**
Real Estate, Dwellings & Business Services	**199,036**	**274,300**	**198,901**
Community, Social & Personal Services	**53,372**	**145,100**	**53,356**

Note: 1) 2007

SECTORAL DETAILS					COMPETITIVENESS					CONSTRAINTS
Share in total VA %	Export propensity %	IMP/ AC, %	Share in total FDI, %	FDI Attractive-ness %	Capital Intensity %	RCA	Labour productivity ths HUF/ capita	Average Personnel Costs (yearly YTL) ths HUF capita	Wage adjusted Labour produc-tivity	Total Indebted-ness %
100.0	**17.5**	**16.6**	**100.0**	**100.0**	**23.2**	**1.0**	**6,115.3**	**2,398.0**	**2.6**	**44.2**
4.1	**12.3**	**14.5**	**0.6**	**15.4**	**34.6**	**0.8**	**4,134.6**	**1,621.4**	**2.6**	**41.3**
0.5	**1.5**	**4.3**	**0.3**	**58.1**	**15.8**	**0.3**	**10,006.7**	**2,928.6**	**3.4**	**11.1**
0.3	n.a	n.a	n.a	n.a	0.4	0.1	n.a	n.a	n.a	n.a
0.1	n.a	n.a	n.a	n.a	53.2	1.7	n.a	n.a	n.a	n.a
26.4	**53.1**	**45.9**	**36.4**	**137.8**	**19.3**	**1.2**	**5,928.6**	**2,284.0**	**2.6**	**38.5**
2.7	23.8	14.5	2.9	107.7	21.5	1.7	3,670.7	1,907.9	1.9	57.6
0.5	64.9	55.0	0.4	84.9	10.3	1.4	1,468.1	1,335.6	1.1	82.4
0.2	64.9	58.4	0.1	58.9	5.8	1.2	3,107.0	1,382.2	2.2	82.6
0.3	39.4	29.8	0.4	109.0	16.4	1.4	3,249.5	1,534.9	2.1	90.8
1.3	18.9	20.0	1.3	102.7	35.6	0.9	6,017.5	2,058.3	2.9	46.5
2.3	13.9	29.0	1.4	61.0	5.0	0.4	64,025.7	6,160.2	10.4	23.2
2.5	58.2	36.0	2.3	90.1	25.6	2.3	10,212.7	3,474.1	2.9	23.2
1.3	46.7	35.1	1.3	98.9	26.8	1.5	5,864.7	2,819.1	2.1	42.7
1.0	24.6	15.2	2.1	225.3	23.2	1.7	6,004.4	2,255.2	2.7	43.7
2.3	39.0	24.8	3.1	135.3	32.3	1.8	4,282.2	2,115.3	2.0	42.8
2.0	39.0	25.3	1.7	85.0	13.7	1.8	7,909.3	2,395.5	3.3	17.5
5.8	84.8	83.1	6.3	108.3	7.9	1.1	7,940.8	2,202.3	3.6	101.4
3.6	88.0	83.2	12.7	353.2	26.5	1.4	8,375.7	2,647.0	3.2	19.5
0.5	26.7	20.9	0.3	48.5	29.6	1.3	1,316.8	1,972.2	0.7	34.5
4.2	**2.7**	**14.6**	**4.5**	**107.6**	**15.6**	**0.2**	**8,908.3**	**4,140.4**	**2.2**	**20.0**
5.5	**0.3**	**1.4**	**1.0**	**18.5**	**10.9**	**0.2**	**3,330.2**	**1,826.4**	**1.8**	**39.6**
14.4	**15.2**	**17.6**	**14.6**	**101.6**	**14.8**	**0.8**	**3,649.9**	**1,767.8**	**2.1**	**56.6**
12.9	13.2	15.5	13.9	107.4	14.6	0.8	4,198.9	1,895.1	2.2	58.0
1.9	0.1	0.5	0.7	36.0	11.9	0.2	2,272.1	1,470.7	1.5	43.4
9.7	**0.7**	**1.9**	**6.3**	**64.6**	**55.9**	**0.4**	**5,026.3**	**2,819.6**	**1.8**	**45.0**
7.3	1.0	1.9	0.5	6.7	60.5	0.5	5,118.7	2,356.2	2.2	54.9
2.4	0.3	1.9	5.8	238.2	42.3	0.1	4,768.1	5,445.8	0.9	31.3
5.6	**0.1**	**0.1**	**12.7**	**227.4**	**4.8**	**0.6**	**10,438.5**	**5,361.7**	**1.9**	**52.0**
23.5	**0.7**	**0.6**	**23.0**	**97.9**	**27.1**	**1.0**	**15,271.0**	**2,516.1**	**6.1**	**34.9**
5.7	**0.3**	**0.3**	**0.6**	**11.2**	**20.6**	**0.9**	**7,060.1**	**2,148.5**	**3.3**	**57.0**

Source: UniCredit Bank HU Research, UniCredit CEE Strategic Analysis

Kazakhstan – Reliant on oil, but trying to diversify

2011 Best, Stable and Worst sectors

Best		Stable		Worst	
Agriculture	Priority sector and major export sector; over-leveraging in a significant number of cases	Tobacco Products	Some positive prospects	Textiles	Long-term questionable, imports from China and others
Mining	Base of the Kazakh economy	Wood Products (exclude furniture)	Some demand for wooden construction material, but generally production not very promising	Wearing Apparel	Long-term questionable, imports from China and others
Food and Beverages	Huge catching up needs, particularly in processing, storage packaging	Chemicals	Mixed outlook; strong recovery and also future prospects related to agriculture, metall-urgy and pharma, but already very strong credit growth in the past	Leather Footwear	Long-term questionable, imports from China and others
Refined Petroleum, Coke and Nuclear	Government programme for gasoline import substitution, uranium, uranium processing a major and developing industry in Kaz	Rubber and Plastics Products	–	Paper and Pulp	Lack of own raw material base
Mineral-based Products (non-metalic)	Construction materials needed for large government- and oil sector-sponsored infrastructural projects	Machinery, Equipment, Appliances	Strong recovery in 2010, local content policies, but not competitive longer term	Printing and Publishing	Publishing activity rather unstable
Manufacture of basic metals	Metallurgy a major industry in Kazakhstan; country also profits from above-average Asian (Chinese) growth	Electrical Machinery	Strong recovery in 2010, local content policies, but not competitive longer-term	Computers and Office Machinery	Strong import competition
Fabricated Metal Products	Government supports high value-added production in metallurgy; local content policies	Communications Equipment including Semi-Conductors and TVs	–	Hotels and Restaurants	Caution required because of strong pre-crisis expansion; however 2011 Asiada winter games might open some potential in some areas
Motor Vehicles, Trailers and Parts	New assembly plants	Medical, Precision and Optical	Strong recovery in 2010, local content policies, but not competitive longer-term	Construction	Residential doubtful, but large infrastructure projects showing good opportunities for growth
Transport Equipment (excluding Motor Vehicles)	Locomotives assembly to boost growth	Furniture, Jewelry, Toys, Musical, Other Goods	–	Real Estate and Business Activities	Pre-crisis overexpansion not yet overcome in many areas
Recycling	Big needs, some initiatives	Wholesale and Retail Trade	Strong pre-crisis expansion; however renewed need for working capital and some projects might be promising		
Utilities	Huge power station and grid (re)construction programmes	Education	Large government programmes, but not always successful		
Transport, Storage and Telecommunication	Good potential supported by building up of export infra-structure; storage facilities also needed in agriculture	Health and Social Services	Large government programmes, but not always successful		
		Social and Personal Services	–		
		Private Household Services	Pre-crisis overexpansion not yet overcome in some areas, but long-term growth potential for some branches		

Source: ATF Bank Research, UniCredit CEE Strategic Analysis

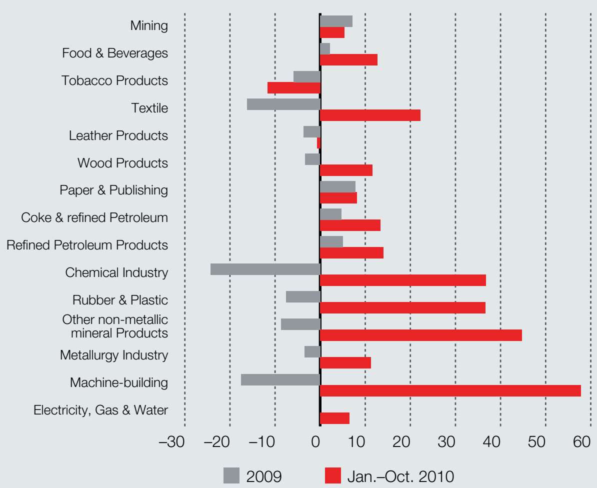
Kazakhstan's economy has strongly recovered from its meagre growth of 1.2% yoy in 2009, and we expect GDP growth to reach 6% yoy in 2010 and 5.3% yoy in 2011. Industry and net exports have been the main drivers of growth, with private consumption and trade also contributing, but investment has remained weak. For 2011 we expect investment to recover and domestic demand to take over as a driving force.

Private consumption was supported by personal income growth and improving employment: Q3 2010 employment was up 3.4% yoy, and monthly wages were 9.6% higher yoy in real terms in September. This provided strong support for retail trade (which grew 12.8% yoy in constant prices over Jan–Oct 2010). Notwithstanding the strong recovery, investment outlays into fixed capital were 1.8% lower in Jan-October than the year before. In manufacturing they increased however 16.4% yoy, with investments in textile and food growing the fastest, and investment in metallurgy representing the largest amount.

Industrial output increased 10.4% yoy in Jan–Oct 2010, with mining up 5.4% yoy, manufacturing 18.7% and electricity, gas and water 6.5% yoy. There was a particularly sharp increase in engineering, chemicals and construction materials – all of which suffered the most from the 2008–2009 crisis. Mining held up relatively well throughout the crisis, but manufacturing is now the most dynamic sector.

Bank credit finally returned to growth (+0.6% mom) in September, after a permanent decrease since May 2009. Loans to the corporate sector were up 0.7% mom, retail 0.2% mom. The stagnation in banks' lending activity appears to be bottoming out and we expect demand-driven credit growth to gain momentum as the recovery in investment broadens.

Industrial Output (YoY % growth)

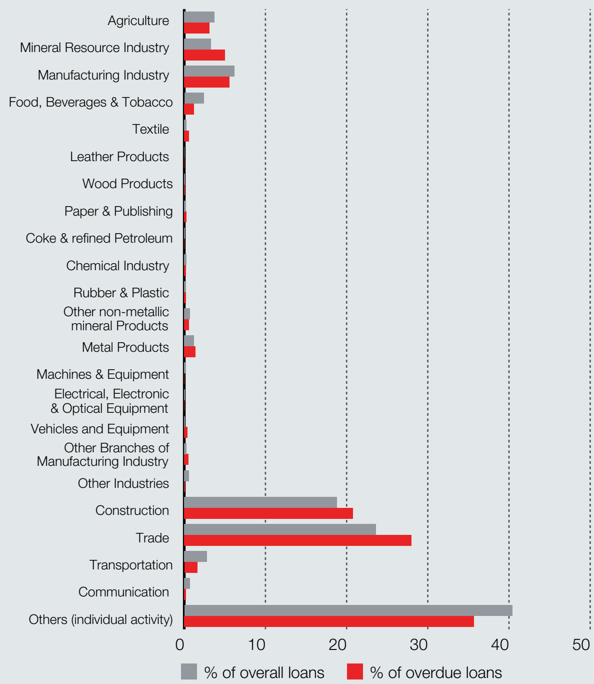


Source: Statistics Agency of Kazakhstan

The **oil and gas** industry remains fundamental for Kazakhstan. Oil and gas mining alone accounts for about 15% of GDP, together with related services the cluster provides 22% of GDP. However, oil and gas is responsible for only about 3% of employment and a small fraction of the overall number of companies. At the same time, because of the large share in intermediate consumption and in investments, the impact of the industry on the economy via multiplier effects is much stronger than 25%. In terms of banking business, however, the oil and gas sector has not been significant: it accounts for only about 4% of the Kazakh banking system's loan portfolio. Instead, the sector attracted capital through FDI. Despite undeniable strengths, such as a rich resource base and growing demand from Asia, sector growth may face some obstables coming from political interference, price volatility and long and difficult site development.

Metals production and **manufacturing** are the other strength of Kazakhstan's economy thanks to rich endowment as well as accumulated engineering skills. The sector will also profit from strong demand from China and government infrastructure projects (see below). At the same time, the low quality of rolled metal makes it difficult to withstand competition, in particular from Russia and China. The authorities' intention to move to higher value added production will contribute to the further development of the sector. In particular, uranium production is an opportunity: Kazakhstan possesses 19% of the proven global uranium deposits; it also has

Loans by industry (Sep. 2010)



Source: National Bank of Kazakhstan, ATF Bank Research qualified personnel and developed mining facilities. Yet, the general work conditions and environmental safety, as well as some missing links in the production chain, create some uncertainty regarding the sector's development.

Kazakhstan also possesses comparative advantages in **agriculture and food** production and is among the tenth largest wheat exporters in the world. However, there is a strong need for upgrading technologies, facilities and procedures for storage, transportation, processing and packaging. Weak sanitary control, high production costs (notably in sugar and dairy) and expensive transportation hinder the sector's competitiveness.

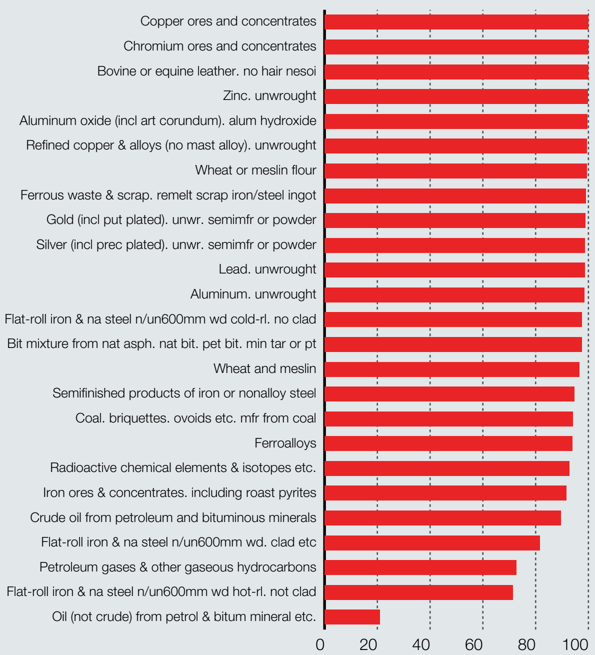
Infrastructure and **power-station construction** will be growing in significance in the coming years due to large government programmes. Projected budget spending in 2011–2013 within the "Program of accelerated industrialisation and modernisation 2010–2014" amounts to KZT 1745 bn (EUR 9.2 bn), with KZT 708 bn of this for "transportation strategy" (which includes Western Europe – Western China corridor) and KZT 586 bn going to agriculture. Railroads will be a focus of upgrading, particularly terminals and rolling stock.

Metal products, some branches of **engineering**, some branches of **chemicals, pharma** and **petrochemicals** have some opportunities because of the government's intention to move to higher value added production. Even though these industries currently have weak comparative advantages, there is some space for their development through import substitution, supported via local content policies and the establishment of joint ventures (e.g. car and locomotive assembly).

Real estate, construction (other than infrastructure) and in part **trade** will remain important areas in the long-term as recipients of rents from the resource economy, but they look less promising for the next couple of years. After exceptionally high lending growth in these sectors in 2006–2007, there was a need for deleveraging, which is still ongoing. Construction and trade account together for more than 40% of the banking system's loan portfolio and for almost 50% of overdue loans. This makes new financing difficult and slows growth in these fields.

To summarise, although resources provide the basis for Kazakhstan's economy, infrastructure development will matter greatly in the coming years, and there is room for some diversification into other sectors. Also, with the oil & gas sector's marginal dependence on domestic bank lending, future credit demand depends on the non-oil economy.

Kazakhstan's strongest sectors (with over USD 100 mn in foreign trade volume; by 2009 revealed comparative advantage: readings above 0%)



Source: Customs Committee of Kazakhstan, ATF Bank Research

Kazakhstan's weakest sectors (with over USD 100 mn in foreign trade volume; by 2009 revealed comparative advantage: readings below 0%)

Source: Customs Committee of Kazakhstan, ATF Bank Research

Kazakhstan – Structural Indicators (2009, unless otherwise stated)

SECTORS	Number of employed[1]	Number of legal entities	Share in VA %
TOTAL	**8,468**	**298,028**	**100.0**
Agriculture, forestry	**2,311**	**13,221**	**6.2**
Fishery	**15**	**422**	**0.1**
Mining	**198**	**1,986**	**18.1**
Manufacturing	**571**	**20,776**	**11.0**
Food industry incl beverages	104	n.a	n.a
Tobacco products	n.a	n.a	n.a
Textile sowing	21	n.a	n.a
leather industry shoe making	2	n.a	n.a
Timber	3	n.a	n.a
Cellulose	14	n.a	n.a
Coke, nuclear products	19	n.a	n.a
Chemical industry	22	n.a	n.a
Resin and plastics	8	n.a	n.a
Other non-metal mineral products	54	n.a	n.a
Metal industry	177	n.a	n.a
Machinery	48	n.a	n.a
Electrical appliances	18	n.a	n.a
Transport Equipment	63	n.a	n.a
Other	8	n.a	n.a
Power gas water distribution	**171**	**1,696**	**1.8**
Construction	**552**	**38,146**	**8.0**
Trade, auto repair	**1,171**	**99,470**	**12.4**
Hotels restaurants	**102**	**3,245**	**0.9**
Transport communication	**586**	**14,254**	**n.a**
Transport	**433**	**n.a**	**8.4**
Communication	**154**	**n.a**	**2.8**
Finance	**97**	**6,727**	**5.0**
Real estate	**394**	**45,315**	**16.1**
Government	**373**	**9,775**	**2.0**
Education	**770**	**15,058**	**3.3**
Healthcare and public services	**351**	**6,104**	**1.8**
Utility and other services	**221**	**21,831**	**2.0**

Note:1) All sub-categories in manufacturing sector data are as of 2008

Source: Statistics Agency of Kazakhstan

Poland – Global relocation and internal strengths

2011 Best, Stable and Worst sectors

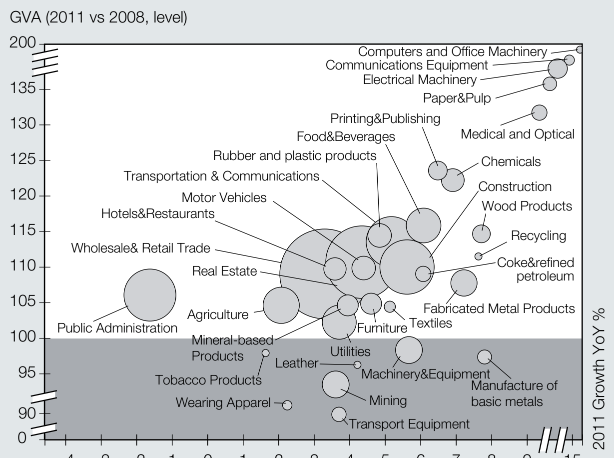
Best		Stable		Worst	
Paper and Pulp	Above-average growth in VA driven by multinationals dominating the industry; strong and relatively stable profitability; cyclical recovery in demand from industrial clients (more stable demand from individuals)	Agriculture	Strong competitive position in EU but relatively low profitability	Mining	Highly volatile financial results and low competitiveness
Computers and Office Machinery	Best performer in VA growth driven by foreign investments (production relocation by global manufacturers); strong competitive position on the EU market due to low labor costs and weak zloty	Food, Beverages and Tobacco	Strong competitive position in EU but relatively low profitability. For Tobacco, some issues related to rising taxation and illegal imports	Textiles	Declining industry, due to structural inability to compete with Asian products
Electrical Machinery	Above-average growth in VA, high penetration with FDIs, generally stable and high profitability	Printing and Publishing	Mature stage with moderate growth potential; challenged by competitors such as TV, free press and Internet; solid profitability (also during the crisis)	Wearing Apparel	Declining industry, due to structural inability to compete with Asian products
Communications Equipment including Semi-Conductors and TVs	Strong growth in VA driven by FDIs (European leader in the production of LCD TVs); gradual recovery in the EU and domestic consumption	Refined Petroleum, Coke and Nuclear	Stable growth in VA and financial performance; significant part of production used as inputs by other industries; stability of supplies and prices of raw materials represent an issue to monitor	Leather Footwear	Declining industry, due to structural inability to compete with Asian products; shoe manufacturing a positive exception competing with cheap imports
Medical, Precision and Optical	Above-average growth in VA; high penetration with FDIs; generally stable and high profitability	Rubber and Plastics Products	Stable growth in VA as well financial performance with significant part of production used as inputs by other industries; stability of supplies and prices of raw materials represent an issue to monitor	Wood Products (exclude furniture)	Existing comparative advantages (labor intensive industry) and favorable FX to support export-driven growth and more stable longer-term outlook; obstacles related to increasing prices and accessibility of wood as well as the financial problems of parent companies conditioning short term outlook (worst)
		Chemicals	Significant part of production is used as inputs by other industries; stability of supplies and prices of raw materials represent an issue to monitor	Basic chemicals	Eroding competitiveness and structural problems of some state-owned companies
		Mineral-based Products (non-metalic)	Large-scale Infrastructure projects financed from the EU funds and growing utilities investments (obsolete infrastructure and increasing environmental requirements); stagnation in residential	Manufacture of basic metals	Highly cyclical industry; performance of some steelworks determined by the situation of their owners, which in many cases is not good (short term outlook worst); more stable prospects longer term

Best	Stable		Worst	
	Machinery, Equipment, Appliances	Highly penetrated with FDIs and focusing on exports (comparative advantages thanks to low cost and flexible labor force); consistent, solid financial results also during the crisis but highly diversified in terms of financial situation and performance	Fabricated Metal Products	Highly cyclical industry with performance of some steel-works determined by the situation of their owners, which in many cases is not good (short-term outlook worst); more stable prospects longer term
	Motor Vehicles, Trailers and Parts	Performance influenced by volatility of EU market	Transport Equipment	Dependent on recovery in global investments
	Recycling	Stable outlook but very immature stage of development	Furniture, Jewelry, Toys, Musical, Other Goods	Existing comparative advan-tages (labor intensive industry) and more stable longer-term outlook; financial problems of parent companies conditioning short-term outlook (worst)
	Utilities	Consistent, solid financial results but relatively low growth in GVA; ongoing consolidation of the utilities sector should assure cost benefits; may also reduce competition increasing pricing power		
	Construction	Large-scale Infrastructure pro-jects financed from EU funds (cumulated before Euro 2012) and growing utilities invest-ments (obsolete infrastructure and increasing environmental requirements); stagnation in residential construction		
	Wholesale and Retail Trade	Stable growth in domestic consumption; generally low but stable profitability; increasing domination of large retailers (e.g. Real, Tesco, Auchan) and discounts a danger for small stores		
	Hotels and Restaurants	Solid and steady investment growth (projects started before the crisis and those connected with EURO 2012); relatively stable profitability; general under-development of the local base		
	Transport, Storage and Tele-communication	Growth in telecommunication driven by increasing internet usage and telecom-media convergence; recovery in foreign trade stimulates de mand for transport/logistic services; unesolved structural problems of some state-owned operators (PKP, LOT)		
	Real Estate and Business Activities	Fast growth in shared service centers and business process outsourcing and off-shoring centers (BPO&O); positive spill-over from the increasing de-mand derived from the fast developing medium/high tech sectors within the manu-facturing Industry		

Source: Pekao Research

Poland remains one of the fastest developing economies in Europe. After being the only EU country to resist the crisis in 2009 (GDP grew by 1.7% yoy), its economy rose even more significantly last year (preliminary estimates point to 3.8% yoy growth) and is expected to continue its acceleration trend this year as well (growth projected at 4.4% yoy). There are several factors that allowed Poland to sustain economic growth in a time of deep global economic slowdown. Its strong reliance on the large internal market (exports amount to only 39% of GDP) turned out to be the most important safety buffer. Additionally the country did not suffer that much from deteriorating external demand, as the depreciating zloty considerably increased the competitiveness of Polish exporters. For the same reason local producers competed more effectively with importers on their home market, which all resulted in a solid positive contribution of net exports to economic growth. At the same time a significant fall in corporate investment was to a large extent offset by infrastructure projects, that are financed mainly from the EU funds and spurred by the forthcoming EURO 2012 tournament. Finally, Poland is still able to attract large foreign investment. The local economy is a clear beneficiary of the continuing relocation of global production, increasing its competencies in increasingly sophisticated industries. Investment projects, which started a few years ago, are now drivers of sudden production increases in some medium- and high-tech sectors (especially in the production of computer and communication equipment or consumer electronics), which is followed by the development of numerous R&D centres of global companies. In recent years Poland has also become a desired location for numerous Business Process Outsourcing (BPO) centres. Offering a vast pool of skilled labour, the country is now shifting to more advanced Knowledge Process Outsourcing (KPO) services, specialising in areas such as data search and analysis, market research, financial research & analysis or healthcare & life science.

Value added by sector (real terms)



Source: Pekao Research, UniCredit CEE Strategic Analysis

During the crisis most of Poland's economic sectors performed better than their CEE peers. This was especially visible in the case of the Construction and Manufacturing sectors. The first was supported by infrastructure projects, which helped it to sustain stable growth, although in other EU countries construction even recorded double-digit declines. The latter sector was much more immune to the global economic downturn, as it benefited from solid domestic demand and production kick-off in some new local factories operated by multinational players.

The Polish economy still has strong fundamentals for its further growth, however the short-term outlook of particular sectors is diverse. Within manufacturing these disparities result from different patterns of business cycles (especially in their recovery stage).

One of Poland's success stories is the spectacular development of the **electronic and electrical equipment** industry, where within only a few years Poland has been transformed from a peripheral producer into a large net exporter. The country has recently attracted numerous foreign investments in medium/high-tech industries (such as consumer electronics, office or telecommunication equipment), as it is a popular destination of production relocation by multinational companies (e.g. LG Phillips, Toshiba, Funai, Sharp, Dell). All these sectors are strongly export-oriented and in some business areas (e.g. LCD TV sets) Poland has become a main production base for the EU market. Supported by the weak zloty, local producers were able to increase their profitability in 2009, despite reduced sales volumes on the contracting EU market. In 2010 they remained strongly competitive, which helped them record solid growth in export sales. The gradual revival of Western European markets and other production kick-offs in newly-built factories will help the aforementioned industrial sectors to outperform the economy in 2011 as well. An additional strength of producers of electronic equipment is the relatively high and stable profitability.

Another industrial sector that shows a strong resilience to an economic slowdown is the production of **medical, precision and optical equipment**. It is represented mainly by relatively small and highly specialised companies (among which many are foreign-owned). During the crisis the sector was able to sustain high profitability and currently is also returning to its previous dynamic development path, especially as its domestic market still offers significant untapped growth potential.

Among the best performers there is also a place for the **pulp & paper** industry, which during the entire decade showed high profitability and above-average value added growth. During that time it has attracted a large amount of foreign investment by multinationals (International Paper, Mondi, Arctic Paper) that dominate the sector. Its short-term outlook is still very positive as recovery of the European economy should stimulate higher industrial demand, whereas individual demand remains generally strong and stable.

Most sectors of the Polish economy have a generally good and stable outlook, which does not mean they avoided some problems during the economic slowdown. A variety of economic activities causes some of them to turn in a much better performance than the others and in our view members of this group are on the verge of being assessed either as best or worst performers.

The service sectors have especially high growth potential, but as their growth has recently decelerated, on a short-term perspective they are generally perceived as stable performers. Growth in **hotels and restaurants** is propelled by the dynamic development of the domestic infrastructure, including that associated with the organisation of the EURO 2012. Its positive effects will be however more visible in 2012, although expected recovery of demand from the corporate sector should gradually limit a visible overcapacity in this field already in 2011. The perception of the **transport, storage and telecommunication** sector is ambiguous due to its diversity. The communication segment has the best outlook due to increasing internet penetration and positive effects of telecom-media convergence. Consistent recovery in trade exchange will stimulate growth in the transport/logistics segment; however tight competition results in significant margin erosion. Additionally in some segments (rail transport, air transport, postal services) large state-owned operators (PKP, LOT, Poczta Polska) struggle with long-standing structural problems.

The **food, beverages and tobacco** industry is a mixture of processing activities characterised by constant growth and stable but relatively low profitability. Within this category some segments outperform in terms of revenue and value added growth, which is largely driven either by the legal environment (biofuels) or rising foreign demand (meat and fish processing). On the other hand, the beverage and tobacco sectors are distinguished by their above-average profitability. The development of many segments is supported by foreign capital, which is especially widely represented in brewery (Heineken, SAB Miller, Carlsberg), non-alcoholic beverages (Coca-Cola, PepsiCo), tobacco (Phillip Morris, BAT, House of Prince) and the other food processing segment (Nestle, Masterfoods, Unilever, Ferrero, Cargill). The cumulative value of FDIs in the Polish food industry amounts to ca. EUR 8 bn, which accounts for 20% of foreign capital invested in the domestic manufacturing sector. In the long term, the positive outlook for the food industry stems from the dynamic growth of household incomes and the high competitive advantages of Polish food producers as well as their increasing recognition on the EU market. On the other hand, the tobacco industry will experience increasing growth barriers (resulting from excise tax increases, spreading smoking bans and changing social habits).

Production of **chemicals and pharmaceuticals** is another complex sector comprised of diverse business segments with various growth prospects. During the crisis cyclical slowdowns in some of them (e.g. basic chemicals, construction chemicals) were compensated for by strong performance of the others (pharmaceuticals or consumer chemicals like cosmetics and detergents). On the aggregate level, the chemical industry is characterised by its stability as well as average growth and profitability. In addition, the basic chemicals segment is also widely represented by foreign producers – especially in consumer chemicals production (Procter&Gamble, Unilever, Reckitt-Benckiser, L'Oreal, Avon), the paint industry (Akzo Nobel, PPG Industries) and the pharmaceutical sector (GlaxoSmithKline, Sandoz, Sanofi-Aventis, TEVA).

A couple of years ago the production of **motor vehicles** was a real star among Polish manufacturing sectors – but is now influenced by high volatility of the EU market, as over 95% of domestic vehicle production is sold abroad. It did not suffer that much from the EU market contraction in 2009 owing to government scrap programmes that sustained high demand on small cars produced in Poland. On the other hand their abandonment in 2010 resulted in temporary production stoppages in Polish car factories. Already highly penetrated by foreign capital, the industry does not attract as much FDI as recently. For this reason a previous strong growth stimulus in the form of new factory production will instead lose its momentum. Nevertheless, the domestic sector remains a competitive production base for the large EU market and certain plants belong to the most effective ones within their global companies. Political decisions on the location of a particular car model's production may however become a potential danger for the domestic industry in the medium term (e.g. new Fiat Panda production recently moved to Italy).

The Polish **construction** sector remained relatively strong during the crisis, as the only one in the European Union to sustain slight production growth in 2009. It was primarily stimulated by infrastructure projects financed from the EU funds (mainly transport infrastructure and other public objects like schools or sports halls), which compensated for production declines (still lower than in the majority of the EU countries) in underperforming residential and commercial segments. In 2010 the sector was affected by an unusually long and cold winter, however statistics on the number of issued building permits indicate no decline in the commercial and infrastructure segment and even the first signs of recovery in residential construction. Still, more significant growth of this industry is not expected before 2012.

Utilities in Poland is a stable industry with strong long-term growth potential. The energy segment is now undergoing complex restructuring, privatisation and deregulation processes, but their slow progress hampers more dynamic growth of the industry. It does, however, bring some positive effects of sector consolidation such as cost reduction and increasing pricing power of producers. As investment needs of this sector are huge (due to a tense supply situation and too strong reliance on coal) it is expected to develop quickly within the next decade, but the most important projects are still suspended or in a very early stage.

Among the worst performers are industries that struggle with many serious structural problems such as underinvestment, overemployment, declining market or definite loss of competitive advantages. Many problems of companies from these sectors are intensified by long-standing inactivity of their state owners.

Coal-mining and quarrying is the industry that suffers from decreasing value added, which is caused by low competitiveness on the global market. The Polish energy sector's high coal reliance assures stable internal demand (with non-market prices supporting the state-owned mining sector), but partial dependence on exports makes the mining business very volatile due to low market power of Polish producers. Potential improvement in the sector's cost effectiveness requires huge investment that is not possible due to the lack of sufficient funds (banks are generally reluctant to finance the industry). Only Jastrzebska Spolka Weglowa, which concentrates on coking coal production (no.1 European producer), seems to have higher potential, as it mainly supplies the steel industry and records quite satisfactory financial results.

Highly labour-intensive light industry (**textiles, wearing apparel and leather industry**), is consistently losing a competitive race with low-cost producers from Asia. In better shape are generally those textile companies which have outsourced manufacturing of their own brand products to low-cost countries and concentrate only on effective marketing on the domestic and nearby markets. A general exception is shoe producers who are able to compete more effectively with cheap imports, for which reason we regard this segment as quite stable.

Producers of **basic chemicals** are the only chemical segment that may underperform in the coming years. Its increasing problems are mainly due to limited access to key resources that erodes their competitiveness against low-cost producers. High reliance on Russian gas, prices of which are artificially linked to oil prices, results in highly volatile profitability of this business. The industry is strongly oriented toward weak outlook and declining segments such as fertilisers or some other inorganic chemicals. The sector also suffers from general underinvestment as well as a chronic lack of production assets in some potential business areas (e.g. particular polymers). State ownership of the largest companies (unsuccessful privatisation attempt in 2010) contributes to some other typical problems such as overemployment or high indebtedness.

Poland – Structural indicators (2008)

SECTOR	MARKET STRUCTURE		
	Number of Enterprises (in 1000)	Number of employed (in 1000)	Number of SME (in 1000)
TOTAL	**3,757**	**14,037**	**3,752**
Agriculture, Hunting, Forestry, Fishing	**96**	**2,142**	**96**
Mining & Quarrying	**3**	**185**	**3**
Manufacturing	**372**	**2,705**	**370**
Food products, beverages and tobacco	31	465	31
Textiles and textile products	48	225	47
Leather and leather products	9	32	9
Wood and wood products	40	145	40
Pulp, paper & paper products; publishing & printing	34	146	34
Coke, refined petroleum products & nuclear fuel	0	16	0
Chemicals, chemical products and man-made fibres	5	108	4
Rubber and plastic products	15	174	15
Other non-metallic mineral products	21	146	21
Basic metals and fabricated metal products	58	383	58
Machinery and equipment n.e.c.	23	220	23
Electrical and optical equipment	31	210	31
Transport equipment	10	213	10
Manufacturing n.e.c.	46	222	46
Electricity, Gas & Water	**5**	**214**	**4**
Construction	**425**	**840**	**425**
Wholesale & Retail Trade	**1,136**	**2,269**	**1,136**
Restaurants & Hotels	**115**	**276**	**115**
Transportation & Communications	**269**	**809**	**269**
Financial Intermediation	**137**	**346**	**137**
Real Estate and Business Activities	**634**	**1,133**	**634**
Public Administration and Defense	**27**	**919**	**26**
Education	**97**	**1,039**	**97**
Health and Social Services	**175**	**748**	**174**
Social and Personal Services	**267**	**414**	**266**

SECTORAL DETAILS				COMPETITIVENESS			CONSTRAINTS	
Share in total VA %	Share in total FDI %	FDI Attractive-ness %	Capital Intensity %	RCA	Labour productivity (Manufacturing = 100)	Average Personnel costs, (Manufacturing = 100)	Total Indebted-ness, %	Bank Indebted-ness, %
100.0	100.0	100.0	19.5	100	103.1	108.7	41.5	12.6
3.7	0.5	12.8	11.1	n.a	25.3	108.7	22.9	7.7
2.5	0.2	7.3	20.0	423	193.7	200.3	22.8	2.2
18.7	31.1	166.1	23.9	98	100.0	100.0	46.9	14.1
2.8	4.8	170.7	25.7	94	87.3	90.8	50.4	17.0
0.8	0.3	34.7	8.4	110	52.2	61.4	50.0	12.3
0.1	n.a	n.a	8.1	122	43.0	62.0	44.5	12.2
0.7	n.a	n.a	20.8	202	68.6	71.9	47.6	24.2
1.4	3.1	222.1	20.5	83	137.3	119.5	44.2	13.1
0.8	0.1	10.3	43.8	13	707.2	216.6	44.3	25.8
1.2	3.2	262.4	29.5	87	160.8	142.8	31.1	9.8
1.1	2.3	203.9	34.9	94	94.5	98.7	47.1	13.6
1.4	n.a	n.a	31.8	96	136.1	105.8	38.3	11.4
2.8	4.5	162.7	22.1	132	104.8	104.6	44.9	12.6
1.5	1.7	113.3	17.5	82	97.8	114.4	52.5	10.4
1.5	1.0	67.4	16.8	97	103.6	109.9	53.2	12.6
1.6	4.6	282.4	26.7	127	110.1	123.5	55.4	8.6
1.0	n.a	n.a	16.2	230	68.0	78.3	51.6	16.1
3.2	3.6	110.9	43.3	18	219.3	152.4	19.1	5.6
7.6	2.2	28.3	30.4	n.a	131.3	92.1	54.1	15.7
18.0	16.5	91.4	10.7	n.a	115.1	89.9	55.5	13.3
1.2	0.5	37.4	18.7	n.a	64.7	68.0	40.3	23.1
7.0	6.1	86.8	23.0	n.a	125.6	113.6	39.4	10.8
5.3	19.3	367.0	9.2	n.a	219.7	186.6	70.2	25.3
13.9	17.4	125.5	25.0	n.a	177.0	113.4	30.0	13.5
6.0	n.a	n.a	8.3	n.a	93.8	140.4	n.a	n.a
4.7	n.a	n.a	11.1	n.a	65.9	109.5	29.9	9.2
3.8	n.a	n.a	12.8	n.a	72.8	106.0	43.1	18.3
3.8	0.6	16.7	30.5	n.a	134.2	100.4	38.2	13.5

Source: Concise Statistical Yearbook of the Republic of Poland 2009, Central Statistical Office, National Bank of Poland, Pekao Research

Romania – Export-led recovery is supportive but structural weaknesses persist

2011 Best, Stable and Worst sectors

Best		Stable		Worst	
Wood Products (exclude furniture)	Strongly export-oriented sector, representing around 3% of total exports	Agriculture	Unaffected by global crisis but suffering some delays in structural reforms; some support from EU funds till 2013	Mining	Declining trend since a few years with exception for extraction of crude petroleum and natural gas (= ~70% of total mining) influenced by regulated prices (rather stable outlook) and some investment projects of major players (OMV Petrom to invest EUR 135 mn in gas extraction)
Rubber and Plastics Products	On a recovery path since 2010; sector correlated with the car-components industry, which is expected to further boost next year (German tire maker Continental to invest EUR 70 mn to expand local plant)	Food and Beverages	One of the biggest manu-facturing industries (6.2% of total VA); less impacted by the downturn but still dreclining in 2009–2010	Tobacco Products	Negatively influenced by regulatory changes and hike in excise duties
Chemicals	Export-oriented industry with stable outlook; pharma sector with better outlook (Best)	Paper and Pulp	Might also be some positive side effects from Romania's well-performing wood pro-duction industry (through diversification of investment in related industries)	Textiles	Declining sectors
Manufacture of basic metals	Country ranked 13th in steel production in EU; some investment projects announced for the near future; local aluminum producer Alro, controlled by Russian owners, managed to receive a EUR 180 mn syndicated loan managed by EBRD, which contributed with USD 75 mn to the total sum	Refined Petroleum, Coke and Nuclear	Planned investment projects provide ground for stable outlook; OMV Petrom estimates its offshore crude oil production will rise by 300,000 boe this year following new technologies developed for two of its oil blocks in the Black Sea	Wearing Apparel	Declining sectors
Electrical Machinery	Strong growth in 1H 2010 and sector already above pre-crisis levels, thanks to multi-nationals relocation of production toward Romania in search of efficiency; further production transfers along the value chains of products such as vehicles, durables, other electrical equipments expected	Fabricated Metal Products	Still contracting in 2010, but stabilisation expected	Leather Footwear	Declining sectors
Motor Vehicles, Trailers and Parts	Further production transfers along the value chains of pro-ducts, given competitive advantages driven by lower costs of production	Machinery, Equipment, Appliances	Competitive advantages for low production costs	Printing and Publishing	No much room for fast recovery unless some innovatory changes might appear for lower cost-efficiency production

Best		Stable		Worst	
Utilities	Less affected than other sectors, showing even a strong positive evolution in 2009 and 2010; room for consolidation and efficiency, new opportunities	Computers and Office Machinery	Competitive advantages for low production costs	Mineral-based Products (non-metalic)	Strongly correlated with construction industry
		Communications Equipment including Semi-Conductors and TVs	Competitive advantages for low production costs. This industry is also export oriented, being in the chain of European manufacturing	Transport Equipment (excluding Motor Vehicles)	Strongly declining during 2010 (–38%) with still risky outlook, despite some possible investments in near future
		Medical, Precision and Optical	Competitive advantages for low production costs	Construction	Severely under pressure; some support for infrastructure will derive from EU structural funds and government support plans
		Furniture, Jewelry, Toys, Musical, Other Goods	Recovery started in 2H 2010, led by export demand, expected to remain the driver untill local demand recovers	Wholesale and Retail Trade	Overall retail sales down in 2010 (worst), but some subsegments have performed very well (e.g. pharma or fuel retail)
		Recycling	Strongly declining in the last couple of years but some stabilisation expected	Real Estate and Business Activities	Still severely under pressure
		Hotels and Restaurants	Services in general affected by declining disposable income but stabilisation expected with long-term improvement driven by current unused potential		
		Transport, Storage and Telecommunication	Services in general are affected by declining disposable income but stabilisation expected		
		Public Administration and Defense	Fiscal tightening negatively influencing government-related sectors such as Education or Health and Social Service and Public administration		
		Education	Fiscal tightening negatively influencing government-related sectors Isuch as Education or Health and Social Service and Public administration		
		Health and Social Services	Fiscal tightening negatively influencing government-related sectors such as Education or Health and Social Service and Public administration		
		Social and Personal Services	Fiscal tightening negatively influencing government-related sectors such as Education or Health and Social Service and Public administration		
		Private Household Services	Fiscal tightening negatively influencing government-related sectors such as Education or Health and Social Service and Public administration		

Source: UCT Research, UniCredit CEE Strategic Analysis

A scenario of prolonged recession materialised in Romania during 2010. The fiscal austerity measures enforced last summer accentuated the negative output gap and resulted in an estimated contraction of –2.5% yoy last year. The decoupling of the Romanian economy from regional and EU recovery was mainly driven by local factors. The country is just now facing the harming effects of a pro-cyclical fiscal policy that was employed during the last couple of years. Very weak domestic demand has been hit hardly by a tighter fiscal policy and austerity measures. Furthermore, relatively high inflation driven by the VAT hike and international food price shocks left no more room for monetary policy to support the economy through lower interest rates.

Looking ahead, the good exports dynamic is expected to provide some relief but Romania's economy is expected to continue to underperform relative to the rest of the region (with GDP growth projected at 1.7% yoy for this year).

The necessary structural reforms in Romania are strongly supported by post-accession EU structural and cohesion funds with total allocation amounting to EUR 27 bn to be absorbed by 2013. The absorption rate based on approved contracts was 90.83% (EUR 7.9 bn) in September 2010, which is a considerable improvement from 57.3% in September 2009 while the cash-based absorption rate calculated by the actual funds that reached the final recipient is still considerably lower at 13.5%. Infrastructure projects amounting to EUR 5.6 bn (including the Romanian government's contribution) represent one of the most important components of these allocations. Moreover, the government endorsed a EUR 4 bn infrastructure upgrade programme for the period 2011–2015 for rehabilitation of local roads, the development of 100 water distribution and sewage projects and co-financing of other projects initiated by local administrations.

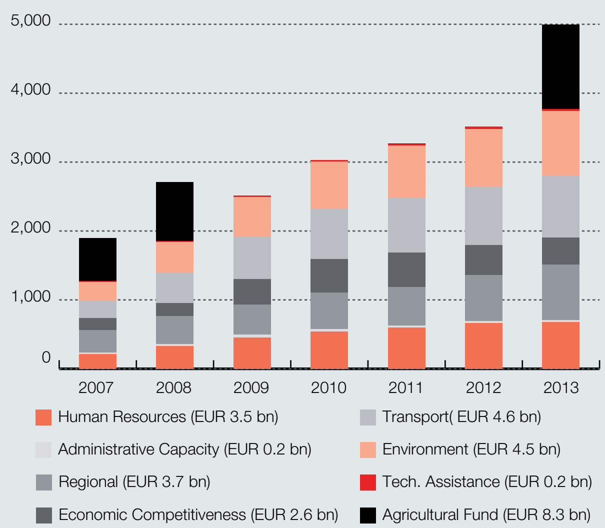
Sectors strongly related to export activities, such as **wood products, manufacturing of basic metals, electrical equipments, motor vehicles, trailers and parts** performed exceptionally well during 2010. Two industries, the electrical machinery and the motor vehicles, trailers and parts industries experienced one of the strongest rebounds during 2010 (above 30%) following the successful performance of the previous year, when they increased their share in total Romanian exports from 5% to 8% and from 13% to 16%, respectively. The positive trend has been driven by multinationals moving production to Romania for cost reasons. Export performance has remained strong despite the end of scrap incentives in EU markets. We expect the positive trend to continue (although at a somewhat slower pace) with further production transfers along the value chains of products, given the competitive advantages driven by the lower costs of production.

Several other industries which function as suppliers to these two major sectors – such as **rubber and plastics** or **basic metals** performed well last year and the positive trend is expected to continue in 2011.

The **wood products** industry has been performing well throughout the crisis with good potential still to exploit, given the widespread availability of natural resources (forests cover more than 25% of the country's territory).

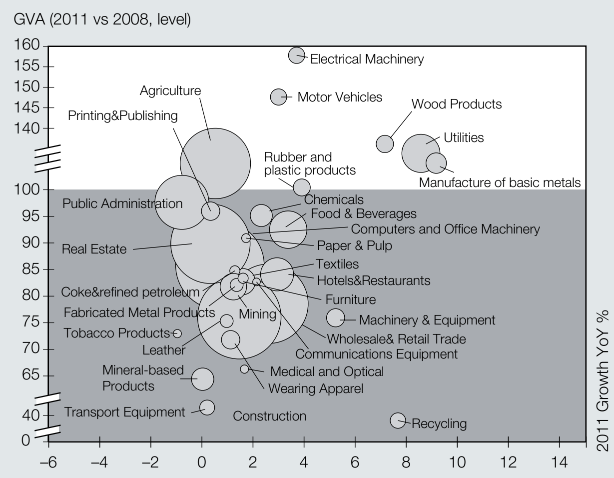
Utilities have been less affected than other sectors, even showing strong positive development in 2009 and 2010. There is still room for consolidation and efficiency with good opportunities, particularly in renewable energy and bio-fuel, for which several projects already have been announced. Among the announced investment plans, the power group Enel signed an agreement with Romanian energy group Elcomex to develop a 272MW wind farm in Dobrogea (worth more than EUR 400 mn), German E.ON energy company plans

Evolution of post-accesion funds (2007–2013, 27 bn €)



Source: European Commission

Value added by sector (real terms)[1]



Note: 1) Size of the ball = value added in billion USD

Source: UCT Research, UniCredit CEE Strategic Analysis

to develop three wind farm projects (estimated at EUR 200 mn) also in northeastern Romania, and Verbund and Martifer have two separate wind power projects in the county of Tulcea with a combined installed capacity of 240 MW (EUR 360 mn in investment). EnergoNuclear, the company that is developing reactors 3 and 4 of the Cernavoda nuclear plant, has opened the tender for works necessary for commissioning the nuclear power production facilities of 720 MW each (estimated at EUR 3.2 bn).

Several industries have been evaluated as stable this year from different perspectives. **Agriculture** is among the least affected by the global crisis but suffering some delays in structural reforms and is strongly weather-driven. Some support might come from the EUR 8.3 bn allocated from EU funds until 2013, which are expected to accelerate structural reforms such as the consolidation of farming land. Despite the strong potential, these developments proved to be very slow and we maintain a rather stable outlook for the sector. **Food and beverage** is one of the biggest manufacturing industries in Romania (accounting for 6.2% of total value added). Despite the lower price elasticity relative to other categories (e.g. durables), the sector has been on a declining trend both in 2009 and 2010 and is expected to be influenced by the still weak dynamic in consumption expected for this year.

Industries with higher value added, such as **machinery and equipment, computers and office machinery**, and **communications equipments** are closely tied to the global recession with a disastrous 2009–2010 and not much investment expected in 2011.

Wholesale and retail trade has been negatively impacted by the collapse in domestic consumption, although some sub-segments have performed very well, such as pharmaceutical or fuel retail and differentiation among sub-segments is expected to persist this year as well.

Some industries have been undergoing structural changes during the last couple of years with no clear outlook for recovery in the near future. The **mining and quarrying** sectors have been in a continuous decline over the last four years. However, the still significant weight of thermoelectric energy based on coal (24% in 2008) probably will continue to be supplied mainly from internal coal production (69% of the total in 2008). This can be translated into further reorganisation and modernisation of these sub-sectors which, however, requires significant investment. Overall, despite the unexplored potential, the prospects for the mining and quarrying sectors remain negative at the current stage due to their lower competitiveness on international markets and strongly regulated prices. The situation is better for **petroleum and gas extraction**. Petrom (owned by OMV Austria) is the main exploiter of oil reserves, while state-owned Romgaz is the main natural gas extractor and producer. The gas supply from internal sources represents around 64% of the country's total needs.

Cost advantages continue to play a major role in shaping Romania's international attractiveness, but over the last decade the country has lost significant ground in lower value-added sectors such as **textiles, wearing apparel** and **leather**. As most of the foreign investors in these sectors use outsourcing contracts, exit costs from the market are low and foreign players move easily, searching for even lower costs in less developed countries. However, exports of textiles and leather products are still important, representing 14% of the country's total exports.

Some industries such as **construction** and **real estate** have been **hard hit** by the global crisis and further contraction is still in the cards. Some support for infrastructure-related projects might come from the EU structural funds and government support plans, however we consider them insufficient to support a full recovery of the industry this year. The **mineral-based products (non-metallic)** industry is strongly correlated with th construction sector activity. Consequently, after the significant decline in 2009–2010 there is not much hope for any significant recovery.

Romania-Structural Indicators (2008, unless otherwise stated)

SECTOR	MARKET STRUCTURE Number of enterprises	Number of employees	Number of SME
TOTAL	**554,967**	**4,620,671**	**546,244**
Agriculture	**13,602**	**118,349**	**13,568**
Mining	**1,083**	**85,708**	**1,061**
Manufacturing	**57,305**	**1,391,311**	**56,402**
Food and Beverages	9,593	205,067	9,468
Tobacco Products	16	1,618	14
Textiles	1,770	35,824	1,746
Wearing Apparel	5,867	207,629	5,697
Leather Footwear	1,938	72,709	1,886
Wood Products (exclude furniture)	7,950	73,003	7,922
Paper and Pulp	802	15,389	791
Printing and Publishing	2,460	20,682	2,453
Refined Petroleum, Coke and Nuclear	33	5,008	29
Chemicals	1,132	44,830	1,099
Rubber and Plastics Products	3,147	54,304	3,126
Mineral-based Products (non-metalic)	3,151	56,814	3,102
Manufacture of basic metals	495	52,723	466
Fabricated Metal Products	7,010	114,308	6,948
Machinery, Equipment. Appliances	1,467	68,993	1,407
Computers and Office Machinery	1,176	26,913	1,154
Electrical Machinery	802	48,631	759
Communications Equipment including Semi-Conductors and TVs	n.a	n.a	n.a
Medical, Precision and Optical	n.a	n.a	n.a
Motor Vehicles, Trailers and Parts	506	113,167	440
Transport Equipment (excluding Motor Vehicles)	356	41,017	333
Furniture, Jewelry, Toys, Musical, Other Goods	4,425	80,376	4,378
Recycling	3,209	52,306	3,184
Utilities	**2,872**	**166,657**	**2,746**
Construction	**59,389**	**554,399**	**59,194**
Wholesale and Retail Trade	**214,137**	**1.019,788**	**213,944**
Hotels and Restaurants	**23,653**	**139,476**	**23,631**
Transport, Storage and Telecommunication	**54,538**	**486,937**	**54,372**
Financial Intermediation	**6,840**	**83,609**	**n.a**
Real Estate and Business Activities	**93,428**	**459,898**	**93,231**
Public Administration and Defense	**n.a**	**n.a**	**n.a**
Education	**2,681**	**10,883**	**2,680**
Health and Social Services	**8,677**	**35,453**	**8,670**
Social and Personal Services	**16,762**	**68,203**	**16,745**
Recreational, Cultural and Sporting	4,990	26,120	4,978
Sanitation, Trade Organizations, Other Services	11,772	42,083	11,767
Private Household Services	**n.a**	**n.a**	**n.a**

Note: (1) 2007, (2) 2009

SECTORAL DETAILS				COMPETITIVENESS			
Share in Total VA[1], %	Share in Total FDI[2], %	FDI attractiveness, %	Capital intensity, %	RCA	Labour Productivity (Manufacturing = 100)[1]	Average Personnel costs (Manufacturing = 100)	Wage adjusted Labour Productivity (Manufacturing = 100)
100.0	**100.0**	**100.0**	**40.8**	**100.0**	**127.6**	**108.3**	**117.7**
6.5	**1.1**	**n.a**	**21.4**	**160.0**	**324.0**	**84.2**	**384.7**
1.5	**4.5**	**293.0**	**179.6**	**2.2**	**105.6**	**275.5**	**38.3**
23.6	**31.1**	**131.7**	**37.6**	**103.9**	**100.0**	**100.0**	**100.0**
6.2	4.1	66.3	30.4	29.7	177.9	90.7	196.2
0.1		n.a	n.a	n.a	309.6	n.a	n.a
0.7	1.4	50.3	16.2	44.6	114.5	79.4	144.2
1.1		n.a	23.8	n.a	30.4	n.a	45.6
0.4		n.a	19.8	158.1	35.4	69.4	50.9
1.0	1.9	110.6	71.6	343.8	78.6	63.8	123.2
0.4	n.a	n.a	31.5	23.9	157.1	97.2	161.5
0.6	n.a	n.a	25.6	n.a	173.7	110.2	157.6
0.9	6.3	154.4	n.a	265.0	1011.8	n.a	n.a
1.0		n.a	60.0	37.5	128.3	155.0	82.8
0.9		n.a	83.4	82.1	98.4	98.3	100.1
1.2	3.3	267.5	78.7	38.1	128.0	119.8	106.9
0.9	5.2	585.8	52.0	96.3	99.2	154.3	64.3
1.5	n.a	n.a	35.5	57.4	76.9	100.3	76.7
1.2	1.9	160.9	41.8	74.2	100.9	127.8	79.0
0.2	1.4	n.a	112.2	85.8	33.2	134.6	24.6
1.2		116.0	14.6	94.8	146.3	105.1	139.1
0.3		n.a	n.a	n.a	n.a	n.a	n.a
0.2		n.a	n.a	n.a	n.a	n.a	n.a
2.0	4.7	n.a	n.a	228.9	106.6	124.3	85.8
0.6		852.3	36.9	536.2	79.2	155.6	50.9
1.1	n.a	0.0	19.3	430.8	82.0	75.8	108.1
0.0	0.9	n.a	703.5	66.6	1.5	115.5	1.3
2.3	**5.8**	**250.2**	**121.2**	**2116.9**	**82.0**	**177.9**	**46.1**
10.3	**12.9**	**125.3**	**63.8**	**n.a**	**109.5**	**94.6**	**115.7**
11.7	**12.3**	**105.3**	**54.2**	**n.a**	**67.5**	**84.6**	**79.8**
2.1	**0.4**	**18.8**	**45.5**	**n.a**	**89.7**	**62.7**	**142.9**
11.8	**7.9**	**66.8**	**44.7**	**32.7**	**143.0**	**148.5**	**96.3**
2.2	**19**	**883.3**	**0.0**	**n.a**	**151.6**	**321.3**	**47.2**
13.3	**4.6**	**34.5**	**37.3**	**82.3**	**170.8**	**93.9**	**181.9**
5.3	**n.a**	**n.a**	**0.0**	**n.a**	**n.a**	**n.a**	**n.a**
3.3	**n.a**	**n.a**	**1.2**	**n.a**	**1,776.0**	**54.2**	**3,273.9**
2.8	**n.a**	**n.a**	**7.6**	**n.a**	**465.0**	**86.8**	**535.9**
3.2	**n.a**	**n.a**	**9.1**	**n.a**	**280.6**	**69.8**	**401.8**
1.6	n.a	n.a	n.a	n.a	n.a	n.a	n.a
0.8	n.a	n.a	n.a	n.a	n.a	n.a	n.a
0.1	**n.a**	**n.a**	**n.a**	**n.a**	**n.a**	**n.a**	**n.a**

Source: UCT Research, UniCredit CEE Strategic Analysis

Russia – Comparative advantages and competitive disadvantages to set the rules

2011 Best, Stable and Worst sectors

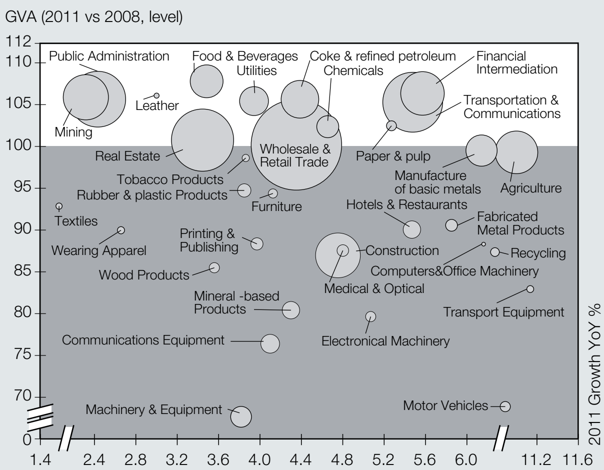
Best		Stable		Worst	
Mining	Robust and resilient demand on domestic and external markets, supported by diversified resource base	Agriculture	Adverse impact of severe droughts should fade in 2011–2012. Structural weaknesses constrain stronger growth	Textiles, Wearing Apparel and Leather Footwear	Rising imports competition to constrain post-crisis recovery
Food and Beverages	Resilient and growing consumer demand	Tobacco Products	Resilient and growing consumer demand, constrained by increasingly adverse regulation	Construction	Investment demand weakness intensified by overhang of unfinished projects from pre-crisis period
Refined Petroleum, Coke and Nuclear, and Chemicals	Robust and resilient demand on domestic and external markets, supported by general drive toward deeper domestic processing of mineral base	Wood Products (exclude furniture), Paper and Pulp, Fabricated Metal Products	Strong resource base constrained by volatility of domestic and external demand, as well as by unstable regulation. Potential long-term benefits from WTO accession	Education	General austerity of the budget framework should weigh on sector performance
Manufacture of basic metals	Strong resource base and stable external demand. Further potential long-term benefits from WTO accession	Printing and Publishing	Robust consumer demand support expansion, while high sensitivity to adverse shocks looms		
Motor Vehicles, Trailers and Parts	Government stimuli to the sector compound post-crisis recovery, rising imports competition to constrain further growth, long-term outlook is stable	Rubber and Plastics Products	Strong imports competition and exposure to the volatile automotive industry constrain further recovery		
Transport Equipment (excluding Motor Vehicles)	Planned expansion of government defense spending should compound post-crisis recovery but imports competition might constrain longer term growth (stable outlook)	Mineral-based Products (non-metalic)	Persistent weakness of construction materials industry to constrain broader recovery		
Utilities	Robust, resilient and growth domestic demand, optimistic tariff indexation outlook	Machinery, Equipment, Appliances, Computers and Office Machinery, Electrical Machinery, Communications Equipment including Semi-Conductors and TVs, Medical, Precision and Optical, Furniture, Jewelry, Toys, Musical, Other Goods	Strong post-crisis recovery is set to be increasingly constrained by imports competitio[illegible]		
		Recycling	–		

Best	Stable		Worst
	Wholesale and Retail Trade, Hotels and Restaurants	Robust, resilient and expanding consumer demand compound trend of increasing penetration of the modern format retail	
	Transport, Storage and Telecommunication	Resilient demand is likely to be constrained by the generally sluggish economic growth	
	Real Estate and Business Activities	Economic recovery to some revival in the sector, despite weak investment	
	Public Administration and Defense	–	
	Health and Social Services	Budget austerity likely to be partly offset by expansion of the commercial services sector, exposed to robust consumer demand	
	Social and Personal Services	–	

Source: UCB RU

The global economic crisis has dealt a major blow to the Russian economy. Hit by large-scale capital flight, falling oil prices and closure of all capital markets, Russia's economy followed the global one into deep recession, culminating in a sharp 11% yoy contraction in 2Q09. As early as the latter part of 2009, however, the global economy started to recover supported by the launch of massive monetary and fiscal stimuli in major developed countries. The Russian economy has also started to show signs of stabilisation and growth. In the initial stages of economic recovery, Russia gained support from robust external demand, mainly benefiting from its proximity to the booming Chinese market. However, in 2010 further growth faced increasingly strong headwinds from a strong rebound of imports, persistent weakness in investment demand as well as general austerity related to the budget. Furthermore, in 2010 Russia was hit by the worst drought in a century, which has dramatically cut agricultural output and further constrained the broader economy. As a result, general economic growth in 2010 also appears to have failed to impress, having expanded by an estimated 3.4% yoy.

Value added by sector (real terms)[1]



Note: (1) Size of the ball = value added in billion USD

Source: UCB RU

In the next couple of years, most of the constraints on Russia's economic development are set to fade, giving way to a more robust expansion as early as 2011. In particular, the supportive base effect for imports should reverse direction, triggering a slowdown in this indicator even despite continued growth. The government is also planning to be more generous ahead of elections in 2011–2012, including budgeting for a resumption of some infrastructure spending, which it has been cutting during 2008–2010. This move is also expected to support much more robust private investment spending.

However, we continue to expect that private consumption is likely to become the driver of Russian economic growth in the near and also in the more distant future. We believe that this trend is likely to get support from the rising tensions on the local labour market due to the continued decline of the population in Russia. Thus, a growing shortage of the working age population is expected to keep strong upward pressure on average wages, thereby supporting robust wage and income growth, even in the case of broader stagnation of the general economy.

Such a composition of major factors behind economic growth in 2011 is set to determine the economic potential of all corresponding sectors of the Russian economy. In particular, we think that exposure to robust and resilient domestic consumer demand is likely to benefit most related sectors, but at the same time should be partly offset by rising import competition for tradable sectors.

Among tradable sectors, we see **food production** among the best performing in the next several years. We note that the sector is relatively more protected from growing import competition by the sheer size of the Russian market, which by all standards is far from being saturated. Moreover, the large size of the market appears to draw robust FDI inflows, even despite healthy imports expansion, and we expect this trend to persist over the next several years at the very least.

On the other hand, both growing import competition and rising labour costs are likely to put increasingly strong adverse pressure on all other tradable sectors exposed to domestic consumer demand. In particular, proximity to a large supplier such as China prompts us to put such sectors as **textiles**, **apparel** as well as

leather under the "worst" category. We note that the importance of import competition is set to further expand, provided an increasing likelihood of Russia's WTO entry in the next one to two years.

However, in the near term, such rising pressure from imports is likely to be at least partly compensated for by the strong low base effect of a sharp 2009 slump. Moreover, an extremely strong low base effect in sectors such as **transport equipment** and **motor vehicles**, compounded by government stimuli programmes, is expected to bring about very strong recovery in the short to medium term, leading us to put them under the short-term "best" category, followed by "stable" in the longer term.

Non-tradable sectors, which do not face import competition, are also likely to be among those best poised to benefit from rising consumption. In particular, we expect **utilities** to continue to expand strongly, encountering robust growth of energy demand from recovering industries as well as an enriched population. **Retail trade, hospitality, transport and others** are also likely to benefit. However, the potential benefits from such expansion in

Russia – Structural indicators (2009 unless otherwise stated)

SECTOR	MARKET STRUCTURE		
	Number of enterprises[2]	Number of Employees[2]	Number of SMEs[2]
TOTAL	**n.a**	**68,489,000**	**300,120**
Agriculture	**230,800**	**6,806,000**	**20,879**
Mining	**17,200**	**1,040,000**	**1,472**
Manufacturing	**411,000**	**11,368,000**	**46,548**
Food & Beverages	56,800	n.a	n.a
Tobacco	n.a	n.a	n.a
Textiles	27,600	n.a	n.a
Wearing Apparel	n.a	n.a	n.a
Leater Footwear	3,200	n.a	n.a
Wood Products (exclude furniture)	35,900	n.a	n.a
Paper & Pulp	56,400	n.a	n.a
Printing & Publishing	n.a	n.a	n.a
Refined Petroleum & Coke	2,700	n.a	n.a
Chemiclas (ecxlude powder & explosives)	15,200	n.a	n.a
Rubber & Plastic Products	18,100	n.a	n.a
Mineral-based Products (Non-metallic)	27,200	n.a	n.a
Manufacture of basic Metals	36,200	n.a	n.a
Fabricated metal Products	n.a	n.a	n.a
Machinery, Equipment & Appliances	50,500	n.a	n.a
Computers & Office Machinery	n.a	n.a	n.a
Electrical Machinery	32,200	n.a	n.a
Communications Equipment including Semi-conductros	n.a	n.a	n.a
Medical, Precision & Optical	n.a	n.a	n.a
Motor Vehicles, Trailers & Parts	3,600	n.a	n.a
Transport Equipment (excluding Motor Vehicles)	6,000	n.a	n.a
Furniture, Jewelry, Toys, Musical, Other Goods	n.a	n.a	n.a
Other manufacturing	n.a	n.a	n.a
Utilities	**26,000**	**1,887,000**	**2,808**
Construction	**426,000**	**5,530,000**	**40,209**
Wholesale and retail trade	**1,797,600**	**12,122,000**	**88,069**
Hotels & Restaurants	**85,900**	**1,294,000**	**8,980**
Transport, Storage and Telecommunication	**238,000**	**5,440,000**	**17,907**
Financial Intermediation	**101,200**	**1,108,000**	**3,801**
Real Estate	**775,400**	**4,991,000**	**56,632**
Public Administration & Defence	**100,300**	**3,672,000**	**19**
Education	**165,200**	**5,982,000**	**729**
Health and Social Services	**75,000**	**4,657,000**	**4,266**
Social & Personal Services	**n.a**	**2,592,000**	**7,801**

Note: (1) 2007; (2) 2008

the near term might be partly offset by ongoing restructuring of these sectors.

Outside of consumer demand, the ongoing recovery of domestic investment demand is likely to support sectors such as real estate – although we continue to rank it within the 'stable' category. However, the overhang of unfinished projects from the pre-crisis period is likely to prevent such a recovery from spreading to the struggling construction industry (still ranked among the "worst" category).

Other sectors exposed to investment demand, such as **basic metals, refined petroleum, chemicals** as well as broader **mining** are expected to continue to benefit from the massive comparative advantages that are given to Russia by its ample natural resource endowments and robust and growing external demand. The importance of this factor is particularly strong given Russia's proximity to the booming Chinese market, and we note that its importance is likely to rise even further with Russia's eventual WTO entry in the future. On the other hand, sectors exposed to budgetary spending, such as education and healthcare are likely to suffer from the growing austerity of the general budgetary framework.

SECTORAL DETAILS				COMPETITIVENESS		CONSTRAINS	
Share in Total VA[2], %	Share in Total FDI, %	Capital intensity	FDI attractiveness	Labour productivity (Total Manufacturing = 100)[2], %	Average Personnel costs (Total Manufacturing = 100), %	Total Indebtedness (Total Debt/Total Liabilities)	Bank Indebtedness (Total bank Indebtedness/Total Liabilities)
100.0	**100.00**	**55.3**	**n.a**	**n.a**	**n.a**	**n.a**	**n.a**
4.9	**1.87**	**50.2**	**32.7**	**24.8**	**87**	**25.0**	**70.30**
9.2	**18.42**	**84.8**	**217.4**	**271.1**	**245**	**44.9**	**59.64**
17.4	**21.90**	**49.6**	**148.3**	**100.0**	**100**	**41.9**	**60.10**
n.a	3.92	n.a	n.a	n.a	86.9	47.7	58.32
n.a	n.a	n.a	n.a	n.a	n.a	n.a	n.a
n.a	0.15	n.a	n.a	n.a	50.7	41.4	55.81
n.a	0.00	n.a	n.a	n.a	n.a	n.a	n.a
n.a	0.00	n.a	n.a	n.a	59.3	44.3	57.66
n.a	2.09	n.a	n.a	n.a	68.1	24.8	69.25
n.a	2.07	n.a	n.a	n.a	107.3	39.8	62.35
n.a	n.a	n.a	n.a	n.a	n.a	n.a	n.a
n.a	0.06	n.a	n.a	n.a	219.8	44.9	73.38
n.a	1.20	n.a	n.a	n.a	113.7	53.0	61.58
n.a	1.10	n.a	n.a	n.a	86.1	43.9	56.27
n.a	3.01	n.a	n.a	n.a	102.9	43.1	64.56
n.a	2.89	n.a	n.a	n.a	113.4	39.0	69.74
n.a	0,00	n.a	n.a	n.a	n.a	n.a	n.a
n.a	0.73	n.a	n.a	n.a	105.1	45.5	38.53
n.a	n.a	n.a	n.a	n.a	n.a	38.4	25.06
n.a	0.95	n.a	n.a	n.a	n.a	51.7	39.39
n.a	n.a	n.a	n.a	n.a	n.a	48.6	36.77
n.a	n.a	n.a	n.a	n.a	103.4	57.1	34.84
n.a	3.26	n.a	n.a	n.a	108.5	29.0	59.92
n.a	0.05	n.a	n.a	n.a	n.a	30.6	38.35
n.a	n.a	n.a	n.a	n.a	n.a	39.7	59.09
n.a	n.a	n.a	n.a	n.a	78,1	38.6	58.09
3.0	**8.63**	**142.0**	**2,333.3**	**91.7**	**120**	**77.5**	**38.23**
6.5	**3.54**	**28.9**	**72.3**	**54.2**	**115**	**54.1**	**22.66**
20.6	**14.78**	**3.2**	**107.3**	**53.6**	**92**	**60.2**	**52.95**
1.0	**0.27**	**22.1**	**30.0**	**30.9**	**73.0**	**37.9**	**57.94**
9.4	**4.74**	**145.9**	**31.9**	**65.1**	**130**	**34.4**	**68.86**
4.7	**6.34**	**11.8**	**70.2**	**111.9**	**261**	**47.1**	**72.99**
11.0	**18.66**	**84.0**	**156.4**	**68.9**	**136**	**46.4**	**46.95**
4.9	**n.a**	**19.2**	**n.a**	**56.7**	**134.7**	**47.2**	**26.42**
2.6	**n.a**	**42.5**	**n.a**	**13.2**	**71.2**	**42.2**	**12.22**
3.1	**0.07**	**42.8**	**n.a**	**23.9**	**81.8**	**29.9**	**41.87**
1.7	**0.78**	**87.8**	**n.a**	**24.1**	**85**	**65.4**	**41.84**

Source: ROSSTAT, UCB RU

Slovakia – Tatra Tiger rebounding?

2011 Best, Stable and Worst sectors

Best		Stable		Worst	
Rubber and Plastics Products	Benefits from upturn in car and LCD TV production	Agriculture	Cash flow hit by bad 2010 harvest and cold 2010/2011 winter; strong regional competition	Mining	Declining sector, with high dependency on govt. support
Chemicals	Post-crisis upturn, despite some problematic companies; pharma (generic) doing well (best), rest of sector is stable	Food and Beverages	Higher agricultural prices and weaker household demand to drive some margins squeeze in 2011	Textiles	Declining sector, due to Asian competition
Manufacture of basic metals	Benefits from upturn in car industry	Wood Products (exclude furniture)	Hit by persisting pressure on construction sector, with some recovery underway	Wearing Apparel	Declining sector, due to Asian competition
Computers and Office Machinery	Cyclical upturn, strongly growing from a low base	Paper and Pulp	Very cyclical (mostly in prices), but modern facilities	Leather Footwear	Declining sector, due to Asian competition
Communications Equipment including Semi-Conductors and TVs	Booming sector, with major producer launching new production in 2011	Printing and Publishing	Modern production facilities but outlook influenced by higher VAT rate on books	Construction	Weak demand for new housing or commercial property, uncertain timing of highway projects
Motor Vehicles, Trailers and Parts	Most important manufacturing sector in Slovakia; global competitive advantage	Refined Petroleum, Coke and Nuclear	Major producer reporting loss in 2009, but rebound oil prices should be favorable	Hotels and Restaurants	New capacity built up recently, low occupancy rates, some major hotels near bankruptcy
Utilities	Benefits from more price-increases friendly government	Mineral-based Products (non-metalic)	Constrained by weak con-struction sector (cement, glass)	Transport	–
Telecomunication	–	Fabricated Metal Products	Benefits from car industry upturn and from recent contracts won by major producer in energy sector	Real Estate and Business Activities	Excess supply of residential and commercial property, several projects near bankruptcy
		Machinery, Equipment, Appliances	As sub-suppliers for German producers, benefits from r ecovery in global demand		
		Electrical Machinery	Benefits from revival in house-holds demand for home appliances		
		Medical, Precision and Optical	Sector generally performing well, but some weak producers		
		Transport Equipment (excluding Motor Vehicles)	Positively influenced by recently won contracts with foreign importers (railway wagons)		
		Furniture, Jewelry, Toys, Musical, Other Goods	Furniture sector too dependent on housing market, some signs of recovery in 2011		
		Recycling	Stable sector		
		Wholesale and Retail Trade	Retail trade with non-food productsat 80% of pre-crisis level, real-wage decrease at national level in 2011; diver-gence in performance of small privately-owned stores and big international chains		
		Storage	–		
		Education	Stable sector		
		Health, Social and Personal Services	–		

Source: UniCredit CEE Strategic Analysis, UniCredit Bank SK

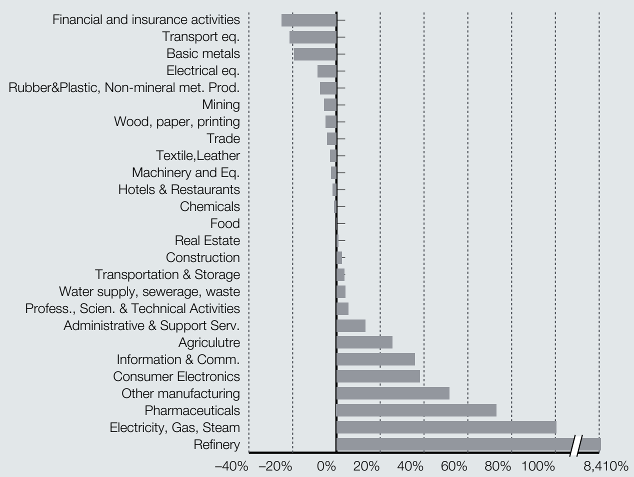
For Slovakia the crisis marked the worst downturn since the transformational recession in the early 1990's. The impact on industries has been strong due to the economy's high dependency on export, overexposure to cyclical sectors such as consumer durables (e.g. cars and consumer electronics) and the euro introduction, which deprived the country's economy of one possible channel of adjustment (currency depreciation). However, the recovery in Western Europe – lead by the German economy – in late 2009 and particularly last year, contributed to the significant rebound of Slovak industry, which reached its pre-crisis level in September 2010. Manufacture of consumer electronics, cars, chemicals and pharmaceuticals spearheaded the recovery. The recent moderate revival of lending activity to the corporate sector (energy and refinery sectors in particular) supports industry's ongoing recovery.

The recovery should continue in the current year as well. However, after the relatively high (expected) growth of 3.9% in 2010, the pace of economic growth should stay more subdued in 2011 (3.1%) predominantly on the back of the government's austerity package. VAT and excise taxes increases as well as government expenditures cuts will weigh on the economy. In addition, the expected acceleration in inflation (4.1%) resulting from higher food and energy prices may result in some stagnation or even decline in the dynamic of real wages in the current year. This means that in an environment of still high unemployment, household consumption will not be among the key growth drivers in 2011. Investment activity is instead expected to gain momentum as some of the investments put on hold during the crisis will be put on stream and some restocking will take place. External demand should also remain supportive for growth also on the back of a broadly-based recovery of Germany's economy.

Despite the improved macroeconomic conditions, Slovakia faces several structural challenges looking ahead. In addition to initiatives to improve the overall business environment, to reform the payroll tax system and to put public finance, social security and health-care on a sustainable footing, the new government plans to continue upgrading the transportation infrastructure. The latter is extremely important for improving access to remote regions for foreign investors. For this purpose, the government has earmarked EUR 3.1 bn from the EU structural funds and state budget for highway construction during 2010–2012. Several strips of highways might also be constructed using public-private partnership (PPP) schemes in the future, although the government will carefully scrutinize the cost of such PPPs (having cancelled some previous overpriced PPP projects). Other areas of focus for drawing EU funds are environment, regional development and Research & Development. EU funds represent a large pool of resources available to upgrade the country's capital stock that can be used to speed up economic convergence toward Western European standards. Slovakia should thus intensify and improve its efforts in drawing EU funds as it has lagged in this regard recently, and cases of non-transparent projects using EU funds and related corruption have emerged.

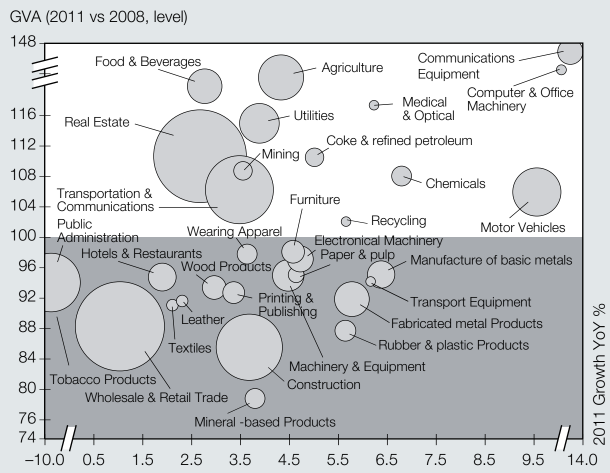
Benefiting from significant competitive advantages in medium-high technology sectors and a consolidated export orientation, in the wake of the crisis Slovakia does not need to re-adapt its economic growth model. Two key manufacturing sectors – **cars and LCDs production** – should continue to be the key drivers of growth in 2011. Substantial FDIs were concentrated recently in those two sectors and despite much weaker global demand than pre-crisis, Slovakia can now benefit from its global competitive advantage, reinforcing its role of production hub for Europe. Apart from existing facilities, a large foreign LCD manufacturer will start new production in the current year and existing car producers will introduce new car models.

Lending by sector (% YTD growth, Oct 2010)



Source: NBS

Value added by sector (real terms)[1]



Note:1) Size of the ball = value added in billion USD

Source: UniCredit CEE Strategic Analysis, Global Insight

Several other sectors which function as suppliers to these two major sectors – such as rubber and plastics or basic metals – will ride the wave and should perform well in the current year. Apart from those, generic pharmaceuticals, office machinery, telecommunications and utilities should experience a very positive dynamic during 2011.

Several major sectors are rated with a stable outlook. **Agriculture** in Slovakia saw substantial productivity gains over the last decade and the expected increase in agricultural prices should remain supportive for its dynamic in 2011. There has been some recent consolidation activity on the local food & beverages market, which should lead to efficiency gains. However, producers will likely see margins squeeze in the current year.

Several sectors should ride the wave of expected increased export and investment activity either domestically or abroad (emerging

Slovakia – Structural indicators (according to NACE 1.1, 2009 unless otherwise stated)

SECTOR	MARKET STRUCTURE		
	Number of Enterprises[2]	Number of SME[2]	Share of SMEs in Total enterprises[1], %
TOTAL - ALL NACE ACTIVITIES	**110,768**	**101,965**	**92.1**
Agriculture. hunting and forestry and fishing	**4,548**	**4,304**	**87.5**
Mining and quarrying	**143**	**137**	**78.5**
Manufacturing	**12,440**	**11,801**	**83.0**
Manufacture of food products. beverages and tobacco	1,327	1,273	77.8
Manufacture of textiles and textile products	863	818	87.7
Manufacture of leather and leather products	216	198	81.7
Manufacture of wood and wood products	1,515	1,476	92.0
Manufacture of pulp, paper and paper products	n.a	n.a	75.0
Publishing, printing and reproduction of recorded media	n.a	n.a	93.8
Manufacture of coke. refined petroleum products and nuclear fuel	10	9	53.8
Manufacture of chemicals. chemical products and man-made fibres	249	231	70.1
Manufacture of rubber and plastic products	751	721	77.9
Manufacture of other non-metallic mineral products	546	516	77.4
Manufacture of basic metals	n.a	n.a	50.0
Manufacture of fabricated metal products. except machinery and equipment	n.a	n.a	85.5
Manufacture of machinery and equipment n.e.c.	954	904	75.9
Manufacture of office machinery and computers	n.a	n.a	85.5
Manufacture of electrical machinery and apparatus n.e.c.	n.a	n.a	79.3
Manufacture of radio, television and communication equipment and apparatus	n.a	n.a	80.0
Manufacture of medical, precision and optical instruments. watches and clocks	n.a	n.a	86.5
Manufacture of motor vehicles, trailers and semi-trailers	n.a	n.a	37.1
Manufacture of other transport equipment	n.a	n.a	69.0
Manufacture of furniture; manufacturing n.e.c.	n.a	n.a	87.9
Recycling	n.a	n.a	90.1
Electricity. gas and water supply	**327**	**299**	**55.1**
Construction	**7,926**	**7,644**	**91.2**
Wholesale and retail trade; repair of motor vehicles, motorcycles and personal and household goods	**38,068**	**36,139**	**91.4**
Hotels and restaurants	**3,814**	**3,653**	**98.1**
Transport. storage and communication	**4,511**	**4,315**	**88.6**
Financial intermediation	**757**	**709**	**88.8**
Real estate, renting and business activities	**29,295**	**26,617**	**96.2**
Public administration and defence; compulsory social security	**2**	**2**	**0.0**
Education	**800**	**750**	**99.1**
Health and social work	**3,402**	**3,306**	**98.0**
Other community, social and personal service activities	**2,434**	**2,291**	**95.2**
Activities of households	**n.a**	**n.a**	**n.a**
Extra-territorial organizations and bodies	**n.a**	**n.a**	**n.a**

Note: 1) 2007; 2) 2008

markets in particular): **fabricated metal products, machinery & equipment, electrical machinery** and **medical & optical equipment** are clear examples.

Although one of the major producers is experiencing problems and might need to be restructured, the **chemical sector** as such should continue to perform well during 2011. The same holds true for the **refinery sector**, where a major producer is returning to profitability and is considering a major investment into a production facility. **Wood, pulp and paper, printing and publishing** should all see a continued recovery in 2011. Last but not least, **wholesale and retail trade** is rated among the stable sectors although some divergence is noted between trade with foodstuffs (relatively resilient during the crisis) and non-foodstuffs trade which has not recovered yet (although postponed demand for some durables may start to materialise in the current year).

SECTORAL DETAILS				COMPETITIVENESS			CONSTRAINTS	
Share in total VA %	Share in total FDI[1], %	Capital Intensity, %	FDI Attractiveness[1]	RCA[2]	Labour productivity (Manufacturing = 100)	Personnel costs, (Manufacturing = 100)[2]	Total Indebtedness[1], %	Bank Indebtedness[1], %
100.0	**100.0**	**20.7**	**100**	**100**	**115.1**	**100.1**	**55.1**	**12.0**
3.9	**0.3**	**20.0**	**8**	**80**	**143.1**	**n.a**	**31.2**	**6.2**
0.6	**1.0**	**34.3**	**32**	**4**	**185.2**	**108.2**	**49.2**	**8.2**
19.6	**38.9**	**21.7**	**169**	**114**	**100.0**	**100.0**	**56.3**	**13.2**
1.8	2.4	22.0	126	64	100.7	90.8	60.1	14.5
0.6	0.4	9.8	42	85	42.5	58.1	60.0	12.9
0.2	0.3	11.2	110	132	35.7	61.7	64.1	5.2
1.3	0.4	8.0	32	155	98.6	74.9	69.1	26.4
0.5	1.3	52.9	221	144	167.3	117.0	47.5	11.5
0.7	0.2	8.5	28	154	100.2	122.6	60.1	14.4
0.3	4.6	106.0	536	208	301.6	223.9	27.5	0.2
0.7	1.9	38.4	207	57	145.9	117.1	48.3	16.4
1.1	1.9	20.4	179	87	103.0	96.4	57.9	15.5
1.1	2.3	27.6	168	103	123.6	112.8	48.1	14.2
1.1	6.2	35.7	231	151	120.1	140.2	49.7	11.9
2.8	2.9	8.1	94	108	127.8	97.5	66.4	11.6
1.3	2.7	24.2	162	97	73.5	105.2	64.5	15.9
0.1	0.0	7.0	49	80	56.4	92.6	54.7	8.8
1.2	1.7	16.0	107	107	67.8	81.4	62.1	11.2
1.0	2.3	11.1	309	129	135.4	91.7	74.9	6.7
0.4	0.1	6.5	22	29	98.2	102.1	49.4	3.9
2.1	8.1	36.1	293	155	148.4	127.9	57.9	14.3
0.3	0.0	18.3	0	143	99.2	114.1	63.4	26.2
0.7	–0.9	10.7	–146	115	74.7	85.5	59.5	17.4
0.1	0.1	8.4	44	n.a	122.3	126.1	57.7	15.2
5.5	**13.9**	**57.5**	**241**	**139**	**438.2**	**138.9**	**31.2**	**4.1**
9.5	**1.1**	**2.7**	**14**	**n.a**	**125.6**	**96.4**	**66.6**	**7.4**
15.9	**12.1**	**6.7**	**79**	**n.a**	**96.0**	**99.3**	**66.7**	**11.2**
1.4	**0.2**	**12.1**	**16**	**n.a**	**52.4**	**62.7**	**67.5**	**24.3**
7.1	**5.2**	**41.8**	**67**	**n.a**	**117.6**	**105.9**	**42.3**	**8.3**
4.1	**17.6**	**20.4**	**501**	**n.a**	**266.8**	**185.6**	**81.0**	**49.5**
15.1	**8.9**	**25.0**	**42**	**23.0**	**181.4**	**115.7**	**66.0**	**17.2**
7.1	**0.0**	**29.5**	**0**	**n.a**	**119.8**	**97.1**	**17.6**	**0.0**
3.4	**0.0**	**11.3**	**0**	**n.a**	**52.4**	**84.6**	**36.1**	**1.4**
3.4	**0.2**	**11.7**	**8**	**n.a**	**65.6**	**88.9**	**38.2**	**7.7**
3.5	**0.4**	**9.9**	**11**	**40**	**123.7**	**86.8**	**55.5**	**7.5**
n.a	**0.0**	**n.a**	**n.a**	**n.a**	**n.a**	**n.a**	**n.a**	**n.a**
n.a	**0.0**	**n.a**	**n.a**	**n.a**	**n.a**	**n.a**	**n.a**	**n.a**

Source: NBS, Eurostat, DataCentrum, Statistical Office, UniCredit Bank SK

Among the worst performing sectors, developments in the **real estate** industry remain constrained by excess capacity in both residential and commercial property with several projects close to bankruptcy. **Construction** is thus also likely to continue to be in the doldrums in the current year. Although the sector could benefit from the highway construction programme, timing of particular highway projects is still uncertain (however, this represents some upside risk for the sector). For the time being, business surveys among construction managers see activity largely stagnant in the current year and suggest that consolidation may take place in the sector. **Hotels & Restaurants** are also expected to perform relatively weakly as there has been a substantial increase in hotel room capacity recently and occupancy rates are at record-low levels. It seems that Slovak and foreign consumers are still cautious about spending money on travel & leisure and restaurants in Slovakia. Finally, **manufacture of textile, apparel, leather footwear** are expected to continue struggling as they attempt to compete with cheap Asian imports while facing rising upward pressures on domestic wages. The outlook for these sectors is highly uncertain. Only high increases in productivity and shifts into a higher-value added product sub-segment may support the longer-term viability of these sectors.

More generally, substantial improvements in the overall business environment, investment into educational and R&D sectors are among the main challenges the Slovak economy will have to face. If implemented, they will support gradual sectoral re-allocations in the economy, shifts into high value added production and more innovations.

Ukraine – Economy enters 2011 on a solid footing but with large need for modernisation

2011 Best, Stable and Worst sectors

Best		Stable		Worst	
Food and Beverages	Non-cyclical and attractive sector for investments despite unfavorable regulatory framework, some land-policies issues and still low households incomes	Agriculture	High returns on capital, aggressive CAPEX expected in 2011–12, high liquidity but very unproductive sector, lots of low-value-added products in export, land policy issues and poor logistics	Textiles and Wearing Apparel	Non-transparent industry with large number of small "shadow" business
Manufacture of basic metals	Good prospects driven by large capacity, low-cost production, vertical integration, EURO 12 championship opportunities; some issue to monitor related to poor logistics	Mining	Large reserves of coal, iron ore, manganese, sea-port availability, gas-substitution opportunities but low operational efficiency and poor logistics	Machinery, Equipment, Appliances	Strong post-USSR base, opportunities to expand in local agro and mining sector but lack of financing and FDI, dependence on CIS and low protection of intellectual rights
		Tobacco Products	Non-cyclical but devastating regulatory framework and low households incomes	Computers and Office Machinery	Lack of financing and FDI; low protection of intellectual rights; brain drain
		Leather Footwear	Non-transparent industry with large number of small "shadow" business	Electrical Machinery	Lack of financing and FDI; low protection of intellectual rights; brain drain
		Wood Products (exclude furniture)	–	Communications Equipment including Semi-Conductors and TVs	Lack of financing and FDI; low protection of intellectual rights; brain drain
		Paper and Pulp	–	Medical, Precision and Optical	Lack of financing and FDI; low protection of intellectual rights; brain drain
		Printing and Publishing	–	Furniture, Jewelry, Toys, Musical, Other Goods	–
		Refined Petroleum, Coke and Nuclear	Privatisation to boost competition; tariffs growth; vulnerability to world commodity prices; high administrative barriers; low competition; lack of financing	Recycling	–
		Chemicals	Large production capacity, opportunities to expand locally to agro-consumers and export but large dependence on gas, poor logistics, lack of financing and import threat	Utilities	Some export opportunities but outlook influenced by inefficient pricing policies and households subsidies, large state-ownership and huge under-investments
		Rubber and Plastics Products	–		

Best		Stable		Worst	
		Mineral-based Products (non-metalic)	Poor logistics; lack of financing; import threat	Real Estate and Business Activities	Strong correlation with construction industry; low price growth opportunities
		Fabricated Metal Products	Stable outlook supported by vertical integration and EURO 12 championship opportunities but low efficiency, high vulnerability and limited logistics	Public Administration and Defense	State ownership
		Motor Vehicles, Trailers and Parts	EURO 12 championship opportunities; high transit potential; low cars penetration; lack of state support; low competition; lack of financing; low quality	Education	State ownership; lack of financing
		Transport Equipment (excluding Motor Vehicles)	Strong carriage building plants, high transit potential but large depreciation of carriage fleet in Ukraine and CIS, poor logistics lack of financing and high administrative barriers	Health and Social Services	State ownership; lack of financing; low population incomes
		Construction	–	Social and Personal Services	–
		Wholesale and Retail Trade	Productive improvement potential but limited access to international financing, tough regulatory barriers and expensive consumer lending		
		Hotels and Restaurants	EURO 12 championship opportunities but lots of not-transparent small companies and lack of financing		
		Transport, Storage and Telecommunication	–		
		Financial Intermediation	–		

Source: UniCredit Bank, UniCredit CEE Strategic Analysis

After a severe slump in 2009, the Ukrainian economy returned to growth in 2010. Exports were the main growth driver, but domestic demand started to revive at the end of 2010 as well. In the forthcoming quarters we expect private consumption and fixed investments to overtake as main growth drivers. The preparations for the EURO-2012 football championship will support fixed investment, as well as help boost infrastructure and related sectors.

Poor infrastructure is one of the key Ukrainian problems. The World Bank estimate of needed investment for 2006–2015 was USD 100 bn. This would imply at least tripling the current level of public infrastructure spending of 2% of GDP (average 2000–9). There are hopes that hosting the EURO-2012 championship will help boost investment in infrastructure.

Another big issue is decreasing potential of exports as a growth driver due to a weakening competitive position. While in the short-term exports are likely to remain an important growth driver, the medium-to-long term prospects are less convincing unless Ukraine diversifies its exports and moves up the value chain. Ukraine's exports are concentrated in the low valued added sectors, with metals, minerals and chemicals comprising more than 60%. This makes the economy vulnerable to commodity prices shocks and puts it in competition with emerging economies that have stronger cost advantages.

In 2011, the outlook is the best for Iron & Steel, Food & Beverages and Hotels construction, which are to be followed in 2012 by chemical, agro and transport industry.

Iron&Steel is to remain the key industry for Ukraine (today Ukraine is among the top ten world steel producers). Among the industry's strengths are the low cost of labour and low cost of production, which was achieved due to vertical integration. However, the industry is exposed to commodity prices shocks and is dominated by low value added products, which creates some downside risks.

As a defensive sector, **food&beverages** withstood the crisis relatively well. It is also going to benefit from the large internal market and a reviving private consumption. Despite a large number of multinationals the sector remains highly attractive for greenfield investments. However, the regulatory framework deters entry, increases operational costs, limits competition and harms export diversification and growth. The sector experiences lack of financing for both working capital and investments.

Ukraine has large potential in **agriculture**. High returns on capital are attracting foreigners to the sector, and aggressive capital expenditures are expected in 2011–12. Among the sector's main problems are land policy issues, poor logistics and non-alignment with international norms. The sector needs significant financing in order to increase yields to the European level.

The **chemical** sector benefits from large capacity and a strong resource base, but is vulnerable to gas prices shocks due to the high proportion of gas in production costs (up to 80%) and low energy efficiency. The sector was badly affected by a 50% gas price increase in 2009. For the near term, prospects are supported by expected growth of local demand from agro producers.

The **transportation** sector will benefit significantly from hosting the EURO-2012 championship in terms of investment in roads and airports construction, which will help the country to realise its high transit potential as well. The government continues to play a dominant role in the sector, and liberalising its closed segments is an important agenda for future reforms.

Despite inheriting a strong base from the USSR times, **machinery** faced significant depreciation and needs major investment. The industry has limited local demand. In the medium term it could benefit from the CIS demand (especially for carriages) and possible demand from the agro sector. Some sub-sectors (aviation, defence industry) could show growth quicker than others. But they are negatively affected by a brain drain and weak protection of intellectual property rights.

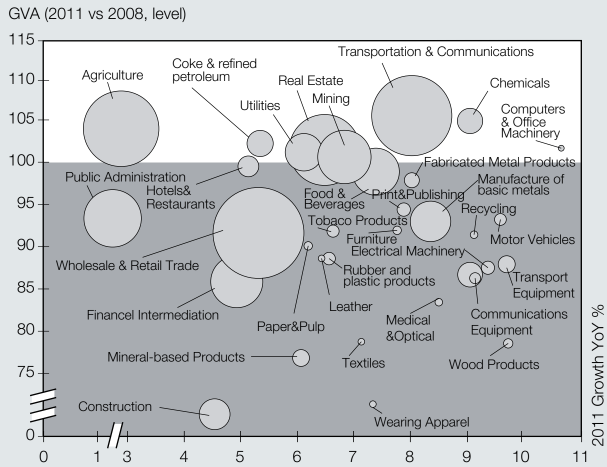
Different subsectors of **construction** have different outlook. Hotels construction is considered to be among the top-performing sectors, to be driven by the requirements of EURO+2012 hosting and, consequently, government support and foreign investment. Construction of office and retail space has a "stable" outlook, as there is still a gap in space indicators compared to European countries, however, the development is much linked to the general business activity and needs investments. Residential real estate is directly linked to retail lending, which is expected to stagnate for quite some time.

Energy generation and distribution suffers a lot from ineffective state governance. Continuous losses of the sector, caused by an inefficient system of heating subsidies for households and low payment discipline, lead to underinvestment and degradation of capacities. Moreover, the sector is very energy-inefficient: Ukraine is among the most energy-intensive countries in the world. However, there is hope that IMF requirements for elimination of subsidies and privatisation may help transform the sector.

Mining has been traditionally the backbone of Ukraine's economy. Large coal, iron ore, manganese reserves in Ukraine enabled not only building vertically-integrated metallurgical giants, but also securing strong export potential. However, the sector has low operational efficiency. Despite having large coking coal reserves, Ukraine imports more than one-third of coking coal needs due low quality of local coal. Additional investments would also be needed to improve the environmental standards in the sector, although so far the authorities have been rather lenient on the issue.

In the medium-to-long run, Ukraine faces a challenging task of modernising itself. It has major opportunities to benefit from its excellent location, abundant natural resources, and skilled and low-wage labor force. However, pervasive corruption, a decrepit infrastructure, lack of rule of law and other obstacles to business reduce the country's attractiveness for investment and hinder its general development.

Value added by sector (real terms)[1]



Note: (1) Size of the ball = value added in billion USD

Source: UniCredit CEE Strategic Analysis, Global Insight

Ukraine – Structural indicators (according to NACE 1. 1, 2009 unless otherwise stated)

SECTORS	MARKET STRUCTURE	SECTORAL DETAILS			COMPETITIVENESS	CONSTRAINTS	
	Number of employees	Share in total VA, %	Share in total FDI, %	FDI attractiveness %	Average Personnel Cost (Manufacturing = 100)	Total Indebtedness, %	Bank Indebtedness, %
TOTAL	**8,274.8**	**100.0**	**100.0**	**34.5**	**87.3**	**64.1**	**18.1**
Agriculture	**729.9**	**7.2**	**2.0**	**9.5**	**57.1**	**62.2**	**655.1**
Fishing and forestery	**n.a**	**n.a**	**0.0**	**n.a**	**n.a**	**n.a**	**n.a**
Mining	**n.a**	**3.9**	**2.6**	**23.4**	**n.a**	**n.a**	**n.a**
Manufacturing	**n.a**	**15.8**	**29.8**	**64.9**	**n.a**	**n.a**	**n.a**
Food, Beverages, Tobacco	n.a	n.a	4.6	n.a	n.a	n.a	n.a
Textiles	n.a	n.a	0.4	n.a	n.a	n.a	n.a
Wood Products (exclude furniture)	n.a	n.a	0.7	n.a	n.a	n.a	n.a
Paper and Pulp, Printing and Publishing	n.a	n.a	0.6	n.a	n.a	n.a	n.a
Refined Petroleum, Coke and Nuclear	n.a	n.a	1.1	n.a	n.a	n.a	n.a
Chemicals. Rubber and Plastics Products	n.a	n.a	3.1	n.a	n.a	n.a	n.a
Mineral-based Products (non-metalic)	n.a	n.a	2.0	n.a	n.a	n.a	n.a
Manufacture of basic metals, Fabricated Metal Products	n.a	n.a	13.9	n.a	n.a	n.a	n.a
Machinery, Equipment, Appliances	n.a	n.a	2.9	n.a	n.a	n.a	n.a
Other	n.a	n.a	0.7	n.a	n.a	n.a	n.a
Utilities	**n.a**	**3.5**	**0.8**	**7.7**	**n.a**	**n.a**	**n.a**
Construction	**518.8**	**2.4**	**5.5**	**78.6**	**62.3**	**86.1**	**44.2**
Wholesale and Retail Trade	**1,265.8**	**13.5**	**10.8**	**27.6**	**70.4**	**95.5**	**33.0**
Cars trade and repair	137	n.a	n.a	n.a	79.3	86.8	27.6
Wholesale trade	675.9	n.a	n.a	n.a	78.3	96.7	33.6
Retail trade	452.9	n.a	n.a	n.a	55.9	95.7	33.7
Hotels and Restaurants	**139.6**	**n.a**	**1.1**	**n.a**	**51.4**	**57.9**	**30.6**
Transport, Storage and Telecommunication	**1,101.8**	**11.3**	**4.1**	**12.4**	**111.5**	**41.3**	**5.9**
Financial Intermediation	**80.7**	**n.a**	**31.1**	**n.a**	**113.5**	**69.7**	**n.a**
Real Estate and Business Activities	**922**	**n.a**	**10.6**	**n.a**	**82.4**	**44.6**	**14.7**
Education	**35.3**	**5.2**	**0.0**	**0.2**	**66.3**	**25.4**	**12.8**
Health and Social Services	**92.1**	**3.5**	**0.3**	**3.0**	**59.8**	**46.9**	**22.0**
Social and Personal Services and other	**182.5**	**n.a**	**1.4**	**n.a**	**91.0**	**61.0**	**20.2**

Source: State Statistics Committee of Ukraine, UniCredit Bank

Annex – Methodology Notes

Bulgaria – Structural Indicators

Number of enterprises: total number of companies with business activity, Source: Coface Bulgaria Credit Management Services Ltd.

Number of SME: number of companies with number of employees up to 250 and either annual turnover up to EUR 50 millions or total assets up to 43 million BGN (excluded are sole proprietorships), Source: Coface Bulgaria Credit Management Services Ltd.

Share in VA: Relative share of each sector in Total Gross Value Added for the whole economy (in current prices), Source: National Statistical Institute.

Share in Total FDI: Foreign Direct Investment (stock), Source: Bulgarian National Bank.

FDI Attractiveness: FDI Attractiveness = Share in FDI (stock) / Share in VA, Source: Bulgarian National Bank, National Statistical Institute.

Capital Intensity: Capital Intensity = Expenditure for Acquisition of Tangible Fixed Assets / GVA, Source: National Statistical Institute.

RCA: Revealed Comparative Advantage = Share in Total Exports / Share in Total Imports, Source: National Statistical Institute.

Average Wage Indicator: (Average Wage Sector/ Average Wage Economy)*100, Source: National Statistical Institute.

Wage adjusted Labour Productivity: Wage adjusted Labour Productivity = Labour Productivity / Average wage per employee, Source: National Statistical Institute.

Total Indebtedness: Total Indebtedness = Total Debt / Total Liabilities, Source: National Statistical Institute.

Bank Indebtedness: Bank Indebtedness = Short-term and Long-term Bank loans / Total Liabilities, Source: National Statistical Institute.

Croatia – Structural Indicators

Generally, FINA data from financial statements of enterpreneurs do not cover state entities (public administration, defence, public education and health care systems) and producers which are not registred as companies (i.e. are not liable for profit tax – craftmen, individual farmers and fishermen, etc.). FINA data also do not cover banking and insurance industries sectors. So, totals for economy and some sectors are downward distorted.

Number of enterprises: Number of entities which actually presented and submitted financial statement for year 2009 to FINA (Financial Agency). All legal and physical persons which are liable for profit tax, according to the law, are obliged to submit their financial statements. Source: FINA

Number of SME: SME are defined as companies with total revenue up to HRK 300mn). Source: FINA

Share in total VA: VA of specific sector divided by total VA added (Zagrebaèka banka Research from FINA data). Source: FINA

Share in Total FDI: Foreign Direct Investment (stock as of 31th December 2009, cumulated from beginning of 1993). Source: CNB (Croatian National Bank)

FDI attractiveness: Calculated by Zagrebaèka banka Research from FINA and CNB data. This indicator for Financial activities is distorted because banking and insurance industry are excluded from FINA data (so share in VA for Financial sector does not cover VA of banking and insurance industry). FDI Atractiveness = Share in FDI (stock) / Share in VA. Sources: FINA, CNB

Capital Intensity: Calculated by Zagrebaèka banka Research from CBS data. Capital Intensity = Gross Fixed Capital Formation / VA. Source: CBS

RCA: Calculated by Zagrebaèka banka Research from CBS data. RCA = Share in Total Exports / Share in Total Imports. Source: CBS

Labour Productivity: Calculated by Zagrebaèka banka Research from FINA data. Labour Productivity = VA / Number of Employees (in HRK per employee&year). Source: FINA

Average Personnel Costs: Calculated by Zagrebaèka banka Research from FINA data. Average Personnel Costs = Total Personnel (Labour) Costs (net wages + contributions from/on wages for pensions, social and health care + other personnel costs) / Number of Employees (in HRK per employee&year). Source: FINA

Wage Adjusted Labour Productivity: Calculated by Zagrebaèka banka Research from FINA data. Wage Adjusted Labour Productivity = Labour Productivity / Average Personnel (Labour) Costs. Source: FINA

Total Indebtedness: Calculated by Zagrebaèka banka Research from FINA data. Total Indebtedness = Total Debt / Total Liabilities. Source: FINA

Bank Indebtedness: Calculated by Zagrebaèka banka Research from FINA data. Bank Indebtedness = Bank Debt / Total Liabilities. Source: FINA

Czech R. – Structural Indicators

Number of enterprises: registered enterprises and entrepreneurs. Source: Czech Statistical office (CZSO)

Number of employees: Source: CZSO

Share in Total VA: Share of sector VA out of the total VA. VA = Gross Value Added (in current prices). Source: CZSO

Share in Total FDI: Share of sector FDI out of Total FDI. Source: Czech National Bank

FDI Attractiveness: Share in FDI/Share in VA. Source: Czech national bank, CZSO

Capital Intensity: Purchase of the fix assets (tangible&intangible) divided by VA. Source: CZSO

Labour Productivity: VA / number of employees (in CZK per employee & year). Source: CZSO

Average Personnel Cost: Total personal costs / number of employees (in CZK per employee & year). Source: CZSO

Hungary – Structural Indicators

Number of enterprises: total number of registered companies, Source: Central Statistical Office.

Number of employees: number of employees – average for the year, Source: Central Statistical Office.

Number of SME: number of companies with number of employees up to 250 and annual turnover up to EUR 50 millions. Source: Tax Bureau.

Share in VA: Relative share of each sector in Total Gross Value Added for the whole economy (in current prices), Source: Central Statistical Office.

Export Propensity: Export Propensity = Exports / Gross Output, Source: Central Statistical Office.

Import / Apparent Consumption: Apparent Consumption = Gross Output + Imports – Exports, Source: Central Statistical Office.

Share in Total FDI: Foreign Direct Investment (stock), Source: National Bank of Hungary.

FDI Attractiveness: FDI Attractiveness = Share in FDI (stock) / Share in VA, Source: National Bank of Hungary, Central Statistical Office.

Capital Intensity: Capital Intensity = Expenditure for Acquisition of Tangible Fixed Assets / GVA, Source: Central Statistical Office.

RCA: Revealed Comparative Advantage = Share in Total Exports / Share in Total Imports, Source: Central Statistical Office.

Labour Productivity: Labour Productivity = GVA / Number of Employees, Source: Central Statistical Office.

Average personnel cost: Average wage per employee, Source: Central Statistical Office.

Wage adjusted Labour Productivity: Wage adjusted Labour Productivity = Labour Productivity / Average wage per employee, Source: Central Statistical Office.

Total Indebtedness: Total Indebtedness = Total Debt / Total Liabilities, Source: Tax Bureau.

Poland – Structural Indicators

Number of enterprises: Number of entities recorded in the REGON register as of 31 XII 2008. Source: CONCISE STATISTICAL YEARBOOK of the Republic of Poland

Number of employed persons – Number of employees, employers and own-account workers, outworkers, agents, members of agricultural production co-operative etc. as of 31 XII 2008.
Source: CONCISE STATISTICAL YEARBOOK of the Republic of Poland

Number of SME: Number of entities with the number the employees to 249 persons. Source: CENTRAL STATISTICAL OFFICE "Structural changes of groups of the national economy entities in 2008" .

Share in total VA – Sector Gross Value Added/Total Gross Value Added. Bank Pekao-MRO calculation. Source: CONCISE STATISTICAL YEARBOOK of the Republic of Poland

Share in total FDI: Sector FDI/Total FDI. Bank Pekao-MRO calculation. Source: National Bank of Poland "Foreign Direct Investment in Poland in 2008"

FDI Attractiveness: Share in total FDI/Share in total Gross Value Added. Bank Pekao-MRO calculation.

Capital Intensity: Investment Outlays/Gross Value Added. Calculated by Bank Pekao – MRO. Source: CONCISE STATISTICAL YEARBOOK of the Republic of Poland

RCA: Revealed Comparative Advantage computed as Share in Total Export/Share in Total Imports. Data refer to Industry. Bank Pekao-MRO calculation. Source: Statistical Yearbook of Industry – POLAND.

Labour Productivity: Gross Value Added/Number of employed. Calculated by Bank Pekao-MRO. Source: CONCISE STATISTICAL YEARBOOK of the Republic of Poland

Average Personnel Cost – Average monthly gross wages and salaries per paid employee. Source: CONCISE STATISTICAL YEARBOOK of the Republic of Poland

Total Indebtedness – Total Debt / Total Liabilities. Data refer to non-financial enterprises in which the number of employees exceeds 9 persons. Data do not include farmers, banks and insurance institutions, public administration and defense, higher education institutions, public education, public health and social services. Calculated by Bank Pekao- MRO. Source: Central Statistical Office

Bank Indebtedness – Total Bank Credits and Loans / Total Liabilities Data refer to non-financial enterprises in which the number of employees exceeds 9 persons. Data do not include farmers, banks and insurance institutions, public administration and defense, higher education institutions, public education, public health and social services. Calculated by Bank Pekao- MRO. Source: Central Statistical Office

Romania – Structural Indicators

Number of enterprises: Total number of enterprises, Source: NIS – Structural Survey

Number of employees: Total number of employees in enterprises, Source: NIS – Structural Survey

Number of SMEs: Total number of SMEs, defined as enterprises with less than 250 employees. Source: NIS – Structural Survey

Share in Total VA: Sector Gross Value Added (constant prices LC) / Total Gross Value Added (constant prices LC). UniCredit Tiriac calculation. Source: NIS – National Accounts

Share in Total FDI: stock of foreign direct investments in EUR, Sector FDI / Total FDI, sourced by NBR.

FDI Attractiveness: Share in Total FDI / Share in Total Gross Value Added (GVA). UniCredit Tiriac calculation. Source: FDI from NBR and GVA from NIS – National Accounts.

Capital Intensity: Gross Fixed Capital Formation/Total sector GVA in constant prices. UniCredit Tiriac calculation. Source: NIS – National Accounts.

RCA: Revealed Comparative Advantage computed as Share in Total Exports/Share in Total Imports. UniCredit Tiriac calculation. Source: NIS – Foreign Trade Division (primarily sourced by NCA).

Labour Productivity: Gross Value Added / Number of employees. UniCredit Tiriac calculation. Gross Value Added, in current prices LC, and Number of employees sourced by NIS – Structural Survey. Manufacturing = 100

Average Personnel Cost: Total expenses with the personnel / Number of employees. UniCredit Tiriac calculation. Total expenses with the personnel, in current prices LC, and Number of employees sourced by NIS – Structural Survey. Manufacturing = 100.

Wage Adjusted Labour Productivity: Labour Productivity / Average Personnel Cost. UniCredit Tiriac calculation. Manufacturing = 100. Source: NIS – Structural Survey.

Sources

NIS – Structural Survey: Represents a statistical method conducted by the National Institute of Statistics that covers all economic sectors. Micro indicators are calculated following a national scale inquiry upon a sample of enterprises relevant to the entire national economy. The enterprises are classified for each economic sector according to CAEN, Rev.2.

NIS – National Accounts: It turns the results of the official statistical surveys into national accounts having in view the methodological principles of ESA 95 (European System of Accounts). It uses data coming from MPF (public budget execution, balance sheets, and tax on revenues statements of individuals) and by NBR (balance of payments document).

NIS – Foreign Trade Division: It covers, in cooperation with National Customs Authority (NCA) import and export figures in EUR terms, based on enterprises custom statements and national inquiry standard forms.

Russia – Structural Indicators

Number of enterprises: The indicator characterizing number of organisations and their local units which are carrying out production activities irrespectively of a main kind of activity, i.e. by one of the following actual kind of activity – mining and quarrying, manufacturing, production and supply of electricity, gas and water. Source: Rosstat

Number of SME: In accordance with the Federal law of 24 July 2007 209-FZ "On development of small and medium entrepreneurship in the Russian Federation" (clause 4) small businesses (legal entities) are consumer cooperatives and commercial organisations (except state and municipal unitary enterprises) included in the state register of legal entities and meet the following conditions:

1) total share of participation of the Russian Federation and the constituent entities of the Russian Federation, municipalities, foreign legal entities, foreign citizens, social and religious organisations (associations), charitable and other funds in the charter capital (share fund) should not exceed 25 percent (except assets of joint-stock investment funds and closed share investment funds); the share belonging to one or several legal entities, which are not entities of small business, should not exceed 25 percent.

2) average number of employees for the previous period should not exceed 100 persons.
   Average number of employees of small enterprises is estimated considering all their employees including persons who work according to civil law based agreements and pluralists considering real time worked and also employees of missions, affiliates and other local units of the given legal entity. Source: Rosstat

Share in VA: Relative share of each sector in Total Gross VA for the whole economy (current prices). Source: Rosstat

FDI Attractiveness: Share in FDI stock/share in VA

Capital Intensity: Gross fixed capital formation/VA

Average personal cost: Average wage in manufacturing /Average wage in Sector*100

Total Indebtedness: Total debt / Total liabilities Source: Rosstat

Bank Indebtedness: Total bank indebtedness/Total liabilities Source: Rosstat

Slovakia – Structural Indicators

Number of enterprises: Based on Statistical official registry of organizations including only active entity – yearly average. Source: Statistical Office

Number of SME: SME – up to 250 employees, based on Statistical official registry of organizations including only active entity – yearly average. Source: Statistical Office

% of SME: Share of entities with turnover lower than EUR 1 mn. on total number of enterprises (UniCredit Bank calculation) Source: DataCentrum, Statistical Office

VA: Gross value added Source: Eurostat

Share in VA: VA of specific sector divided by total VA added (UniCredit Bank calculation). Source: Eurostat

Share in Total FDI: FDI of specific sector divided by total FDI (UniCredit Bank calculation). Source: National Bank of Slovakia (NBS)

Capital Intensity: Gross fixed capital formation over VA (UniCredit Bank calculation). Source: Eurostat

FDI attractiveness: Share in FDI (stock as of end of period) over Share in VA (UniCredit Bank calculation). Source: NBS, Statistical Office

RCA: Relative competitive advantage – Share in Export over Share in Import (UniCredit Bank calculation). Source: Statistical Office

Labor productivity: VA over number of employee, manufacturing=100 (UniCredit Bank calculation). Source: Statistical Office, Eurostat

Personal costs: Personal costs represent a sum of cost spent by employer to recruit and train their employees, remunerate their work as well as to ensure their social welfare according to obligations adopted.Total labour costs include both direct labour costs and indirect labour costs minus subsidies – manufacturing = 100. Personal costs are estimated by average gross wage for sub-sectors of manufacturing, mining and electricity gas and water supply. (UniCredit Bank calculation) Source: Statistical Office

Total indebtedness – Total debt over Total liabilities based on financial statement, Source: DataCentrum

Bank indebtedness – Total bank debt over Total liabilities based on financial statement, Source: DataCentrum

Ukraine – Structural Indicators

Number of employees: including full-time, part-time and not-paid employees. Source: Statistical Office

Share in VA: Gross Value Added of specific sector divided by total (UniCredit Bank calculation). Source: Statistical Office

Share in Total FDI: FDI of specific sector divided by total FDI (UniCredit Bank calculation). Source: Statistical Office

FDI attractiveness: Share in FDI (stock as of end of period) over Share in VA (UniCredit Bank calculation). Source: Statistical Office

Personnel costs: Personal costs represent a sum of cost spent by employer to recruit and train their employees, remunerate their work as well as to ensure their social welfare according to obligations adopted. Manufacturing = 100. Source: Statistical Office

Total indebtedness – Total debt over Total liabilities based on financial statement, Source: Statistical Office

Bank indebtedness – Total bank debt over Total liabilities based on financial statement, Source: Central Bank, Statistical Office

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