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Moody's view – sovereigns and banks

Flash overview

Petr Vins, General Manager, CEE

Belgrade, November 2012

Agenda

- **Sovereigns** - our current view on the global economy
- Potential effects on Central and Eastern Europe
- Linkage to Developing countries too

- **Banks** – recent changes in ratings
- Inverse gap: Can a subsidiary be stronger than the parent bank ?
- What is different: 2009 vs 2013

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Sovereigns – Moody’s current view

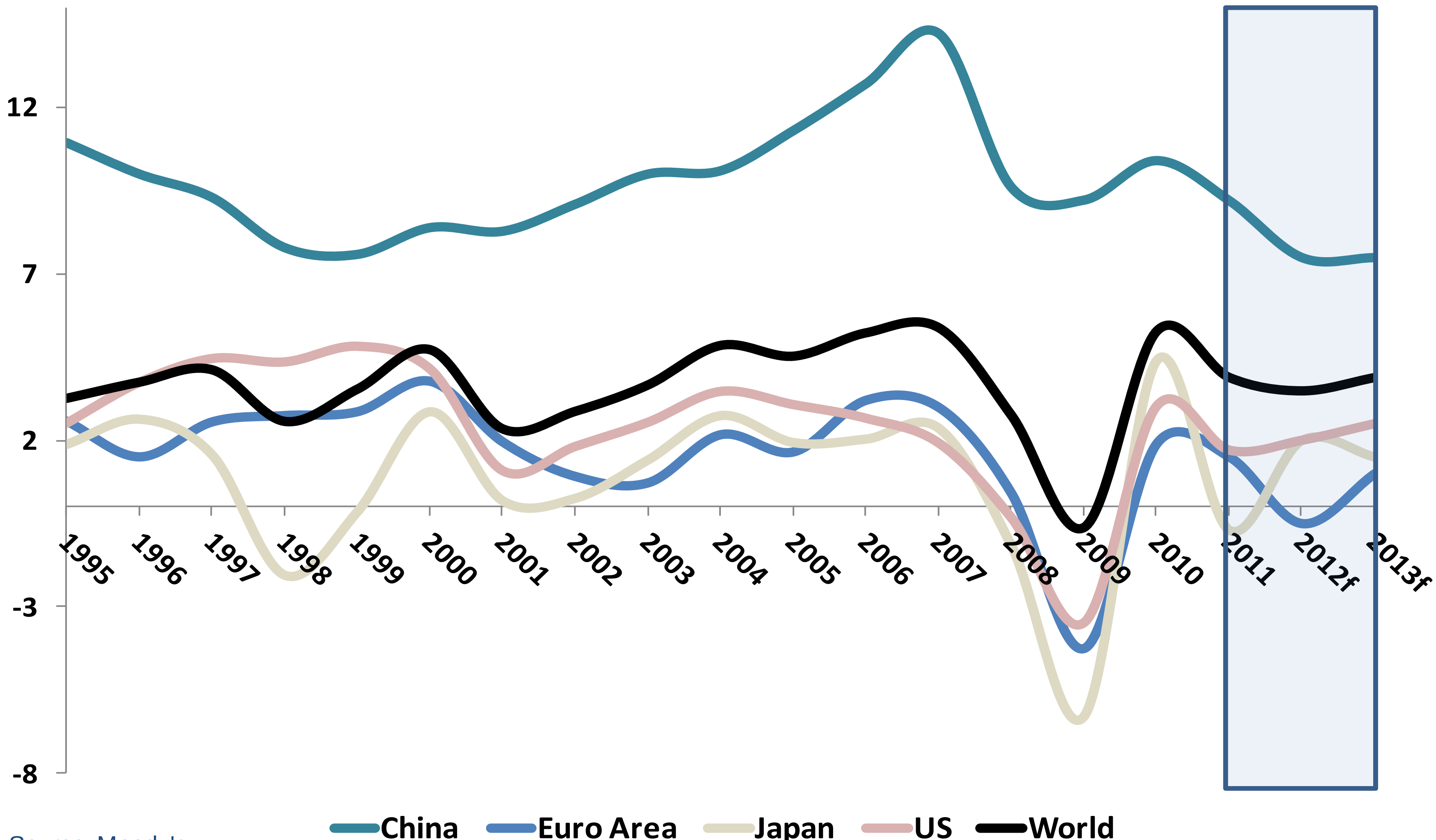
Our global outlook, in a nutshell

MIS's *central* macroeconomic scenario is one of a further slowdown in growth. Why? Well…

» Fiscal consolidation, banking and household sector deleveraging, financial market volatility, and high unemployment are expected to continue to constrain growth in several *developed* economies, especially in high income Europe

» Major developing economies also to decelerate

Our 2012-2013 forecasts: The World

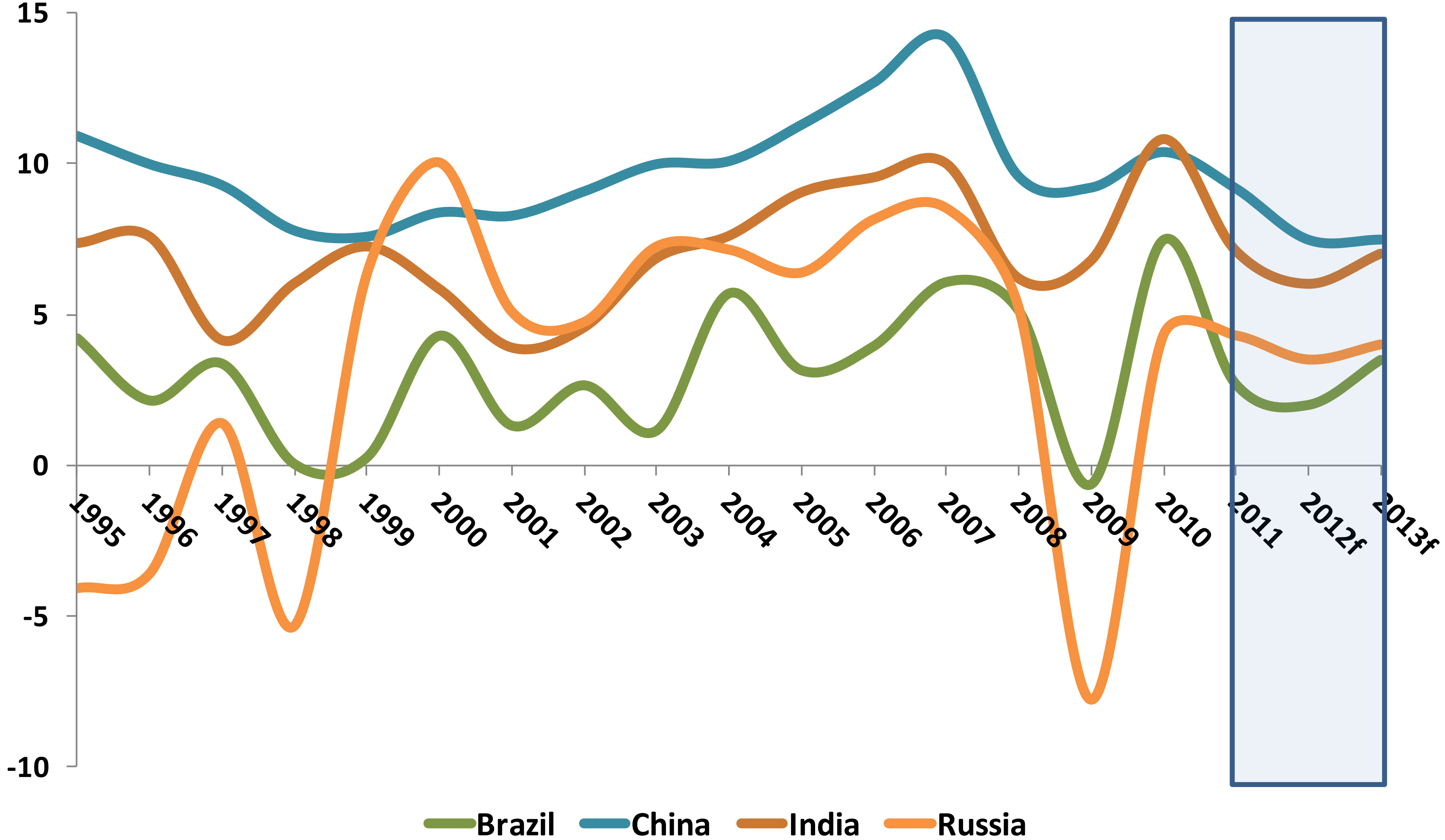


Source: Moody's

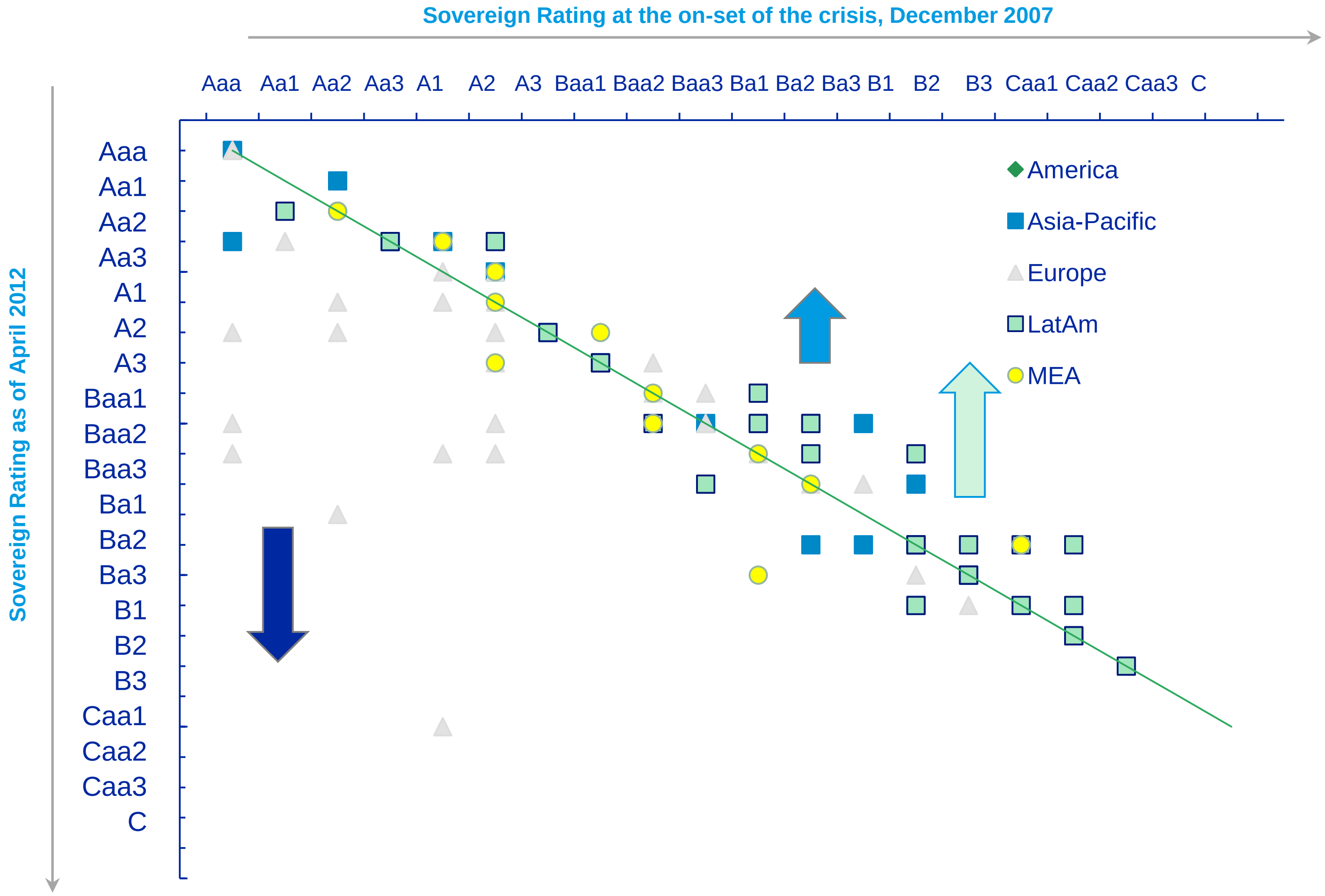
2012-2013 forecasts: Adding some granularity

Countries	2012F		2013F	
	Growth central range	Unemployment central range	Growth central range	Unemployment central range
Argentina	3.5/4.5	--	3.5/4.5	--
Australia	2.5/3.5	5.0/6.0	3.0/4.0	4.5/5.5
Brazil	1.5/2.5	--	3.0/4.0	--
Canada	1.5/2.5	7.0/8.0	2.0/3.0	6.5/7.5
China	7.0/8.0	--	7.0/8.0	--
Euro area	-1.0/0.0	--	0.5/1.5	--
France	-0.5/0.5	9.5/10.5	0.5/1.5	9.5/10.5
Germany	0.0/1.0	5.5/6.5	1.0/2.0	5.5/6.5
India	5.5/6.5	--	6.5/7.5	--
Indonesia	5.5/6.5	--	6.0/7.0	--
Italy	-2.5/-1.5	9.5/10.5	-1.5/0.0	9.5/10.5
Japan	1.5/2.5	4.0/5.0	1.0/2.0	4.0/5.0
Mexico	3.0/4.0	--	3.0/4.0	--
Russia	3.0/4.0	--	3.5/4.5	--
Saudi Arabia	5.0/6.0	--	3.5/4.5	
South Africa	2.5/3.5	--	3.0/4.0	--
South Korea	2.5/3.5	3.0/4.0	3.5/4.5	3.0/4.0
Turkey	2.0/3.0	--	3.5/4.5	--
UK	-0.5/0.5	8.0/9.0	1.5/2.5	8.0/9.0
US	1.5/2.5	8.0/9.0	2.0/3.0	7.5/8.5

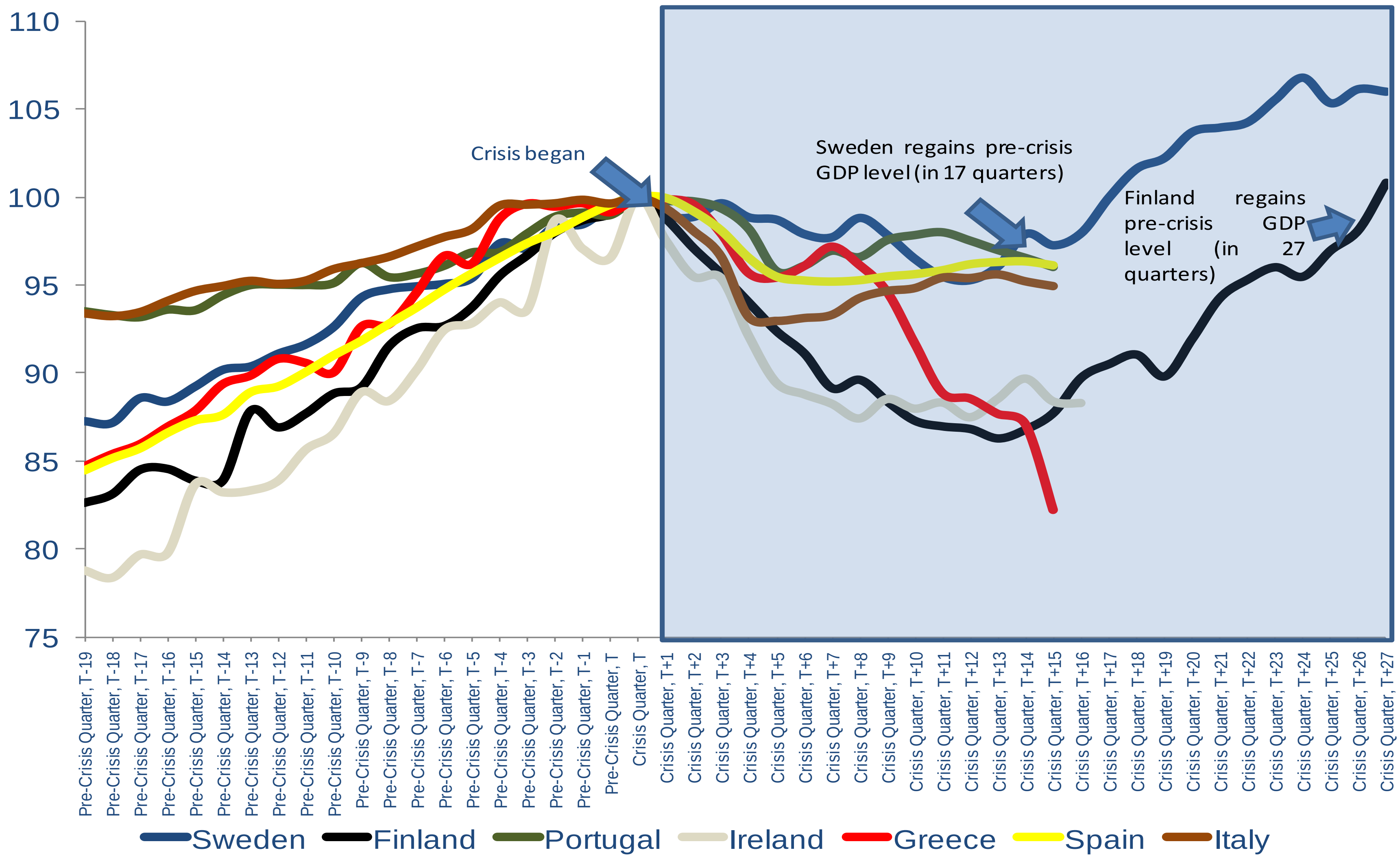
2012-2013 forecasts: GDP growth, BRICs



Regional Rating Trends: Negative in Europe, Positive in Latin America



Adjustment in Europe far from being complete…



Source: HAVER

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Potential effects on Central and Eastern Europe

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Exposures…

» CEE in general very linked to EU

» Not exactly a surprise: sheer geographical proximity to a large, developed market, and several have institutional frameworks that further facilitate strong economic linkages

» This is obviously the case for the EU's MS, but applies to other set of countries too

And by how much? Trade…

	X as a GDP%	X to EU as a GDP%	X to EA as a GDP %	X to EA5 as a GDP %
		EU's MS		
Avg.	*47.6*	*33.5*	*22.8*	*4.1*
Bulgaria	43.2	25.9	18.8	7.5
Czech Rep.	59.0	49.1	38.8	4.2
Hungary	71.0	52.9	38.5	6.0
Latvia	37.9	25.0	11.8	0.9
Lithuania	56.8	33.5	17.8	2.0
Poland	35.3	26.9	18.7	3.1
Romania	30.0	20.8	15.6	5.1
		EU's ACs		
Avg.	21.7	12.6	10.1	5.1
		European Neighbourhood		
Avg.	31.9	12.0	8.2	3.9

Sources: EUROSTAT, DG TRADE, IMF, UNECE

And by how much? FDI…

	EU % of FDI	EA % of FDI	EA5 % of FDI
EU's MS			
Avg.	*84.3*	*71.8*	*6.0*
Bulgaria	88.8	87.4	9.1
Czech Republic	89.0	84.3	4.7
Hungary	77.4	74.5	1.7
Latvia	77.7	51.0	1.4
Lithuania	80.2	41.0	0.5
Poland	86.5	78.2	10.3
Romania	90.7	86.2	13.9
EU's ACs			
Avg.	*76.0*	*64.3*	*16.9*
European Neighbourhood			
Avg.	*46.8*	*30.2*	*1.2*

Sources: EUROSTAT, WIIW, national central banks and statistical offices

And by how much? Bank flows…

	EU	EA	EA5
	EU's MS		
Avg.	*57.7*	*43.5*	*14.3*
Bulgaria	59.2	58.3	37.7
Czech Republic	83.9	81.8	7.9
Hungary	70.5	67.9	16.2
Latvia	60.8	6.7	2.8
Lithuania	40.5	5.6	1.2
Poland	46.7	43.1	17.6
Romania	42.0	41.1	16.6
	EU's ACs		
Avg.	*45.5*	*44.8*	*20.9*
	European Neighbourhood		
Avg.	*6.6*	*5.9*	*2.0*

Source: IMF, BIS.

3 Linkage to Developing countries too

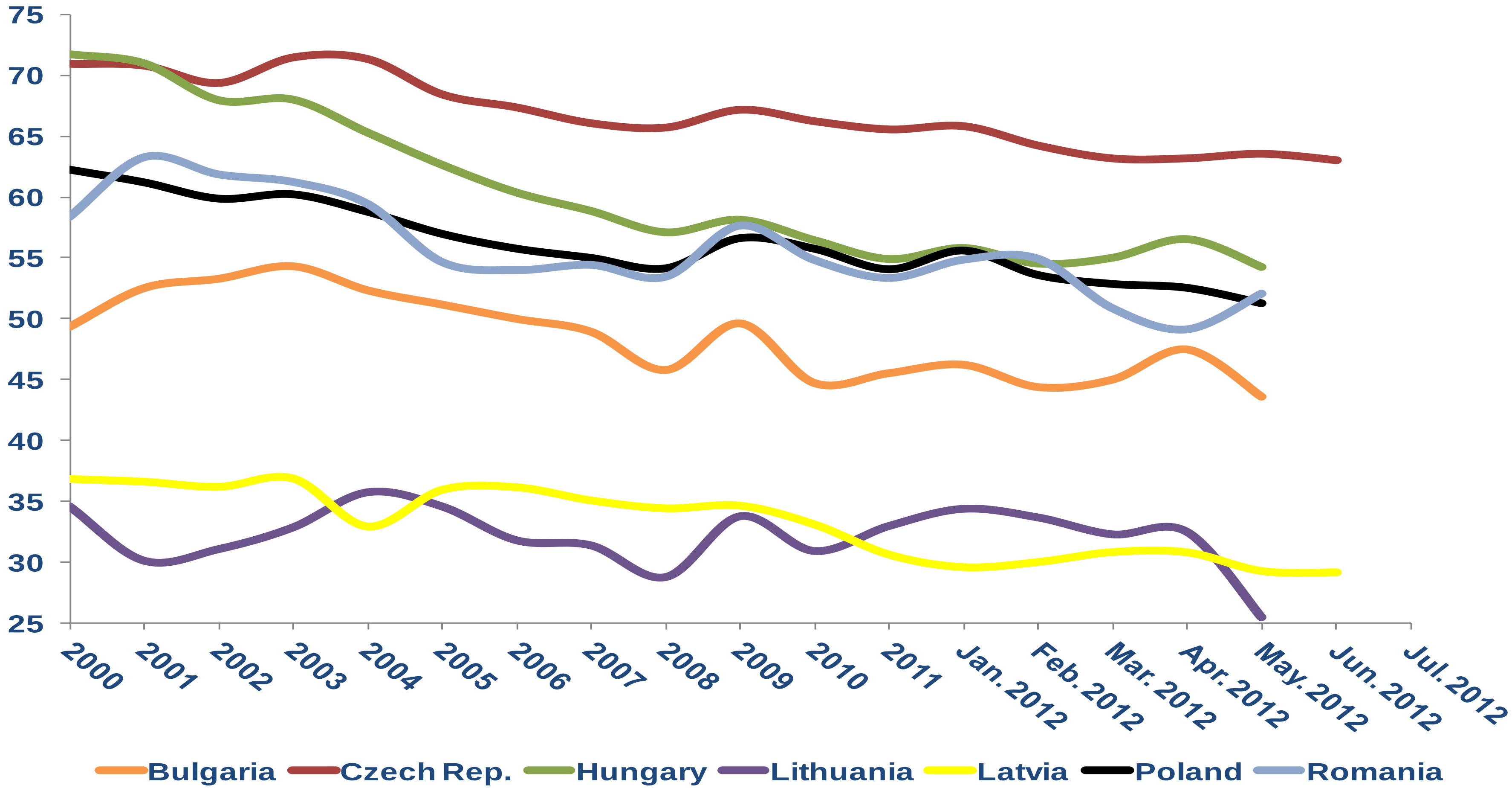
Other “Transitions”….

» Exposures should and can change, in reply to both:

1. Structural changes (the “secular trend” of greater economic clout for Developing nations)…
2. …and cyclical factors (the ongoing cyclical weakness in the EU/EA)

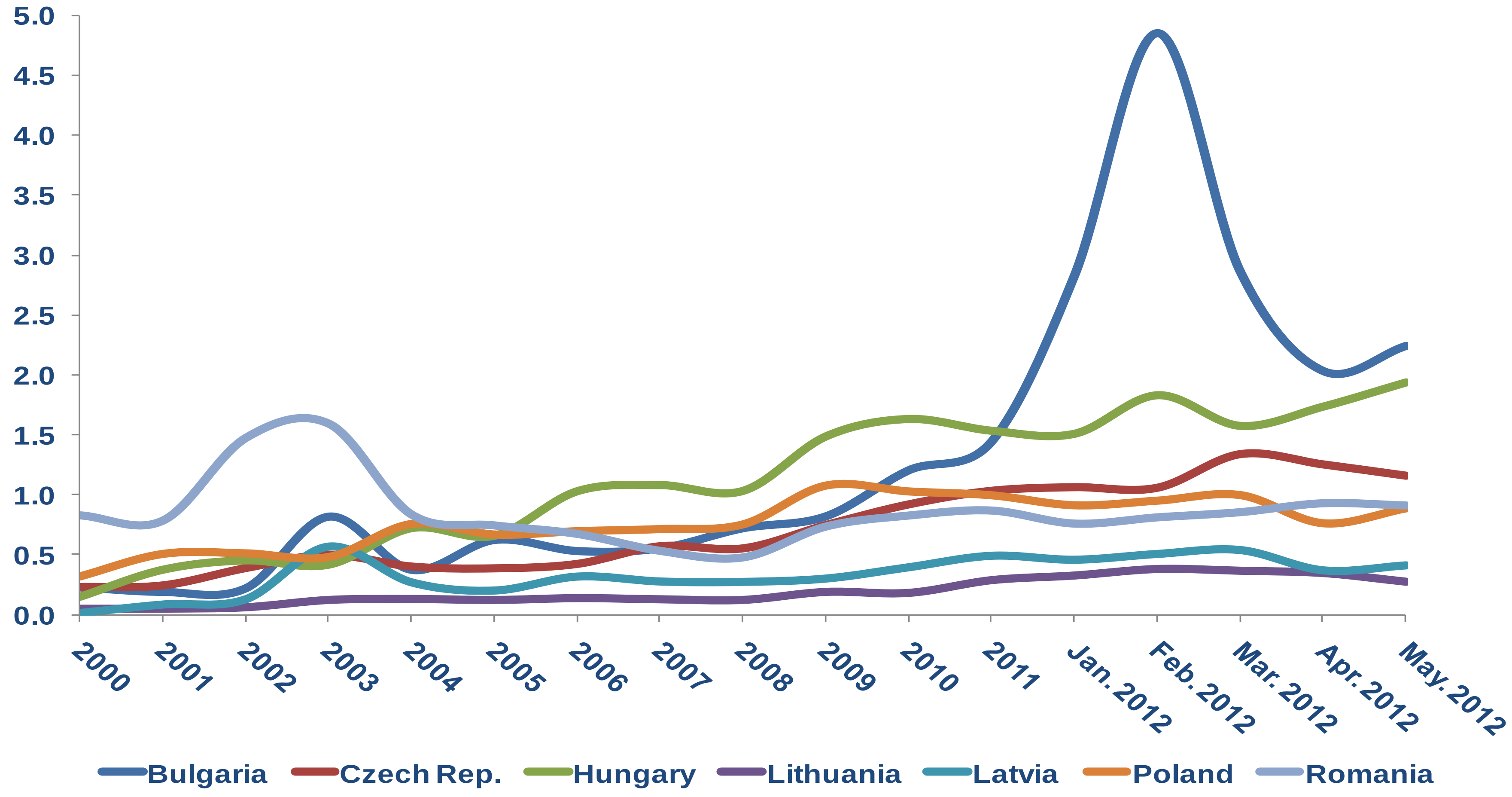
» But has this happened?

Trading away (I): share of EA in exports



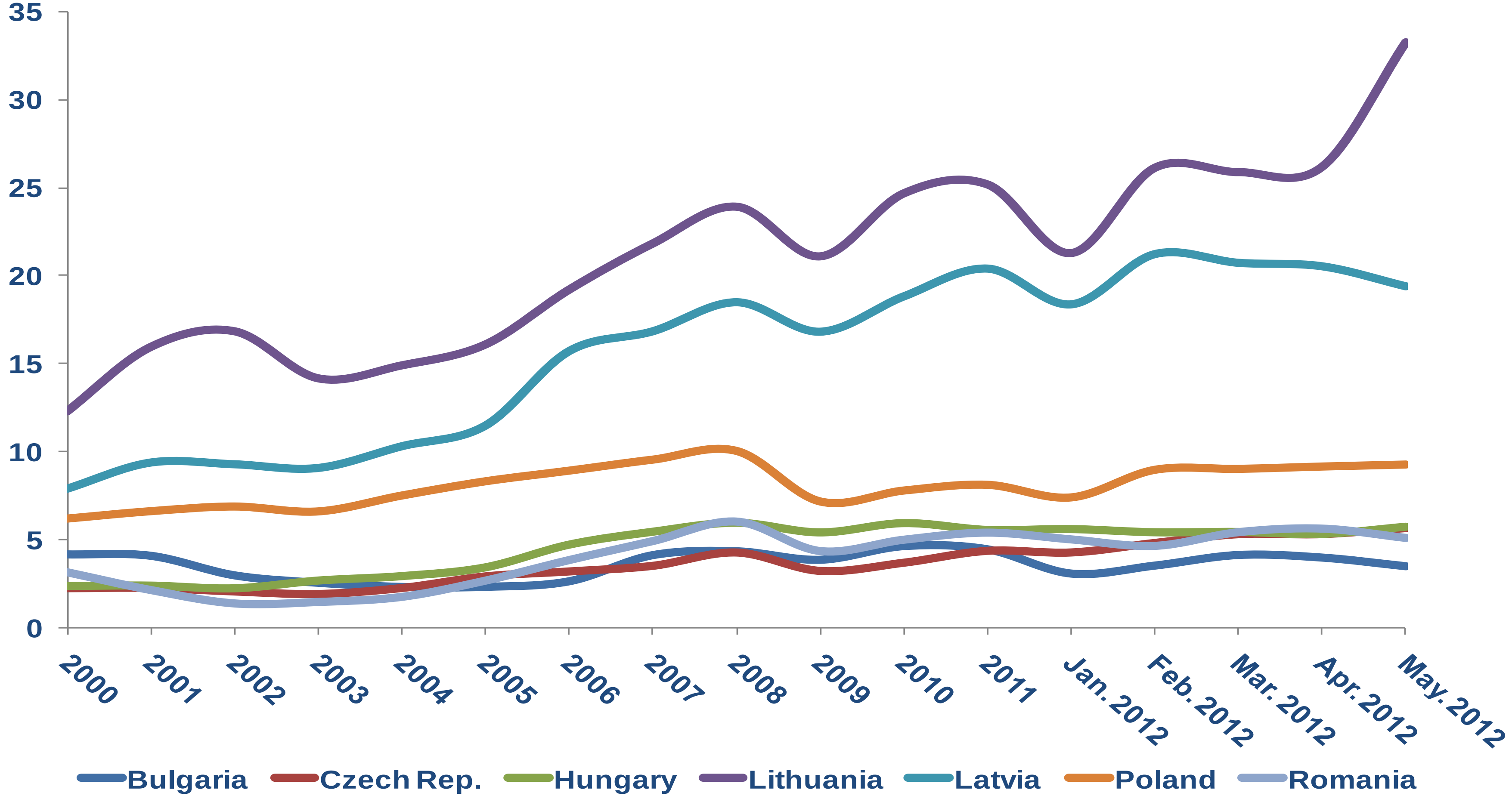
Source: EUROSTAT.

Trading away (II): share of China in exports



Source: EUROSTAT

Trading away (II): share of the Western CIS in exports



Source: EUROSTAT

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Well, not yet

» ..and likely to continue…

» But there is really no escape the conclusion that, for the foreseeable future, the EU will remain being the largest “external shock” that the CEE countries will have to deal with

Examples of Moody's rated entities in CEE – moves in 2011

-	Quality of credit	Moody's	Example
INVESTMENT GRADE	*Gilt-edged*	Aaa	
	Very high	Aa1	
		Aa2	
		Aa3	M6 Duna (BSS)
	Upper-medium	A1	**Slovenia, Czech Rep., Slovakia, Estonia**, Prague, CS, SID Banka, SPP
		A2	**Poland,** CEZ, PKO BP, Tatrabanka, Warsaw
		A3	PGE, Telek. Polska, Elering, Poznan, Tallinn
	Medium grade	Baa1	**Lithuania**, Telco Slovenije, Ceske drahy, Energa
		Baa2	**Bulgaria,** BVS, BPH Bank
		Baa3	**Croatia, Latvia, Romania**, Transelectrica, BCR, BRD, Raiff RO & Raiff BG, DSK, Zagreb
SPECULATIVE GRADE	*Questionable*	Ba1	**Hungary,** PKN Orlen, Hidroelectrica , NLB, NKBM
		Ba2	OTP Bank, K&H Bank, Getin Noble Bank,
		Ba3	**Montenegro**, Corp. Com. Bank, City of Novi Sad, CET 21 (SS), FHB Bank
	Poor quality	B1	**Albania**, NWR, AVG, TVN, Atlas Bank, Veles
		B2	**Bosnia**, Agrokor, Credins Bank, BKT, PBG
		B3	Baltic Int. Bank, Trasta Komercbanka, CME, CEDC
	Very poor or in default	Caa1	
		Caa2	Zlomrex
		Caa3	Petrol BG
		Ca	
		C	

* As of December 2011

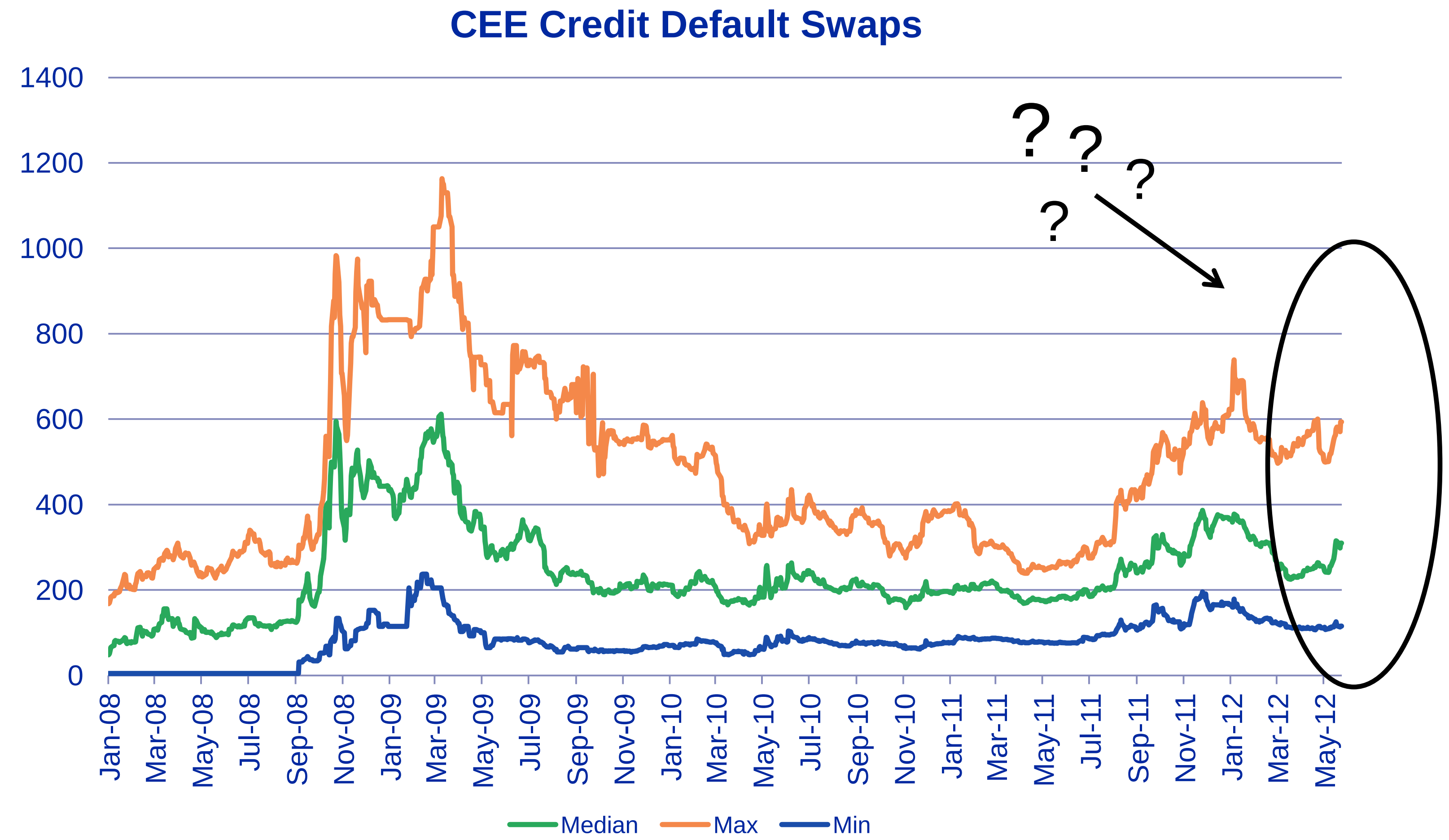
How We Got Here

Rating History*

	Current	8 Year Change	2004	2005	2006	2007	2008	2009	2010	2011
Czech Republic	**A1**	**0**	A1	A1	A1	A1	A1	A1	A1	**A1**
Estonia	**A1**	**0**	A1	A1	A1	A1	A1	A1	A1	**A1**
Poland	**A2**	**0**	A2	A2	A2	A2	A2	A2	A2	**A2**
Slovakia	**A2**	+1	A3	A2	A1	A1	A1	A1	A1	**A1**
Slovenia	**A2**	-2	Aa3	Aa3	Aa2	Aa2	Aa2	Aa2	Aa2	**A1**
Lithuania	**Baa1**	-1	A3	A3	A2	A2	A2	Baa1	Baa1	**Baa1**
Bulgaria	**Baa2**	+3	Ba1	Ba1	Baa3	Baa3	Baa3	Baa3	Baa3	**Baa2**
Croatia	**Baa3**	**0**	Baa3	Baa3	Baa3	Baa3	Baa3	Baa3	Baa3	**Baa3**
Latvia	**Baa3**	-4	A2	A2	A2	A2	A3	Baa3	Baa3	**Baa3**
Romania	**Baa3**	+3	Ba3	Ba1	Baa3	Baa3	Baa3	Baa3	Baa3	**Baa3**
Hungary	**Ba1**	-6	A1	A1	A2	A2	A3	Baa1	Baa3	**Ba1**
Turkey	**Ba2**	+2	B1	Ba3	Ba3	Ba3	Ba3	Ba3	Ba2	**Ba2**
Montenegro	**Ba3**	-1	NR	NR	NR	NR	Ba2	Ba3	Ba3	**Ba3**
Albania	**B1**	**0**	NR	NR	NR	B1	B1	B1	B1	**B1**
Bosnia & Herzegovina	**B3**	**0**	B3	B3	B2	B2	B2	B2	B2	**B2**

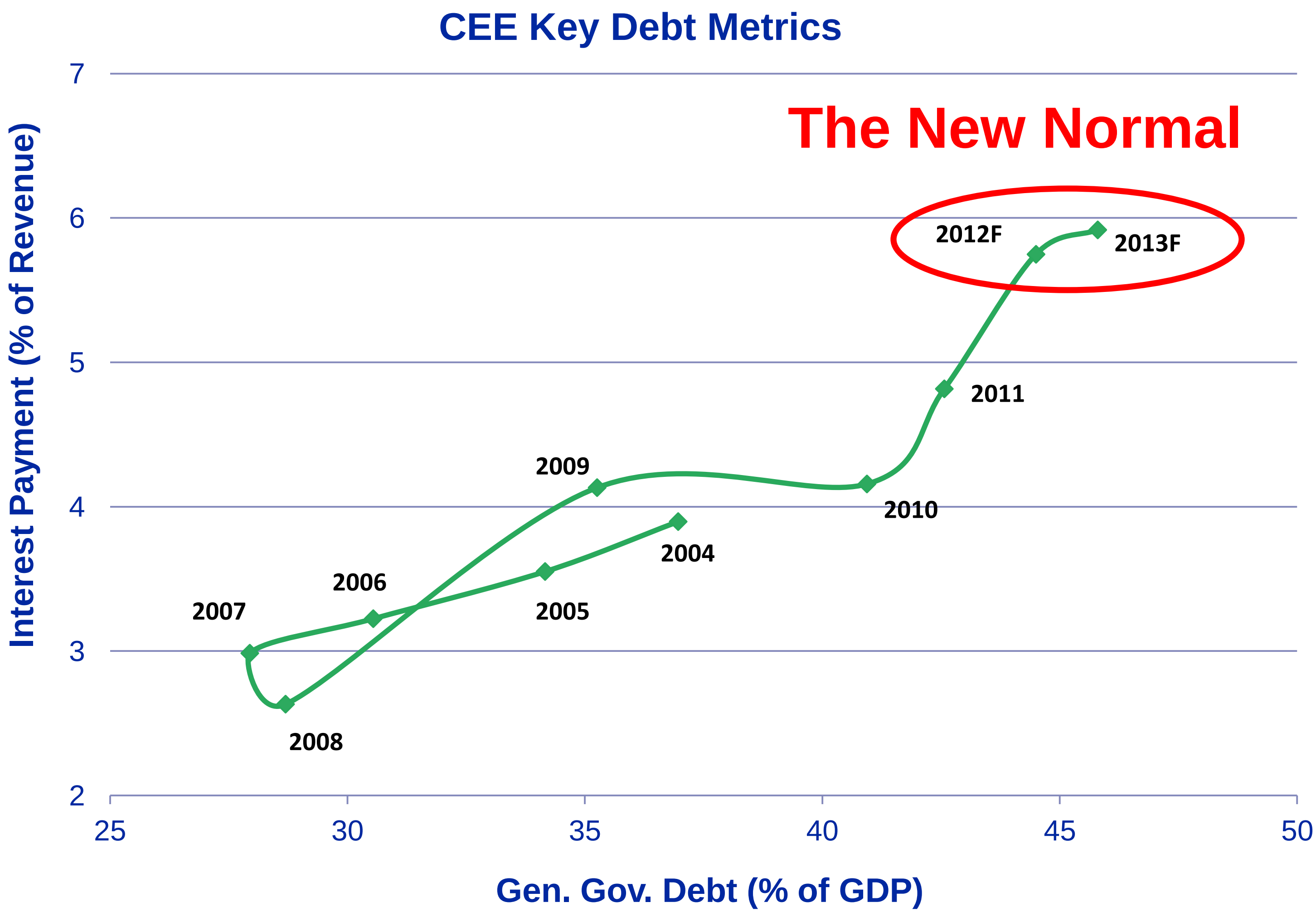
*Rating at year-end, data as of June 2012

Where to NOW...?



Source: Bloomberg

A “New Normal” For CEE



Source: Eurostat and Official National Sources

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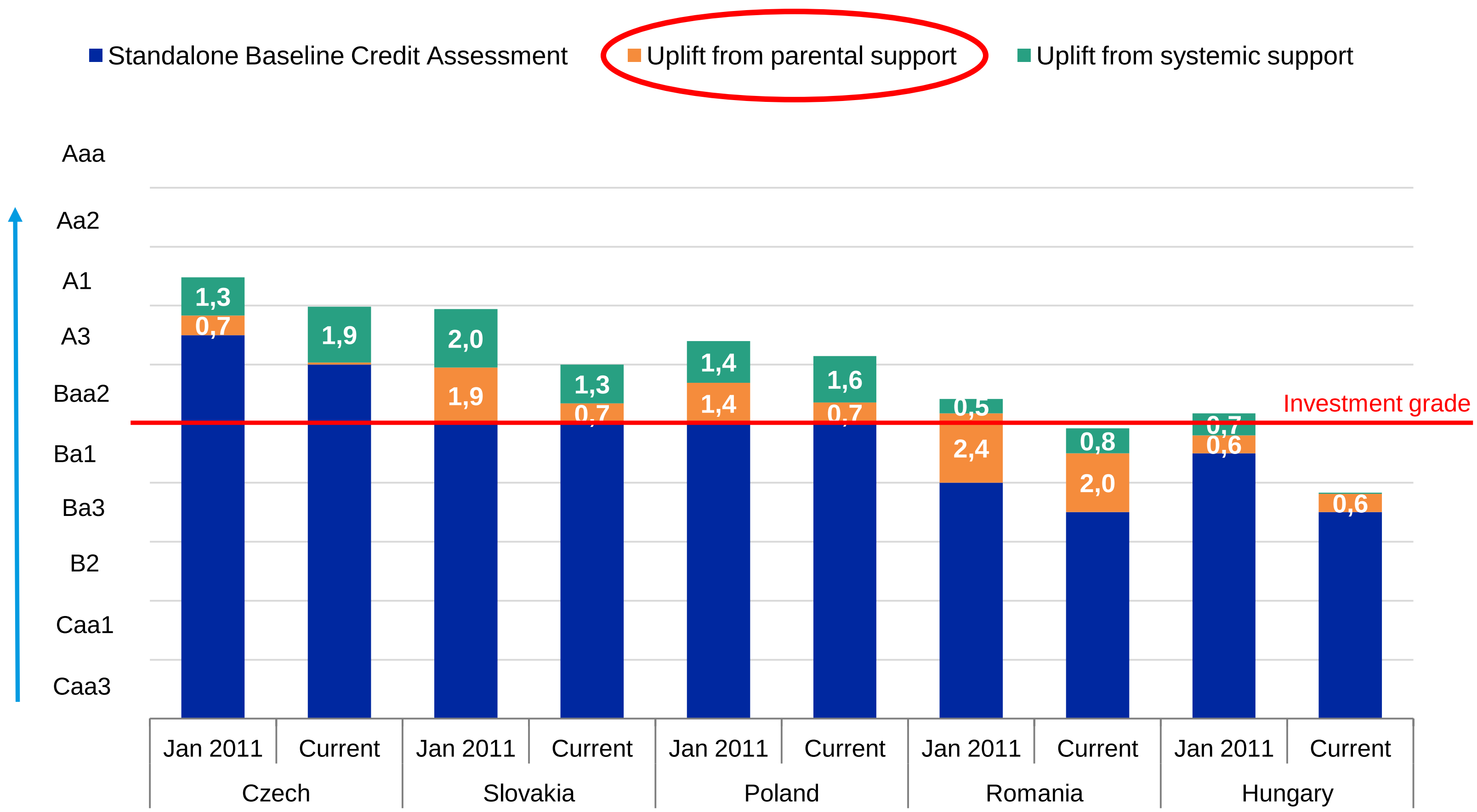
Banks – recent changes in ratings

Rating developments in the CEE in 2012…

» …principally driven by parental downgrades affecting the supported ratings of CEE subsidiaries

» – Reduction in uplift from parental support



Parental support considerations:

- How we define parental support?
  - Financial strength of the parent (expressed as stand-alone rating) …

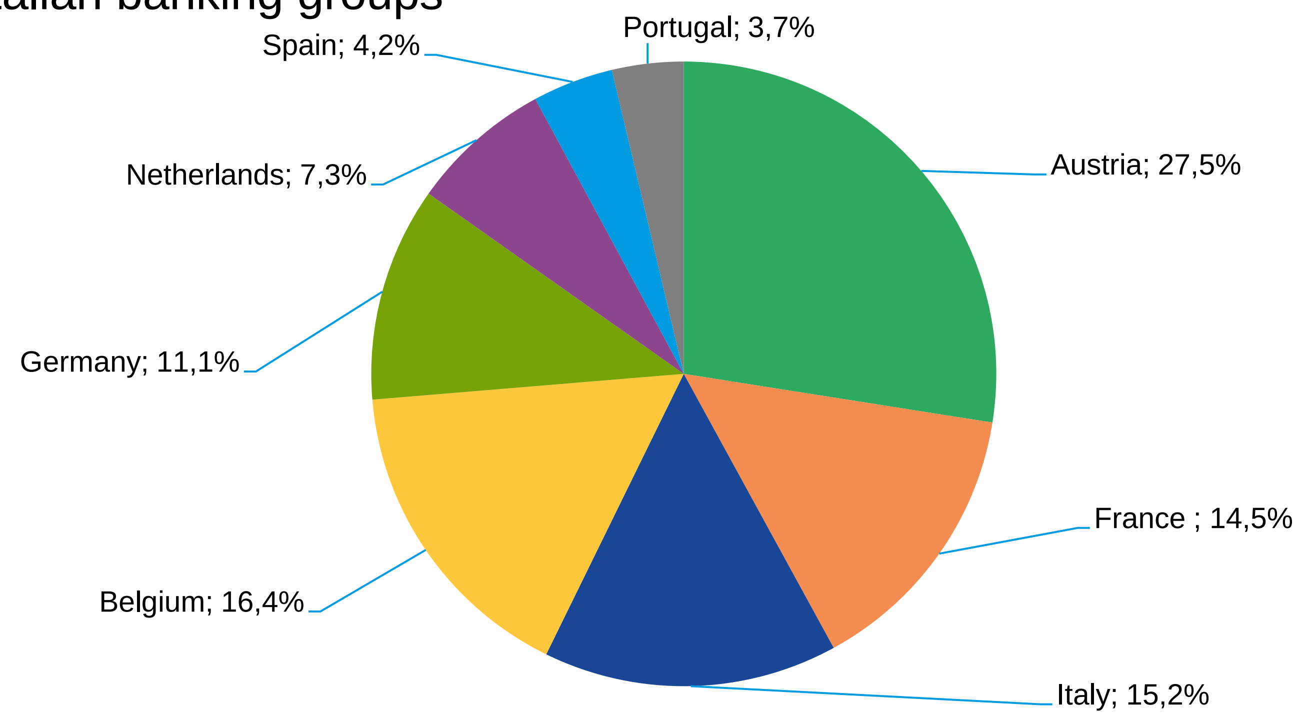
  …and resulting *willingness* and *capacity* to support subsidiaries

- What *constrains* parental support in the current market?
  - Regulatory pressures on capital and liquidity on parent banks
  - Parents' strategic priorities are shifting towards national / domestic markets
  - Long-term potential of some foreign markets is reassessed under new funding conditions

Moody's view: when resources are limited parent banks will prioritise their *core franchise* at the expense of foreign operations

West European ownership in the CEE banking systems

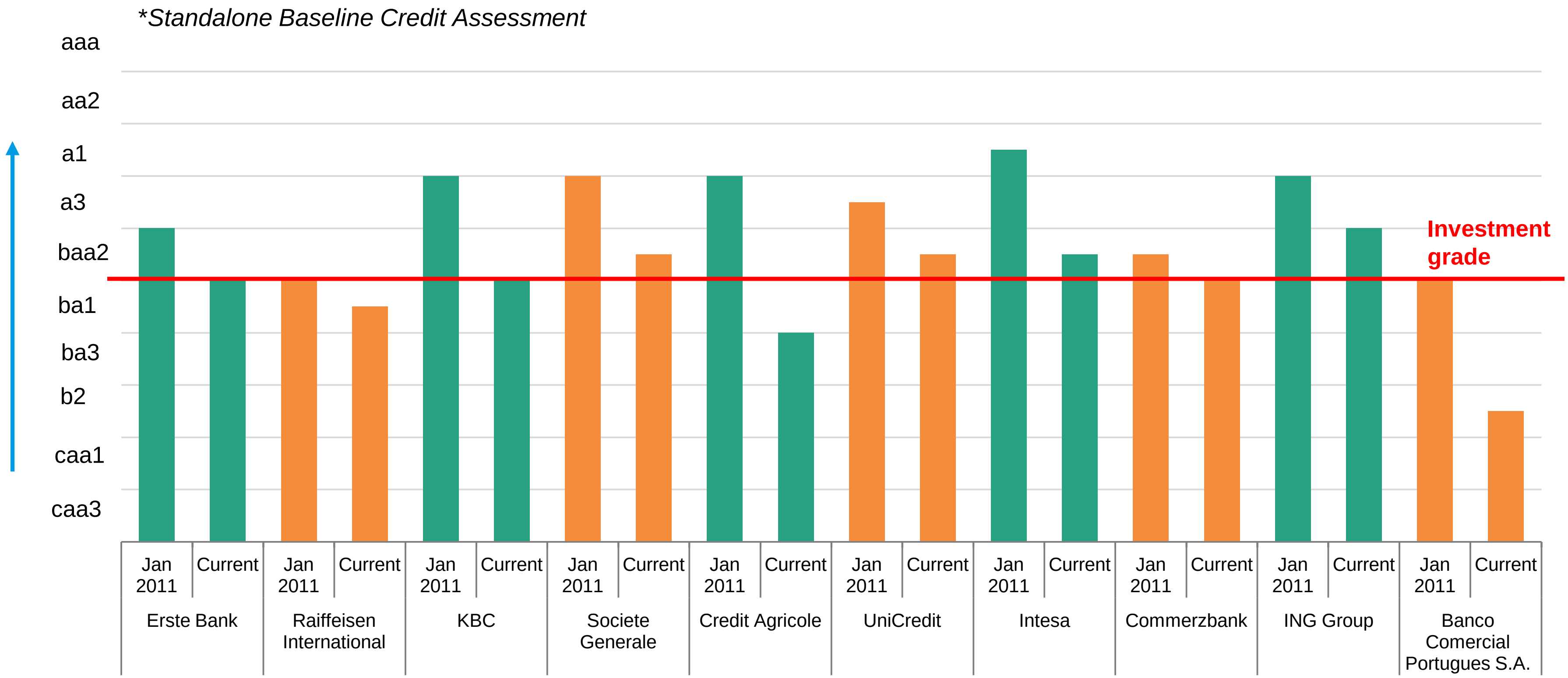
» Meet the parents: The largest parental groups exposed to the CEE are Austrian, Belgian,
Italian banking groups



Note: The chart depicts the split of foreign ownership within following CEE banking systems: Czech Republic, Hungary, Poland, Slovakia and Romania)
Source: Moody's Investors Service, Banks' IFRS reporting as of YE 2011

Rating developments on the West European parents

» *Standalone ratings declined*: Average 3 notches for the major West European parents since the beginning of 2011



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Inverse gap: Can a subsidiary be stronger than the parent bank?

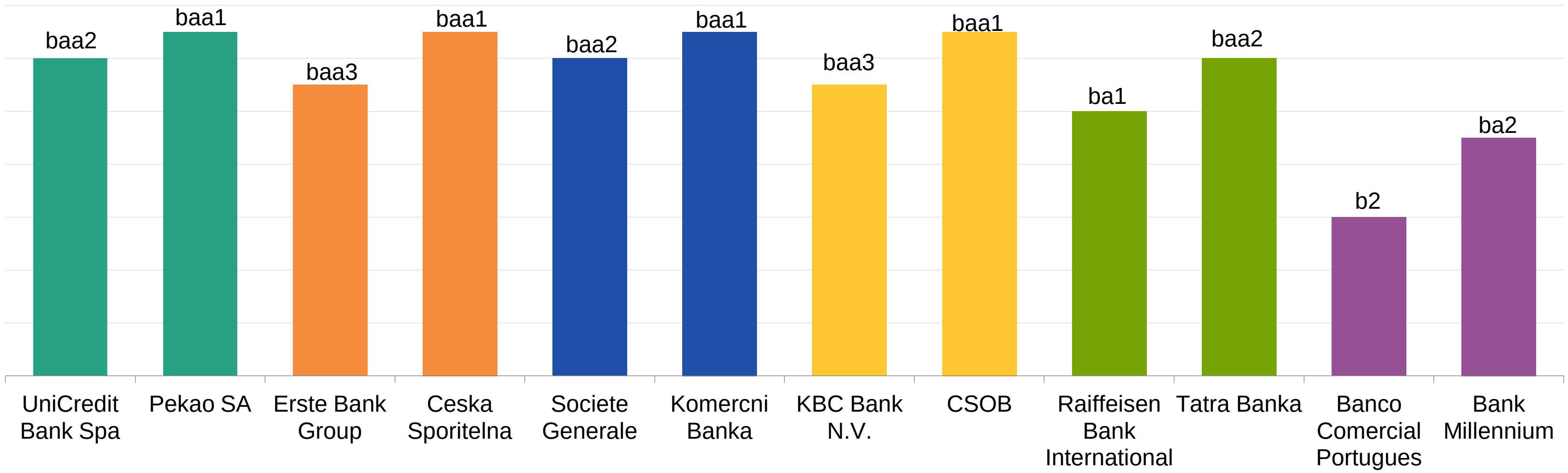
Can I do better than my parent bank?

» For the “Inverse Gap” Moody's considers *inter alia*:

- Sub’s domestic market is insulated from the macro pressures affecting the parent
- Ownership structure and board composition - representation of the other stakeholders, minorities
- Brand association, risk management and shared client-base with the parent
- Strength of standalone independent franchise of the subsidiary
- Exposure to the parent on the both sides of the balance sheet
- Funding structure of the subsidiary / nature of intercompany transactions
- Strong regulatory ring-fencing from undue parental interference / capital repatriation

- Not formulaic model – case-by-case basis

CEE subsidiaries that are higher rated on a stand-alone basis vs parent banks



*Standalone Baseline Credit Assessment

Moody's view: *Fully* delinking parent/sub ratings may be impossible to achieve in practice

– Can the subsidiary survive if the parent defaults – group-wide contagion?

– Severely underperforming parents may drag down well-performing individual subsidiaries in the current market

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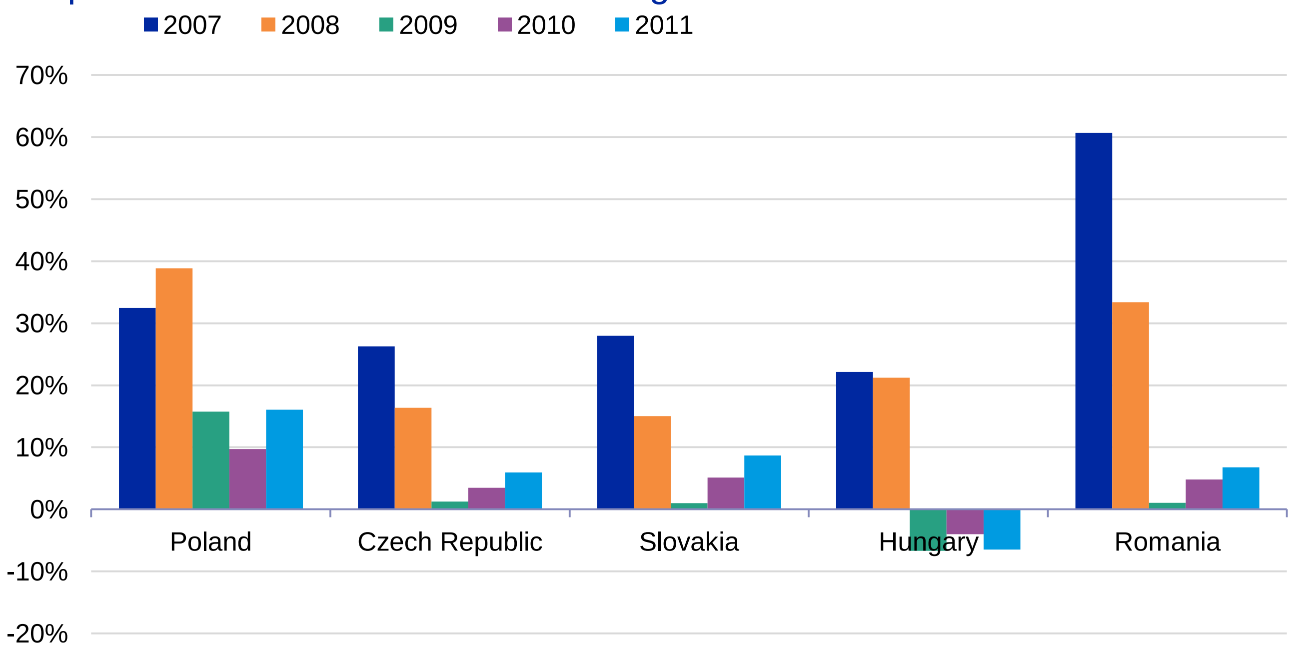
What is different: 2009 vs 2013

European trends are affecting the CEE market

- Current retrenchment resembles 2009
- Defensive strategies dominate banks' outlooks for 2013
- Expect: competition for retail deposits and profit pressures

» What is different?

Loan-portfolios are more seasoned: loan growth rates of banks between 2007 and 2011



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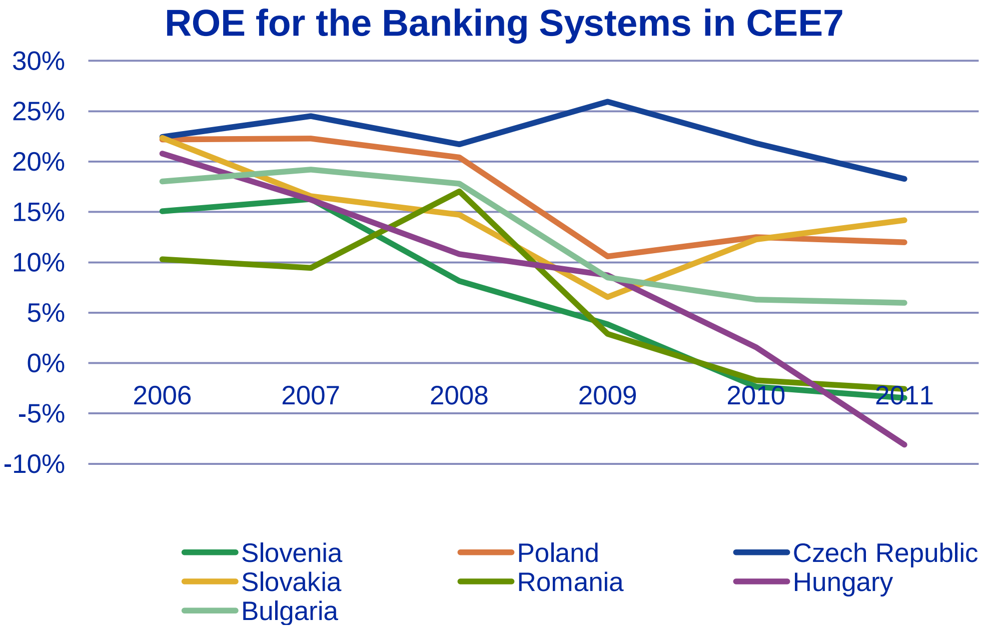
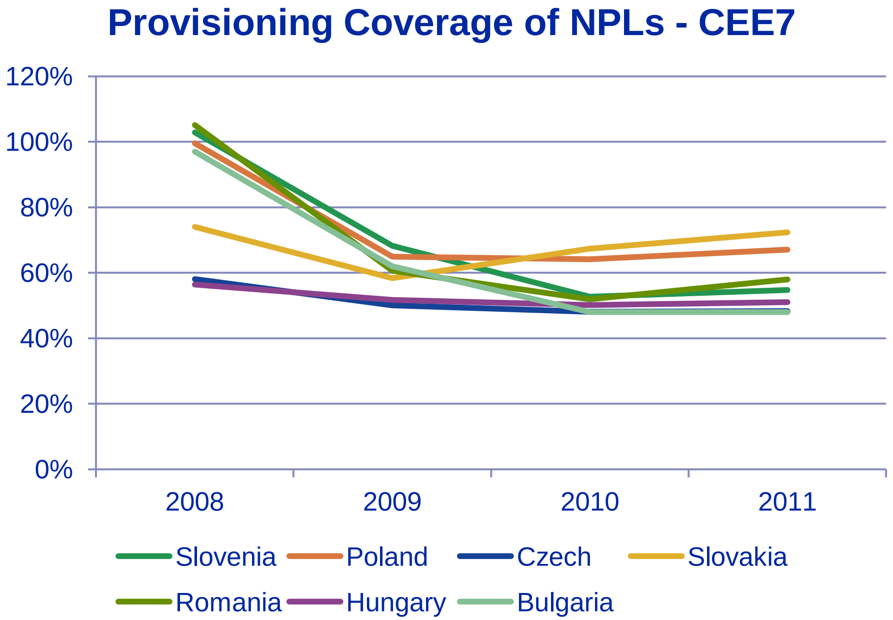
NPLs increasing while Profitability going down

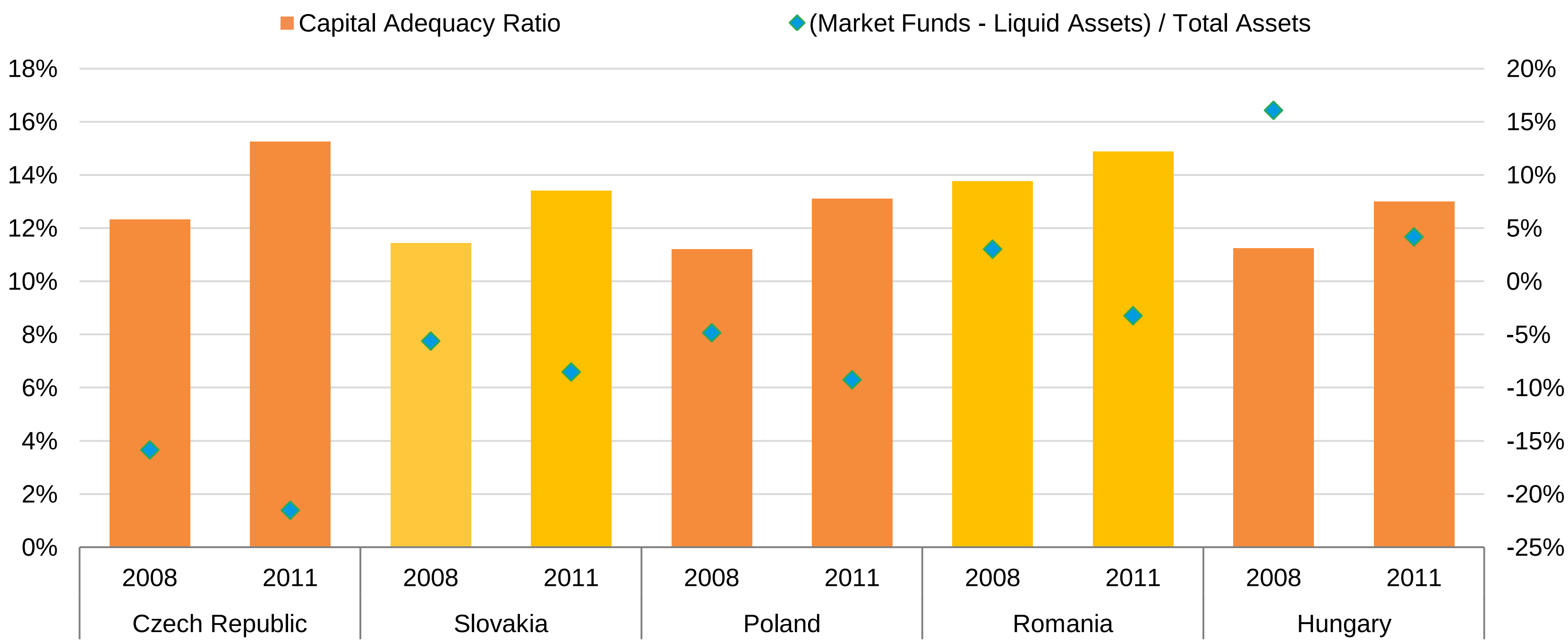
- Lower buffer from superior pre-crisis profitability
- Deteriorating asset quality – i.e., rising non-performing loans (NPL)
- Lower NPL coverage by provisions – i.e., higher write-off risks





European trends are affecting the CEE market

Both capital and liquidity ratios of CEE banks are more robust 2008 vs. 20011



- NB – decline in the (market funds-liquid assets)/Total asset ratios means improvement in the liquidity position

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European trends are affecting the CEE market

Moody's view: 2013 compared with 2009

– Three stronger banking systems (Czech, Poland, Slovak) have enhanced internal capacity to weather the expected retrenchment

– Hungary and Romania will be weighed down longer - Western parents are not generous anymore

– However, the shock from external environment could be even more profound in 2013 vs 2009

Summary – key takeaway messages

- Parental rating actions were decisive in affecting ratings of the CEE subsidiaries in 2012
- On average the parental support has become more selective i.e. pushing the subs towards increased independence
- European wide retrenchment is influencing the strategies (and ratings) of the CEE subs in 2013
- Some of CEE banks can maintain stronger credit profiles compared to the parents under special circumstances
- In the next year:
  - The three leading banking systems have internal buffers to deal with the retrenchment
  - The two struggling systems will remain underperforming longer
  - However, external shock from the EU turmoil can be long-lasting compared to the initial stages of the crisis

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moodys.com

Petr Vins

General Manager, CEE

T +420 – 224.222.929

petr.vins@moodys.com

Katerina Blahutova

Associate Business Development

T +420 – 221.666.362

katerina.blahutova@moodys.com