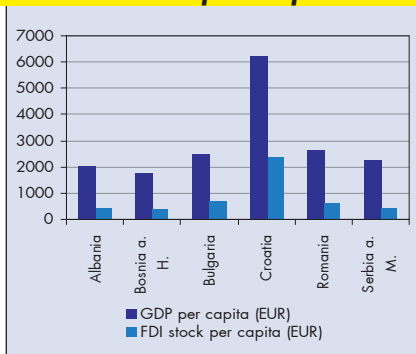


South East Europe in the spotlight

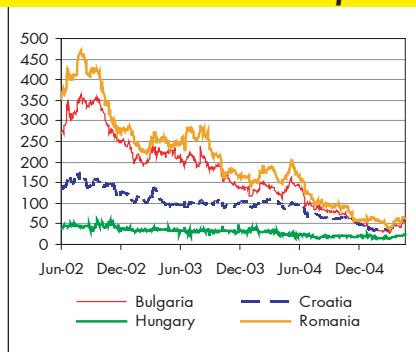
May 2005

GDP and FDI per capita



Note: Figures for 2004, in EUR
Source: WIIW, local national banks

Risk assessment development



Note: EUR EMBIG government spreads (bp)
Source: JP Morgan, Raiffeisen Research

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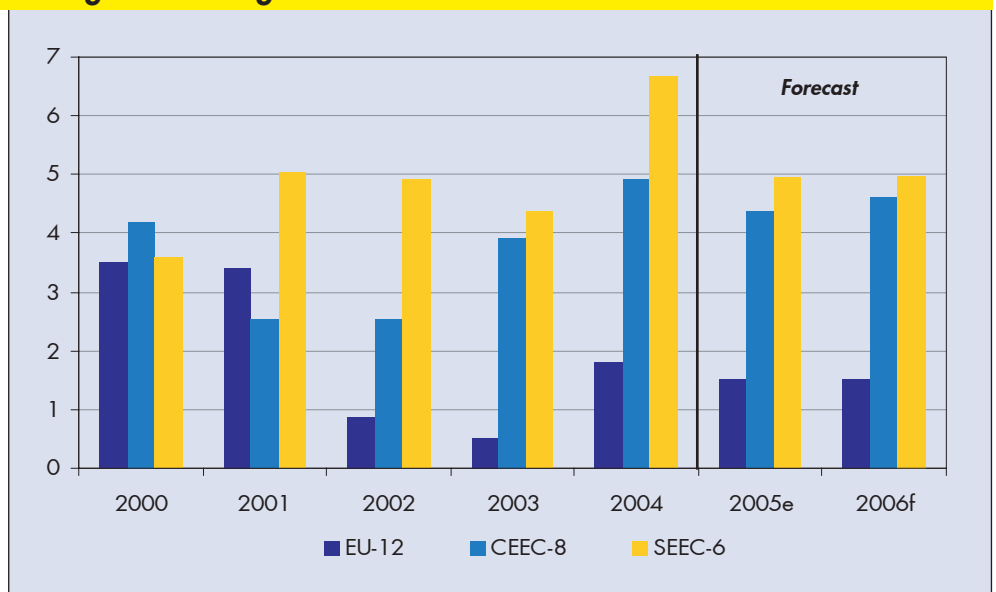
Highlights

■ Looking back at our initial issue of "South East Europe in the spotlight" from October 2003 we can identify significant developments that have taken place in the meantime, both with respect to the region's journey towards EU integration and in terms of economic development.

■ Bulgaria and Romania completed their membership negotiations in 2004 and signed EU Accession Treaties on 25 April 2005. Pending a positive monitoring report, which will be published by the European Commission (EC) in November, and the ratification of all 25 present EU member states, Bulgaria and Romania are scheduled to join the EU on 1 January 2007. A breakthrough was also achieved in the case of Serbia and Montenegro, with the EC's positive feasibility report on a Stabilization and Association Agreement (SAA). If the remaining hurdles for reaching SAAs with all countries can be cleared by 2007, EU enlargement in SEE could possibly be completed by 2014, a date with significant symbolic value.

■ Real GDP growth remained strong and even accelerated in 2004 with an average growth rate of 6.5%. Inflation continued to decline, but still remained relatively high at 8% on average in 2004. High current account deficits of 8.7% of GDP on average in 2004 continue to reflect structural deficiencies and remain a threat to macroeconomic stability, but the financing of the deficits has improved overall due to the increase in foreign direct investment (FDI). A considerable part of the FDI inflow was generated by the ongoing process of bank privatisation, which is generally seen as an important step towards economic restructuring and bodes well for future economic development.

Strong economic growth in SEE countries continues



Note: Real GDP growth, % yoy
Source: Thomson Financial Datastream, WIIW, Raiffeisen Research



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South East Europe *in the spotlight*

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SEE in the spotlight

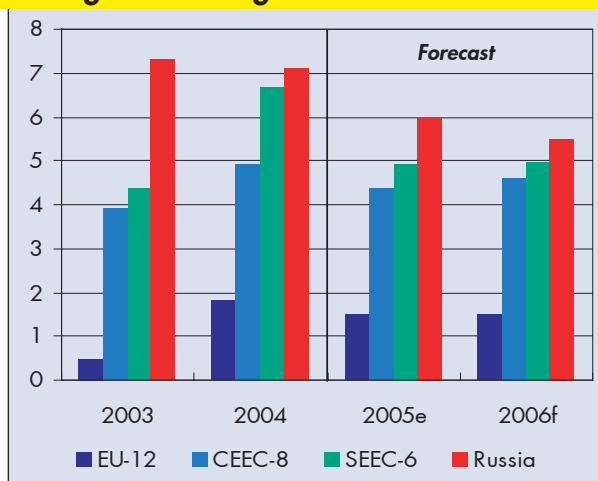
Significant progress on EU integration

In October 2003, we published our first issue of "South East Europe in the spotlight". We consider this to be the logical continuation of our "EU-Convergence" publication series, which highlighted different aspects and key developments of the first wave of eastward EU enlargement in eight issues starting in October 1999. Looking back at our 2003 issue we can identify significant developments that have taken place in the meantime, both with respect to the region's journey towards EU integration and in terms of economic development.

Bulgaria and Romania completed their membership negotiations in 2004 and signed EU Accession Treaties on 25 April. Pending a positive monitoring report, which will be published by the European Commission (EC) in November, and the ratification of all 25 present EU member states, Bulgaria and Romania are scheduled to join the EU on 1 January 2007. The start of membership negotiations with Croatia were postponed at the last minute after the EU insisted that Croatia had not done enough to cooperate with the Hague tribunal. A breakthrough was achieved in the case of Serbia and Montenegro, with the EC's positive feasibility report on a SAA. In the case of Bosnia and Herzegovina, the EC will publish its decision on 19 May, stating whether enough progress has been made on the 16 reform priorities identified in the EC's Feasibility Study of November 2003 to start negotiations on a SAA. If the remaining hurdles for reaching SAAs with all countries can be cleared by 2007, all SEE countries could possibly become EU members by 2014, a date with significant symbolic value.

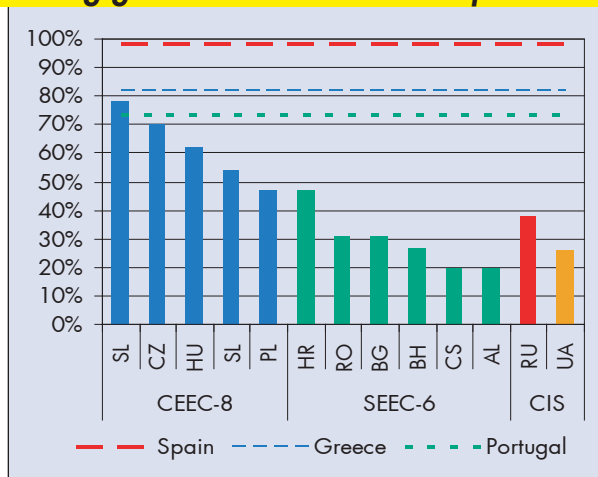
Progress is also apparent on the side of economic development. Real GDP growth remained strong and even accelerated in 2004 with an average growth rate of 6.5%. Inflation continued to decline, but still remained relatively high at 8% on average in 2004. High current account deficits of 8.7% of GDP on average in 2004 still reflect structural deficiencies and remain a threat to macroeconomic stability, but the financing of the deficits has improved overall due to the increase in foreign direct investment (FDI). The FDI stock in the region almost doubled over the last two years and reached EUR 35.8 bn by the end of 2004 which is still only about 1/5 the size of the FDI stock in the eight new member countries. A considerable part of FDI inflow was generated by the ongoing process of bank privatisation, which is generally seen as an important step towards economic restructuring and bodes well for future economic development.

Strong economic growth in SEE continues



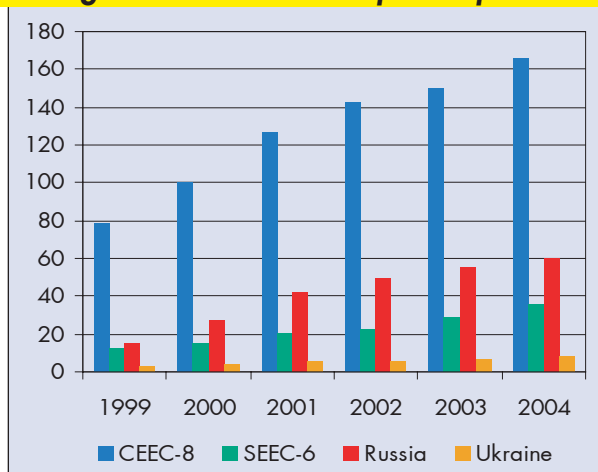
Note: Real GDP growth, % yoy
Source: Thomson Financial Datastream, WIIW, Raiffeisen Research

Strong growth needed to catch up



Note: GDP per capita (at PPP), WIIW estimate for 2004
Source: WIIW, Raiffeisen Research

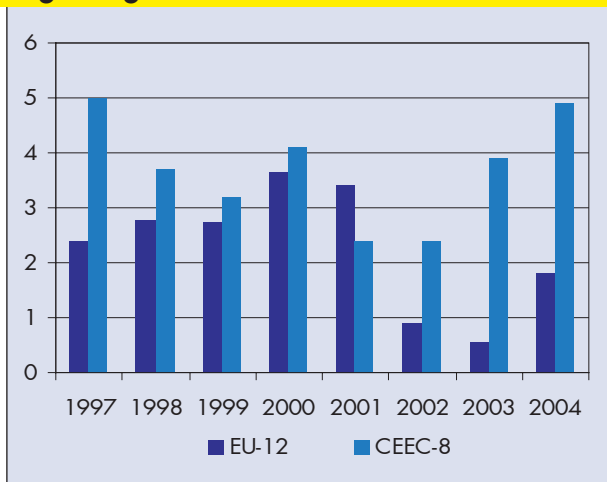
Foreign direct investment picks up in SEE



Note: FDI stock, EUR bn
Source: WIIW, Raiffeisen Research

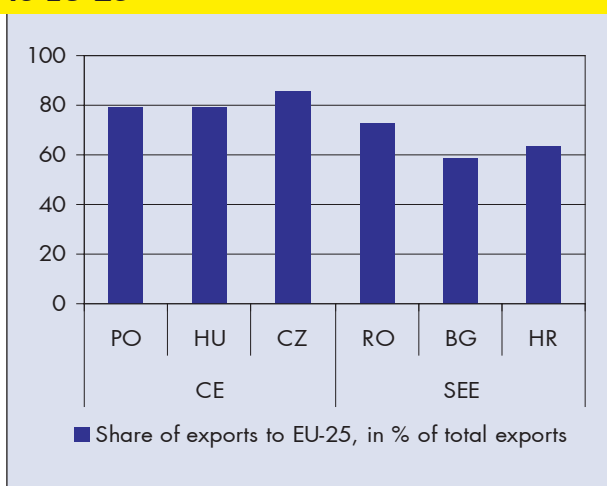
EU facing challenge in Balkans Integration should be completed by 2014

Highest growth in CEEC-8 since 1997



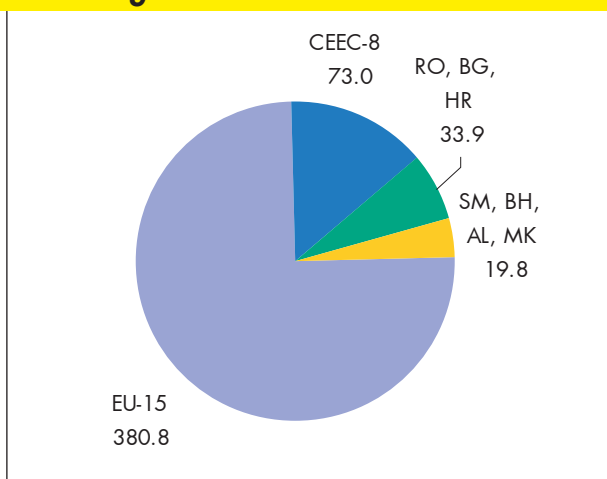
Note: Real GDP growth, % yoy
Source: WIIW, Raiffeisen Research

EU integration should boost export share to EU-25



Source: WIIW, Raiffeisen Research

EU enlargement into SEE to add 54 mn



Note: Population, in mn as of 2004
Source: WIIW, Raiffeisen Research

In May 2004, eight Central and Eastern European countries joined the European Union. Almost one year later both the European Union and the new member countries can legitimately claim that **enlargement has been a huge success**. Frictions during the initial phase of EU membership were minimal, despite a temporary increase in inflation and some market disturbances. GDP growth in the new Member States almost reached 5% yoy, the highest average economic growth since 1997.

The success of the first wave of the EU's eastward enlargement is also of particular importance for those countries that are still striving for EU membership. **Bulgaria** and **Romania** managed to finalize their membership negotiations in 2004 and will be intent on sustaining their reform efforts in order to not give any reason to doubt their preparedness to join the EU in 2007. Although 2007 was also **Croatia's** original target for the country to join the EU, this was probably too ambitious even before the recent EU decision to postpone the start of membership negotiations. Now Croatia hopes that the EU will give green light for membership talks by June and to be able to join the EU in 2009. If Croatia cannot convince its critics in the EU that it is in fact doing everything in its power to fully cooperate with the Hague tribunal before Great Britain, one of the harshest critics of Croatia's cooperation with the Hague tribunal, takes over the EU presidency for the second half of 2005, postponement into 2006 is not out of the question. Once the EU agrees to start membership negotiations with Croatia, it could arguably take less time to finish them thanks to and in comparison with the experience of the first and second wave of eastward EU enlargement.

The EU's decision, despite being disappointing for Croatia, still sent an important message to the other countries in the western Balkans: EU membership requires taking up the responsibilities that go along with the benefits of membership, and that the EU will not be ready to compromise on the Copenhagen political criteria in general and on the cooperation with the Hague tribunal in particular. However, the EU has also to be careful that the golden carrot of membership does not move out of sight or out of reach for the countries in the western Balkans to maintain the momentum for a continuation and acceleration of the political, economic and institutional reforms that are still necessary for accession to the EU in the foreseeable future.

Serbia and Montenegro passed a crucial hurdle with the European Commission's approval of the feasibility report assessing the readiness of Serbia and Montenegro to negotiate a Stabilisation and Association Agreement (SAA) with the EU, which is the first institutional step towards EU membership. The decision can be seen as a reward for Belgrade's cooperation with the Hague tribunal, where twelve suspects turned themselves in during this year alone, including Nebojsa Pavkovic, a Serb general who is charged with atrocities in Kosovo. It is believed that it would take about a year to negotiate the SAA once the EU ministers approve a mandate in June or July. One of the remaining political challenges is reaching a decision on the future status of Kosovo. Also a number of key suspects remain at large, including Bosnian Serb wartime leader Radovan Karadzic and his military commander Ratko Mladic.

Despite recognizing the progress **Bosnia and Herzegovina** has made on the 16 reform priorities identified in the European Commission Feasibility Study of November 2003, the EU is still demanding further steps ahead of a possible start of negotiations on signing a SAA, including implementation and enforcement of the adopted legislation and cooperation with the Hague tribunal. **Macedonia** received its SAA and also filed its formal membership application in early 2004 already. Membership negotiations could start as soon as 2006. **Albania** also hopes to finalize talks about the SAA this year, but the EU has cautioned that progress will depend on the result of parliamentary elections and the pace of reforms.

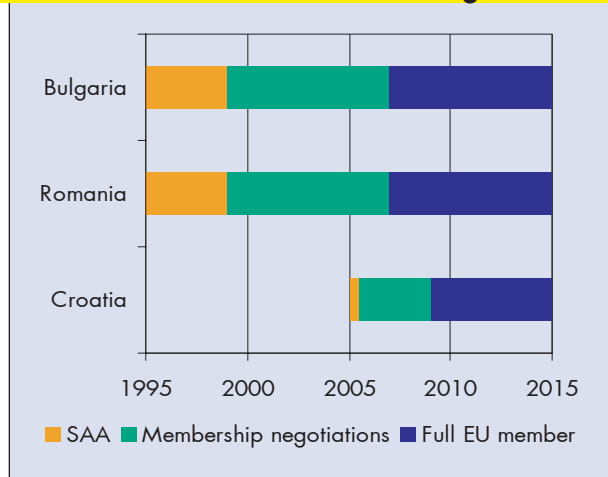
If all of the unresolved questions can be solved and SAAs concluded by 2007, the countries of the western Balkans could possibly join the EU sometime by the middle of the next decade. The "International Commission on the Balkans", a body made up of respected senior figures from across Europe, recently presented a report on the future of the Balkans in which it urged the EU to speed up the integration of the countries. The EU should be prepared to spend heavily to help the region integrate, rather than continuing to spend already huge sums on funding a military presence there to keep a fragile peace. In its conclusions the report identifies 2014 as the historic date and Sarajevo as the symbolic place where the EU should proudly announce the arrival of the European century with the completion of the EU's enlargement into the western Balkans.

Scenario for EU integration in SEE

	SAA	Start negotiations	EU entry
Bulgaria	1995 (EEA)	1999	2007
Romania	1995 (EEA)	1999	2007
Croatia	2005	2005	2009
Macedonia	2004	2006-2007	2012-2013
Albania	2007	2009	by 2014
Bosnia a. H.	2007	2009	by 2014
Serbia a. M.	2007	2009	by 2014

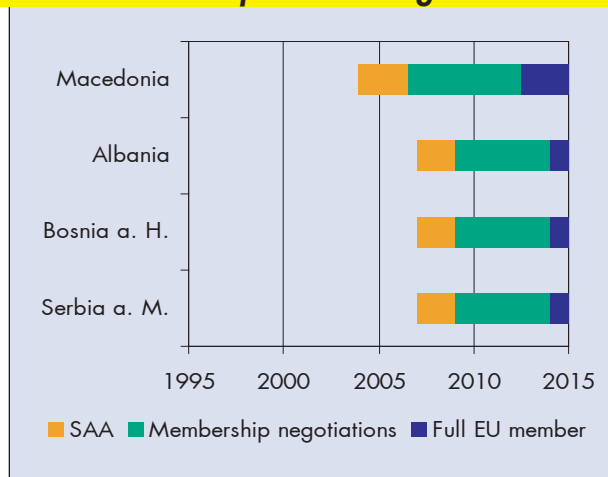
Source: WIIW, Raiffeisen Research

Schedule for near-term EU enlargement



Source: WIIW, Raiffeisen Research

Schedule to complete EU integration in SEE

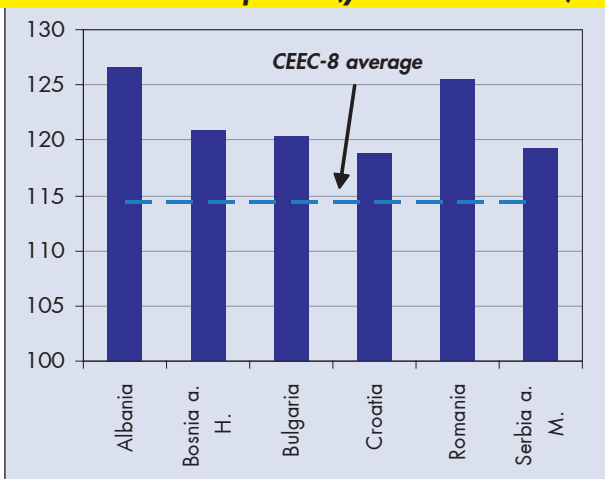


Source: WIIW, Raiffeisen Research



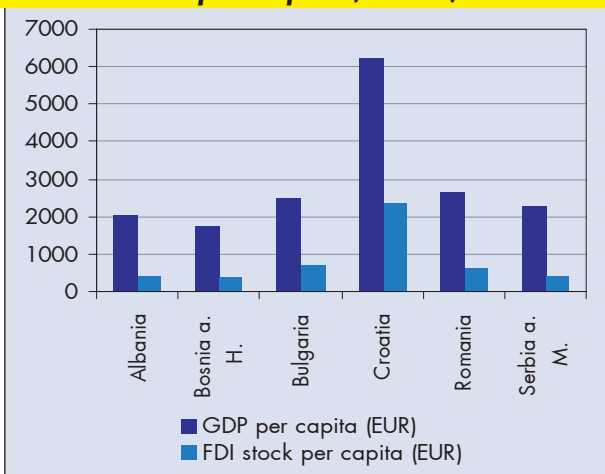
Economic revival to continue growing imbalances still challenging

GDP at constant prices (year 2000=100)



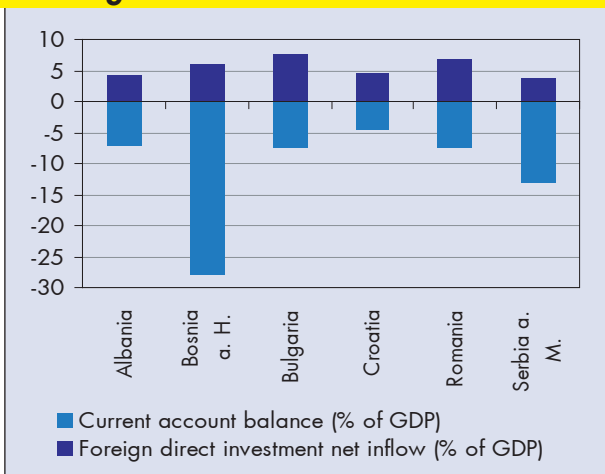
Note: Figures for 2004
Source: WIIW, Raiffeisen Research

GDP and FDI per capita (in EUR)



Note: Figures for 2004
Source: WIIW, local national banks

Coverage of the current account deficit

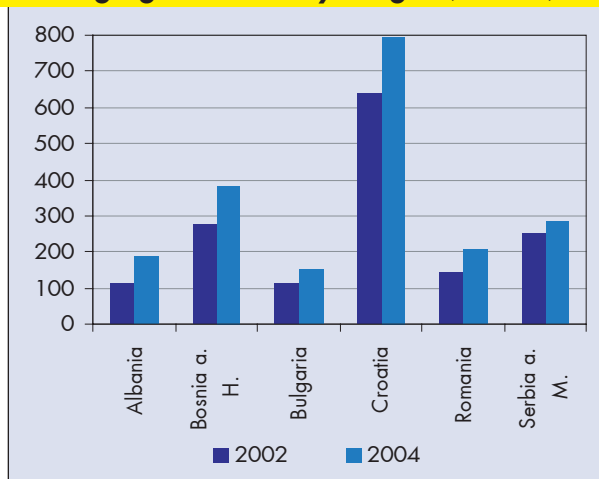


Note: Figures for 2004
Source: Thomson Financial Datastream, WIIW, Raiffeisen Research

Strong output growth and **decelerating inflation** were among the major characteristics of South East Europe **in 2004**. On the whole, this growth has been underpinned by healthy consumption and growing fixed investment, with industry and services largely responsible for entire trend. However, the growth pattern was uneven and varied from country to country. In **Bulgaria** and **Romania**, growth has been receiving a boost from surging investment activity, in particular from substantial FDI inflows, and domestic consumer confidence translating into robust domestic demand and stimulating export expansion. In **Albania**, growth was largely influenced by favourable business conditions in the agricultural sector and the development of the financial sector. Labour remittances from abroad also added positively to economic growth. **Turkey**, by far the largest SEE economy and an EU hopeful, returned to double-digit growth owing to internal economic stability and the disinflation process, which boosted domestic demand. The EU's integration plans for Turkey managed to produce strong impetus for domestic and international investors with regard to monetary and fiscal stabilization. Nevertheless, not all SEE countries were able to impress us with stellar growth. In **Croatia**, economic growth decelerated on the back of restrictive measures aimed at curbing the growing imbalances and credit-induced consumer spending. In a nutshell, Croatia still runs rather high twin deficits and witnessed domestic credit expansion contributing to growing external indebtedness. In **Serbia and Montenegro**, the economy appears to have been turning a corner with growth accelerating and inflation falling. Despite the fact that the two entire republics' economies are effectively split and operating their own currencies, the Serbian economy was a major force in driving the republics' growth upwards. A debt reduction agreement negotiated by Serbia and adjustment of domestic businesses to the changing economic environment facilitated by comprehensive reforms benefited the Serbian economy which achieved impressive economic expansion in 2004. In **Bosnia and Herzegovina**, the economy was expanding moderately with the industrial sector working as a major force. Actually, the country remained unable to develop the private sector and the economy remained rather split between its two major ethnic enclaves. Putting everything into perspective, we anticipate that a slightly better economic outlook for Western Europe and improving domestic conditions together with progress in reforms will work positively for

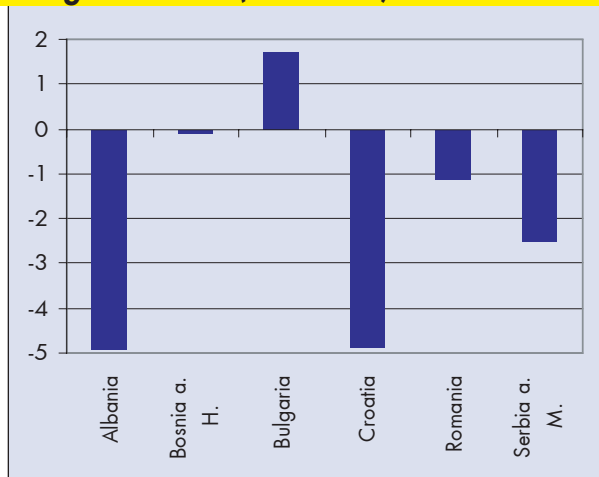
many SEE countries, helping them to preserve good growth. However, we believe that in Romania, Turkey and Serbia growth will cool down somewhat, whereas in Croatia we will see only a slight improvement in economic activity. In many SEE countries **we will continue to see FDI inflows** helping to attract foreign businesses and boost domestic activity. EU accession will continue to work as a magnet for non-candidate countries in the SEE region who are keenly interested in following the road travelled by Bulgaria and Romania which will likely be joining the EU in 2007, or Croatia which might open accession talks this year and join the EU in 2008-2009. As regards prices nearly all countries managed either to sustain low inflation or, in case of Romania and Turkey, embark on the downward path of disinflation. Yet, as nearly all SEE countries are net importers of energy resources we project high world energy prices will continue to put pressure on domestic inflation. Growing wages will also fuel inflation, while SEE economies will have to strike a meaningful balance between growth in wages and productivity so as to preserve economic efficiency. Suddenly, growing producer prices indicate a growing problem in this direction and raw material prices will only aggravate the matters which might translate into somewhat higher consumer inflation in 2005. Nevertheless, the SEE region is not without problems and among greatest challenges facing the SEE economies are imbalances, particularly high deficits on fiscal and current accounts. Whilst twin deficits are usually regarded as a "teething problem" for many Emerging market economies and capital inflows often help to cover financing gaps, in some SEE countries the deficits might become impossible to sustain over the medium term. Despite a small decline projected for 2005, current account deficits will remain particularly acute in Bosnia, Serbia, Romania and Albania whilst investment inflows might not be sufficient to mitigate possible outflows. In Turkey and Croatia, current account deficits will be declining albeit remaining still high whereas adding fiscal deficits can aggravate problems. In this light we expect SEE governments to focus their **attention on curtailing the twin deficits** through a combination of more restrictive policies and fiscal prudence, which should mitigate imbalance problems at the expense of economic expansion. Overall, our economic outlook for SEE remains favourable but fighting imbalances will remain high on the agenda of SEE governments and the central banks in the region.

Average gross monthly wages (in EUR)



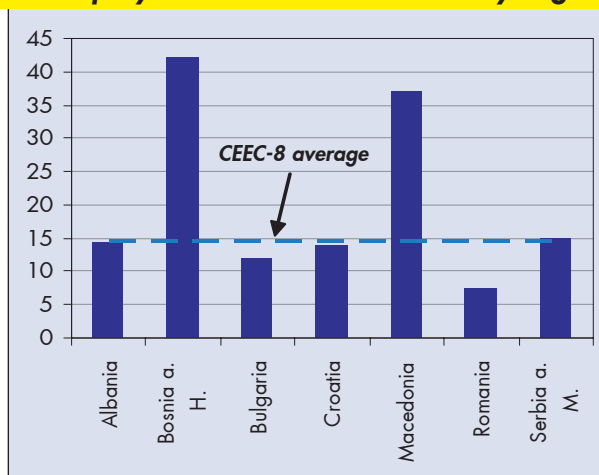
Source: WIIW, Raiffeisen Research

Budget balance (% of GDP)



Source: WIIW, Raiffeisen Research

Unemployment in SEE remains very high



Note: Figures for 2004; based on Labour Force Survey (LFS)
Source: WIIW, Raiffeisen Research

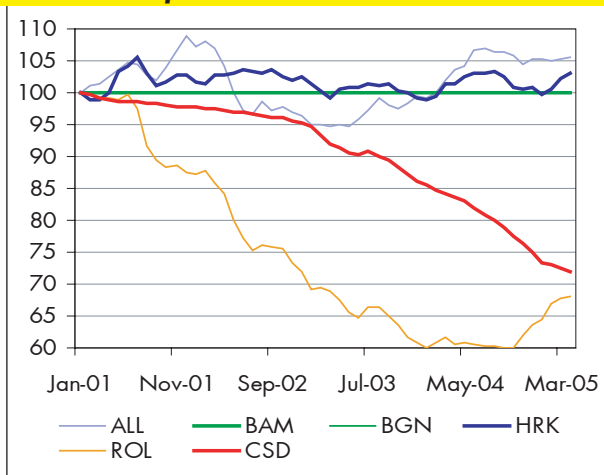
Convergence story continues but markets develop only slowly

Exchange rate regimes

	Regime	Currency	Currency code
Albania	managed float	lek	ALL
Bosnia and Herzegovina	currency board	marka	BAM
Bulgaria	currency board	lev	BGN
Croatia	managed float	dinar	HRK
Romania	managed float	leu	ROL
Serbia	managed float	dinar	CSD
Montenegro	euroisation	euro	EUR

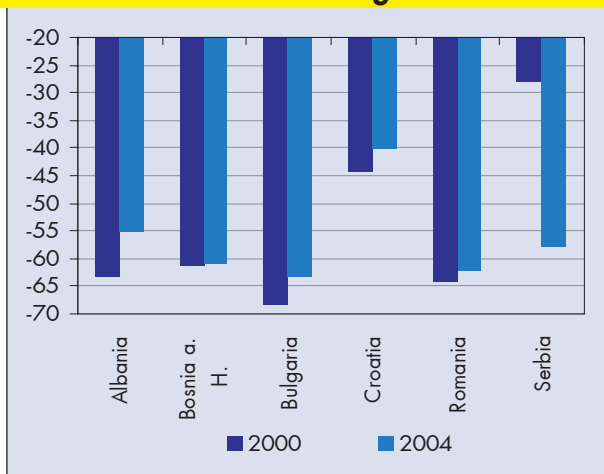
Source: National Banks, Raiffeisen Research

Currencies per 1 EUR



Note: Currency development indexed (January 2001=100)
Source: Thomson Financial Datastream, Raiffeisen Research

Undervaluation of exchange rates vs. PPP



Note: %-deviation of exchange rate from purchasing power parity (negative sign = undervaluation)
Source: WIIW, Raiffeisen Research

The exchange rate regimes in most of the SEE countries remain very rigid and in most cases are fixed against the EUR or take the form of a strictly managed float. **Kosovo** and **Montenegro** even use the euro as their official currency. **Bulgaria** and **Bosnia and Herzegovina** opted for a currency board fixing their currencies to the EUR. Thus, local currencies of those countries are not freely convertible and cannot be traded outside of these countries. We expect that both of the countries will maintain their currency boards in the coming years or in the case of Bulgaria until it joins EMU (projected as early as 2009). In recent years, **Albania** has moved to a more managed floating exchange rate system. Remittances coming from Albanians living abroad lead to a sizable inflow of foreign currency. In order to prevent the Albanian lek from appreciating nominally, the central bank occasionally intervenes on the market. The prevailing exchange rate regime in **Croatia** is a system of a managed float with occasional central bank interventions and without a predetermined target rate or band. Traditionally, the exchange rate fluctuates depending on the season, going stronger in summer when tourism revenues are pouring into the country, but over the years the Croatian kuna has remained stable against EUR. After the launch of reforms in late 2000, the **Serbian** central bank managed to bring down inflation from more than 100% by the end of 2000 to below 10% on average in 2003 by maintaining a stable exchange rate of the dinar against the EUR. Personnel changes in the central bank and the widening of the current account deficit that came with the significant real appreciation resulted in a change of this policy in 2003. In order to limit the extent of real appreciation, the central bank has maintained a smooth path of nominal depreciation since then, with the negative side effect of inflation edging up to above 10% again in 2004. At the end of October 2004 the central bank of **Romania** decided to let the leu float more freely. Since then the leu has been driven by appreciation pressures coming from a strong inflow of foreign direct investment (including finalisation of several large privatisation projects) and the announced liberalisation of the capital account. Turning a deaf ear to the IMF's warnings, Romania decided to go ahead, allowing free access to the Romanian interbank foreign exchange market to non-residents from 11 March and to leu deposits from mid-April 2005.

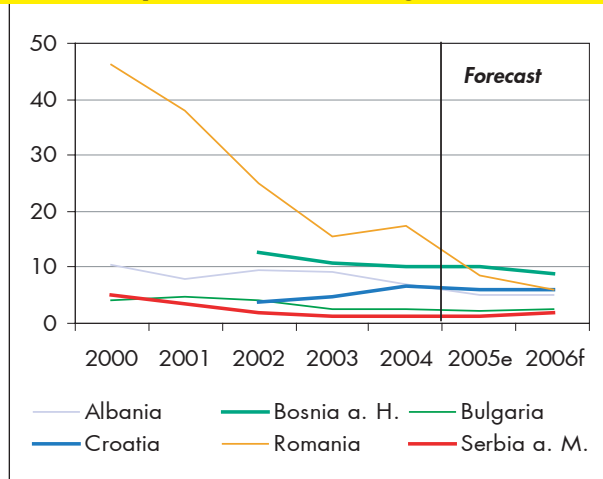
Continued liberalisation of the foreign exchange market in the whole region should result in both a

widening and deepening of the markets. However, in many of the countries the complete elimination of barriers for short-term capital is likely to be postponed since they are seen as a threat for the countries' monetary, currency and overall economic stability. Currently, these countries also have to deal with the problem of relatively shallow and underdeveloped financial markets, in particular the money market, which, it is believed, has to be shielded from premature exposure to international competition. Proper functioning of the money market is a necessary precondition for a monetary policy that uses predominantly indirect monetary instruments connected with the money market.

After allowing foreigners access to the foreign exchange market and to leu deposits in April, Romania plans to open up the market for government bonds on 1 January 2006. Romania also considers allowing foreigners access to short-term money market instruments and T-bills from January 2007. While there is a local currency bond market in Bulgaria, with maturities up to ten years being auctioned regularly by the Ministry of Finance, the participation of foreign investors is still minimal due to restrictions on capital movements and the poor liquidity on the secondary market. Croatia is the one country in the region where foreigners can freely invest in local currency government bonds already. Among the eight Croatian government issues on the domestic market currently traded, however, only two are not indexed to the EUR/HRK exchange rate.

Despite the thin and underdeveloped local currency markets in the region, there is the possibility to participate in the convergence story via Eurobonds denominated in EUR (or USD) in Bulgaria, Croatia and Romania. We retain an upbeat view on the potential of Eurobonds of the soon-to-become EU members Bulgaria and Romania. This also extends to Croatia where we see the possibility of closing the gap between the spread of Croatia and of similarly rated Bulgaria. Furthermore, we find Romanian bonds relatively cheap compared with Bulgaria and Croatia. As regards new opportunities, Serbia has entered the market with a new bond. With a spread over 200bp it might be a reasonable opportunity, in particular with regards to the EU's recent positive feasibility study. As regards credit ratings, we remain optimistic about the prospects for further rating upgrades in the region in the process of EU integration.

3m money market rates (avg)



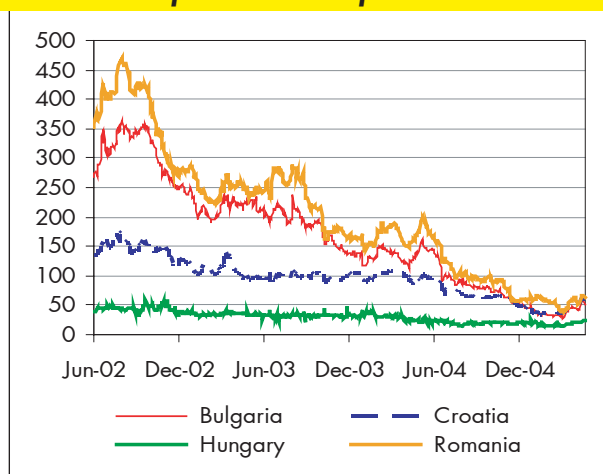
Note: Serbia: weighted average interest rates on short-term loans; Bosnia: interest rates of commercial banks on short-term loans; Source: Thomson Financial Datastream, National Banks, Raiffeisen Research

Foreign currency credit ratings

	Moody's	Standard & Poor's	Fitch
Short-term debt			
Bosnia a. H.	n.r.	n.r.	n.r.
Bulgaria	n.r.	A-3	F3
Croatia	P-3	A-3	F3
Romania	n.r.	B	F3
Serbia a. M.	n.r.	B	n.r.
Long-term debt			
Bosnia a. H.	B3	n.r.	n.r.
Bulgaria	Ba1	BBB-	BBB-
Croatia	Baa3	BBB	BBB-
Romania	Ba1	BB+	BBB-
Serbia a. M.	n.r.	B+	n.r.

Note: n.r....not rated
Source: Bloomberg

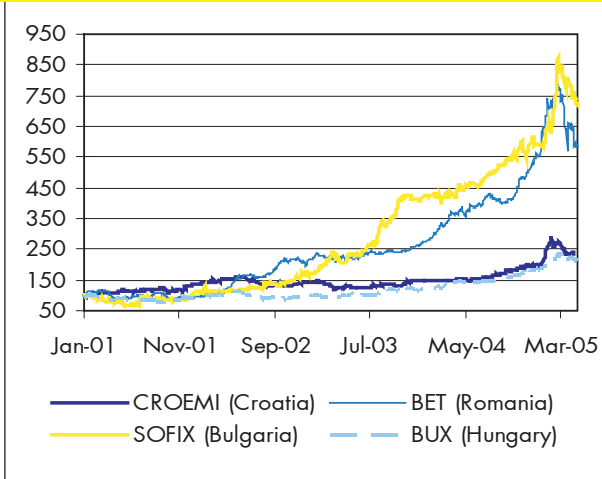
Eurobond spread development



Note: EUR EMBIG government spreads (bp)
Source: JP Morgan, Raiffeisen Research

SEE stock exchanges in the center of interest

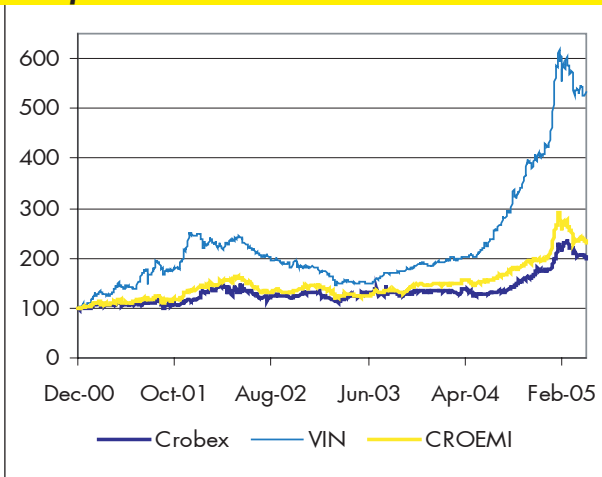
South East European indices



Note: In local currency; rebased to 100

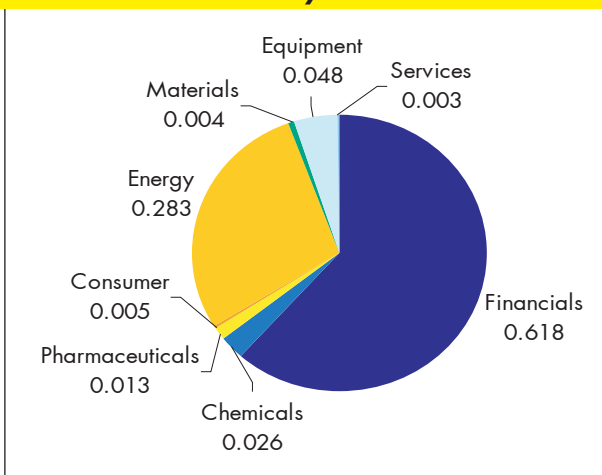
Source: Raiffeisen Research, Thomson Financial Datastream

Comparison of Croatian indices



Source: Raiffeisen Research, Thomson Financial Datastream, VSE

Romania: Turnover by sector



Source: Bucharest Stock Exchange; March 2005

While the equity markets in CEE are quite well known, interest in South East Europe (SEE) is steadily increasing for many investors. Above all, the stock exchanges in Romania, Bulgaria and Croatia are not only best known in the region, but are also most developed as compared to Western standards.

The **Croatian** equity market is based on two stock exchanges: the Zagreb Stock Exchange (ZSE) and the Varaždin Stock Exchange (VSE). Both of the two exchanges have their own equity index (ZSE: Crobex, VSE: VIN). However, due to the circumstance that not all important stocks are listed on a single exchange, Raiffeisen RESEARCH's local unit decided to create a new index (CROEMI) to circumvent this disadvantage. In the recent past, it was quite obvious that the Croatian equity market has been very sensitive to political risks (e.g. postponement of the EU accession talks). At the moment, the market is stagnating, registering only mild movements to the up- or downside depending on business results and/or news on the individual companies. In our view, the future development of the local equity market will depend on whether EU talks start again or not. Since we expect the accession talks to be only postponed and therefore not totally cancelled, we still take a positive view regarding the Croatian equity market in the long run.

In **Romania**, the Bucharest Stock Exchange (BSE) put in an outstanding performance in 2004, with the EUR-based BET index gaining 112%. The BET index is comprised of the ten largest and most liquid shares listed on the BSE (except SIFs - financial investment companies). Positive macro-economic developments and the re-rating of country risk stimulated foreign investors' appetite while declining interest rates and a stronger currency pushed domestic investors into equities. However, it should be noted that the market is still driven by domestic investors, which accounted for 67% of total purchases in 2004. Following several years characterized by companies' lack of interest in raising funds on the capital market, we expect 2005 to be the year of IPOs. Taking into consideration Romania's positive macro-economic outlook, conclusion of the EU Accession Treaty in April 2005, and further appreciation of the domestic currency as well as the upcoming IPOs of state-owned and private sector companies, we expect the positive growth trend on the BSE to continue in 2005.

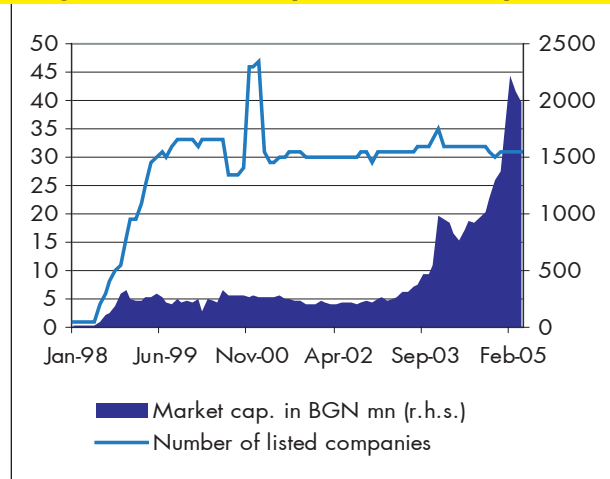
The **Bulgarian** equity market was re-established in 1991. By the end of 1999 there were 32 companies listed on the Official Market and about 1,000 companies admitted for trading on the Free (OTC) Market as a result of the Mass Privatisation Program (in comparison to around 300 companies at the end of 2004). In 2000, the BSE-Sofia launched its official index, SOFIX, which is a market capitalization weighted price index (base value: 100 points). The SOFIX portfolio consists of the 13 top domestic stocks. Similar to the development of other stock exchanges in the region, overall market capitalization increased by almost 50% in 2004.

In 2005, the development of the Bulgarian capital market and the stock exchange in particular will be strongly influenced by the signing of the EU Accession Treaty at the end of April and the outcome of the elections in June.

The **Sarajevo** Stock Exchange (SASE) was founded in September 2001 and commenced trading on 12 April 2002, as a central marketplace in the Federation of Bosnia and Herzegovina. In general, trading on the SASE takes place on three markets - the Official Market, the Investment Fund Market and the Free Market. During the privatisation process so called PIFs (Privatisation Investment Funds) have been founded. Each of the 24 listed PIFs - 11 are traded on the SASE (Federation of Bosnia and Herzegovina) whereas the remaining 13 are listed on the BLSE (Banjaluka Stock Exchange; Republic of Srpska) - is managed by a separate fund management company. Moreover, an index has been established for each of the two stock exchanges (SASE: BIFX; BLSE: FIRS; base value: 1,000 points) to track the performance of PIFs comfortably at a single glance. Since the beginning of this year prices went up as international investors showed interest and started buying. But as demand faded, prices declined again. However, as the economy is starting to recover, we expect that the values of the PIFs will rise, since they - at least partly - consist of cyclical companies. In addition to that, there should also be a positive impact based on the circumstance that there are still numerous sizable companies waiting for privatisation, in which the PIFs have a significant stake.

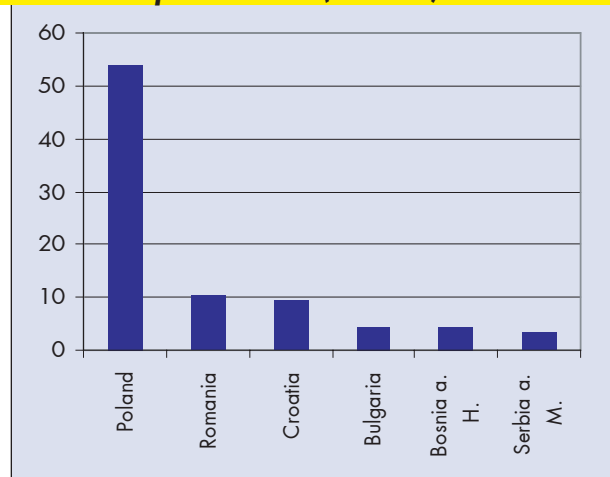
There are no significant equity markets and/or information available for **Albania** and **Serbia and Montenegro**.

Bulgaria: Market cap. & listed companies



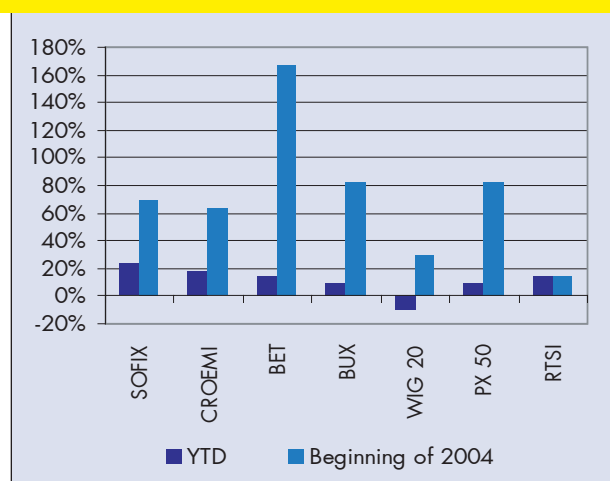
Source: Bulgarian Stock Exchange

Market capitalization (EUR bn)



Source: FEAS, local stock exchanges

Performance of selected indices



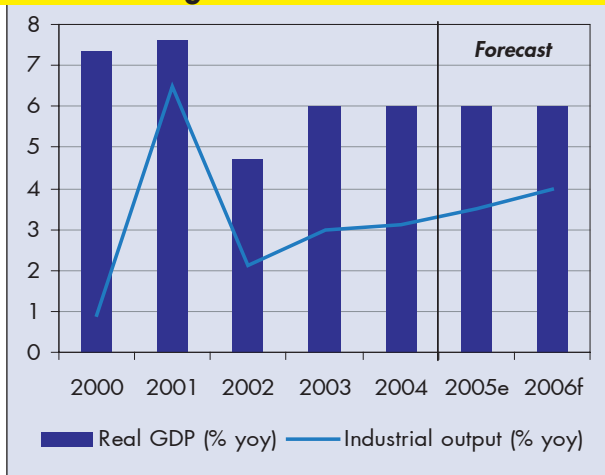
Source: Raiffeisen Research, Thomson Financial Datastream



Elections in July

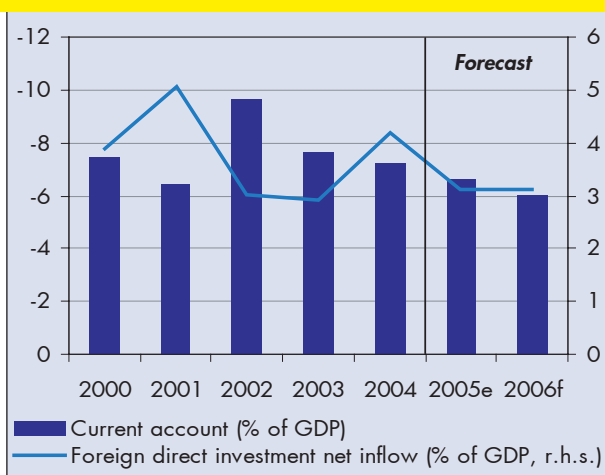
Focus on EU membership in any case

Robust GDP growth



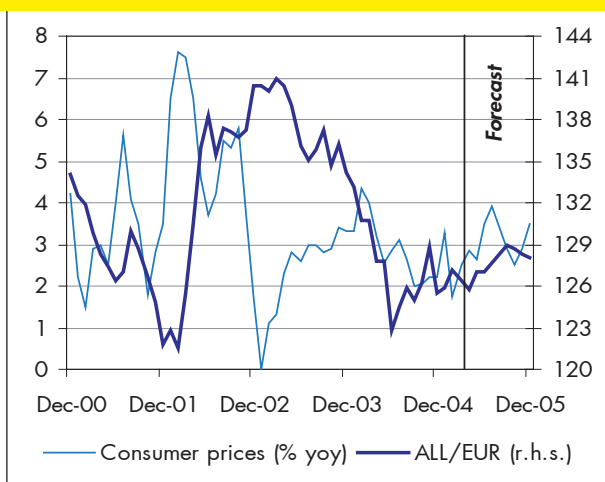
Source: Thomson Financial Datastream, WIIW, Raiffeisen Research

Current account and FDI inflows



Source: Thomson Financial Datastream, WIIW, Raiffeisen Research

Inflation at low level



Source: Thomson Financial Datastream, WIIW, Raiffeisen Research

EU integration is strongly supported by Albania's political parties and population. The **parliamentary elections of 3 July**, according to international standards will be one of the main steps in negotiations, in the second half of 2005, on the way to a Stabilisation and Association Agreement with the EU. As for the results of the elections, the ruling Socialist Party of Albania (SPA) and the Democratic Party of Albania (DPA), the main opposition party, should again remain the two main parties. However, the end-2003 local elections showed that the popularity of these parties has declined. The Socialist Movement for Integration (LSI) within the Socialist Party of Albania came up as a new independent political force on 6 September 2004. We expect that neither the SPA nor the DPA will win an outright majority in the parliament, despite their coalitions with other parties. In this situation, the smaller parties will have more representatives in the parliament.

Albania is expected to be invited in the next NATO summit in 2006 to join the North Atlantic Alliance and become NATO member in 2008. The central attention of foreign policy in 2005 will continue to be closer integration with the West, regardless of the results of the election.

Real GDP grew by 6% in 2004. Real GDP growth rates have averaged 7.5% per year for the period 1998-2004. In line with the acceleration in 2003, growth in economic activities in 2004 included the following components: transport 10.6%; trade, hotels and restaurants 8.6%; post and communication 6.8%; construction 6%; other services 5.6%; agriculture 3.8% and industry 3.1%. The private sector accounts for about 75% of GDP. The growth of lending to the private sector rose to 38.6% yoy in January 2005 compared with the figure of 34.3% for the same month of 2004.

In 2004, average annual inflation was low at 2.9%, declining at the end of the year to 2.2%. Inflation has been within the limits set by the Bank of Albania (BoA), namely 2-4% for 2004 and 2005 and to the levels of Albania's main trading partners in the EU (Italy and Greece). We expect that for 2005 and 2006 average annual inflation will be nearer to 3%, despite the higher prices due to the influx of emigrants and tourists during summer or national holidays that will bring large inflows of foreign currency. Fiscal constraints, relative currency stability and lower global oil prices

will help monetary policy, which has been instrumental to macroeconomic stability.

Foreign exchange market interventions by the BoA have been aimed at smoothing exchange rate fluctuations and preserving reserve cover: at the end of 2004 there was cover for more than 4 months of imports.

The BoA has lowered the repo rate (now 5%) with the aim of preventing the appreciation of the Albanian lek (ALL) in real terms. The latest move came in March following a series of 150bp since April 2004. We expect that the BoA will maintain a stable nominal peg to the EUR at an average of ALL 127.5 for 2005, thus controlling inflationary pressures. The movement of the ALL against the USD is strongly correlated (77% in 2004) with that of the EUR against the USD, reflecting the fact that Albania conducts the majority of its foreign trade with euro zone countries.

The 2004 fiscal performance improved for the third consecutive year. The deficit before grants narrowed to 5.2% of GDP compared with a target of 6% of GDP. New measures should boost economic activities for revenues such as the reduction of the corporate income tax rate from 25% to 23% and the small business tax rate on turnover from 4% to 3% or the exemption from VAT for sub-contractors of re-export companies. Moving forward with the Stabilisation and Association Agreement with the European Union will involve further reductions of tariffs.

Albania benefits from one of the most open trade regimes among the transition countries. Import tar-

iffs are among the lowest in the region, coupled with very limited non-tariff barriers and several free trade agreements are in place with countries in the region. In 2004, 90.6% of Albania's total exports went to the EU, its main trading partner, which provided 68.1% of total imports. Italy and Greece are the two main trading countries in the EU, that Albania share respectively 73.1% / 32.6% and 12% / 18.5% of total exports / imports for 2004. The weakening of the US dollar against the euro in 2003-2004 has inflated the US dollar value of Albanian exports. This trend is expected to continue until the end of 2005.

The current account deficit this year should be financed by FDI and official transfers that we expect to cover the deficit respectively by 60% and 20% for 2005. Foreign direct investment inflows for 2004 reached EUR 275 mn and the forecast during the period 2005-2006 is above EUR 650 mn. Privatisation in 2005 includes some major companies: Albtelekom (fixed line telecom), ARMO (refinery), INSIG (insurance), Servcom (oil services), Albpetrol (oil extraction), etc. The procedures for Albtelekom and ARMO are scheduled to commence in May of this year. The list of companies that the government includes in its future programme are the "Albanian Power Corporation" - KESH, the General Directorate of the Railways, the Sea Port of Durres, the coal industry, water supplies, the Italian Albanian Bank (40% stake). The IMF has encouraged strategic privatisation and has cooperated with government for the economic programme that resulted in macroeconomic stability that has been remarkable for recent years.

Key economic indicators and forecasts

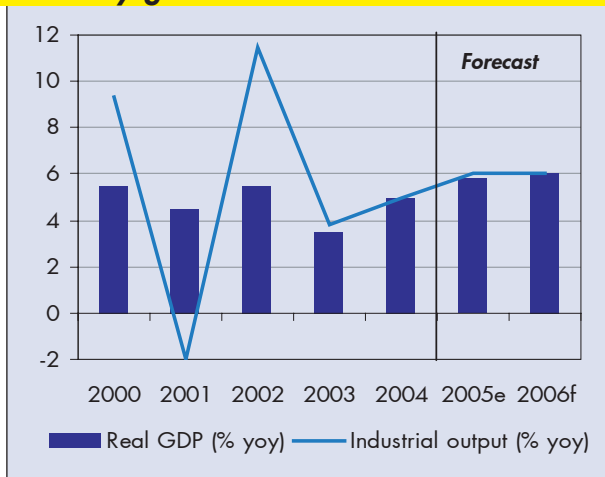
	2000	2001	2002	2003	2004	2005e	2006f
Nominal GDP (EUR bn)	4.0	4.6	4.8	5.4	6.5	7.2	8.0
Real GDP (% yoy)	7.3	7.6	4.7	6.0	6.0	6.0	6.0
Industrial output (% yoy)	0.9	6.5	2.1	3.0	3.1	3.5	4.0
Unemployment rate (avg, %)	17.5	16.6	16.0	15.2	14.8	15.0	15.0
Nominal wages, whole economy (% yoy)	10.2	11.0	11.6	11.0	12.0	12.0	10.0
Producer prices (avg, % yoy)	4.9	-5.4	6.4	6.2	11.1	8.3	5.0
Consumer prices (avg, % yoy)	0.1	3.1	5.2	2.4	2.9	3.0	3.5
Consumer prices (eop, % yoy)	4.2	3.5	1.7	3.3	2.2	3.5	3.5
General budget balance (% of GDP)	-7.5	-6.9	-6.0	-4.6	-4.9	-4.6	-4.0
Current account balance (% of GDP)	-7.4	-6.4	-9.7	-7.6	-7.3	-6.6	-6.0
Official FX-Reserves (EUR bn)	0.6	0.8	0.8	0.8	1.0	1.0	1.2
ALL/EUR, avg	132.7	128.5	132.5	137.6	127.6	127.5	126.0
ALL/USD, avg	143.7	143.5	140.2	121.9	102.6	95.9	90.0

Source: Thomson Financial Datastream, WIIW, Raiffeisen Research



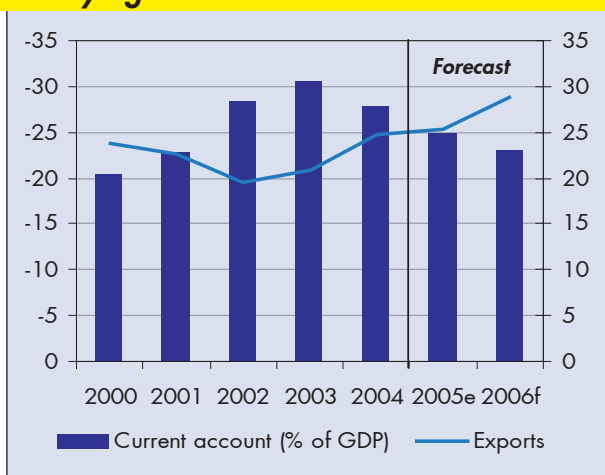
Negotiations with EU might start this year

Economy gains momentum



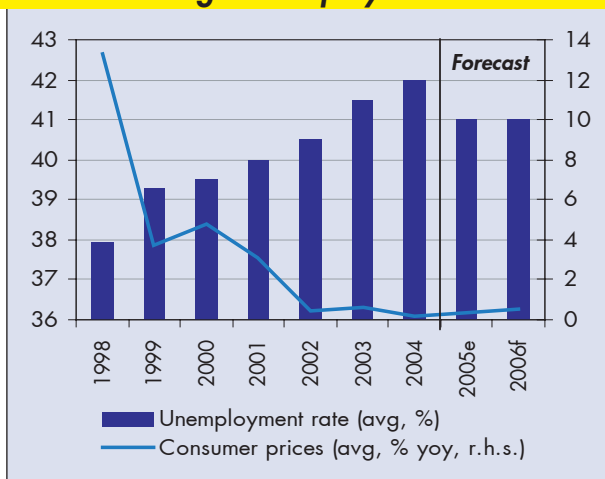
Source: Thomson Financial Datastream, WIIW, Raiffeisen Research

Worrying current account deficit



Source: Thomson Financial Datastream, WIIW, Raiffeisen Research

Intolerable high unemployment rate



Source: Thomson Financial Datastream, WIIW, Raiffeisen Research

The **constitutional and political systems in Bosnia and Herzegovina (BiH)** are characterized by the complexity of the state and the state administration structure conditioned by the Dayton Agreement, the main goal of which was to establish peace in BiH. The Dayton Agreement, signed 10 years ago, is a burden for BiH at the present, as the circumstances and the atmosphere in BiH have changed significantly over the past 10 years. Therefore, it is thought to initiate necessary discussions regarding constitutional changes in BiH on the anniversary of this agreement in November 2005.

The international community, through the institutions of the High Representative to BiH, Mr. Paddy Ashdown, has a significant influence on socio-political events in the country and his decisions so far have created certain disputes within and between certain political groups and caused dismissals within the structures of the BiH political establishment, such as the recent dismissal of high officials in Republika Srpska and dismissal of the member of the BiH Presidency, Mr. Dragan Covic. Despite the resistance, the international community considers the decisions of the High Representative to be significant steps towards improvement and implementation of the highest political standards in BiH correlating with standards of developed Western European democratic states. One political event that should be dominant in the second half of this year is the appointment of the new high representative of the international community in BiH. The new high representative should make a final step towards full democratisation and self-sustainability of the socio-political system.

At the end of 2003, the European Commission adopted the report on readiness of BiH to initiate negotiations with the European Union regarding the Stabilisation and Association Agreement and by the end of this year it is expected to actually start with these negotiations. Mr. Olli Rehn, representative of the EU for enlargement, expressed his satisfaction with the progress accomplished in reforms in BiH. His opinion on initiation of negotiations on stabilisation and BiH's accession is optimistic, and he thinks that they should surely start by the end of this year, provided there is full cooperation with the Hague war crimes tribunal. Certainly, the beginning of these negotiations represents significant progress towards EU integration.

The **economic situation in BiH** was significantly determined by the long war and post-war reconstruction that caused delays in transition processes

in the BiH economy in relation to the more developed countries in CEE. Therefore, currently all segments of the economic system in the country are implementing transition processes at faster rate with the final goal of encouraging economic growth and sustainable development, as well as a significant increase in the living standards in the country. With implementation of reform macroeconomic scenario of mid-term development strategy of BiH, sustainable growth and development goals need to be accomplished by 2007. With this, a 70% level of pre-war GDP would be reached, and functionality and market effectiveness of legal entities would be accomplished in order for the same to be able to respond to the competitive external influences. Basic economic reform over the following mid-term period will be aimed at preserving macroeconomic stability, implementing reforms of the fiscal system and establishing a liberalised electricity and power market, a market of telecommunication services and supporting the development of agricultural production. Special attention will be paid to encouraging the development of an export-driven private sector and establishing an adequate system of social care. Another primary goal in the following period will be the need for final completion of the process of acceptance in the World Trade Organization (WTO).

Significant growth rates in GDP and industrial production are the basic characteristics of the BiH economy, but significant problems are represented by a high unemployment rate. Therefore, special measures have been undertaken in the area of stimulating small and medium entrepreneurship and companies dealing with export activities and related to efforts made to resolve this problem. Also,

these measures are aimed at resolving the high trade deficit resulting from the high deficit on the current account in the balance of payments. On the other hand, with liberalisation and privatisation of the domestic electricity and power market and telecommunications systems, as well as with the already implemented privatisation of the oil sector, during this year and the forthcoming years there will be significant direct foreign investment. The results accomplished in this segment are already noticeable: privatisation of the largest BiH oil company Energopetrol has just been finalised, and interest was expressed by eight bidders with strong business and financial standing. Encouraging and robust growth in direct foreign investment is one measure that should contribute to the stabilisation of the overall balance of payments. Macroeconomic stability is also illustrated by the sustainability of consumer prices, as well as a well-balanced state budget. Implementation of the currency board principle absolutely ensures a stable domestic currency rate and the level of public debt is at a relatively satisfactory level.

One of the upcoming basic changes in the economic system is fiscal reform within the framework of which a new system of value added tax will be implemented. After adoption of legislative framework and implementation of organisational, technical and technological preparations, implementation of the new taxation system will commence on 1 January 2006. The legislative framework determined the unified implementation of the value added tax rate of 17%. Introducing the new taxation system represents a significant step forward in implementation of the taxation system as typically found in developed European countries.

Key economic indicators and forecasts

	2000	2001	2002	2003	2004	2005e	2006f
Nominal GDP (EUR bn)	5.1	5.6	6.0	6.2	6.6	7.1	7.6
Real GDP (% yoy)	5.5	4.5	5.5	3.5	5.0	5.8	6.0
Industrial output (% yoy)	9.3	-2.0	11.5	3.8	5.0	6.0	6.0
Unemployment rate (avg, %)	39.5	40.0	40.5	41.5	42.0	41.0	41.0
Nominal wages, whole economy (% yoy)	9.0	18.4	0.7	3.5	3.5	4.5	4.5
Producer prices (avg, % yoy)	-0.2	2.4	0.6	0.8	1.5	2.0	2.3
Consumer prices (avg, % yoy)	4.8	3.1	0.4	0.6	0.2	0.4	0.5
Consumer prices (eop, % yoy)	7.5	0.9	0.2	0.6	0.2	0.5	0.5
General budget balance (% of GDP)	-7.0	-3.3	-2.2	0.4	-0.1	-0.2	-0.5
Current account balance (% of GDP)	-20.4	-22.7	-28.5	-30.5	-27.9	-25.0	-23.0
Official FX-Reserves (EUR bn)	0.52	1.39	1.27	1.44	1.43	1.53	1.64
BAM/EUR, avg	1.956	1.956	1.956	1.956	1.956	1.956	1.956
BAM/USD, avg	2.116	2.184	2.069	1.728	1.573	1.471	1.397

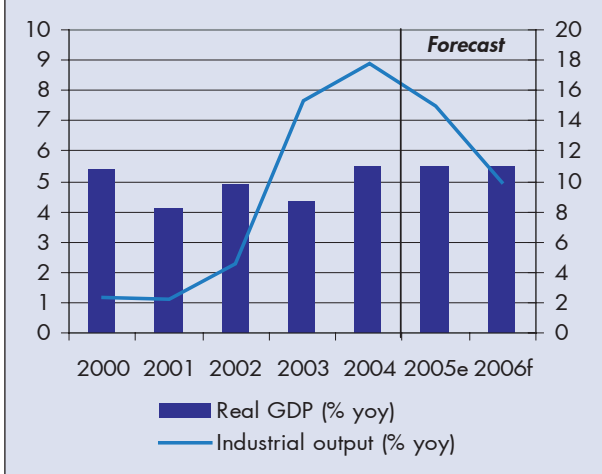
Source: Thomson Financial Datastream, WIIW, Raiffeisen Research



Elections looming in June

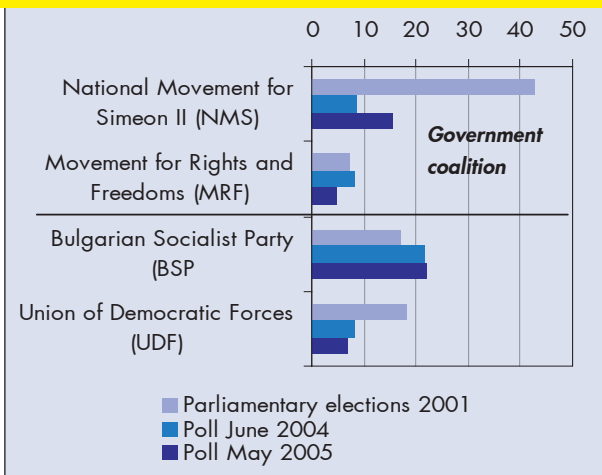
No fundamental shift in policy expected

Real GDP growth (% yoy)



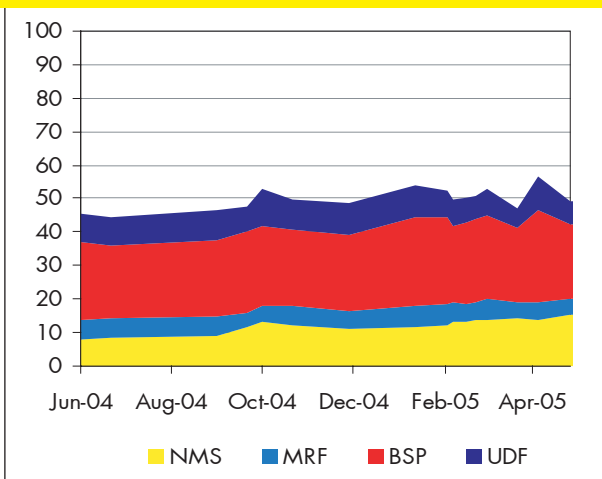
Source: Thomson Financial Datastream, WIIW, Raiffeisen Research

Turnaround for NMS too little too late?



Source: Reuters, Gallup, MBMD, NPOC, Raiffeisen Research

Turnaround for NMS too little too late?



Source: Reuters, Gallup, MBMD, NPOC, Raiffeisen Research

Bulgaria signed the Accession Treaty on April 25 and is expected to become an EU member on 1 January 2007. Despite the steady progress made so far, Bulgaria's entry may be delayed until 2008 if it does not keep up the momentum of preparations and fails to implement the agreed reforms in the judiciary system and the fight against corruption and organised crime. As there is a broad consensus among all political parties on the need to press forward with EU reforms over the remaining months, it is expected that by the end of 2005 the overhaul of the judicial system will be completed. A positive monitoring report (to be issued in November by the EC) would be followed by the ratification of the Accession Treaty by the member states. Upon becoming a EU member Bulgaria, which has its local currency pegged to the euro at a fixed rate under a currency board arrangement, plans to apply in early January 2007 for entering the ERM-II and intends to join the EMU in 2009.

Bulgaria is gearing up for **parliamentary elections to be held on 25 June**. According to the most recent polls from 5 May, the Bulgarian Socialist Party (BSP) is still well ahead of other parties and coalitions with some 22% support, and is widely expected to win the election. The ruling centrist National Movement for Simeon II (NMS) party has improved its position, with a support of 15.6% support (versus 11.6% in January), making it the only ruling party since the beginning of transition to manage to have its ratings reverse a falling trend before the elections. It should also get a boost from recent events such as the signing of the EU Accession Treaty. Even before the signing some 42% of Bulgarians believed there is no better party than the NMS to run the country in the next four years. Therefore, it is not surprising that the NMS has opted to stand independent of its current coalition partner - the ethnic Turk Movement for Rights and Freedoms (with 4.6% support) and the New Timers (2%). Previously it was expected that the three parties would form a Liberal Alliance prior to the election, but recent polls may have convinced the NMS that separately each party will be able to attract more votes judged on their own merits. In case of a more favourable outcome for the NMS a joint post-election program is not excluded.

In search of a formula to secure entry in the next Parliament some new coalitions have emerged. The right political spectrum still remains divided, although two new coalitions have been formed -

the United Democratic Forces and the Bulgarian National Union. The total support for the right-wing political spectrum, including former PM Kostov's party, does not exceed 13%. Although most analysts refrain from making forecasts on the next government (as Bulgarians are sometimes perceived to be unpredictable during elections), there appears to be a good possibility of a centre-left coalition. Regardless of the composition of the next parliament no fundamental shift in policy direction is expected as the framework has been already set - the currency board should remain in place until the adoption of the euro, an economic policy focusing on the implementation of the measures required for EU entry, and maintenance of good relations with the IMF. Nevertheless, if a government led by the BSP emerges some intensification of state intervention and increased income re-allocation might be expected. Deviation from the current conservative debt management policy also cannot be ruled out completely.

With a **real GDP growth of 5.6% in 2004**, Bulgaria's economy enjoyed its strongest performance since the beginning of transition in 1989. Rapid domestic credit growth increased consumption, and buoyant investment was also a major factor. Industrial output growth reached 19% yoy, fixed capital formation increased by 12% yoy and FDI surged to a record high EUR 2 bn, or 10% of GDP. Although domestic demand is expected to ease slightly on the back of restrictive measures on credit growth by the central bank, the anticipated strong inflow of FDI, sustained high revenues from tourism, and lower taxes should all contribute to again solid growth in 2005.

Regardless of the higher global oil prices, the seasonal rise in agricultural prices and increased excise duties for alcoholic beverages, CPI inflation for the first three months of 2005 was 1.9% compared to 3.8% for the same period last year. With no administrative price adjustments in 2005, the government forecasts CPI inflation for 2005 year-end at 3.5%, but keeping in mind a possible spillover effect from the minimum wage increase, 4.0% inflation seems more likely. In February, the rate of registered unemployment fell to 13.11% from 14.23% for the corresponding month in 2004, due to early seasonal job offerings in the private sector. The budget target for 2005 has been set at 11.9%.

In 2004 the current account deficit reached EUR 1.45 bn or 7.5% of GDP, down from 8.6% in 2003. Strong export growth, increased remittances and rapid generation of revenues by the booming tourist sector were among the main reasons behind the improvement in the current account deficit. Although the deficit remains considerable, in 2004 it was fully financed by FDI flows. The government has revised downwards its initial estimate for the current account deficit in 2005 from 8.5% to 7.75% of GDP. Concerns of a possible overheating of the economy and the IMF's strong recommendations have led the central bank to impose additional administrative measures for the most aggressive bank in order to slow down the booming credit growth. However, FDI inflows are expected to increase further this year and should again more than suffice to fully cover the current account deficit. According to government officials should reach EUR 2 bn with the bulk of this going to ICT, utilities and infrastructure.

Key economic indicators and forecasts

	2000	2001	2002	2003	2004	2005e	2006f
Nominal GDP (EUR bn)	13.7	15.2	16.5	17.6	19.7	21.7	24.0
Real GDP (% yoy)	5.4	4.1	4.9	4.3	5.5	5.5	5.5
Industrial output (% yoy)	2.3	2.2	4.6	15.3	17.8	15.0	10.0
Unemployment rate (avg, %)	18.1	17.5	17.5	14.2	12.7	12.0	10.0
Nominal industrial wages (% yoy)	8.9	3.9	4.1	4.6	7.9	7.0	7.0
Producer prices (avg, % yoy)	17.5	3.8	1.3	4.9	5.9	5.0	4.0
Consumer prices (avg, % yoy)	10.3	7.4	5.8	2.3	6.1	4.5	5.0
Consumer prices (eop, % yoy)	11.3	4.8	3.8	5.6	4.0	4.0	5.0
General budget balance (% of GDP)	-1.0	-0.9	-0.6	0.0	1.7	-0.5	-0.9
Current account balance (% of GDP)	-5.6	-7.3	-5.6	-8.6	-7.5	-7.0	-6.5
Official FX-Reserves (EUR bn)	3.4	3.7	4.2	5.0	6.4	7.0	7.5
BGN/EUR, avg	1.956	1.956	1.956	1.956	1.956	1.956	1.956
BGN/USD, avg	2.10	2.18	2.06	1.73	1.58	1.47	1.40

Source: Thomson Financial Datastream, WIIW, Raiffeisen Research



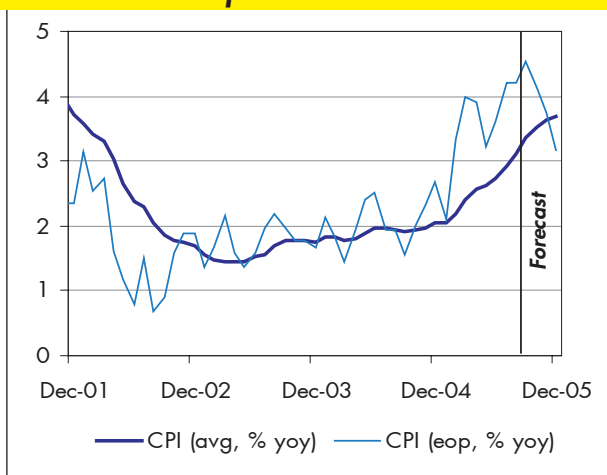
Improving investment climate as an old/new challenge

GDP growth



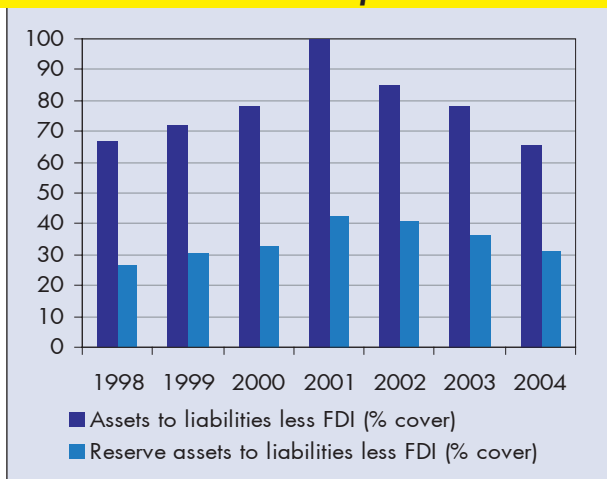
Source: Croatia's Central Bureau of Statistics, Raiffeisen Research

Inflation development



Source: Croatia's Central Bureau of Statistics, Raiffeisen Research

International investment position



Source: National Bank of Croatia, Raiffeisen Research

In December 2004, the European Council set the date for the start of **accession negotiations** with Croatia to be 17 March 2005, provided that Croatia cooperates fully with the ICTY. According to the Council's opinion, Croatia did not show enough political willingness to fulfil this precondition and as a result the negotiations were delayed until review by a special EU delegation in Croatia. In the meantime, the Stabilisation and Association Agreement (the first comprehensive Agreement signed between the EU and Croatia) entered into force. Further preparation for the integration process has been continued, particularly with regard to available pre-accession funds (PHARE, ISPA, and SAPARD). The overall annual budget under these programmes totals EUR 245 mn, to be used during the period of the next two years.

Presidential elections were held in January. As expected, the current president Mr. Mesic was re-elected, beating the candidate from the ruling party HDZ. Local government elections were also held in the middle of May.

The international rating agency Standard & Poor's raised Croatia's long-term foreign currency sovereign credit rating from BBB- to BBB in December (and confirmed it in March). This improved rating reflects the country's strong progress in reforms and the recovering economy. S&P also confirmed the A-3 short-term foreign currency and the BBB+/A-2 local currency rating for Croatia and said the outlook on the ratings was stable. Other agencies did not change the Croatian credit ratings.

The 2004 **GDP growth rate confirmed expectations of a slowdown** in economic activity. With a real rate of growth of 3.8%, GDP reached EUR 27.64 bn. Personal consumption, as the usual growth generator, has been slowing down for the second year in a row. The economic slowdown was influenced by capital formation which is a consequence of the reduction in the government's investments in infrastructure. Since it is obvious that a slowdown in public investments greatly influences the movement of total investments, this being strongly felt in the construction sector where gross added value growth reduced substantially, the need to encourage private investments and attract foreign investments as well as improve the climate for investments came to the foreground once again. This is also one of the main issues in all government documents and arrangements with international institutions

(Fiscal Policy Principles, PEP, Stand-by Agreement and PAL). Over the coming period, in addition to a slight recovery in investment growth, primarily in the private sector, we expect a continuation of positive trends in goods trade. Export growth should be accompanied by positive growth rates in industrial production and retail trade. As a result, in 2005 we expect GDP to grow at a slightly higher rate of 4%.

In line with the government orientation towards domestic capital market in financing the budget deficit and efforts to decrease external vulnerability, external debt has been stabilized at around 80% of GDP and according to the preliminary data its amount even slightly decreased at the beginning of the year. At the end of 2004, banks became the largest borrower in the structure of external debt, while the government's share fell below past level with further steps in that direction. Debt growth in 2005 should be smaller, with a decreased share of public debt, if privatisation revenues meet expectations and cover almost 50% of the planned general government deficit. Therefore, this year's share of public debt in GDP should stabilise, and then decline slowly over the coming years. However, the main factor in achieving this goal is to monitor public expenditures and their adjustment to realised revenues. With the general government consolidated deficit of 4.9% of GDP in 2004, it is evident that a fiscal adjustment was achieved, but the planned deficit of 4.5% was not met. The targeted deficit for 2005 of 3.7% is slightly overoptimistic. In planning this year's revenues, the Ministry of Finance was guided by the revenues realised in 2004 and real GDP growth of 4.4% in 2005. However, revenues and GDP growth in 2004 were below expectations and resulted in a higher-than-expected deficit, thus

creating a lower-than-expected basis. According to our projections, the general government deficit will be 4.0% of GDP.

Apart from reform in major segments of the public sector, privatisation will play an important role this year, especially in view of this year's privatisation plans and the effect their timely and transparent fulfilment will have on deficit financing and the investment climate. Realisation of privatisation projects should consequently increase FDI which fell to its lowest level since 1998 due to the lack of larger privatisation projects in 2004. The favourable improvement that was seen in the current account should continue in the next years. Namely, a significant narrowing of deficit to 4.6% of GDP from 6.9% in 2003 was a consequence of the positive trends in Croatian goods trade e.g. faster growth of exports than imports that will probably continue in the coming period.

During the summer months the exchange rate might again fall to levels seen at the same time last year, which will probably prompt CNB interventions. Expected privatisation in the second half of year should have an impact on the exchange rate movements in the domestic FX markets e.g. departure from the usual seasonal depreciation movements at the end of the year.

Key economic indicators and forecasts

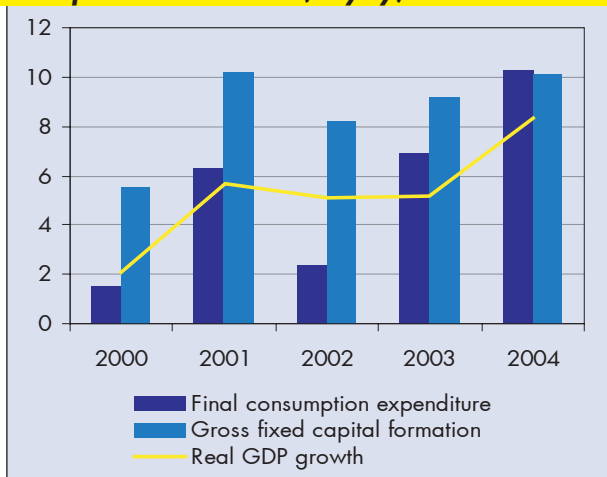
	2000	2001	2002	2003	2004	2005e	2006f
Nominal GDP (EUR bn)	20.0	22.2	24.2	25.5	27.6	29.9	32.2
Real GDP (% yoy)	2.9	3.8	5.2	4.3	3.8	4.0	4.1
Industrial output (% yoy)	1.7	6.4	5.5	4.1	3.7	3.5	3.5
Unemployment rate (avg, %)	21.2	22.0	22.3	19.5	18.2	18.0	17.5
Nominal industrial wages (% yoy)	6.1	8.2	6.9	5.4	5.1	3.9	4.0
Producer prices (avg, % yoy)	9.7	3.6	-0.4	1.9	3.5	2.8	3.0
Consumer prices (avg, % yoy)	6.2	4.9	2.2	1.5	2.1	3.7	2.3
Consumer prices (eop, % yoy)	7.4	2.6	1.9	1.7	2.7	3.2	2.9
General budget balance (% of GDP)	-6.9	-6.8	-6.0	-6.3	-4.9	-4.0	-3.5
Current account balance (% of GDP)	-2.5	-3.7	-8.7	-6.9	-4.6	-4.4	-3.9
Official FX-Reserves (EUR bn)	3.9	5.3	5.6	6.5	6.4	6.6	6.8
HRK/EUR, avg	7.64	7.47	7.41	7.56	7.50	7.43	7.39
HRK/USD, avg	8.28	8.34	7.83	6.68	6.03	5.59	5.28

Source: Thomson Financial Datastream, WIIW, Raiffeisen Research



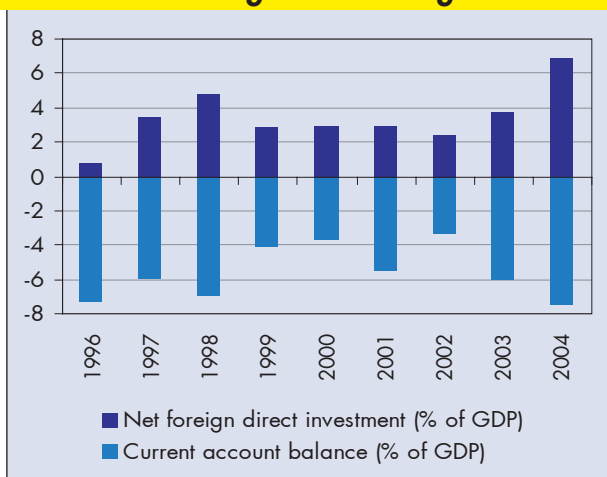
Economy well under way Struggling with the current account deficit

Components of GDP (% yoy)



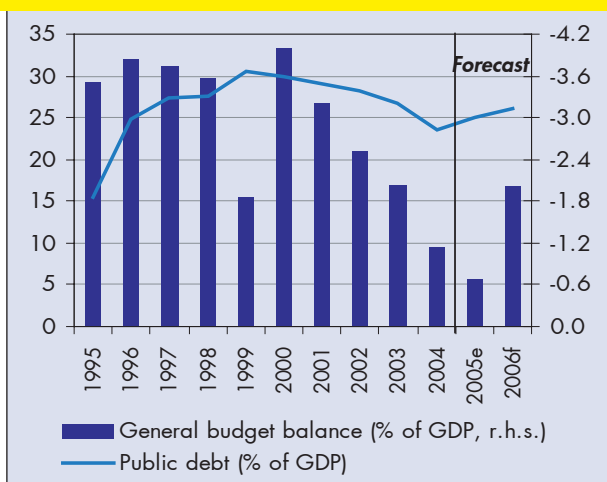
Source: WIIW, Raiffeisen Research

Non debt-creating CA financing



Source: WIIW, Raiffeisen Research

Below the Maastricht criteria



Source: NBR, Raiffeisen Research

The former ruling party PSD managed to get a "functional market economy" tag and close all the negotiation chapters for **EU accession process** by end of 2004, opening up the possibility of signing the accession to Treaty in the spring of 2005.

The current democratic alliance signed the treaty to join the European Union in 2007 on 25 April. A weak majority in Parliament, still not enough to implement the unpopular laws required by the EU integration process could be a reason for a government reshuffling or even early elections.

Despite the fact that the Treaty stipulates 1 January 2007 as the accession date for Romania and Bulgaria, the safeguard clause may postpone accession to 2008 if the Balkan countries do not discharge the commitments they made during the negotiations. The critical issues for Romania are an independent judiciary system and internal affairs and competition and state aid, the last chapters closed. On the one hand, Romania has a bad reputation in terms of corruption, and on the other hand, Romania needs to improve the competitiveness of the economy to face the competitive forces from the European Union. The EU accession process represents the major driver for reform in Romania, with EU integration acting as a calibration mechanism that will maintain the Romanian government on the right path towards progress and reform at the institutional, administrative and economic levels. The theme of EU convergence will also dominate the relationship of Romania with other international financial institutions. The future relationship of Romania with the World Bank will be focused on accelerating growth convergence by improving competitiveness in order to ensure social cohesion, on development of approaches based on systemic solutions and programs, and strengthening institutional capacities to implement the acquis commitments and absorb post-accession funds. The relationship with IMF will be concentrated on ensuring macroeconomic stability, low inflation, a balanced budget and a suitable current account deficit.

Over the last six years, **Romanian economic growth** has averaged above 5% due to the faster pace of reforms undertaken in the economy. Romanian GDP rose 8.3% in 2004, the highest growth rate during transition process. Moreover, GDP growth is expected to continue at rates above 5% in the coming years. The EU and World Bank programs (SAPARD - agricultural and rural development, ISPA

- environment and transport, PAL - judicial reform, privatisation, energy sector reform, business environment, labour markets and capital markets) will also have a real impact in the Romanian economy, providing financing and expertise for sustainable, competitive development.

Inflation declined to 9.3% in 2004, from 14.1% in 2003, being the first single-digit CPI number since the fall of communism in Romania and confirming the disinflation trend of the last five years. For the coming years, we expect inflation to continue declining. The official forecasts are 7% in 2005, 5% in 2006 and 4% in 2007. In order to achieve this, the central bank decided to shift the monetary policy framework to inflation targeting starting from 1 July 2005, hence inflationary expectations may act as a strong anchor. However, we consider the inflation targets to be very ambitious and feel that they might be missed mainly due to adjustments in administered prices and some excise duties, committed to be implemented before accession, and pressure from private demand and price convergence in the services sector.

The current account (CA) deficit widened at end-2004 to EUR 4.4 bn, up 43.9% compared to the previous year, accounting for 7.5% of GDP for 2004. Even though the CA deficit was much larger than the 5.5% of GDP target, almost all of it was financed by foreign direct investment (including capital transfers). After 2006, FDI will probably taper off a bit, being mainly determined by green-field investment and relocation of production capacities by EU companies that want to take advantage of Romania's low profit tax rate and labour force costs. We expect the CA deficit in

2005-2007 to be much larger than the target of 6.9% of GDP. The increase in disposable income (due to lower taxation and higher minimum wage economy-wide) will trigger stronger consumption (and hence more imports), which will also be pushed by ROL appreciation and increased credit growth. Also, imports of machinery and mechanical equipment will go up, triggered by foreign direct investment and the required technology improvement process. On the other hand, we might see a reduction in the export growth rate attributable to exchange rate appreciation which is only partially compensated by productivity gains.

Fiscal policy in Romania has been very tight in recent years, with budget deficits well below the Maastricht criteria and amounting to 1.2% of GDP in 2004. The measure of the introduction of a flat tax rate on profit and personal income of 16%, in force starting 1 January 2005 is seen as a catalyst for foreign investment. Measures still need to be taken to improve income collection, in order to benefit from the fiscal relaxation. The cumulative effect of those measures on the state budget will be discussed with IMF officials during first half of the 2005, when the budget for this year is revised. For the coming period, we expect a still tight budget deficit (below the Maastricht criteria) designed to support disinflation. Some pressure on the budget will appear because of the increased contribution of the government for development programmes partially funded by the EU and acquis implementation and delivering the share contributions to the EU budget starting from the accession date, which accounts for approximately 1% of GDP.

Key economic indicators and forecasts

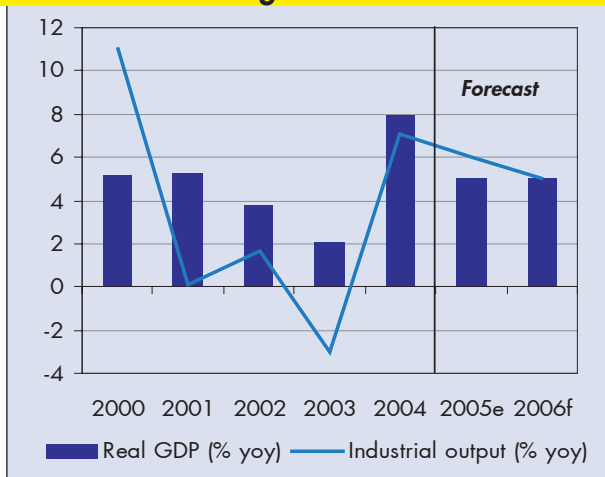
	2000	2001	2002	2003	2004	2005e	2006f
Nominal GDP (EUR bn)	40.3	44.8	48.5	50.7	58.9	76.7	85.1
Real GDP (% yoy)	2.1	5.7	5.1	5.2	8.3	5.0	5.0
Industrial output (% yoy)	7.1	8.4	6.0	3.1	5.3	5.0	5.0
Unemployment rate (avg, %)	11.2	9.0	10.2	7.6	6.8	7.0	7.0
Nominal industrial wages (% yoy)	41.7	51.1	23.6	19.5	23.0	20.0	18.0
Producer prices (avg, % yoy)	53.4	40.3	24.5	19.6	18.6	13.5	11.0
Consumer prices (avg, % yoy)	45.7	34.5	22.5	15.3	11.9	8.5	7.5
Consumer prices (eop, % yoy)	40.7	30.3	17.8	14.1	9.3	8.0	6.5
General budget balance (% of GDP)	-4.0	-3.2	-2.5	-2.0	-1.1	-0.7	-2.0
Current account balance (% of GDP)	-3.7	-5.5	-3.3	-6.0	-7.5	-9.2	-9.9
Official FX-Reserves (EUR bn)	2.7	4.4	5.9	6.4	10.8	14.7	16.4
ROL/EUR, avg	19956	26027	31255	37556	40532	36300	37500
ROL/USD, avg	21693	29061	33055	33200	32637	27293	26786

Source: Thomson Financial Datastream, WIIW, Raiffeisen Research



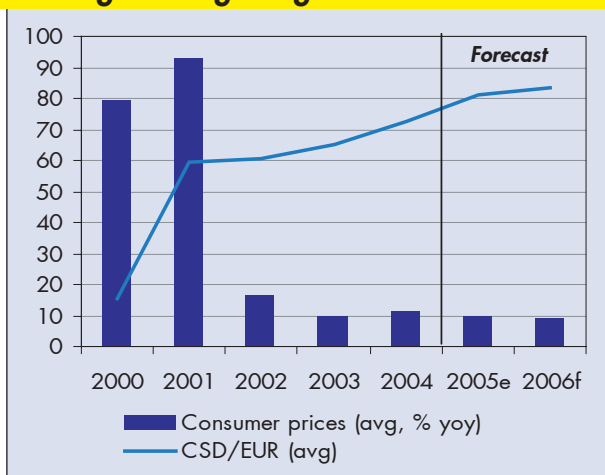
Arriving at European crossroad with an eye to future EU membership

Remarkable GDP growth in 2004



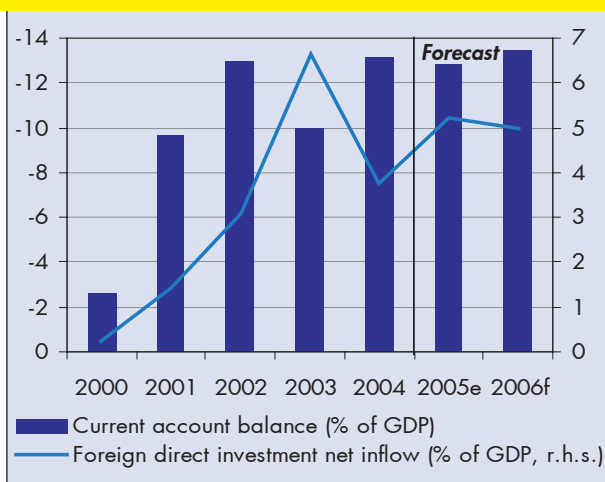
Source: Federal Office of Statistics, WIIW, Raiffeisen Research

Striving for single-digit inflation rate



Source: Thomson Financial Datastream, WIIW, Raiffeisen Research

Current account and FDI inflows



Source: Thomson Financial Datastream, WIIW, Raiffeisen Research

Serbia and Montenegro has made sufficient progress in meeting the prerequisites and developing the capacity to negotiate a Stabilisation and Association Agreement (SAA) with the EU. On 12 April, the **European Commission approved a Feasibility Report** assessing the readiness of Serbia and Montenegro to negotiate a Stabilisation and Association Agreement, an important step towards eventual EU membership. This agreement will establish the first contractual relationship between Serbia and Montenegro and the European Union. According to European Union enlargement representative, Olli Rehn, Serbia and Montenegro has achieved good progress in reforms and cooperation with the Hague tribunal. Previously, the country has failed to fulfil two major requirements - strengthening of the State Union's institutions and cooperation with the International Criminal Tribunal for the former Yugoslavia (ICTY).

In April 2005, the European Commission approved its first package of financial support programmes for the Western Balkans, aimed primarily at reinforcing democracy and the rule of law, human rights, civil society and the media, and the operation of a free market economy. Under the Community Assistance for Reconstruction, Development and Stabilisation (CARDS) programme Serbia and Montenegro will receive EUR 184 mn in 2005. Currently, there are discussions with the International Monetary Fund (IMF) on the conditions for the postponement of the three-year arrangement, which should be extended. The Serbian government is optimistic that an agreement will be reached.

At the beginning of April, European Union foreign policy chief Javier Solana and the leaders of Serbia and Montenegro signed an agreement for changes in the constitutional charter, solving the problem that the parliament of Serbia and Montenegro had with its legitimacy because of the mandates of the representatives which expired in March 2005. The move averted a looming constitutional crisis in the loose union between the two republics. Under an agreement in 2002 (supported by the EU), Serbia and Montenegro had appointed their deputies to a two-year term. Under the new deal Serbia and Montenegro have consolidated their loose union by agreeing to extend the mandate of their joint parliament until new elections are held separately by the two republics. New elections are scheduled for early 2006 in Montenegro and late 2007 in

Serbia. The Assembly of Serbia and Montenegro has 126 members elected for a four-year term, 91 in Serbia and 35 in Montenegro. Mandates are divided among parties and coalitions in proportion to the number of their benches in Serbia's and Montenegro's parliaments. The first parliament was elected on 25 February 2003 by the members of the old federal and the republican parliaments.

Robust economic growth in Serbia and Montenegro is estimated to have reached 8% in 2004. The main drivers were industrial and agricultural production. Due to favourable weather conditions, agricultural production grew by 19.7% in Serbia and the export of farming products showed one of the best export results (EUR 663 mn). However, inflation and the current account deficit are at high levels. Higher oil and agricultural prices were a trigger for higher inflation. Furthermore, on 1 January 2005, the value added tax (VAT) of 18% (replacing the 20% sales tax) came into effect. Although we expect inflation to fall slightly, the government's target of 9.1% might be out of reach in Serbia, while in Montenegro the inflation rate fell to below 3% yoy and is expected to remain low. In order to curb rising inflationary expectations the National Bank of Serbia will continue a firm monetary policy. According to the Monetary Policy Programme of the National Bank of Serbia for 2005, the principal objective of this year's monetary policy is the maintenance of the inflation rate at a single-digit level, namely, between 9% and 10%. Further monetary policy objectives are the preservation of stability in the financial system and increase of net foreign exchange reserves of the banking sector.

A danger lies in the country's real capacity to service its debt. The foreign debt payment schedule for 2005 includes payment of USD 500 mn on the principal debt amount and USD 377 mn in regular interest. The immediate liabilities might be USD 1.1 bn in 2006, USD 1.3 bn in 2007, USD 1.5 bn in 2008, USD 1.6 bn in 2009, and USD 1.4 bn in 2010. According to the IMF a 13% export rate increase and an increase of GDP of between 5% and 6.5% are required in the next two years in order to avoid entering a debt crisis. Curbing domestic demand might help reduce the current account deficit. Furthermore, restructuring of the public sector accompanied by growing private sector might boost exports. Serbia has received a credit rating of "B+" and short-term credit rating of "B" from rating agency Standard and Poor's, which should help to boost FDI in 2005.

Along with structural reforms and a very favourable tax system Serbia should continue on its growth path. The tax regime in Serbia contains a low corporate profit tax rate (at 10%, in Montenegro 9%), tax credits for investing in fixed assets of up to 80% of the assets' value, a 10-year tax holiday for investments of EUR 8 mn or more, government subsidies, tax exemptions, and other incentives for creating new jobs. On 1 January 2003, the government of Serbia implemented a comprehensive 14% flat-tax reform. The new system imposes a flat rate of 14% on labour income, and income from agriculture, forestry, and self-employment, previously taxed at 20%.

Key economic indicators and forecasts

	2000	2001	2002	2003	2004	2005e	2006f
Nominal GDP (EUR bn)	24.9	13.0	16.4	18.1	18.7	19.2	21.4
Real GDP (% yoy)	5.2	5.3	3.8	2.1	8.0	5.0	5.0
Industrial output (% yoy)	11.0	0.1	1.7	-3.0	7.1	6.0	5.0
Unemployment rate (avg, %)	25.6	26.8	29.0	31.7	31.7	32.0	32.0
Nominal wages, whole economy (% yoy)	91.1	129.6	51.7	25.5	23.7	16.0	11.0
Producer prices (avg, % yoy)	102.6	87.7	10.7	5.9	9.5	10.0	8.0
Consumer prices (avg, % yoy)	79.6	93.3	16.6	9.9	11.4	10.0	9.0
Consumer prices (eop, % yoy)	113.4	39.0	15.3	8.1	11.9	7.4	9.1
General budget balance (% of GDP)	-0.9	-1.3	-5.5	-4.0	-2.5	-2.0	-2.5
Current account balance (% of GDP)	-2.6	-9.6	-12.9	-10.0	-13.1	-12.8	-13.5
Official FX-Reserves (EUR bn)	0.6	1.3	2.2	2.8	3.1	3.2	3.5
CSD/EUR, avg	15.3	59.5	60.8	65.3	72.6	81.3	83.3
CSD/USD, avg	16.6	66.4	64.2	57.7	58.4	61.2	59.5

Source: Thomson Financial Datastream, WIIW, Raiffeisen Research

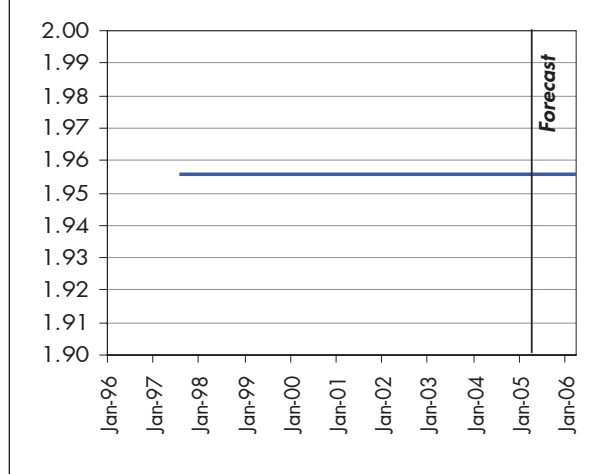


ALL per 1 EUR



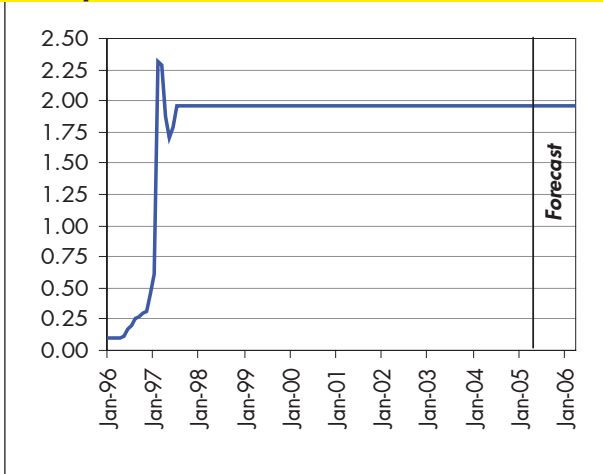
Source: Thomson Financial Datastream, Raiffeisen Research

BAM per 1 EUR



Source: Thomson Financial Datastream, Raiffeisen Research

BGN per 1 EUR



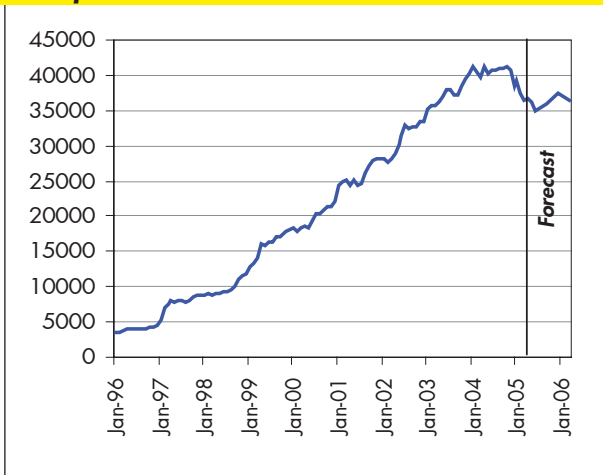
Source: Thomson Financial Datastream, Raiffeisen Research

HRK per 1 EUR



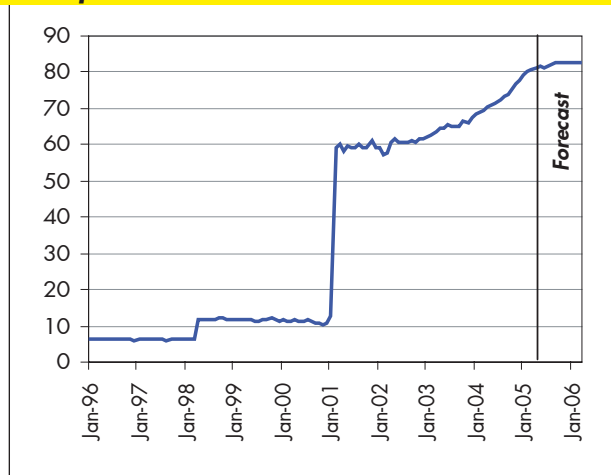
Source: Thomson Financial Datastream, Raiffeisen Research

ROL per 1 EUR



Source: Thomson Financial Datastream, Raiffeisen Research

CSD per 1 EUR



Source: Thomson Financial Datastream, Raiffeisen Research

Real GDP (% yoy)

Countries	2003	2004	2005e	2006f
Poland	3.8	5.3	4.5	5.0
Hungary	2.9	4.0	3.8	3.9
Czech Rep.	3.7	4.0	3.8	3.8
Slovakia	4.5	5.5	4.9	5.5
Slovenia	2.5	4.6	3.5	3.5
CEEC-8*	3.9	4.9	4.4	4.6
Croatia	4.3	3.8	4.0	4.1
Bulgaria	4.3	5.5	5.5	5.5
Romania	5.2	8.3	5.0	5.0
Serbia a. M.	2.1	8.0	5.0	5.0
Bosnia a. H.	3.5	5.0	5.8	6.0
Albania	6.0	6.0	6.0	6.0
SEEC-6	4.4	6.7	4.9	5.0
Russia	7.3	7.1	6.0	5.5
Ukraine	9.4	12.0	8.0	6.0
Belarus	6.8	11.0	10.0	7.5
Turkey	5.8	9.0	6.0	5.5
EU-12	0.5	1.8	1.5	1.5
USA	3.0	4.4	3.7	3.0

* including the Baltic countries

Source: WIIW, Raiffeisen Research

Consumer prices (avg, % yoy)

Countries	2003	2004	2005e	2006f
Poland	0.7	3.5	2.8	2.5
Hungary	4.7	6.8	3.6	3.4
Czech Rep.	0.1	2.8	1.9	2.5
Slovakia	8.5	7.5	2.6	2.3
Slovenia	5.5	3.6	2.0	2.0
CEEC-8*	2.1	4.2	2.7	2.6
Croatia	1.5	2.1	3.7	2.3
Bulgaria	2.3	6.1	4.5	5.0
Romania	15.3	11.9	8.5	7.5
Serbia a. M.	9.9	11.4	10.0	9.0
Bosnia a. H.	0.6	0.2	0.4	0.5
Albania	2.4	2.9	3.0	3.5
SEEC-6	8.5	8.0	6.5	5.8
Russia	13.6	11.0	12.0	9.2
Ukraine	5.2	9.0	10.5	6.5
Belarus	29.0	18.1	12.0	8.5
Turkey	25.3	10.6	10.1	10.8
EU-12	2.1	2.1	2.1	1.9
USA	2.3	2.7	2.5	2.5

* including the Baltic countries

Source: WIIW, Raiffeisen Research

Current account balance (% of GDP)

Countries	2003	2004	2005e	2006f
Poland	-2.0	-1.5	-2.3	-2.3
Hungary	-8.9	-9.3	-7.9	-7.4
Czech Rep.	-6.2	-5.2	-4.9	-4.5
Slovakia	-0.9	-3.4	-4.6	-2.6
Slovenia	-0.4	-0.5	-0.4	-0.5
CEEC-8*	-4.3	-4.3	-4.4	-4.0
Croatia	-6.9	-4.6	-4.4	-3.9
Bulgaria	-8.6	-7.5	-7.0	-6.5
Romania	-6.0	-7.5	-9.2	-9.9
Serbia a. M.	-10.0	-13.1	-12.8	-13.5
Bosnia a. H.	-30.5	-27.9	-25.0	-23.0
Albania	-7.6	-7.3	-6.6	-6.0
SEEC-6	-8.5	-8.7	-9.1	-9.2
Russia	8.2	10.0	6.1	2.9
Ukraine	5.8	10.0	9.5	8.0
Belarus	-2.9	-4.4	-2.2	-1.9
Turkey	-3.3	-5.0	-4.0	-3.5
EU-12	0.3	0.6	0.5	0.4
USA	-4.9	-5.7	-6.0	-5.5

* including the Baltic countries

Source: WIIW, Raiffeisen Research

General budget balance (% of GDP)

Countries	2003	2004	2005e	2006f
Poland	-3.9	-5.7	-4.5	-4.0
Hungary	-5.9	-5.1	-4.8	-4.6
Czech Rep.	-12.5	-3.9	-3.8	-3.4
Slovakia	-3.5	-3.8	-3.4	-2.9
Slovenia	-1.8	-1.9	-1.8	-1.5
CEEC-8*	-5.4	-4.6	-4.0	-3.6
Croatia	-6.3	-4.9	-4.0	-3.5
Bulgaria	0.0	1.7	-0.5	-0.9
Romania	-2.0	-1.1	-0.7	-2.0
Serbia a. M.	-4.0	-2.5	-2.0	-2.5
Bosnia a. H.	0.4	-0.1	-0.2	-0.5
Albania	-4.6	-4.9	-4.6	-4.0
SEEC-6	-2.9	-1.8	-1.7	-2.2
Russia	1.6	4.1	2.5	1.5
Ukraine	0.2	-3.3	-3.0	-2.5
Belarus	-1.3	0.1	-1.5	-1.3
Turkey	-11.7	-7.8	-4.9	-4.3
EU-12	-2.8	-2.7	-2.8	-2.7
USA	-4.6	-4.4	-4.0	-4.0

* including the Baltic countries

Source: WIIW, Raiffeisen Research

Exchange rate LCY/EUR (avg)

Countries	2003	2004	2005e	2006f
Poland	4.40	4.53	4.10	4.00
Hungary	253.8	251.6	250.9	251.9
Czech Rep.	31.8	31.9	30.2	29.8
Slovakia	41.5	40.1	37.8	37.0
Slovenia	234.0	239.0	239.6	239.6
Croatia	7.56	7.50	7.43	7.39
Bulgaria	1.96	1.96	1.96	1.96
Romania	37556	40532	36300	37500
Serbia a. M.	65.3	72.6	81.3	83.3
Bosnia a. H.	1.96	1.96	1.96	1.96
Albania	137.6	127.6	127.5	126.0
Russia	34.7	35.8	36.5	38.5
Ukraine	6.0	6.6	6.8	6.8
Belarus	2353	2680	2961	3150
Turkey	1.69	1.77	1.71	1.86
EU-12	1.13	1.24	1.33	1.40

* TRY/EUR (Lira new redenominated)

Source: WIIW, Raiffeisen Research

Exchange rate LCY/USD (avg)

Countries	2003	2004	2005e	2006f
Poland	3.89	3.64	3.08	2.86
Hungary	224.2	202.3	188.7	179.9
Czech Rep.	28.2	25.7	22.7	21.3
Slovakia	36.7	32.3	28.4	26.4
Slovenia	206.8	192.2	180.2	171.1
Croatia	6.68	6.03	5.59	5.28
Bulgaria	1.73	1.58	1.47	1.40
Romania	33200	32637	27293	26786
Serbia a. M.	57.7	58.4	61.2	59.5
Bosnia a. H.	1.73	1.57	1.47	1.40
Albania	121.9	102.6	95.9	90.0
Russia	30.7	28.8	27.4	27.5
Ukraine	5.3	5.3	5.1	4.9
Belarus	2075	2160	2210	2250
Turkey	1.50	1.43	1.29	1.33
EU-12	0.88	0.81	0.75	0.71

* TRY/USD (Lira new redenominated)

Source: WIIW, Raiffeisen Research





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Cut-off for data: 3 May 2005

This report was completed on 9 May 2005

Editor: Raiffeisen Zentralbank Österreich Aktiengesellschaft

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Published by: Raiffeisen Research GmbH, Peter Brezinschek, 1030 Vienna, Am Stadtpark 9.

Published and manufactured in Vienna.

Printed by: Rabl Druck, 3943 Schrems, Karl Müller-Straße 5

Abbreviations

Currencies and Countries

ALL	Albanian Lek
BAM	Bosnian Marka
BGL	Bulgarian Lev
CSD	Serbian Dinar
CZK	Czech Koruna
EKK	Estonian Kroon
HRK	Croatian Kuna
HUF	Hungarian Forint
LVL	Latvian Lat
LTL	Lithuanian Litas
PLN	Polish Zloty
ROL	Romanian Leu
RUB	Russian Rouble
SIT	Slovenian Tolar
SKK	Slovak Koruna
TRL	Turkish Lira
UAH	Ukrainian Hryvnia

Economic abbreviations

avg	average
yoy	year on year
LCY	Local Currency
GDP	Gross Domestic Product
CA	Current Account
TB	Trade Balance
FDI	Foreign Direct Investments
CPI	Consumer Price Index
PPI	Producer Price Index
FX	Foreign Exchange
ULC	Unit Labour Costs
%-chg	Percentage change
	(not in percentage points)

Stock Exchange Indices

BET	Romanian stock index
BUX	Hungarian stock index
PX 50	Czech stock index
RTSI	Russian stock index
WIG 20	Polish stock index

Equity related

DY	Dividend yield
EG	Earnings growth
LTG	Long term (earnings) growth
P/E	Price earnings ratio

CEEC-4 Central and Eastern European Countries - 4 Czech Republic, Hungary, Poland, Slovakia

CEEC-8 CEEC-4 + Estonia, Latvia, Lithuania, Slovenia

SEEC-6 South Eastern European Countries - 6 Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Romania, Serbia and Montenegro

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