

International v.s. Local Debt Markets Comparison of opportunities for CEE Borrowers

V Polish Debt Market Conference

Warsaw

October 18, 2016

Agenda

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ECB as a Main Driver of Market and Spread Development

Potential ECB Measures

Our research thinks that after March 2017 the ECB will start to taper

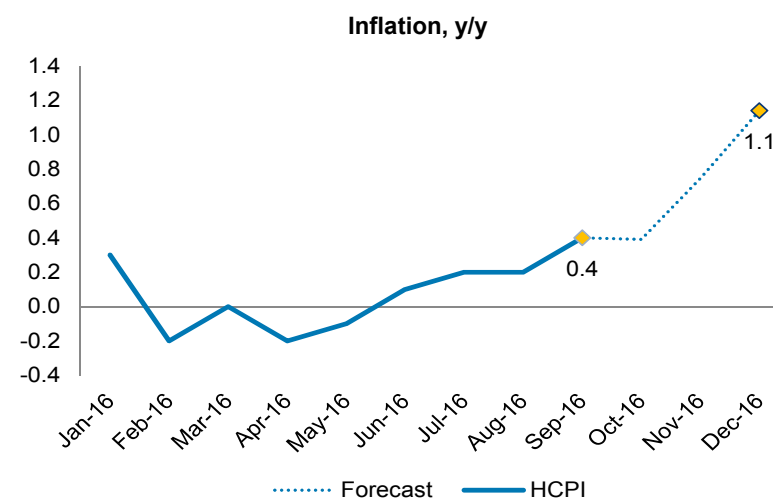
Economic forecast

The upcoming ECB meeting should bring **no change to the outlook for monetary policy**. We think that after March 2017 the ECB will start to taper...



- **Inflation will increase** (a sustained adjustment in the path of inflation consistent with its inflation aim, baseline scenario of ECB staff projections seems to be the benchmark)
- **Economy is resilient**
- **Political pressure is increasing**
- **Collateral Damage (Banking sector)**
- **Supply problems remain**
- **Doubtful success to raise inflation**

...but **technical adaptations** to the APP are **likely to come...**



Potential ECB measurements

We think that the ECB will adapt its asset purchase relatively soon, **due to scarcity of German and Dutch bonds**.

We see **four options** for the ECB to alter its purchase program:

- | | | |
|----------------------------------------------------------------------------------------------------------|--|-------------------------------------------------------------------------------------------------------------------------------------|
| 1. Change distribution (currently ECB capital key) of purchases among sovereign issuers | | highest likelihood , as this would be easy to implement and would shift the weights in an acceptable manner |
| 2. Increase issue/issuer limit from current 33% | | moderate likelihood , as this could lift the ECB's share to a blocking minority |
| 3. Lower yield limit from current -0.4% | | unlikely , as the market could react with a renewed downward shift of the yield curve, eradicating the impact of the measure |
| 4. Increase scope of purchasable securities; last huge fixed income market available would be financials | | unlikely , as the purchase of financials would put the ECB in the position of supervisor and creditor at the same time |

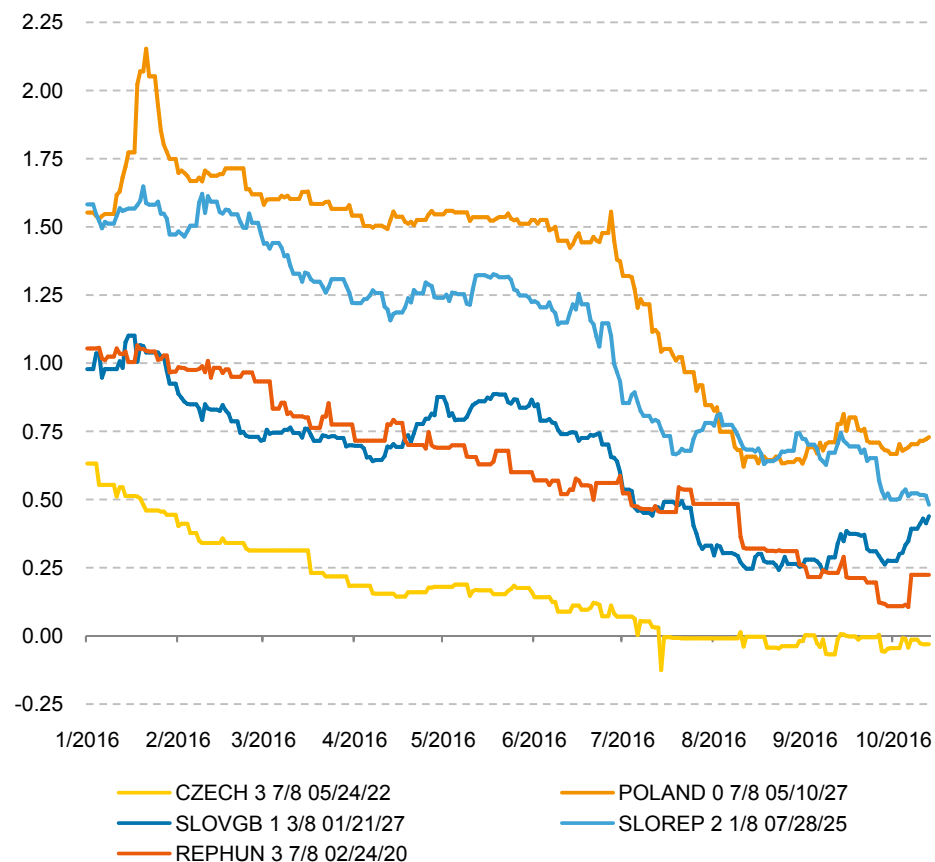
Our most favored option would be supportive for peripheral bonds.

Source: Bloomberg, Erste Group Research

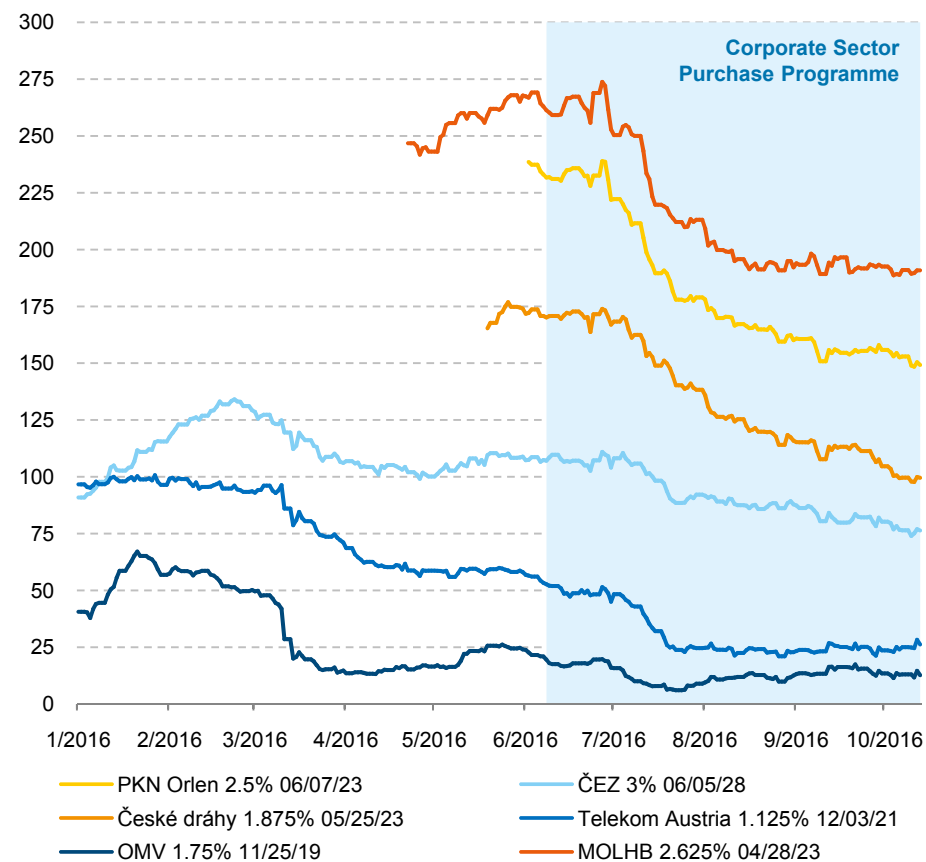
ECB as a Main Market Driver

PSPS and CSPP as a main drivers of pushing yields / spreads lower

Selected Government Bond Yields (EUR, %)



Selected Corporate Bond Spreads (EUR, bps)



Source: Bloomberg, as of October 14, 2016

Bond Market - Eurozone

Yields picking-up again towards year-end & tapering rumours

Prevailing market sentiment

Risks for our forecasts are on downside

- ECB policy is the major risk factor
- After years of low inflation and falling yields, markets have become reluctant to abandon bonds
- Progress towards the ECB's inflation goal will be slow. So, speculation on further monetary loosening could remain in the market for some time

Regardless of when the ECB will start to taper:

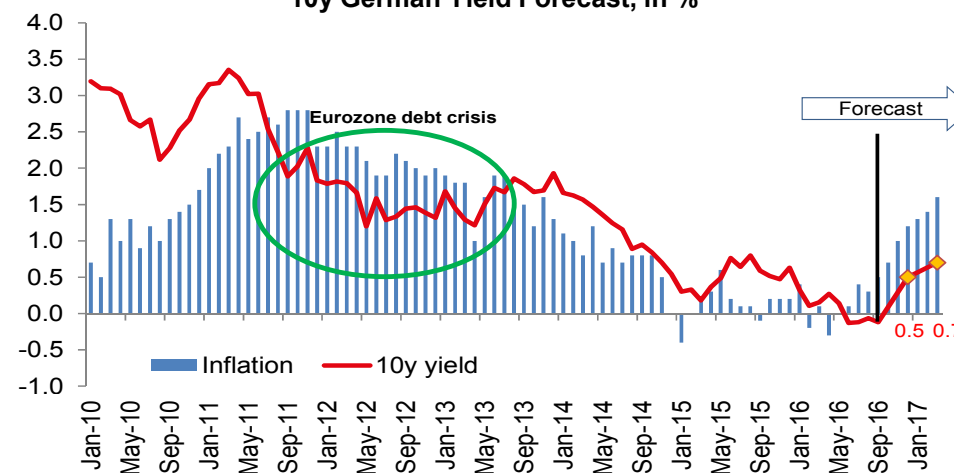
- The market currently depends on one price-insensitive dominant buyer
- The ECB will withdraw at some time; if at that time inflation has started to increase, even worse
- Once the ECB signals an end to its purchases, everybody will be running for the exit at the same time. Some will not make it

EUR & USD interest rate forecast (in %)¹

	current	Dec 16	Mar 17	Jun 17	Sep 17
ECB Main Refinancing Rate	0.00	0.00	0.00	0.00	0.00
3M Euribor	-0.30	-0.30	-0.30	-0.25	-0.03
Germany Government 10yr	0.02	0.50	0.70	1.00	1.00
EUR Swap 10yr	0.39	0.80	1.00	1.30	1.30
	current	Dec 16	Mar 17	Jun 17	Sep 17
Fed Funds Target Rate*	0.29	0.63	0.88	1.13	1.38
3M Libor	0.87	0.94	1.19	1.44	1.70
US Government 10yr	1.62	2.10	2.30	2.60	2.70
EURUSD	1.12	1.10	1.12	1.14	1.16

* Mid of target range

10y German Yield Forecast, in %



Inflation & GDP outlook¹⁾

Inflation	2013	2014	2015	2016	2017
Eurozone	1.3	0.5	0.1	0.3	1.5
USA	1.5	1.6	0.1	1.3	1.9
GDP	2013	2014	2015	2016	2017
Eurozone	-0.2	1.1	1.9	1.5	1.7
USA	1.9	2.4	2.4	1.7	1.9

¹⁾ By regulations we are obliged to issue the following statement: Forecasts are no reliable indicator for future performance

Source: Bloomberg, Erste Group Research (10 October 2016)

Domestic Polish Market Development

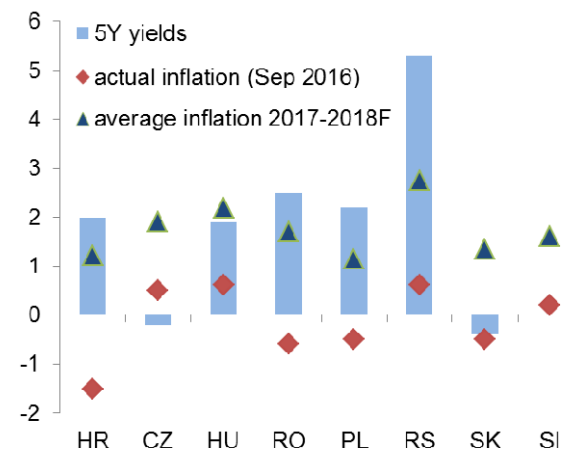
Polish Government Funding

As of September 2016 Poland financed roughly 90% of its borrowing needs

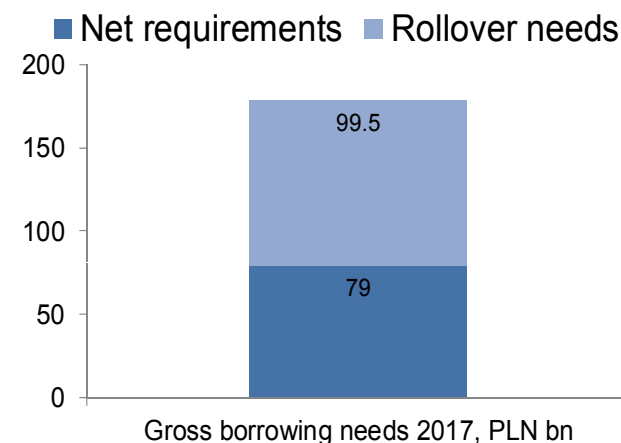
Highlights of 2017

- Ministry of Finance plans to start pre-financing next year borrowing needs on the LCY bond market as there are no Eurobonds issuances planned for the rest of the year. By the end of the year, **roughly 20% of next year borrowing needs is planned to be financed**.
- Total gross borrowing needs are planned **for PLN 178.5bn in 2017**, out of which PLN 79bn constitutes net financing needs with headline deficit cap at PLN 59.4bn.
- Although, this year tax revenues have surprised to the upside and budget deficit is likely to be below fiscal limits (we currently see it at 2.6% of GDP), **meeting all expenditures next year relies heavily on closing the VAT gap**.
- Ministry of Finance can still rely on revenues from bank tax, however to a lesser extent than initially planned. It is no surprise then that VAT rate will remain at 23%. Especially, **lowering retirement age as of October 2017** is going to generate additional expenditures.
- In order to balance relatively high supply with demand, however, Poland may face **increasing costs of financing the deficit**.
- Looming risks for another rating downgrade and worsening economic outlook are likely to **increase risk premium asked by investors to hold Polish debt**.
- We expect **short-end of the curve to remain anchored around current levels**. Central bank openly communicated its wait-and-see strategy and no change in rates is broadly expected throughout next year.
- Long end of the curve will remain sensitive to local political and fiscal risks as well as to global sentiment.
- In upcoming months, among key international events possibly affecting Polish yield curve are **FOMC decision on interest rate in US** and **ECB decision on the future form of QE in Eurozone**.

5Y yields and inflation (%)



Funding needs in 2017



Source: Ministry of Finance, Erste Group Research

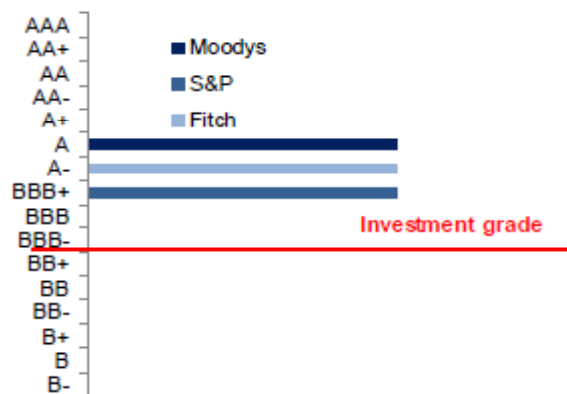
Polish Treasury Bonds Market

Cost of deficit financing may increase

Shrinking investor base

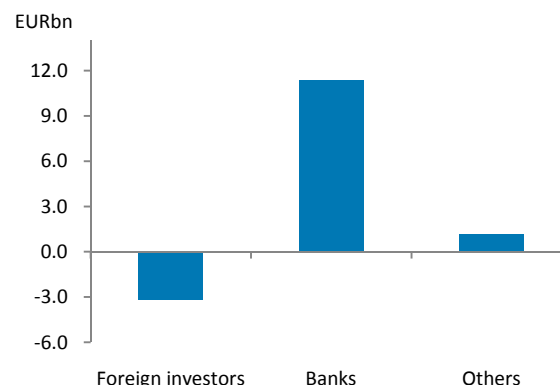
- Poland may face **increasing costs related to budget deficit financing** when it comes to balance relatively high supply with demand for treasury bonds
- Foreign investors have withdrawn more than EUR 3.2bn** since the beginning of this year due to several factors (i.e. downgrade of Polish rating by S&P in January). Investment and capital outflows have also touched other emerging markets (increase of global instability). Nevertheless, **foreign investors still constitute almost 35% of Polish treasury bondholders**
- The drop in non-resident holdings has been compensated by **Polish banks which have increased their share in domestic debt** (+EUR 11bn, from 33% at the beginning of this year up to 39% in September 2016)
- Assuming that non-residents hold off engaging in Poland, **weakening demand may put moderate pressure on yields**. Furthermore, looming risks for another rating downgrade and worsening economic outlook are likely to increase the risk premium asked by investors to hold Polish debt
- Polish sovereign bonds **spread versus Bunds is expected to remain elevated next year** and for political and fiscal risks to remain relatively high

Credit rating of Polish sovereigns



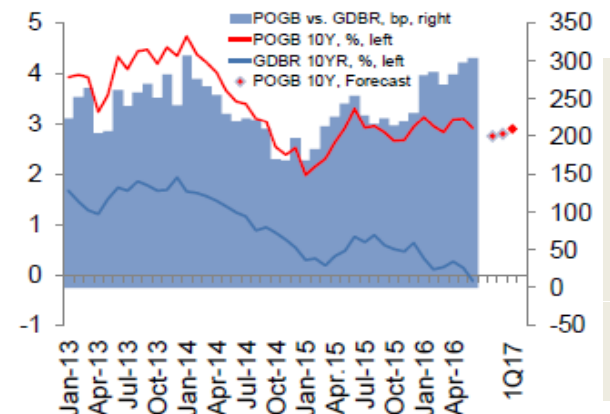
Source: Bloomberg, Erste Group Research

YTD change in LCY bond holdings



Source: Ministry of Finance, Erste Group Research

Yields forecast



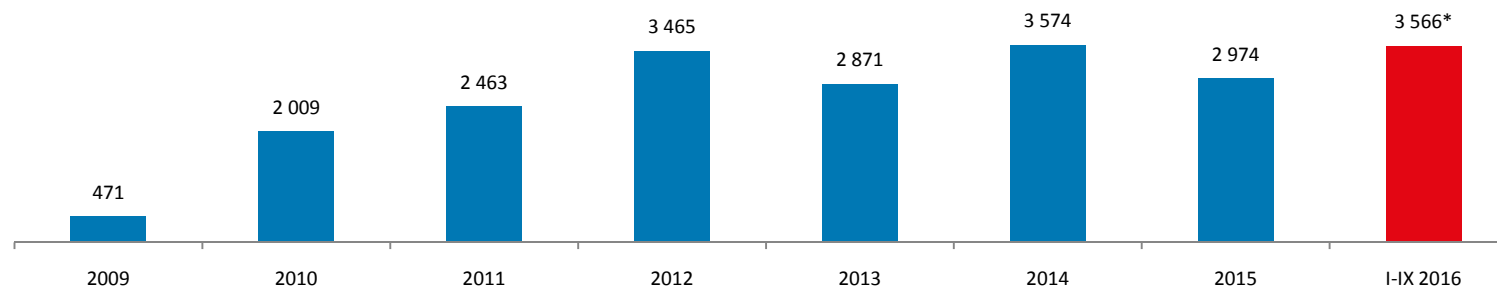
Source: Bloomberg, Erste Group Research

Market value and growth – PLN domestic placements

Issue level of more than EUR 3bn p.a. with a typical issue size of EUR 7m

Total amounts issued per year by Polish corporate issuers (EUR m)

After the 2008-2009 crisis, the Polish DCM market experienced high growth, with total PLN-denominated issue size of EUR 471m in 2009 and EUR 2bn in 2010

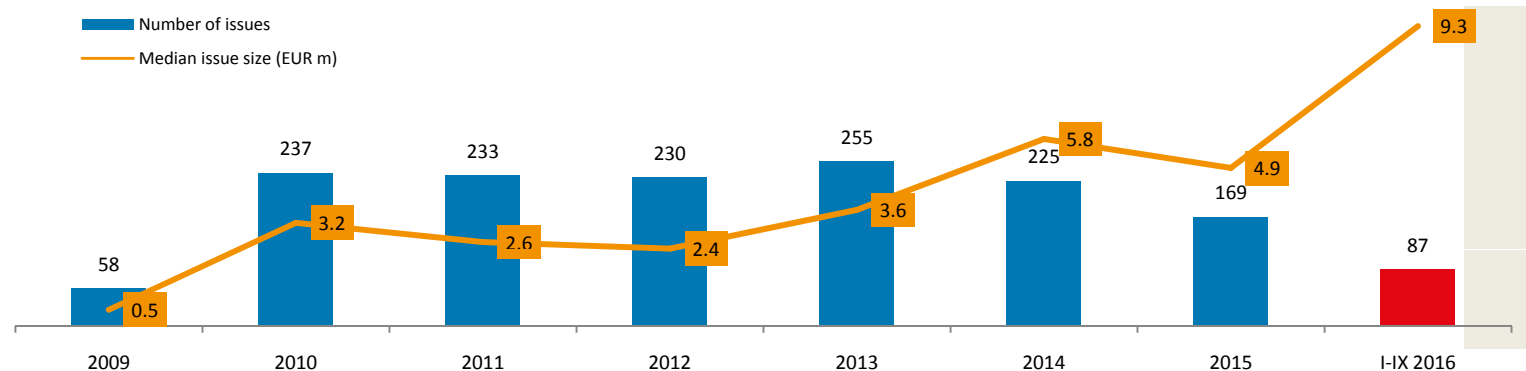


Source: Bloomberg, Cbonds, Erste analysis

Number and median value of Polish corporate bond issues (EUR m)

The median issue size in the last years amounted to EUR 4-9m

Despite smaller number of issues, median amount of bond issue has increased significantly



Source: Bloomberg, Cbonds, Erste analysis

* Including BGK issues

Market structure – domestic placements

Increasing importance of bond market in low interest rate environment

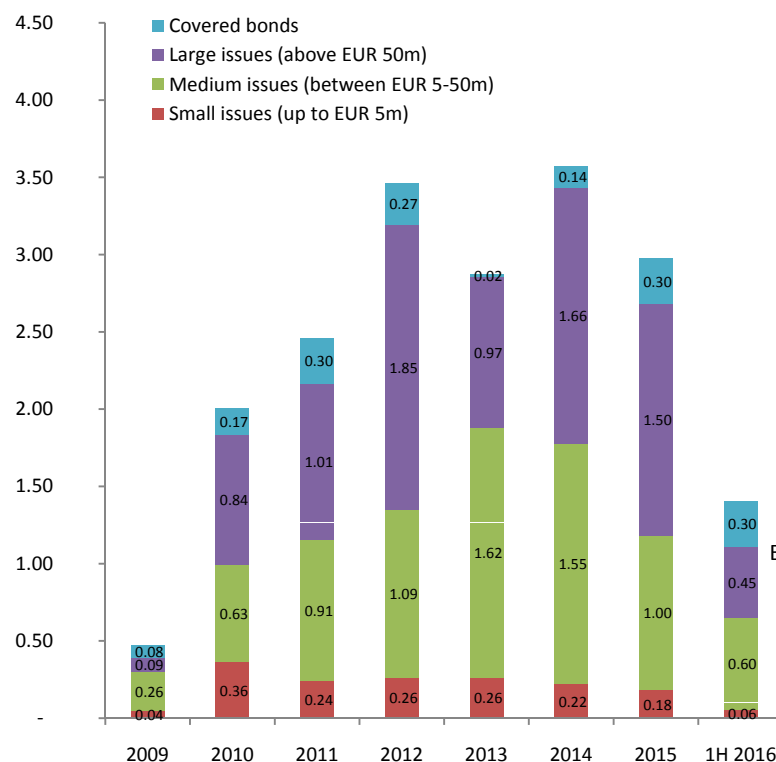
In the last few years, the market has been almost evenly split between medium and large issues

1H 2016 turned out to be the record high period in terms of the bond value offered in public offerings

Total demand posted by retail investors amounted to EUR 510m while bond supply was capped at EUR 220m

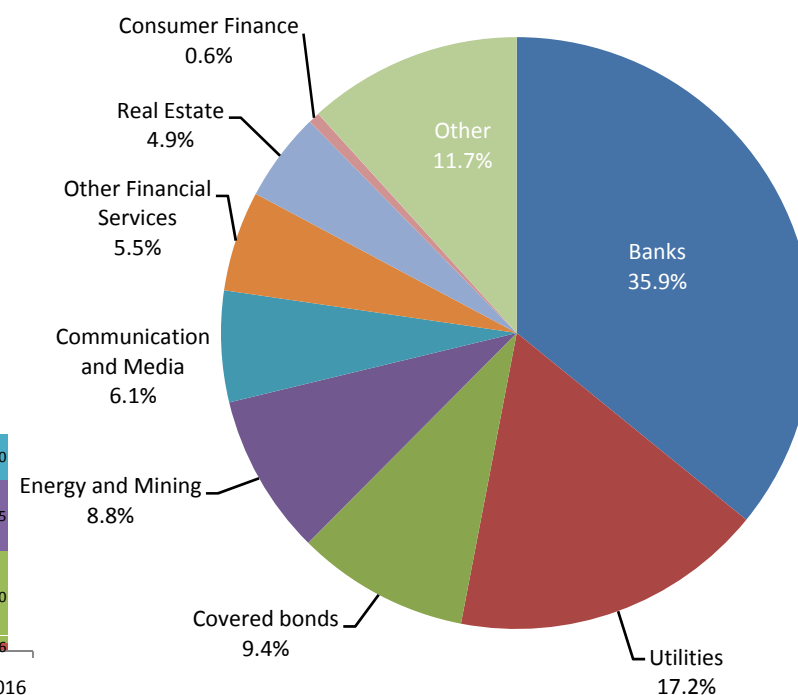
Newly introduced law also supported growing interest in covered bonds - average issue size of EUR 50m in 1H 2016

Total amounts issued by year, split by issue size (EUR bn, including covered bonds)



Source: Bloomberg, Erste analysis

Issuer distribution by value of total outstanding issues (including covered bonds) as of 1H 2016



Source: Bloomberg, Erste analysis

Polish bond market – current overview

Polish mortgage banks with sizable covered bond issues on the horizon

Growing interest in covered bonds

- Covered bonds (both mortgage and public) are becoming an attractive investment alternative complementary to the government bonds holdings. Covered bonds typically offer **higher interest at comparable or even higher credit rating** (Poland: A2 negative, BBB+ negative, A-)
- Recently implemented changes to the Polish law on covered bonds, among others made this product **even more attractive for international investors**. In order to gain access to the large base of EUR creditors, major **problem with withholding tax has been solved**
- Last two covered bond series of PKO Bank Hipoteczny **attracted interest from international investors** incl. EBRD who were allotted approx. 4% of the first benchmark series and approx. 25% of the following one
- Successful track record of 3 covered bond series with each offered at even lower interest (WIBOR3M plus margin 0.75%, 0.65% and 0.59% respectively) allowed PKO Bank Hipoteczny to issue EUR 500 mil (due in 2022) yesterday at MS plus 18 bps (as a part of the established European Covered Bond Issue Program worth EUR 4bn)

ISIN code	Issue date	Maturity	Nominal value (PLN)	Coupon	Issue rating
PLPKOHP00017	11.12.2015	11.12.2020	30 000 000	WIBOR3M+0,75%	Aa3
PLPKOHP00025	27.04.2016	28.04.2021	500 000 000	WIBOR3M+0,65%	Aa3
PLPKOHP00033	17.06.2016	18.06.2021	500 000 000	WIBOR3M+0,59%	Aa3

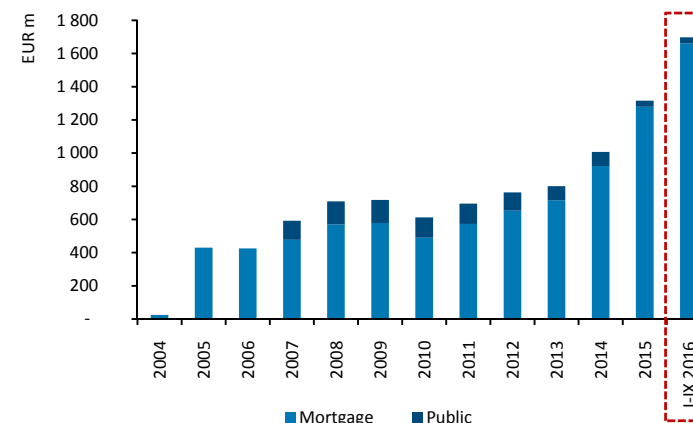
Source: <http://www.pkobh.pl/relacje-inwestorskie/emisja-listow-zastawnych/>

Outstanding covered bonds listed on Catalyst

Issuer	Rating	Number of issues		Total amount issued
		in PLN	in EUR	in EUR m
mBank Hipoteczny	A (Fitch)	14	14	1,020
Pekao Bank Hipoteczny	AA+ (Fitch)	8	6	310
PKO Bank Hipoteczny	Aa3 (Moody's)	3	0	230

Source: Catalyst, Erste analysis

Polish covered bonds outstanding

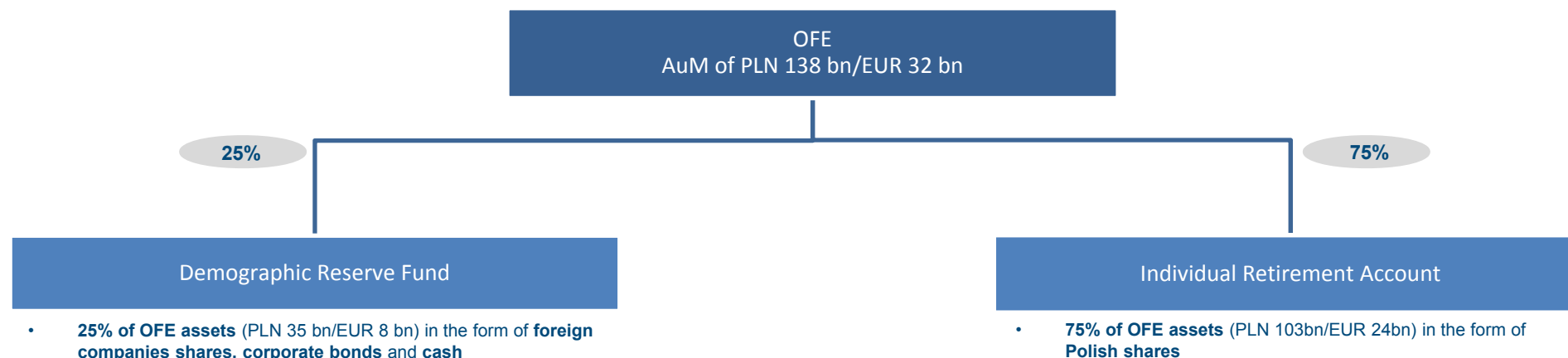


Source: Catalyst, Erste analysis

Polish bond market – current overview

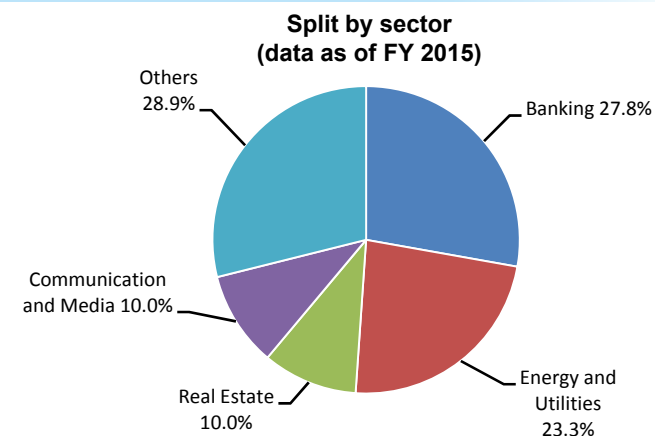
Distant law regulations and new investment opportunities

Polish Pension Fund (OFE) reform



- At the beginning of July 2016, Polish Ministry of Development has proposed **changes to pension system in Poland**. The new reform is expected to come into force in 2018
- **Since 2014, Polish Pension Funds (OFE) are not allowed to invest into government bonds, thus started looking closer on the corporate bonds market.** As of July 2016, OFE held more than EUR 2bn of corporate bonds (mainly listed on Catalyst market)
- Proposed changes may have **material effect on the issuers who plan to roll-over the existing bond series** were OFE are the largest bondholders. If OFE (or in the future FRD) are no longer allowed to invest into corporate bonds, the issuers will be forced to partially buy back the issues or try to refinance them at higher margins
- Those issuers who are able to tap the international market may find **euro-denominated bonds or SSD/NSV** as very competitive and tailored financing solutions

Corporate bonds held by Polish Pension Funds



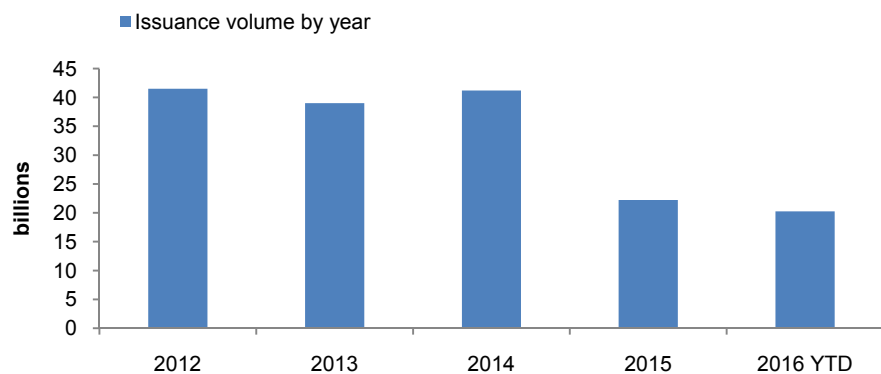
Source: Bloomberg, Erste analysis

Opportunities at International Markets

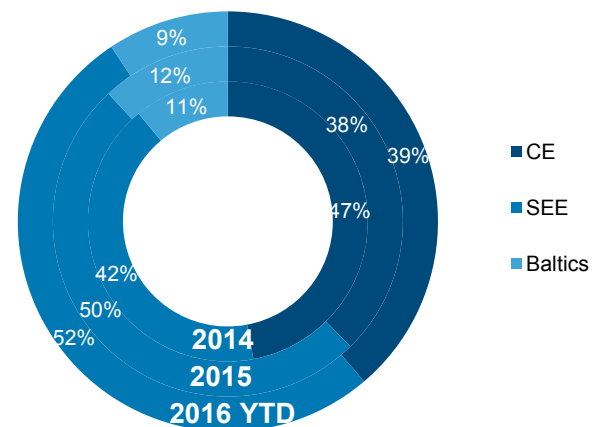
CEE Primary Issuance

Majority of international bonds coming out of CEE have been EUR-denominated in 2016YTD

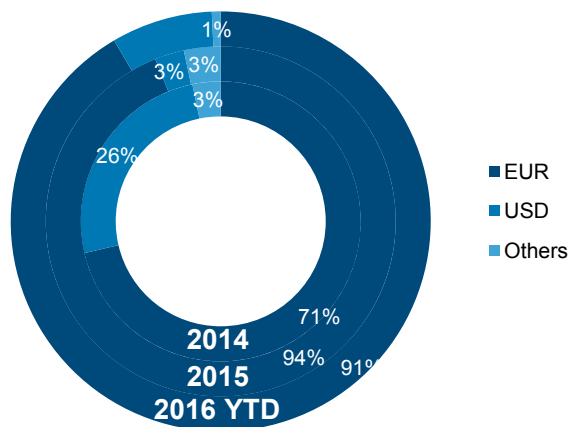
Total CEE Issuance since 2012 (bn, EUR)



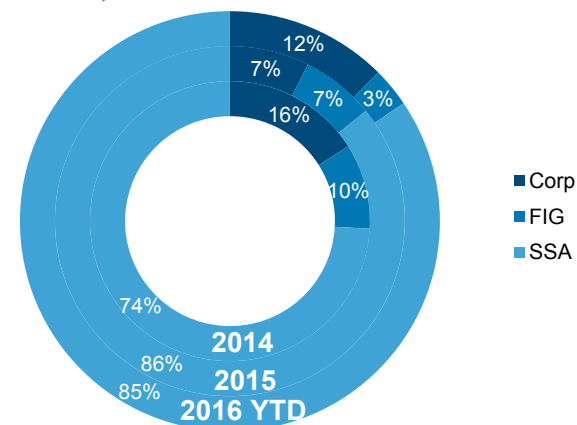
Region Breakdown, 2014– 2015YTD



Currency Breakdown, 2014 – 2016YTD






Sector Breakdown, 2014 – 2016YTD



Sovereign Issues out of the CEE Region in 2016

In 2016 we have already seen CEE sovereigns issuing Eurobonds in medium to long-term maturities

Issuer	Issue date	Issue Rating (at issue)	Coupon (%)	Currency	Volume (mn)	Tenor	Maturity	Re-offer
BGK 	14.10.2016	NR / NR / A-	1,75	EUR	200 (tap)	10	6.5.2026	ms+90 bps
Latvia 	30.9.2016	A3 / NR / A-	0,375	EUR	650	10	07.10.2026	ms+19 bps
Romania 	28.9.2016	Baa3 / BBB- / BBB-	2,875	EUR	1000 (tap)	12	26.05.2028	ms+177 bps
Lithuania 	15.9.2016	A3 / A- / A-	2,125	EUR	450 (tap)	19	22.10.2035	ms+28 bps
Slovenia 	7.9.2016	Baa3 / A / BBB+	1,5	EUR	1 000	19	25.3.2035	ms+98 bps
Macedonia 	26.5.2016	/BB-/BB+	5,625	EUR	450	7	26.5.2023	ms+583.9 bps
Romania 	20.5.2016	Baa3 / BBB- / BBB-	2,875	EUR	1 000	12	26.5.2028	ms+225 bps
Slovenia 	11.5.2016	Baa3 / A- / BBB+	2.125 / 2.25	EUR	1,250 (tap) / 1,500 (tap)	10 / 16 (orig.)	2025 / 2032	ms+95 bps / ms+135 bps
Latvia 	10.5.2016	A3 / A- / A-	1,375	EUR	650	20	18.1.2036	ms+50 bps
BGK 	28.4.2016	NR / NR / A-	1,75	EUR	500	10	6.5.2026	ms+120 bps
Poland 	13.4.2016	A2 / BBB+ / A-	2,375	EUR	750 (tap)	20 (orig.)	18.1.2036	ms+125 bps
Poland 	31.3.2016	A2 / BBB+ / A-	3,25	USD	1 750	10	6.4.2026	UST+150 bps
Bulgaria 	14.3.2016	Baa2 / BB+ / BBB-	1.875 / 3.000	EUR	1,144 / 850	7 / 12	2023 / 2028	ms+185 bps / ms+235 bps
Montenegro 	4.3.2016	Ba3 / B+ / NR	5,750	EUR	300	5	10.3.2021	ms+603.6 bps
Slovenia 	26.2.2016	Baa3 / A- / BBB+	3,125	EUR	125 (tap)	30 (orig.)	7.8.2045	ms+175 bps
Slovenia 	25.2.2016	Baa3 / A- / BBB+	2,250	EUR	1 500	16	3.3.2032	ms+145 bps
Romania 	18.2.2016	Baa3 / BBB- / BBB-	2.750 / 3.875	EUR	750 (tap) / 500 (tap)	10 / 20 (orig.)	2025 / 2035	2.55% / 3.90%
Austria 	16.2.2016	Aaa / AA+ / AAA	0.750 / 1.500	EUR	3,500 / 1,500	10.5 / 31	2026 / 2047	ms+6 bps / ms+35 bps
Slovakia 	14.1.2016	A2 / A+ / A+	1,625	EUR	1 000	15	21.1.2031	ms+38 bps

EUR Corporate Bond Market Overview

ECB's Corporate Sector Purchase Program (CSPP) continues to drive market

Bumpy start to 2016

- At the beginning of the year, the turmoil on the Chinese stock market and the significant oil price drop pushed credit spreads significantly wider. Commodity-related sectors, such as Metals & Mining and Oil & Gas, were especially hard hit.

Sentiment started to improve in February

- The oil price stabilized in mid-February. Leading economic indicators proved quite resilient. China's government succeeded in alleviating concerns over a potential hard landing for the Chinese economy. In addition, the prospect of further monetary easing by the ECB calmed investors' nerves. Credit spreads gradually started to tighten.

ECB's CSPP triggered rally from March 10 onwards

- The ECB clearly beat market expectations with the measures announced on March 10. Inter alia, it extended its purchase program to IG corporate bonds. IG and HY spreads have tightened significantly since then. CSPP started on June 8. So far, the purchased volume has exceeded market expectations.

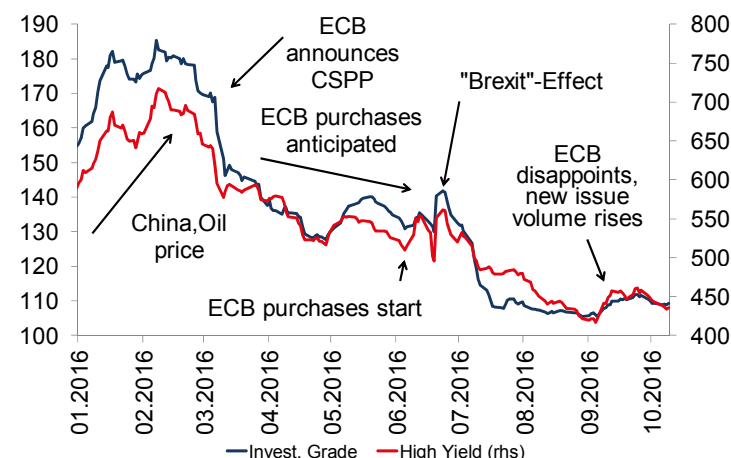
'Brexit' vote had no lasting effect on spreads

- The 'Brexit' vote on June 23 briefly pushed spreads wider, especially in the HY segment. However, the vote as such had no lasting impact on the EUR corporate bond market. Credit spreads have fallen to their annual lows in early September. However, the recent surge in new issue volumes and ECB tapering rumors have put upward pressure on spreads.

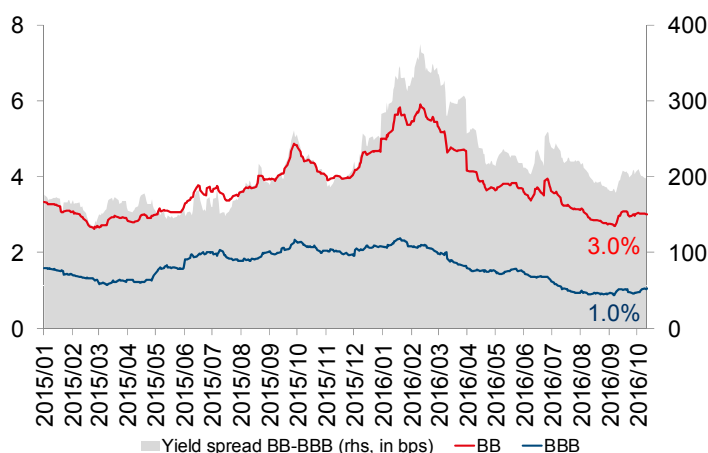
Spread levels still adequate, but further significant tightening unlikely, in our view

- In our view, the ratio of achievable spreads to the fundamental credit quality of companies is still adequate. However, we do not see any further significant spread tightening potential.
- The ECB's CSPP should remain the EUR corporate bond market's driving factor in the foreseeable future. This should put a cap on spreads, especially for IG issuers.

EUR benchmark spreads* in 2016 – in bp



EUR BB vs. BBB yields* – in %



EUR Primary Market

EUR primary market strongly benefits from ECB's CSPP

Large fluctuations in 1H16

No real summer break and an intense autumn

2016 expected to be another very strong issuance year

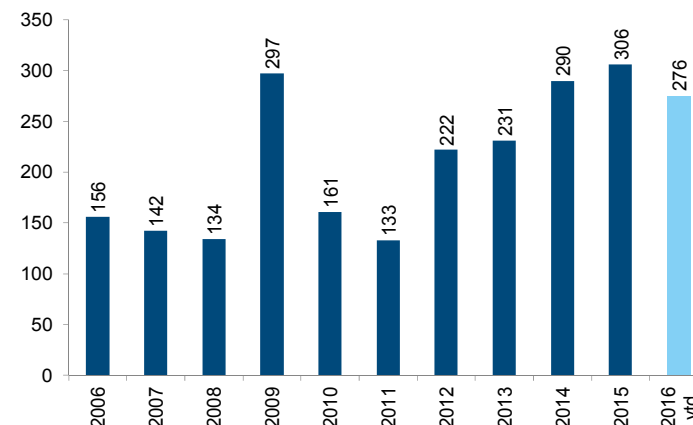
Favorable conditions for issuers

CEE issuers tapping EUR primary market

Bonds due by end of 1Q17: EUR 310bn

- Following an extraordinarily weak start to 2016, issuance activity gained momentum from mid-February on, in line with tightening spreads. After three very strong months (March-May: EUR 136bn) in the run-up to ECB's CSPP, issue volumes went back slightly; not least due to increased volatility around the 'Brexit' referendum, from which the EUR primary market has recovered quickly. Stimulated by ECB's CSPP, the summer break was less pronounced than in previous years. With an issue volume of EUR 14bn, this August was the strongest since the EUR primary market came into existence. Also, September (EUR 41bn) prove to be very active.
- Based on the current dynamics, our upward revised forecast for the full year 2016 amounts to EUR 300bn. We expect another very strong year on the EUR primary market and do not exclude another record issuance year.
- We see the currently high level of issuance activity persisting in the coming weeks and months. Boosted by the ECB's CSPP (focusing on IG papers), demand is constantly high while investors continue seeking yields. This leads to well-filled order books and supports lower credit risk premiums.
- In 2016 YTD, a number of CEE issuers had already tapped the EUR primary market, some of them with benchmark papers. Given the favorable market environment for issuers, we also expect other CEE companies to place their EUR bonds in 2016.
- EUR corporate bonds maturing in 2016 and 1Q17 amount to EUR 310bn, with thereof 5% (or EUR 14bn) accounting for companies from the CEE region.

Issue volume in EUR bn



EUR primary market – CEE issuers in 2016 YTD

Issuer	Country	Sector	Issue volume in EUR mn	Ø Maturity in years	Ø Coupon in %	Issuer rating Moody's / S&P / Fitch
MOL	HU	Energy	750	7	2,625	- / BB+ / BBB-
ORLEN	PL	Energy	750	7	2,500	- / Baa3 / BBB-
BULGARIAN ENERGY	BG	Utilities	550	5	4,875	Ba1 / - / BB-
ČESKÉ DRÁHY	CZ	Industrial	400	7	1,875	Baa2 / - / -
RCS-RDS (via Cable Comm)	RO	Telecom	350	7	5,000	- / - / -
CEZ	CZ	Utilities	200	2	0,782	Baa1 / A- / A-
UNITED GROUP	RS	Telecom	150	4	7,875	B2 / B / -
TELEKOM SLOVENIJE	SI	Telecom	100	5	1,950	Ba2 / - / -
LATVENERGO	LV	Utilities	25	6	1,900	Baa2 / - / -
ESIN	SK	Energy	20	5	5,000	- / - / -
VITOL SAS	SK	Energy	20	2	0,000	- / - / -
GEN-I	SI	Utilities	15	3	2,400	- / - / -
IDC	SK	Food	8	8	1,770	- / - / -
EBIOSS	BG	Industrial	2	5	7,000	- / - / -

Source: ECB, Bloomberg, Erste Group Research; as of October 13, 2016

Details of ECB's CSPP

EUR Corporate Bond Market benefitted from ECB's CSPP

CSPP started on June 8

- On March 10, the ECB announced the extension of its bond purchase program to the corporate sector. On June 8, six central banks in the Eurozone began purchasing EUR-denominated corporate bonds (excluding bank bonds) on behalf of the ECB.

Criteria for eligible corporate bonds set

- Eligible bonds must have an investment grade rating with at least one of the three large rating agencies (Moody's S&P, Fitch). However, the central banks will not sell them if they lose their investment grade rating.
- The time to maturity of eligible bonds is between 6M and 30Y.
- Corporate bonds of issuers located in the Eurozone but with headquarters outside the Eurozone (e.g. Switzerland, Great Britain or the US) can be bought, if all other criteria are met.
- Issuance volume is not relevant, but a maximum of 70% of each ISIN's outstanding volume can be purchased under the CSPP. Hybrid bonds and subordinated bonds issued by insurance groups are not subject to the CSPP.

Total CSPP holdings published weekly

- Total CSPP holdings are published on a weekly basis (as of October 7: EUR 32bn). The list of purchased ISINs is published weekly, but the volume purchased per ISIN is not disclosed. The breakdown between the primary and secondary market is announced at the end of every month (as of September 30: primary – 10.9%, secondary – 89.1%).
- The weekly average purchase volume amounts to EUR 1.9bn. This was higher at the beginning of the CSPP and is again above average, after lower purchase volumes during summer.

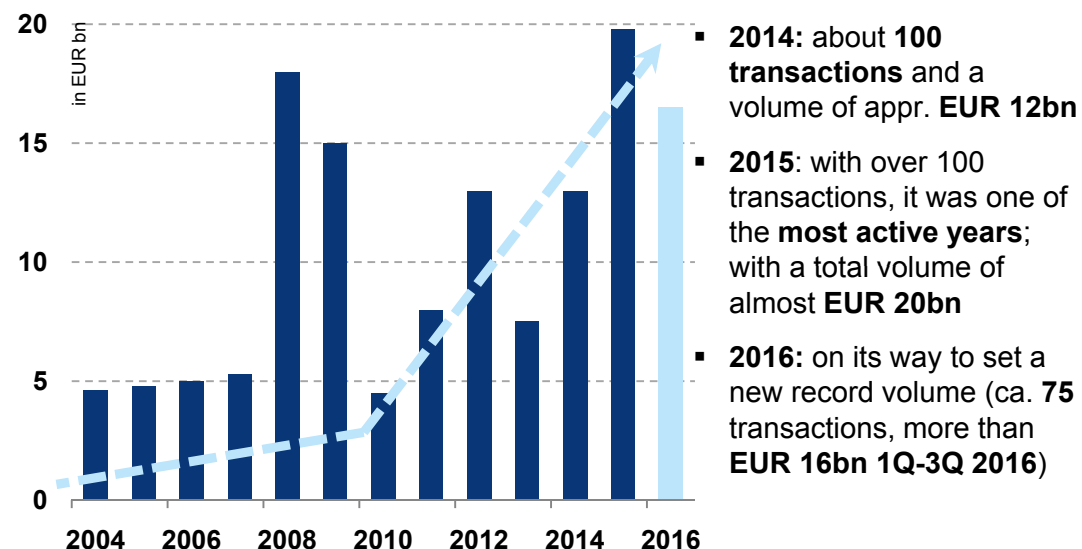
CEE issuers whose bonds were purchased in CSPP

Issuer	ISIN	Country	Industry	Issuer rating Moody's / S&P / Fitch
EESTI ENERGIA	XS1292352843	EE	Utilities	Baa3 / BBB / -
ELERING	XS0645947457	EE	Utilities	A2 / - / -
PETROL D.D. LJUBLJANA	XS1028951777	SI	Energy	- / BBB- / -
SPP DISTRIBUCIA AS	XS1077088984	SK	Utilities	Baa2 / - / A-
SPP INFRASTRUCTURE FIN	XS0953958641	SK	Utilities	Baa2 / - / A-
SPP INFRASTRUCTURE FIN	XS1185941850	SK	Utilities	Baa2 / - / A-
ZAPADOSLOVENSKA ENRG AS	XS0979598207	SK	Utilities	- / A- / -
ZAPADOSLOVENSKA ENRG AS	XS0979598462	SK	Utilities	- / A- / -

Market Development of Corporate SSD

Dynamic market takes up further speed in 2016

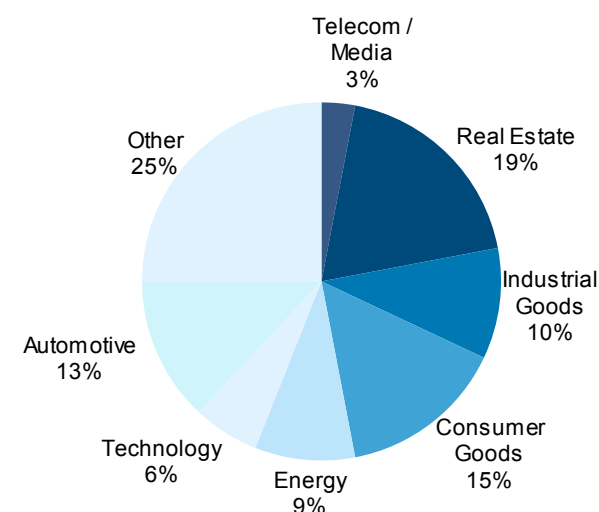
Development of annual SSD volume



Leading trends

- Besides refinancing and M&A activities also „**Green SSD**“ transactions started to contribute to issuance activities in 2016
- Continuing trend to **transactions with higher volumes** (average volume: 2014 about EUR 120mn, 2015 about EUR 175mn, 1H 2016 about EUR 240mn); in 1st half of 2016 7 transactions > EUR 500mn
- Substantial **interest in longer maturities**; 5 und 7 years remain in the focus
- **Internationalization** of borrowers (even though the relative portion of non-German issuers slightly fell in 2015 relative to a large increase of the total SSD issue volume) and investors

Issue volume by industry 2015



Selected transactions

Launch	Issuer	Marketed Volume
10/2016	freenet	EUR 200mn
09/2016	IMCD	EUR 125mn
09/2016	Semperit	USD 75mn
09/2016	Renolit	EUR 50mn

Sources: Erste Group market observations and estimations

Thank you for your attention!

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