Panel Discussion

Financial Sector Issues in Central Europe

ICEG EUROPEAN CENTER

Laszlo Balassy

Head of Citi Markets & Banking

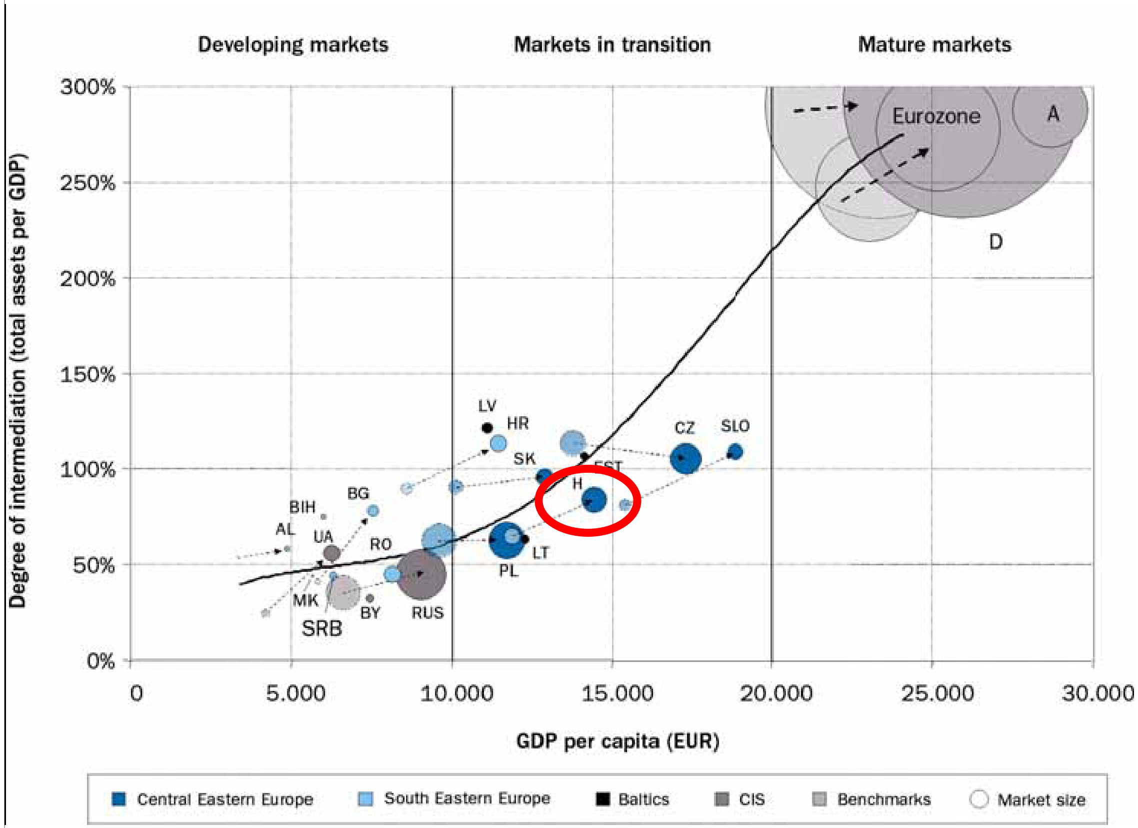
Citibank Zrt, Hungary

26 March 2008

CE Banking Market Still Has a Huge Potential...

The banking sector in Central Europe has already come a long way, but there is still far to go before growth opportunities are capped by structural ceilings

Degree of intermediation and GDP per capita between 2001-2005



Source: Central and Eastern European Banking Study 2007, zeb/, EFMA

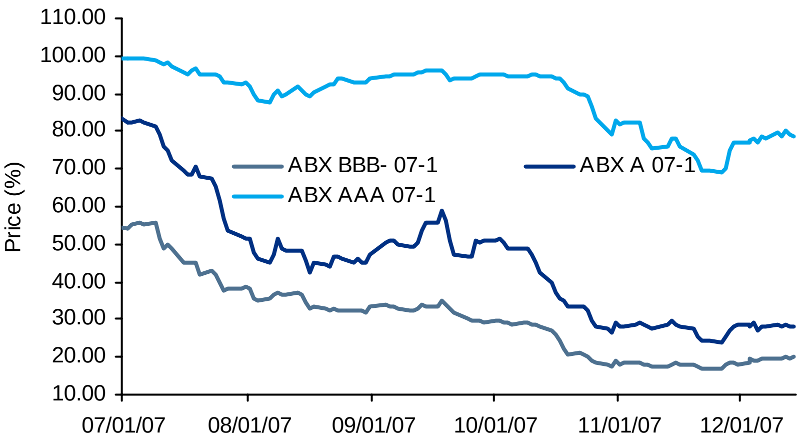
- **CE is still the most dynamic and very profitable banking region in Europe with strong expected growth rates for the coming years**
- Based on banking intermediation, CE banking markets are still far away from reaching the status of mature markets
- This lag is caused by the lack of full integration of banking services and products into the daily life of customers
- The future growth of the CE banking markets will be affected by
  - A higher GDP per capita ratio and
  - The increasing influence and importance of the financial market

* Source: zeb/, EFMA

... But Current Market Environment Will Limit Growth

The credit turmoil of July 2007 brought the leveraged finance market to a standstill, and led to $120+bn of credit related write-downs among banks and brokers so far

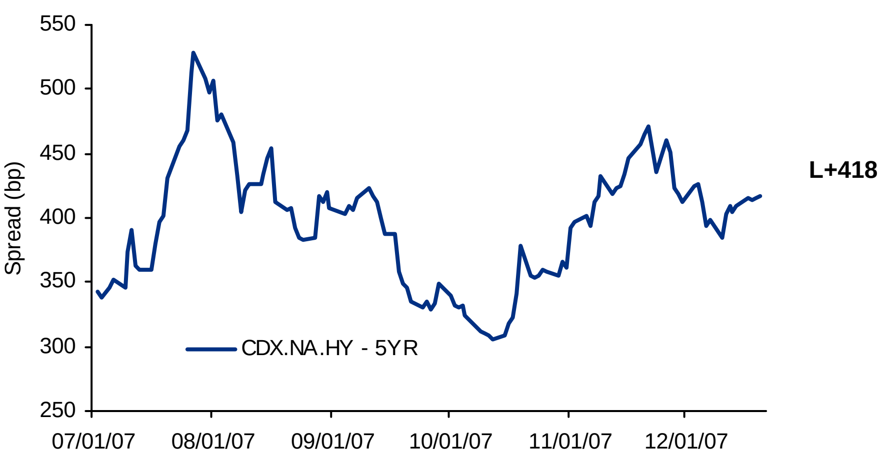
Subprime Mortgage Indices



Financial Impact on Banks and Brokers

- $120+bn announced write downs. Some estimates total losses may reach even $3-400 bn
- $30+ bn equity infusions (mainly from SWF)
- $25+bn hybrid capital raised
- Bear Stearns bail out

High-Yield Bond CDS Index



CDX NA HY Index (the "HY Index") is composed of a hundred **non-investment grade** high-yield bond issued by companies domiciled in North America with equal weighting.

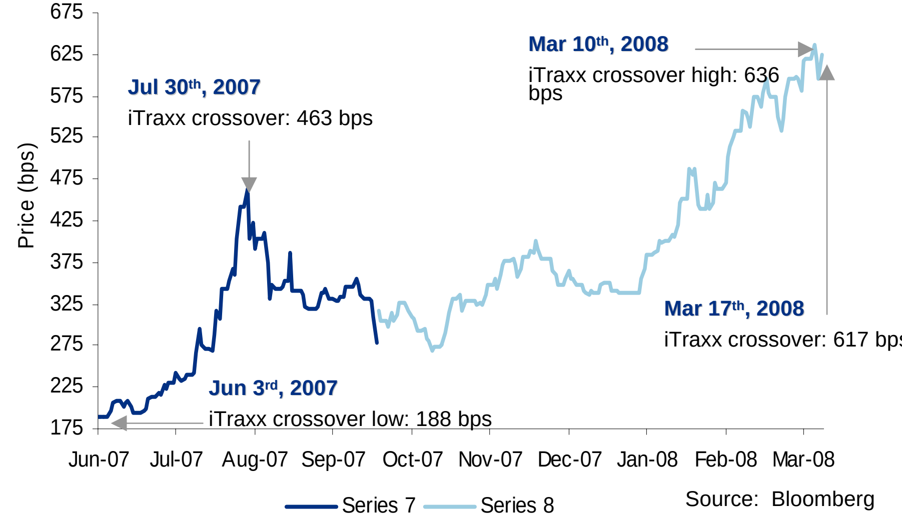
High-Yield Loan Index

LCDX is a tradable index with a hundred equally-weighted underlying single-name **loan-only credit default swaps** (LCDS). The default swaps each reference an entity whose loans trade in the secondary leveraged loan market, and in the LCDS market.

Risk Premiums and Volatilities Have Increased

VIX – Equity Volatility Index

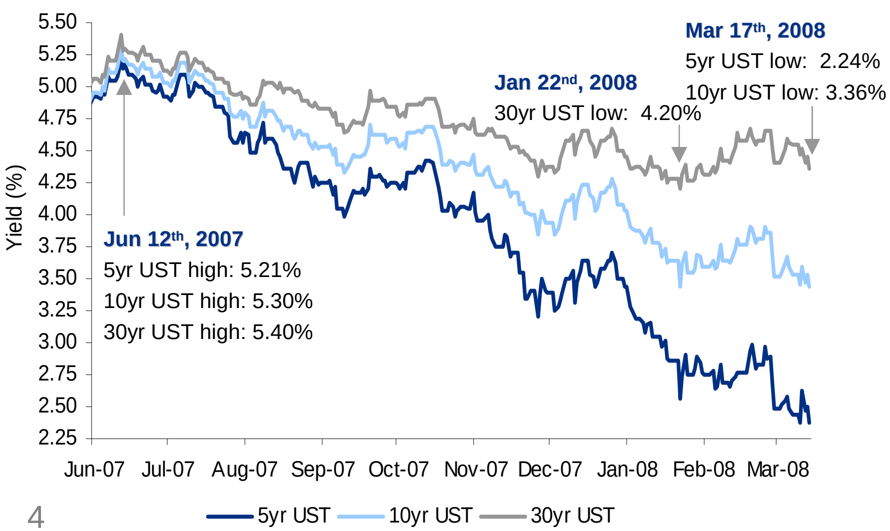
iTraxx Crossover 5-year – CDS Index



Source: Bloomberg

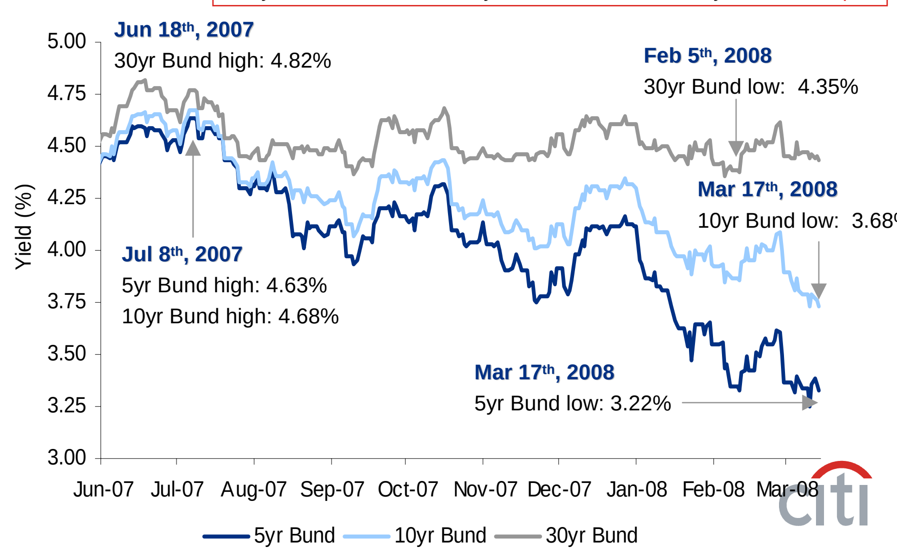
UST Yields

Mar 10th, 2008	Mar 17th, 2008	Yield Diff
5yr UST: 2.38%	5yr UST: 2.24%	5yr UST: -14bps
10yr UST: 3.46%	10yr UST: 3.36%	10yr UST: -10bps
30yr UST: 4.47%	30yr UST: 4.31%	30yr UST: -16bps



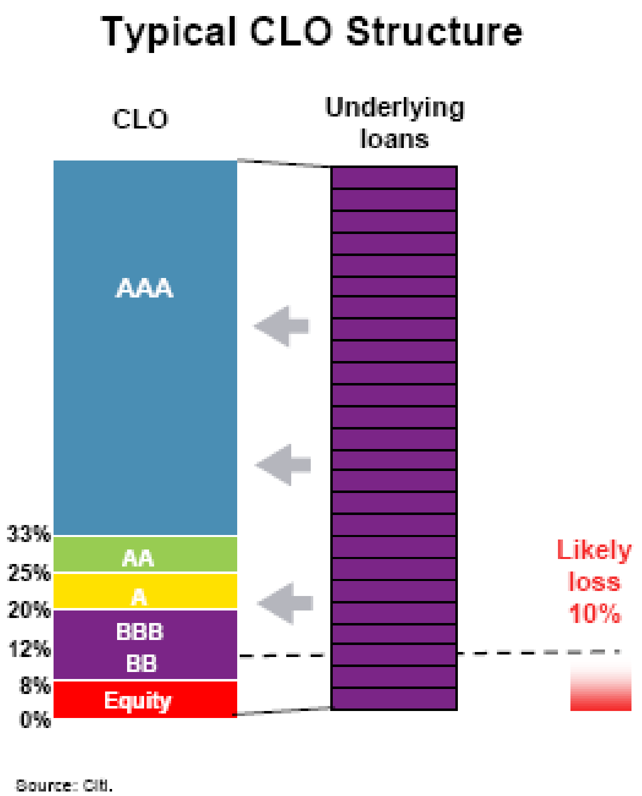
Bund Yields

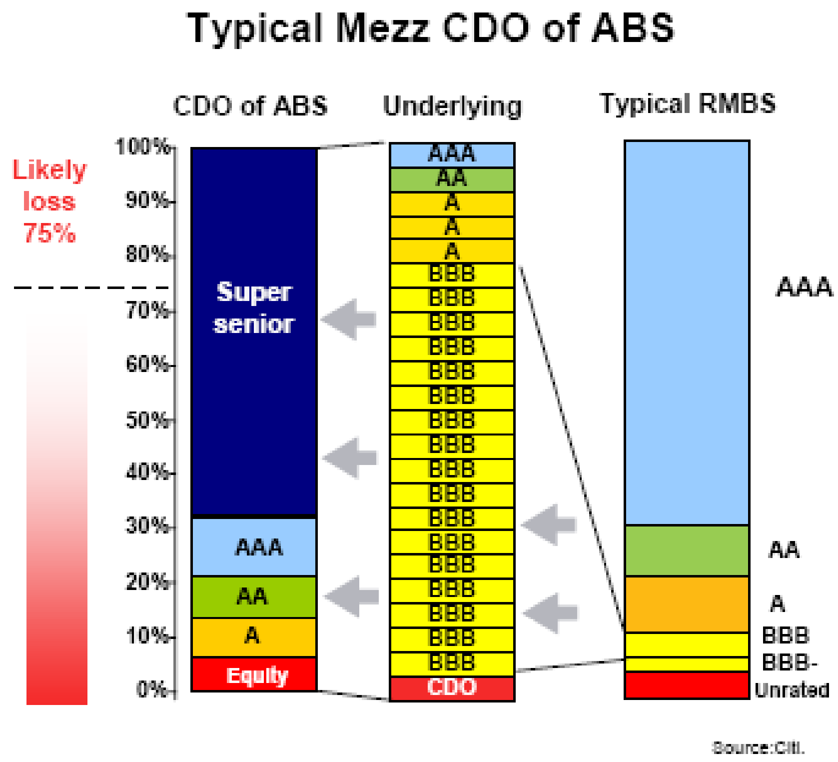
Mar 10th, 2008	Mar 17th, 2008	Yield Diff
5yr Bund: 3.25%	5yr Bund: 3.22%	5yr Bund: -3 bps
10yr Bund: 3.73%	10yr Bund: 3.68%	10yr Bund: -5 bps
30yr Bund: 4.44%	30yr Bund: 4.43%	30yr Bund: -1 bps



Understanding the Writedowns

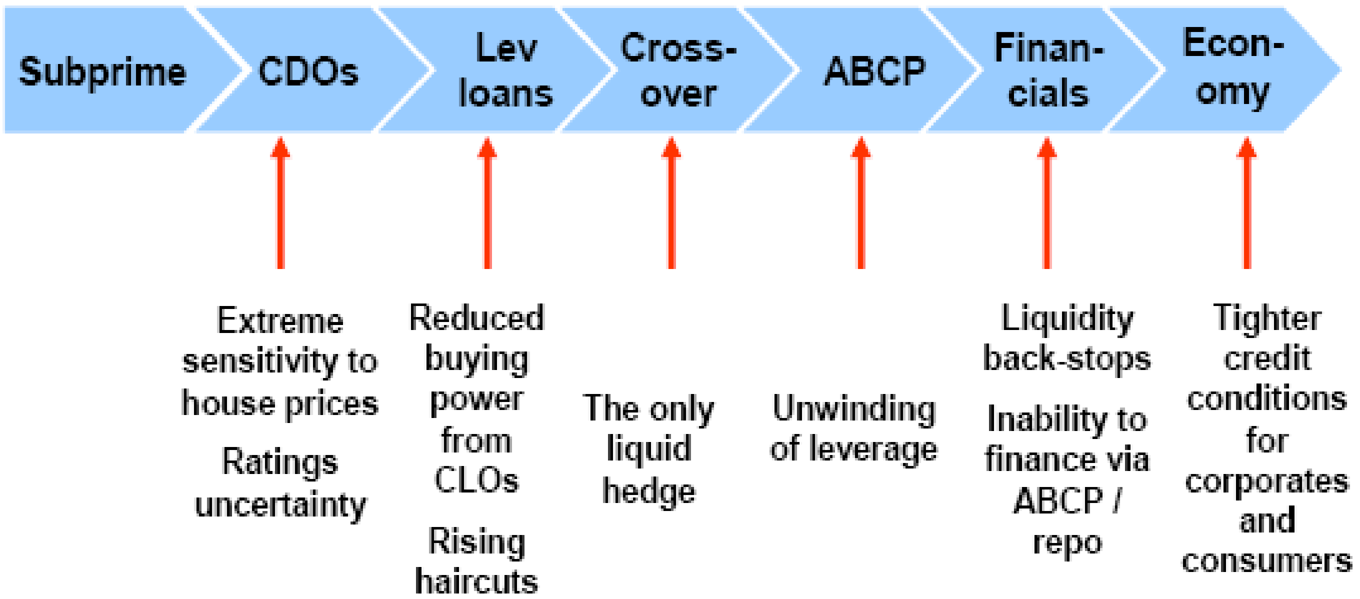
The extra layer makes CDOs of ABS unique. CDOs of ABS have a vulnerability at the senior tranche level.





Mapping the Markets Affected

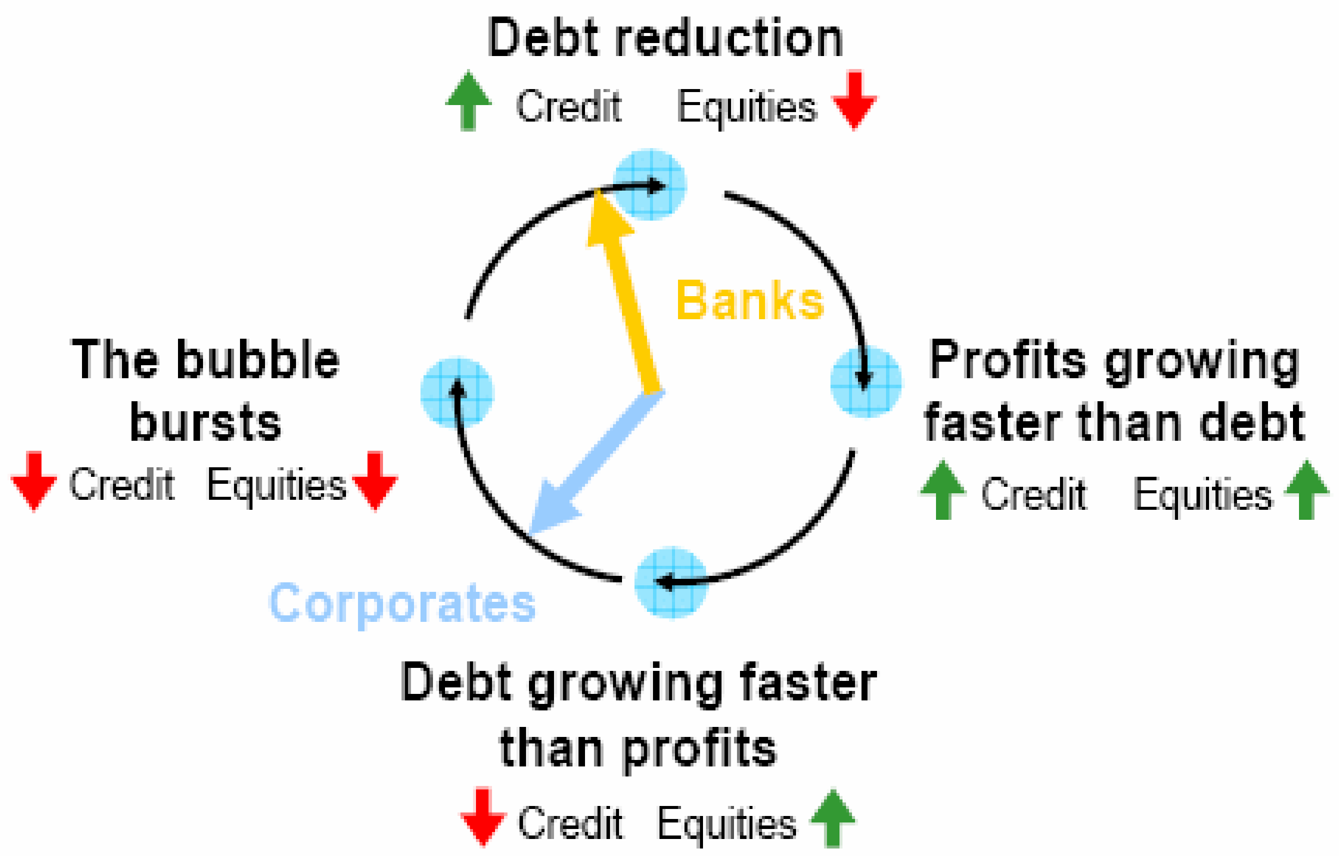
Although sparked by US markets, the globality of the financial markets transmits impacts to Europe



Source: Citi.

The Leverage Cycle

Financials are raising equity even as corporates are still buying it back



What Does it Mean for Central Europe?

Banks

- European banks are dominant in Central Europe – with less direct exposure to the core of the crisis
- Though secondary impacts (e.g. repricing of risk) will put pressure on the European banks as well
- Competition and relationship considerations may limit their ability to pass on repricing
- Balance sheet is becoming a scarce resource because of
  - Liquidity
  - Cost of Funding
  - Capital Adequacy
  - Return on Capital
- Acquisition financing as a large engine of corporate banking growth to be challenged by markets, asset prices, revaluation of collateral

Corporates

- Higher funding cost
- Reduced bank appetite
  - Amounts
  - Tenors
  - Terms
- Higher WACC, lower IRR
- Reduced financial flexibility
- Increased refinancing risk

Well capitalised and liquid firms (both corporates and banks) may see significant buying opportunities