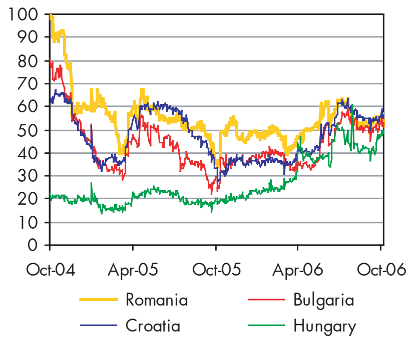
South East Europe
in the spotlight

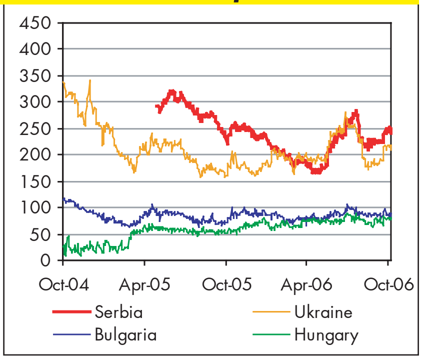
October 2006

EUR Eurobond spreads



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

USD Eurobond spreads



USD EMBIG government spreads (bp)
Source: JP Morgan, Raiffeisen RESEARCH

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Highlights

■ According to the European Commission Bulgaria and Romania are in a position to take on the rights and obligations of EU membership on 1 January 2007. However, they shall report regularly on progress in addressing specific benchmarks (the first report is to be submitted by 31 March 2007). Should either country fail to address the benchmarks adequately, the Commission will apply the safeguard measures of the Accession Treaty. These include infringement procedures, competition policy measures, measures for the management of EU funds and monitoring mechanisms, for example in the areas of Internal Market and Justice, Liberty and Security.

■ Future economic developments in the South East European region, especially in international trade and FDI inflows, will be influenced significantly by the establishment of the newly transformed Central European Free Trade Agreement organisation. The current members of CEFTA, namely Bulgaria, Croatia, Romania and Macedonia, most probably will be joined by Albania, Bosnia and Herzegovina, Serbia, Montenegro, Kosovo and Moldova.

■ Once again stock markets in the South East European region put in a very good performance during the first nine months of 2006. The Bucharest Stock Exchange showed heavy gains so far this year. The Croatian equity market managed to show - mainly driven by the Pliva takeover story - a quite high return of 47% in the first three quarters of the year. The Serbian indices as well as the Bulgarian indices strongly performed and climbed to record-high levels in the third quarter of 2006. Last but not least in Bosnia and Herzegovina optimism prevailed on the local stock exchanges.

Go South East!

Source: web pages of the governments, Raiffeisen RESEARCH

Raiffeisen RESEARCH
RZB Group

South East Europe
in the spotlight

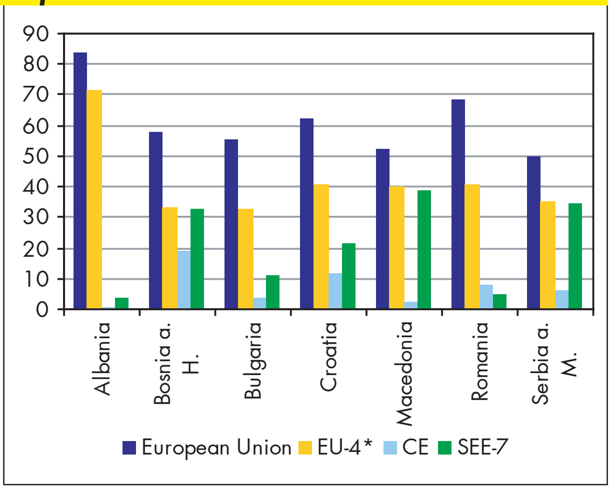
Big chance
Go ahead and take it

"It (CEFTA) is a great waiting room for EU enlargement, preparing members financially and socially for life in the European Union." (Dragan Barbutovski, a spokesman for the stability pact of South East Europe)

The EU is by far the most important trading partner for South East Europe. In 2005, total trade between the EU and South East Europe amounted to EUR 79 bn, an increase of 53% compared to 2001. The EU has offered preferential access to the Western Balkans since 2001 - since that time, exports from these countries to the EU have grown by 38%. However, foreign investment in the region remains low. An integrated regional market with a simplified single set of trade rules should make the region more attractive for inward investment. Trade between South East European countries has been boosted by the establishment of bilateral Free Trade Agreements. Trade within the region increased from EUR 2.6 bn in 2002 to more than EUR 3.5 bn in 2004. For instance, Croatia increased its trade with its regional neighbours by 27%, while Bosnia and Herzegovina boosted its regional trade by 63%. The enlargement and modernisation of the Central European Free Trade Agreement (CEFTA) will build on these encouraging results. The Agreement will consolidate the bilateral trade concessions, which are currently included in 31 different bilateral Free Trade Agreements - which already liberalise more than 90% of trade in the region, including almost all trade in industrial products.

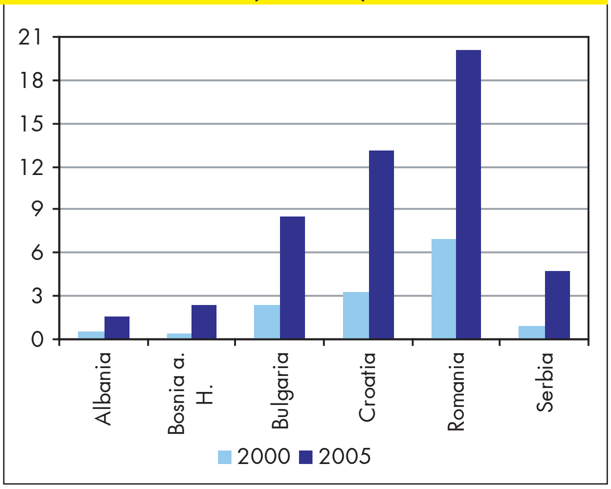
South East European countries are focusing their attention on attracting more foreign direct investment, through which the national economies can encourage production and the import of know-how, can increase employment, infrastructure development, and help to reduce poverty, etc. Therefore, the countries are looking for innovative ways. For example, on 30 June 2006, the Serbian government enacted the "Regulation Setting the Conditions for and Way of Attracting Direct Investments", which provides for pecuniary incentives from the budget for the newly employed. Montenegro published a FDI incentive strategy in July 2006. And Albanian Prime Minister Sali Berisha wants to attract investors with a sell-off, calling the strategy "Albania for 1 EUR". However, before milk and honey is flowing, demands such political stability, infrastructure improvement, quality of education have to be met. The first steps have already been taking and with joint action the South East Europe clan might cause some surprises.

Exports to ... as % of total



Figures as of 2005
** EU-4: Austria, Germany, Greece, Italy*
Source: IMF Direction of Trade Statistics, wiiw, Raiffeisen RESEARCH

Inward FDI stock (EUR bn)



Source: wiiw, Raiffeisen RESEARCH

Tax rates as investment incentives?

	Corporate tax rate (%)	Capital gains tax rate (%)	VAT rate (%)	Social security contribution*
Albania	20	20	20	30.7
Federation of Bosnia a. H.	30	30	17	27.9
Rep. Srpska	10	10	17	42.0
Bulgaria	15**	15	20	23.98–24.68
Croatia	20	20	22	17.2
Macedonia	15	10.5	18	n.a.
Montenegro	9	9	17	16.1
Romania	16	16	19	30.75–34.75
Serbia	10	10	18	17.9

** (%) paid by the employer*
*** Bulgaria's parliament approved a cut to 10% from 2007*
Source: PricewaterhouseCoopers

New trade agreement
to boost growth in SEE?

Flag of CEFTA

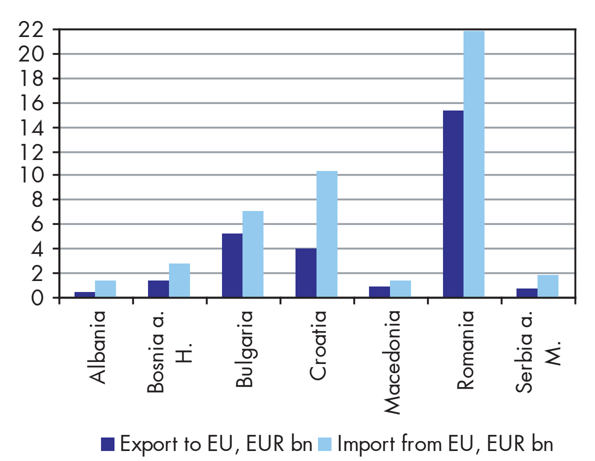
CEFTA: Central European Free Trade Association (Agreement)
Source: Wikipedia

Basic informations

	Total area, km^2	Population, mn	GDP/ capita*	FDI stock/ capita*
Albania	28,748	3.2	2,281.3	488.0
Bosnia a. H.	51,066	4.0	2,050.0	598.0
Bulgaria	110,994	8.0	3,048.9	1,105.0
Croatia	56,594	4.4	7,617.8	2,970.0
Macedonia	25,713	2.0	2,450.0	735.0
Montenegro	13,812	0.6	2,854.7	895.0
Romania	238,391	21.7	4,382.5	930.0
Serbia	88,361	7.5	3,266.7	641.0
Total SEE	613,679	51.4	27,951.8	8,362.0

Moldova: population 4.5 mn, area 33,843 km^2
** in EUR*
Source: Eurostat, wiiw, Raiffeisen RESEARCH

Foreign trade with EU



Figures as of 2005
Source: Eurostat

Future economic developments in the region, especially in international trade and FDI inflows, will be influenced significantly by the establishment of the newly transformed Central European Free Trade Agreement organisation. The European Union proposed a free trade zone in the Western Balkans, in order to stimulate economic cooperation between the countries and to reduce barriers. However, this idea sparked intense reactions across the countries, and unfortunately these reactions have been mostly politically motivated. In order to dodge the negative political connotations, it was decided that liberalisation of trade and investments in the SEE region should be undertaken through reorganisation of CEFTA. CEFTA was founded in 1992 in order to gradually implement free trade between Poland, Hungary, and the former Czechoslovakia. Later Slovenia, Romania, Bulgaria and Croatia also joined CEFTA. Macedonia joined the organisation as the newest member in 2006. The agreement aimed for gradual abolition of duties on industrial products and a decrease in duties on agriculture products. The organisation was successful in preparing the countries for market competition and represented an important step in transition towards a market economy. CEFTA lost a great deal of importance after 2004, when most of the members entered the EU and left the association.

Currently, the volume of trade between SEE countries is relatively low as a result of the disruption in economic cooperation during the last decade. Also, many unsolved political issues and the restructuring of the individual national economies has hindered a recovery in regional trade. The current members of CEFTA, namely Bulgaria, Croatia, Romania and Macedonia, most probably will be joined by Albania, Bosnia and Herzegovina, Serbia, Montenegro, Kosovo and Moldova. Bulgaria and Romania will be obliged to leave the organisation after obtaining full EU membership at the start of 2007. Until then, the "new CEFTA" will cover an area with a population of just above 55 million or around 12% of EU population. The latest data suggest that GDP of the new CEFTA members amounts to more than EUR 200 bn, representing around 1.8% of the current GDP of the EU. The new agreement would substitute the complex network of bilateral agreements which has significant limitations and barriers to the free movement of goods and capital. Although the current system of bilateral agreements has shown many shortfalls, it has had a positive effect on trade growth since the end of the last decade. It might be expected that a new CEFTA agreement would not only enhance intra-area trade and investments between the member countries, but might also contribute to integration of the SEE economies into the EU market. The plan for reorganisation and modernisation of CEFTA is finished and member countries are set to approve and sign it (most likely by the end of October 2006).

Strong economic activity is generating pressures on import growth, not only due to high household consumption but also as a result of the recent strong investment cycle in the SEE region. Still struggling to significantly improve goods exports, especially to the EU market, most of the countries face high trade deficits. Unfavourable trends in international trade in goods have significantly contributed to the external imbalances of the SEE countries and are thus in part responsible for generating the current account deficits. The most desirable way to finance such deficits is via foreign direct investment (FDI), i.e. inflows of non-speculative long-term foreign capital. For the new members of the EU, FDI has had a proven positive impact on exports and production growth, job creation and in improving efficiency at the microeconomic level.

Over the last couple of years strong growth in FDI was seen in the region, especially in Romania and Bulgaria. Foreign investors' increased interest came as a result of the EU perspective for the region, lower average labour costs than in the new Member States, proximity to the EU market, robust economic growth and ongoing reforms. The privatisation process in SEE countries contributed positively to the increase of FDI inflows. In the coming years privatisation receipts should remain high, since a still significant proportion of assets is in government hands in SEE countries. Liberalisation in the transportation and communication sector, utility services and privatisation of financial institutions might continue to generate strong flows of foreign capital to the region in the coming years. Most of the SEE countries have recently adopted proactive investment promotion policies, offering various incentives, as they realize the importance of FDI for economic growth. It remains to be seen whether the new free trade agreement will represent only the political will of the governments and the EU or if it will indeed generate positive effects on the economies of the SEE countries. But one thing is sure: the future economic development of the region will continue to depend greatly on the success of the SEE countries in pursuing the necessary reforms.

Important privatisation projects in SEE

Company	Sector	Country	Already privatised
Hrvatski Telekom	Telecommunications	Croatia	51.0%
INA	Oil and gas company	Croatia	25.0%
Croatia osiguranje	Insurance company	Croatia	19.8%
NIS	Oil and gas company	Serbia	0.0%
Telekom Srpske	Telecommunications	Bosnia a.H.	0.0%
Romtelecom	Telecommunications	Romania	0.0%
Toplofikatsia Sofia	Steam-heating plant	Bulgaria	0.0%
INSIG	Insurance company	Albania	39.0%

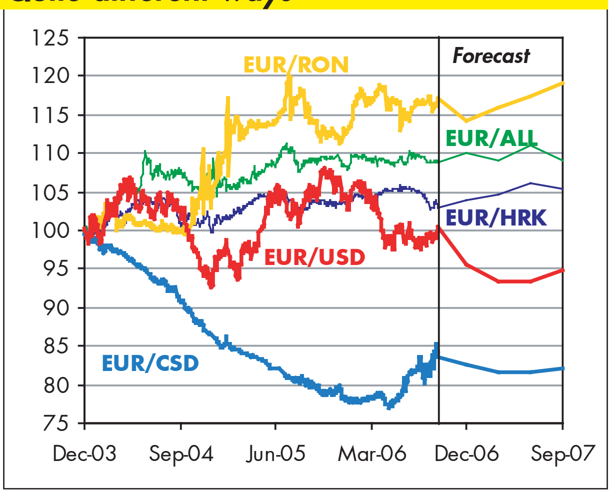
Source: Ministries of Privatisation

Long-term debt ratings

	S&P (LCY/FCY)	Moody's (LCY/FCY)	Fitch (LCY/FCY)
Albania	not rated	not rated	not rated
Bosnia a. H.	not rated	B2/B2	not rated
Bulgaria	BBB+/BBB	Baa3/Baa3	BBB+/BBB
Croatia	BBB+/BBB	Baa1/Baa3	BBB+/BBB-
Macedonia	BBB-/BB+	not rated	BB+/BB+
Romania	BBB/BBB-	Baa3/Baa3	not rated/BBB
Russia	A-/BBB+	Baa2/Baa2	BBB+/BBB+
Serbia	BB-/BB-	not rated	BB-/BB-
Slovakia	A/A	A2/A2	A+/A
Slovenia	AA/AA	Aa2/Aa2	AA/AA
Turkey	BB/BB-	Ba3/Ba3	BB-/BB-
Ukraine	BB/BB-	B1/B1	BB-/BB-

Source: Bloomberg

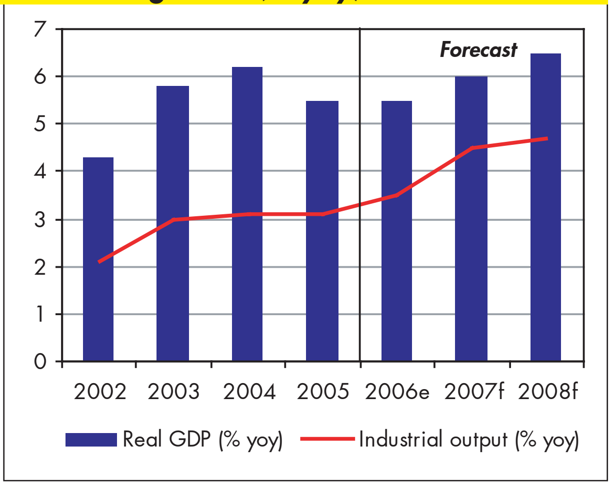
Quite different ways



Currencies per 1 EUR, indexed (31 December 2003 = 100)
Source: Thomson Financial Datastream, Reuters, Raiffeisen RESEARCH

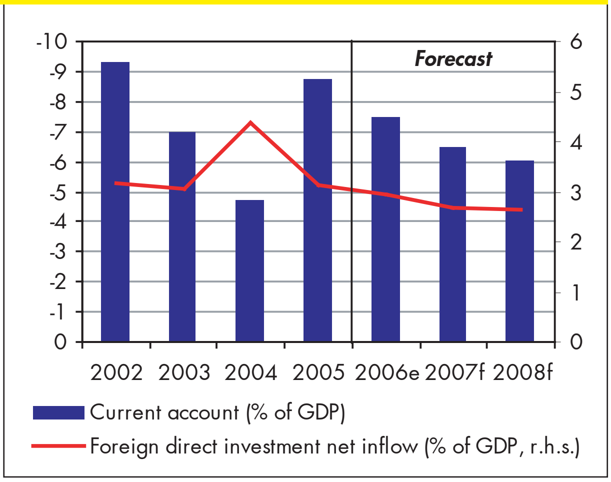
Carpe diem!
Investment opportunities in sight

Real GDP growth (% yoy)



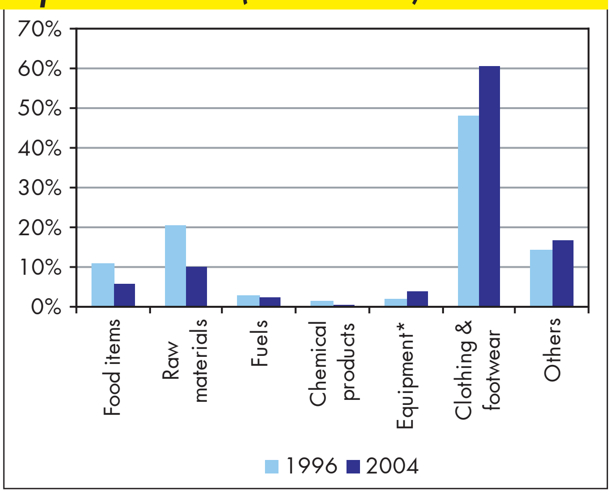
Source: Thomson Financial Datastream, wiiw, Raiffeisen RESEARCH

Current account and FDI inflows



Source: Thomson Financial Datastream, wiiw, Raiffeisen RESEARCH

Export structure (shares in %)



* machinery & transport
Source: UNComtrade database, Raiffeisen RESEARCH

Recent economic growth, which was around 6% in the last years, has been driven mainly by construction, business services and transport. Thanks to favourable weather conditions, export growth accelerated as well, underpinned by a pick-up in tourism and positive developments in agriculture and agro processing. Albania should now have solved the shortage of electricity which caused a slight setback for the economy in 2005 and in the first quarter of 2006. Growth in the remaining period of 2006 will be supported by domestic demand, underpinned by further rapid expansion of bank credit, strong inflows of remittances from abroad, and the expected surge in public investment in the remainder of the year. We expect acceleration in growth in 2007 to 6%, in line with an anticipated improvement in conditions in the power sector. Promotion of the recent initiative of the government "Albania for 1 EUR", is considered a real economic revolution, targeting significant growth, and expected to create new jobs and reduce unemployment. This initiative, offering facilities and favourable conditions for the domestic and foreign investors, targets the transformation of Albania into a producing and exporting country. Albania's multi-year agreements with the IMF and the World Bank will set the economic framework for the coming period. The new agreements put a stronger emphasis on structural and institutional reforms, and on improving the business environment.

The economy has enjoyed a prolonged period of rapid, non-inflationary growth, with macroeconomic policies demonstratively improved. Inflationary expectations were anchored at low levels, allowing the monetary policy stance to gradually relax, while reserves increased and the exchange rate maintained a mild trend appreciation.

On the fiscal front, current expenditure, the deficit and domestic borrowing have been curtailed, and the 2005 budget delivered the first surplus since the beginning of the transition process. The general government budget showed an unexpected surplus in the first half of 2006, as revenue collection ran ahead of targets, and capital expenditure was far below projections.

The current account deficit rose to an estimated 7% of GDP owing in part to emergency power imports towards year-end, which increased the trade deficit. The expansion of the C/A deficit was driven by the larger trade deficit and a smaller surplus on current transfers. The trade deficit rose 30% in the first quarter 2006. Total imports rose 26% yoy, due to the need for large-scale electricity imports during the domestic power shortages in late 2005 and early 2006. Exports increased by 16%. The modest performance reflects increased competition from low cost Chinese textiles and footwear producers as well as sluggish growth in Italy, which is by far Albania's largest export market. The main trading partners remain Italy, Greece, Germany, Turkey Macedonia, France and China. Higher trade deficits will be only partly offset by a continued increase in the current transfers surplus, reflecting strong remittances from abroad. Albanian exports to the EU will face no quantitative restrictions under the SAA agreement. More significant is the SAA requirement that Albania eliminate import tariffs on goods from the EU over a 4-year period, with 40% of this reduction taking effect by the start of 2007.

Despite strong support among multilateral lenders for the sale of the dominant fixed-line operator ALBTELECOM, to a Turkish consortium, the government decided to suspend and re-examine the privatisation once it took office. A lengthy period of uncertainty regarding this sale could affect investor interest in other proposed privatisations, including the state-owned oil and insurance companies, minority state shareholdings in the mobile telecommunications and banking sectors, and possibly the state's electricity distribution assets. The World Bank portfolio includes 15 investment projects with a total amount to be disbursed of about USD 179.1 mn. The EBRD provides support for the development of key infrastructure projects in the energy, transport and municipal and environmental infrastructure sectors. It has already signed a EUR 35 mn guaranteed loan to Albanian Government, EUR 21 mn loan to Airport Partners Albania, and a third sovereign guaranteed loan of EUR 40 mn to Albanian Power Corporation. The project aims to balance energy generation and improve power supply. Furthermore, the EBRD is playing an important role in promoting and supporting the development of the private FDI sector. It is a financing partner in almost all large FDI in Albania. These investments have a significant demonstrative effect and provide encouragement to further promote much-needed FDI in the country. Albania continues to require substantial investment for the rehabilitation and improvement of the energy and transport infrastructure, as well as private sector projects.

Real GDP growth is projected to return to its trend rate of 6% in 2007 as the electricity situation improves, and productive investment begins to rise. With demand pressure contained through an appropriate policy stance-aided by reductions in the rate of credit growth, we expect that inflation will be held within the target range, while ongoing fiscal consolidation will allow a steady improvement in government solvency. Public savings will increase over the programme period as the government improves its revenue administration and reduces the share of current expenditure in total spending-including through lower interest costs resulting from better debt management. The 2006 budget and the medium-term fiscal framework have been designed to strike a balance between debt reduction and the need for growth enhancing. Forecasts include a further two percentage point decline in public debt relative to GDP and a fall in resource to domestic financing from 2.7% of GDP in 2005 to 2.4% in 2008. Total expenditure relative to GDP is programmed to be contained at 30% of GDP.

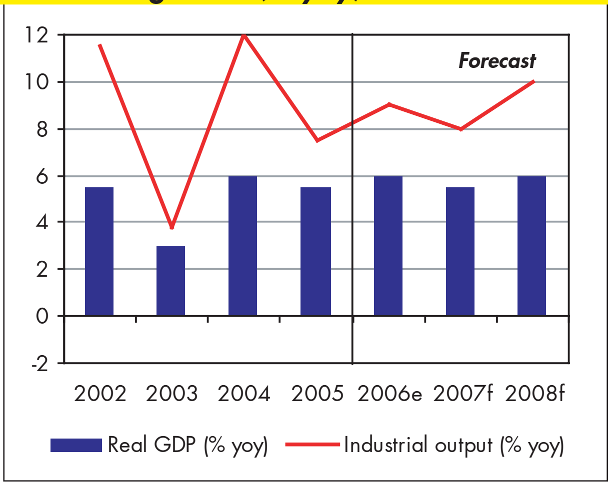
Key economic indicators and forecasts

	2002	2003	2004	2005	2006e	2007f	2008f
Nominal GDP (EUR bn)	4.8	5.2	6.1	6.7	7.3	8.0	8.6
Real GDP (% yoy)	4.3	5.8	6.2	5.5	5.5	6.0	6.5
Industrial output (% yoy)	2.1	3.0	3.1	3.1	3.5	4.5	4.7
Unemployment rate (avg, %)	16.0	15.2	14.7	14.3	14.1	14.0	13.7
Nominal wages, whole economy (% yoy)	11.6	11.0	12.0	12.0	12.0	12.0	12.0
Producer prices (avg, % yoy)	6.4	6.2	11.1	8.3	5.0	5.0	5.5
Consumer prices (avg, % yoy)	5.2	2.4	2.9	2.4	2.5	3.0	3.3
Consumer prices (eop, % yoy)	1.7	3.3	2.2	2.0	2.4	3.0	3.5
General budget balance (% of GDP)	-6.0	-4.8	-4.9	-3.4	-3.0	-3.5	-3.5
Current account balance (% of GDP)	-9.3	-7.0	-4.7	-8.7	-7.5	-6.5	-6.0
Official FX-Reserves (EUR bn)	0.8	0.8	1.0	1.2	1.3	1.4	1.6
EUR/ALL (avg)	132.4	137.6	127.6	124.1	123.1	122.1	122.0
USD/ALL (avg)	140.0	122.2	102.6	99.9	97.7	91.8	91.7

Source: Thomson Financial Datastream, wiiw, Raiffeisen RESEARCH

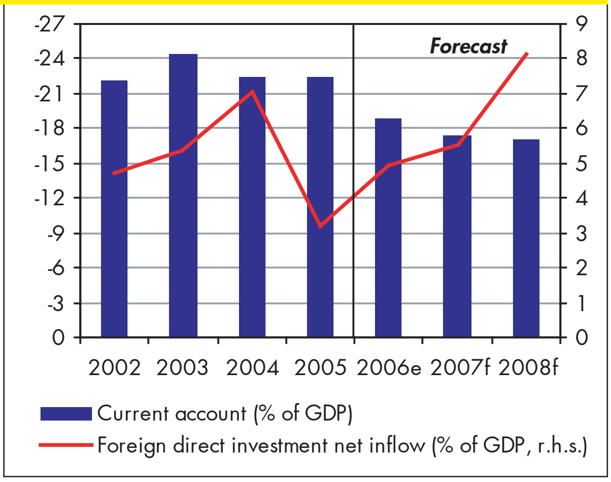
Beginning to see the light
but still a little bit hazy

Real GDP growth (% yoy)



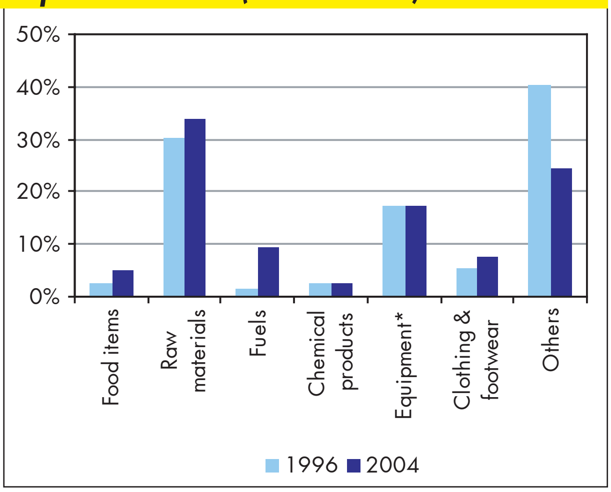
Source: Thomson Financial Datastream, CBBiH, Raiffeisen RESEARCH

Current account and FDI inflows



Source: Thomson Financial Datastream, wiiw, Raiffeisen RESEARCH

Export structure (shares in %)



* machinery & transport
Source: UNComtrade database, Raiffeisen RESEARCH

The economy in Bosnia Herzegovina has continued to exhibit positive trends this year. As we predicted in the previous report, in line with the successful beginning of negotiations on a SAA with the European Union as well as the strengthening domestic economy, the international credit rating agency Moody's improved the country's credit rating from B3 to B2, with a stable outlook for the future. Moreover, the Governor of the Central Bank of BiH expressed the opinion that next year the country should receive a credit rating from other international credit rating agencies, probably Standard and Poor's or Fitch. Constant growth, continuation of the privatisation process, and the creation of a free-trade zone for the Balkans should support higher levels of foreign direct investment.

The most important political event in Bosnia Herzegovina was the general elections held on 1 October 2006. Voters elected the Three-Member Presidency and deputies for the country's parliaments. According to unofficial elections results released on 5 October, the new three-members presidency will consist of Haris Silajdzic (Party for Bosnia and Herzegovina) as the Bosniak representative, Nebojsa Radmanovic (Independent Alliance of Social Democrats) as the Serb representative, and Zeljko Komsic (Social Democratic Party) as the Croat representative. These are significant changes in comparison to previous elections when the Presidency of BiH consisted of representatives of the Party of Democratic Action, the Serb Democratic Party, and Croatian Democratic Union BiH. The results of the elections for the State National Representatives show that the Party of Democratic Action won in the Federation of BiH with 25.36%, followed by the Party for BiH (22.98%), the Social Democratic Party (13.75), the Croatian Democratic Party BiH (8.84%), and the Croatian Democratic Union 1990 (6.96%). On the other hand, the result for RS shows an election victory for the Independent Alliance of Social Democrats, which took 48.94% of the votes compared to 20.19% votes for the Serb Democratic Party. Over the next three months, tough negotiations for potential coalitions are expected, both at the state level and the level of Federation of BiH. European integration issues were secondary in the election campaign. Nevertheless, the leaders elected at the general elections will have to take responsibility for the future of the country and leading it towards the European Union. The representatives of the leading parties also must take steps to modernize state organisation. Therefore, negotiations on constitutional reforms should be continued in the upcoming period.

During the first half of this year, Bosnia and Herzegovina saw significant growth in business activities. Industrial production grew by 10.8% in RS and 6.8% in the Federation of BiH. At the same time, the country saw a reduction in the current account deficit caused by higher export activity by domestic firms. Consequently, the BiH's economy should achieve massive GDP growth of nearly 6 percent this year. In H1 2006, exports of goods grew by 27% in comparison to the same period of the previous year, while imports of goods decreased by 7%. In the second quarter of this year, most goods were exported to Croatia (18.8%), followed by Italy (14.4%), Slovenia and Germany (12.8% each). Base metal products accounted for the most significant contribution to increasing export activity. On the other hand, the majority of goods was imported from the neighbouring countries and Germany. Successful introduction of Value Added Tax contributed to the process of fiscal consolidation. Nevertheless, its introduction should cause a higher level of inflation in comparison to recent years. Moreover, higher oil prices in H1 also contributed to inflationary pressure. We expect the average CPI to be around 7%, but it must be stressed that the inflationary pressure should ease in the period to come. Even though registered unemployment is high (around 43%), the ILO unemployment rate reached a substantially lower value of around 31%.
Although BiH's economic system is characterized by robust GDP growth, a stable domestic currency, and a steadily improving business environment, a substantial decline in FDI was seen in 2005. On the other hand, the amount of FDI was higher in the first half of this year compared to same period of the previous year and reached a value of EUR 107 mn. In the period 1994-end of June 2006, most FDI was invested in the production sector (57%), the banking sector (17%), and the trade sector (7%). In order to promote FDI, the Foreign Investments Promotion Agency (FIPA) started preparing the strategy for promoting foreign direct investment. The strategy should introduce potential foreign investors to investment opportunities in the country. All activities of the Privatisation Agency in the Federation of BiH concern implementation of the privatisation plan for 2006, which includes the sale of 24 state-owned companies. High energy potential makes BiH's energy sector attractive for foreign investors. The government of the Federation initiated activities for the selection of potential partners related to investment in the electrical power sector. On the other hand, the Government of RS has decided to sell 65% of shares in the Telecom of RS. Many international telecom companies such as, Deutsche telecom, Telecom of Serbia, and Russian, Hungarian, and French firms are interested in this telecom company in BiH. In relation to the privatisation of state companies, it is clear that the Governments must accelerate this process in the Federation of BiH as well as in RS.

In conclusion, it must be underlined that BiH's authorities need to make efforts to accelerate economic reforms, which will contribute to strengthening the capability of the country's economy. Further steps by the Government also must target an improvement in the quality of public administration as a pre-condition for many other reforms.

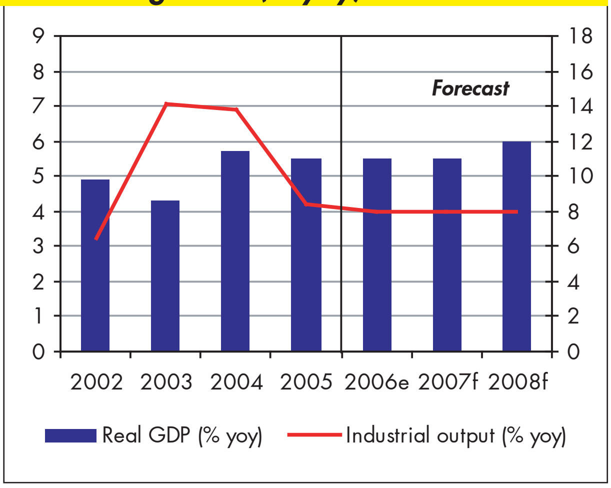
Key economic indicators and forecasts

	2002	2003	2004	2005	2006e	2007f	2008f
Nominal GDP (EUR bn)	6.0	6.3	6.9	7.5	8.2	8.7	9.5
Real GDP (% yoy)	5.5	3.0	6.0	5.5	6.0	5.5	6.0
Industrial output (% yoy)	11.5	3.8	12.0	7.5	9.0	8.0	10.0
Unemployment rate (avg, %)	40.5	41.5	42.0	44.0	43.0	42.0	42.0
Nominal wages, whole economy (% yoy)	0.7	3.5	4.2	4.5	4.5	4.5	5.0
Producer prices (avg, % yoy)	0.6	0.8	1.5	2.0	2.3	2.5	2.2
Consumer prices (avg, % yoy)	0.4	0.6	0.4	3.6	6.9	6.0	5.0
Consumer prices (eop, % yoy)	0.2	0.6	0.4	4.3	7.3	5.0	5.0
General budget balance (% of GDP)	-0.2	0.8	1.8	0.5	0.3	0.1	-0.5
Current account balance (% of GDP)	-22.1	-24.5	-22.4	-22.5	-18.9	-17.5	-17.0
Official FX-Reserves (EUR bn)	1.27	1.44	1.75	2.14	2.40	2.61	2.71
EUR/BAM (avg)	1.956	1.956	1.956	1.956	1.956	1.956	1.956
USD/BAM (avg)	2.068	1.737	1.572	1.573	1.552	1.471	1.471

Source: Thomson Financial Datastream, wiiw, Raiffeisen RESEARCH

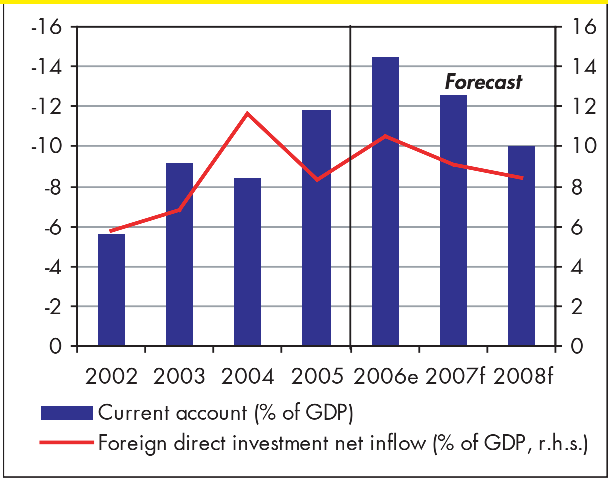
EU membership secured
but conditions remain

Real GDP growth (% yoy)



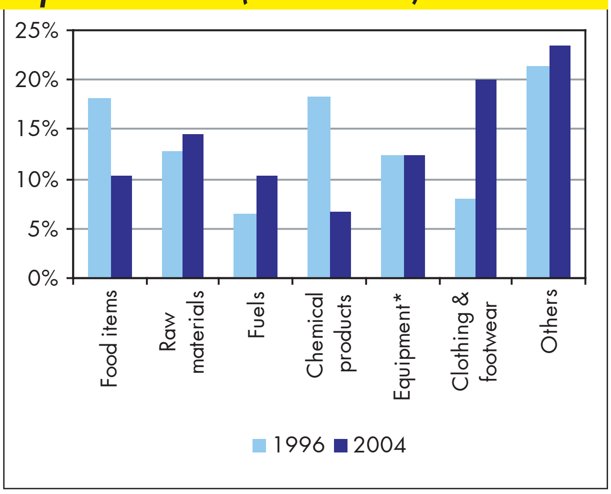
Source: *Thomson Financial Datastream, wiiw, Raiffeisen RESEARCH*

Current account and FDI inflows



Source: *Thomson Financial Datastream, wiiw, Raiffeisen RESEARCH*

Export structure (shares in %)



** machinery & transport*
Source: UNComtrade database, Raiffeisen RESEARCH

Bulgaria and Romania applied for membership of the European Union in 1995. Accession negotiations with both countries were opened in February 2000 and were completed in December 2004. In April 2005, the Accession Treaty was signed. Bulgaria and Romania have made far-reaching efforts to adapt their legislation and administration to the laws and rules of the European Union, but further tangible results are needed in the areas of judicial reform and the fight against corruption, money-laundering and organized crime. Nevertheless, the European Commission confirmed the 2007 entry target for Bulgaria and Romania. Although the Commission refrained from activating any safeguard clauses at this stage, Bulgaria (and Romania) will enter the European Union under the toughest terms imposed on any new entrant. Bulgaria will be subject to stringent post-accession monitoring and controls to ensure that reform momentum is sustained, and at the same time to reassure the growing number of enlargement critics. In particular, the government must push forward with reforms in its judicial system, agriculture, food safety standards, aviation safety, copyright laws and its ability to properly administer EU aid. Failure to maintain the pace of reform will bring a heavy price as the country might be deprived of full membership benefits. Bulgaria will have to report every six months on its progress in specific areas.

Economic growth accelerated in the second quarter of 2006, with GDP growth coming in at a surprising 6.6% yoy in Q2 2005 (highest value since 1998) and 6.1% yoy for the first half of the year, well outperforming government's forecast of 5.5% growth. The main drivers were industry and services, which grew by 9.0% and 4.7% respectively. Fixed capital creation, which was up 20.3% yoy (bringing its share of GDP to 25%) also contributed to the rise. The good performance to date should be reflected in the final figure of GDP growth in 2006, which could be close to 6%. If the government implements the currently discussed measures for increased growth such as lowering the corporate tax (to 10-12%) and social security payments (by 3%) this could also put 2007 growth closer to 6%.

In recent months, headline inflation decelerated due to a drop in food prices. Consumer price inflation fell to 6.8% in August from 7.6% in the previous month. The high base effect from last year's summer floods and the relatively good harvest this year have prompted us to expect a further reduction of inflation through to the end of the year towards something closer to the 6.5%, and closer to the government's forecast of 6.6%, provided that oil prices continue on their downward trend. As for 2007 we believe 5% year-end inflation is an achievable target taking into account some significant price pressure related to EU accession.

The biggest threat however remains the widening of the current account deficit despite this year's booming exports in the summer. The cumulative January-July shortfall expanded to 7.6% of GDP, up from 5.0% a year earlier. As summer tourism receipts start to wear off, the end-year deficit would almost double from its current level to 14.5%. The deterioration is attributable to strong domestic demand fuelled by continuing lending growth, rather than a loss of competitiveness. For the second month in a row, cumulative exports outpaced imports, rising by 29.1% and 26.6% respectively on an annual basis. Over a longer-term perspective we expect the investment boom to lead to a more balanced trade and current account deficit.

As in previous years, the deficit has been comfortably covered by FDI, which financed 87% of the external gap in the period Jan-July against 59.2% for the same period last year. Investors are also reassured by the continued strict fiscal discipline, producing a surplus of 3.5% of GDP forecast, which might - despite some spending later this year - overshoot the government target of 3%. To counter the risks arising from the high C/A deficit, next year's budget plan (currently under discussion) envisages a 0.8% budget surplus again - against the 2% recommended by IMF - arguing that the difference of 1.2% of the surplus will be used to co-finance EU-backed projects and pay Bulgaria's contribution to the EU budget. Although the first year of accession is expected to be the hardest from the fiscal point of view, the government will refrain from any relaxation which may cause any potential risks to the currency board with its fixed peg to the euro.

Recently, the Government presented an unprecedented plan for infrastructure development for the period 2006-2015 for a total value of EUR 8 bn, which will be partially EU financed. The plan has already attracted the interest of the international financial institutions. Public-private partnerships will also be encouraged by the Government. The opportunities are enormous, with the projects in the energy sector ranging from the mega Belene nuclear power plant to medium and smaller thermal power plants, electrical power inter-systems links with neighbouring countries, and gas pipelines. In the transport sector, the plan envisages the modernisation and renovation of the railway infrastructure, upgrading of several Pan-European transport corridors, construction of intermodal terminals, construction and upgrading of motorways, concessions of port, airport and railway infrastructure, etc. In the field of protection of the environment the projects include construction or reconstruction of sewer systems, urban waste water treatment plants, new dams, regional household waste landfills, facilities for treatment of biodegradable waste and rehabilitation of urban water supply systems. Given the scarce resources of the municipalities for investment purposes in the environmental sector, public-private partnerships will be promoted by the state. Such partnerships will be particularly relevant in tourist sector infrastructure.

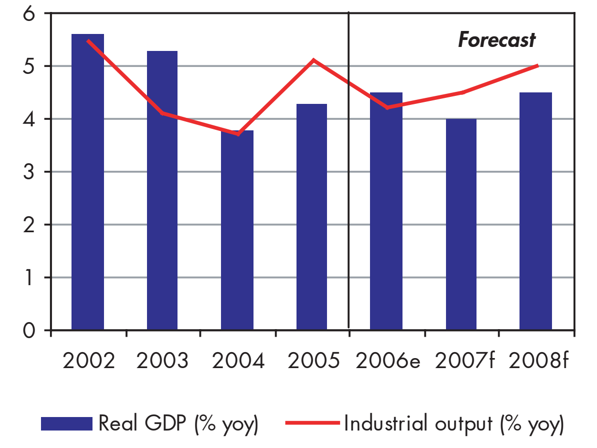
Key economic indicators and forecasts

	2002	2003	2004	2005	2006e	2007f	2008f
Nominal GDP (EUR bn)	16.5	17.7	19.6	21.4	24.3	26.8	29.6
Real GDP (% yoy)	4.9	4.3	5.7	5.5	5.5	5.5	6.0
Industrial output (% yoy)	6.5	14.1	13.8	8.4	8.0	8.0	8.0
Unemployment rate (avg, %)	17.8	13.7	12.0	10.1	9.5	9.0	8.5
Nominal industrial wages (% yoy)	4.1	4.4	7.9	8.7	7.5	7.5	7.5
Producer prices (avg, % yoy)	1.3	4.9	5.9	6.9	10.0	6.0	5.0
Consumer prices (avg, % yoy)	5.8	2.3	6.1	5.0	7.5	5.0	4.0
Consumer prices (eop, % yoy)	3.8	5.6	4.0	6.5	5.5	4.5	3.5
General budget balance (% of GDP)	-0.6	0.0	1.7	2.4	3.0	2.0	1.5
Current account balance (% of GDP)	-5.6	-9.2	-8.4	-11.8	-14.5	-12.5	-10.0
Official FX-Reserves (EUR bn)	4.2	5.0	6.4	6.8	7.0	7.5	8.0
EUR/BGN (avg)	1.956	1.956	1.956	1.956	1.956	1.956	1.956
USD/BGN (avg)	2.06	1.73	1.58	1.58	1.55	1.47	1.47

Source: Thomson Financial Datastream, wiiw, Raiffeisen RESEARCH

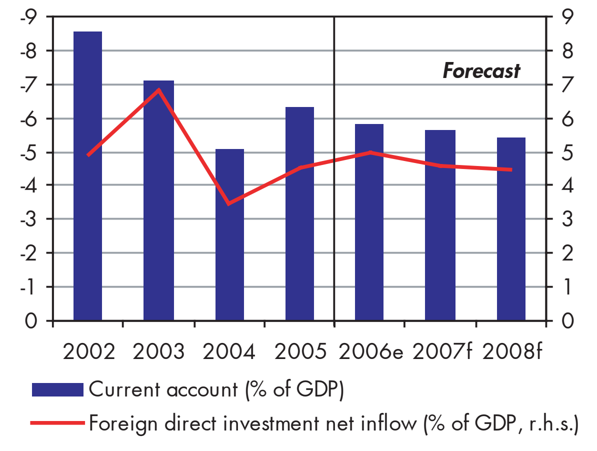
Active investment promotion
No time to lose

Real GDP growth (% yoy)



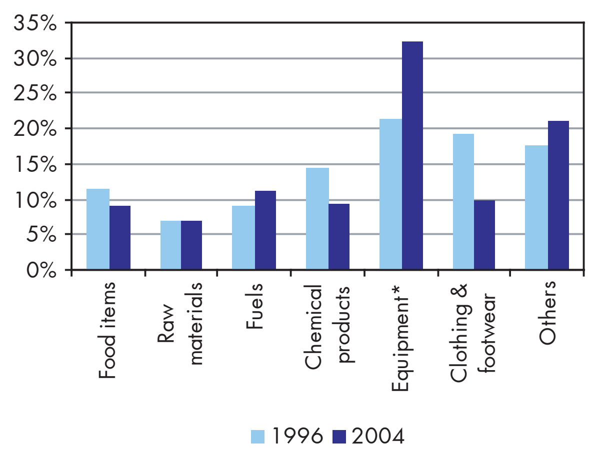
Source: Thomson Financial Datastream, wiiw, Raiffeisen RESEARCH

Current account and FDI inflows



Source: Thomson Financial Datastream, wiiw, Raiffeisen RESEARCH

Export structure (shares in %)



** machinery & transport*
Source: UNComtrade database, Raiffeisen RESEARCH

At the start of October, a year had passed since the EU officially opened negotiations with Croatia. In the past year almost all of the chapters were subjected to the screening process, but only one chapter has been closed so far. Some speed-up in reforms and in the harmonisation of legislation with the acquis communitarie is necessary in order to achieve the optimistic goal of joining the EU by the end of the decade. Recently, some internal dissidence in the EU about the future enlargements and constitution has also caused further speculation on the date of the Croatian entry into EU.

At the beginning of 2006, real GDP growth (6% yoy) beat most expectations, and positive trends were also recorded in the real sector. The continuation of the investment cycle resulted in significant growth in capital investments in Q1, mostly in the private sector, with real annual growth above 18%. Nonetheless, in Q2 economic activity began to slow down, resulting in deceleration of GDP growth to 3.6%. Again, the main contributor to GDP growth was the increase in capital investments, but at a much lower pace than previously. Household consumption continues to record below-average growth, while on the other side government consumption was prominent, with the strongest growth since mid-2003. On the supply side, service activities continue to record the strongest growth, especially in tourism, transportation and construction. We expect that somewhat positive momentum in the economy will be maintained, and that GDP growth for 2006 as a whole might amount around 4.5%. In the upcoming years the pace of Croatian economic growth should remain between 4 and 4.5%. Strong investment will continue to have a positive impact on GDP growth, while we also expect more from the export of goods in the coming years.

Loan growth remained robust in 2006, averaging above 20% yoy, as a result of the increased investment activity of companies as well. Lending activities put additional pressures on the growth of foreign debt. Croatia continued to record significant imbalances in foreign trade. Although tourist receipts still generate a strong surplus on the services account it is nonetheless not enough to cover the huge trade deficit.

Last year, the C/A deficit increased to 6.3% of GDP, with similar unfavourable trends noticed during first half of this year when the shortfall on the current account amounted the 7.9% of GDP. Further deterioration of the external balance, and the growing C/A deficit and foreign debt, forced central bank to enforce new restrictive monetary policy measures. Although the results of these measures are still not clearly visible we expect that with some lag we might see a slowdown in loan growth and foreign debt growth. Such monetary tightening should also have a significant impact on the further economic developments, especially on the household consumption and investment activity.

In the light of the significant external imbalance, inflows of FDI become especially relevant. The relative size of cumulative FDI inflow in Croatia, measured as FDI per capita, is just slightly below the average of the new member states and considerably above the average of the countries of the SEE region. Although the amount of FDI is satisfactory, we cannot say the same for the structure of investments. In last 13 years only around 60% of net FDI was related to equity investments. Also, in the structure of total equity investments, greenfield investments represent only smaller part while most of the FDI in fact represents privatisation receipts. As a consequence, this has contributed to an absence of the positive effects of the FDI on production, export growth and job creation, as it has been seen in other transition countries.

The current system of investment incentives is complicated and is defined under numerous laws, making it difficult for potential investors to calculate all the benefits when investing in Croatia. As the result of slow reforms in the health and social security system, the high social contributions are generating higher labour costs than in the other SEE countries. That is why we believe Croatia should specialize in attracting FDI in capital intensive industries that create more value added.

Recently, some speed-up in reforms, but also in realizing the importance of FDI, has been noticed in Croatia. After long preparation, the government institution for investment promotion finally began operational work on active investment promotion. Moreover, reforms aimed at improving the business climate were undertaken, especially in respect of digitalizing public services and land registers. But there is still lot a room for other reforms, especially in the fight against corruption and the removal of existing bottlenecks. The aforementioned positive trends led to an increase in FDI inflows, but also aim at a shift towards more greenfield investments. We expect that the new law on investment promotion, scheduled for the start of next year, could additionally enhance FDI inflows in the upcoming years. Also some important privatisation projects are still in the pipeline. The government is still a majority shareholder in the leading insurance company as well as in two banks. Furthermore, privatisation of the minority government shares in the telecom and the national oil and gas company should attract foreign capital as well.

Key economic indicators and forecasts

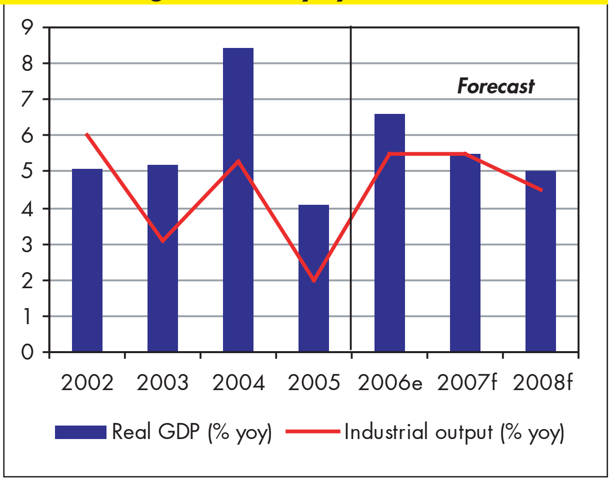
	2002	2003	2004	2005	2006e	2007f	2008f
Nominal GDP (EUR bn)	24.5	26.2	28.4	31.0	33.8	36.3	39.2
Real GDP (% yoy)	5.6	5.3	3.8	4.3	4.5	4.0	4.5
Industrial output (% yoy)	5.5	4.1	3.7	5.1	4.2	4.5	5.0
Unemployment rate (avg, %)	22.3	19.5	18.2	18.0	17.5	16.0	15.5
Nominal industrial wages (% yoy)	7.4	5.2	4.9	5.4	5.8	5.9	5.6
Producer prices (avg, % yoy)	-0.4	1.9	3.5	3.0	3.2	2.7	3.0
Consumer prices (avg, % yoy)	1.7	1.8	2.1	3.3	3.4	2.8	2.9
Consumer prices (eop, % yoy)	1.8	1.7	2.7	3.6	2.8	3.0	3.2
General budget balance (% of GDP)	-6.0	-6.2	-4.8	-4.1	-3.5	-3.5	-3.0
Current account balance (% of GDP)	-8.6	-7.1	-5.1	-6.3	-5.8	-5.6	-5.4
Official FX-Reserves (EUR bn)	5.7	6.6	6.4	7.4	9.0	10.0	10.8
EUR/HRK (avg)	7.41	7.56	7.50	7.40	7.32	7.28	7.25
USD/HRK (avg)	7.83	6.68	6.03	5.95	5.81	5.47	5.45

Source: Thomson Financial Datastream, wiiw, Raiffeisen RESEARCH

Morning has broken

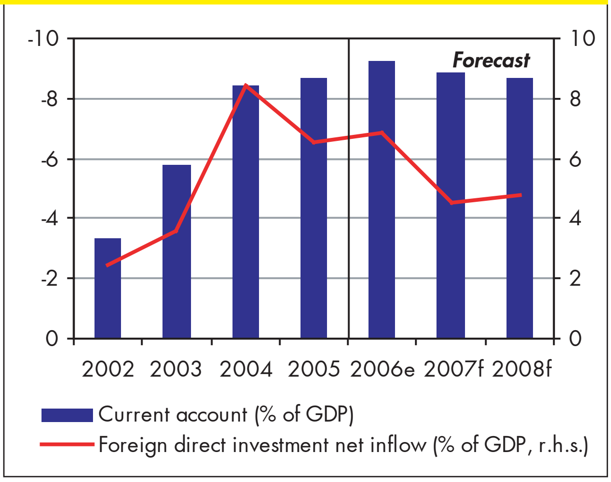
Blackbird has spoken

Real GDP growth (% yoy)



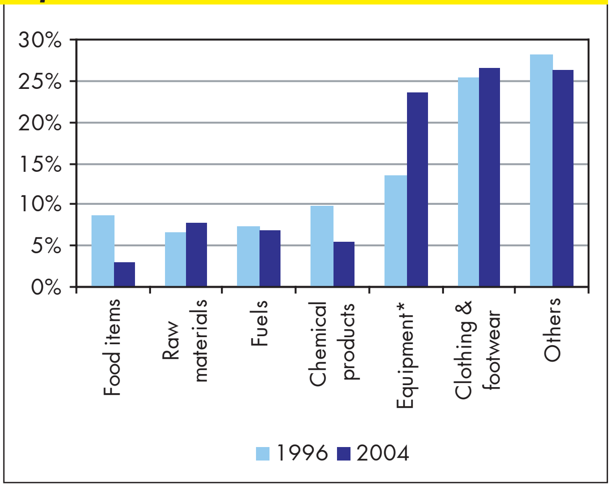
Source: Thomson Financial Datastream, wiiw, Raiffeisen RESEARCH

Current account and FDI inflows



Source: Thomson Financial Datastream, wiiw, Raiffeisen RESEARCH

Export structure (shares in %)



* machinery & transport
Source: UNComtrade database, Raiffeisen RESEARCH

The European Commission recommended Romania for membership of the EU on 1 January 2007. However, there are still a limited number of areas (judicial reform, fight against corruption and organized crime, agricultural funds, and food safety) where further work will be necessary and for which the Commission proposes a package of rigorous accompanying measures. In the long term, EU accession will provide a framework for strong real convergence and institutional modernisation. Accordingly, we expect especially robust FDI inflows and high GDP growth rates. Fitch Ratings already upgraded Romania's foreign currency sovereign credit rating to "BBB" from "BBB-" in September. Standard & Poor's also revised its outlook for Romania from stable to positive, keeping the "BBB-" rating for foreign currency long-term debt. Recently, Moody's Investors Service upgraded the Romanian government long-term and short-term foreign and local currency ratings to "Baa3"/"P-3" with a stable outlook. The foreign currency country ceiling for long-term bonds was upgraded to "A1" as well as the foreign currency bank deposit ceilings to "Baa3"/"P-3". The short-term foreign currency country ceiling remains at "P-1". Now Romania has been upgraded to investment grade by all major rating agencies.

After slowing down in 2005, due to devastating floods and the base effect, economic growth bounced back vigorously in H1 2006 (7.4% yoy). As available data point also to sustained economic activity in the second half of the year, it is almost sure that GDP growth in 2006 will not be lower than 6.6%. Moreover, with good agricultural output, it is possible that GDP growth may even surpass 7% in 2006. There is also good news in that the important industrial sector has also bounced back vigorously (6.5% ytd in June compared with 2.5% in 2005). However, this strong economic growth is backed by a very fast increase in domestic aggregate demand and a rapid widening of the current account deficit, both of which raise important policy concerns.

Household consumption continues to be the main driver of domestic aggregate demand. Its very fast expansion (13.1% yoy in H1 2006) has pushed the central bank to gradually tighten monetary policy by increasing the policy rate and banks' minimum reserve requirements. However, the growth of non-government credit shows no signs of deceleration (56.9% yoy in Aug), meaning that there is no reason to expect a decrease in the policy rate or a softening of administrative measures in the near future. In time, even though the restrictive monetary policy should curb the expansion of household consumption, the expansion of domestic aggregate demand should remain robust as public consumption and investments will increase. In fact, we expect investments to become the main driver of domestic aggregate demand in the next years. It seems that potential GDP growth (growth that could be sustained without inflationary pressures) is higher than the NBR's 5.5% estimation (between 5.7%-6%, according to our estimation).

The large C/A deficit, and especially its very fast pace of increase, has started to raise more and more concerns. Our analysis shows that the C/A deficit reached a record 9.4% of GDP in Q2 2006. The C/A deficit mainly reflects the negative gap between exports and imports. Although exports exhibit strong growth (17.3% ytd in Aug), they have not succeeded in compensating for the fast increase in imports (25.2% ytd in Aug). The widening of the foreign trade deficit is the result of massive imports of technology and capital goods (machinery and mechanical devices, transport means and materials), which should enhance economy's potential to grow. The last two years have already shown a change in exports' structure towards goods with higher value added. At the moment, net FDI inflows offer a very good coverage of the C/A deficit (82.2% in Aug), and we expect this to be the case in the near future. Some privatisation projects to be completed in 2007 (CEC saving bank and three state-owned electricity distributors), as well as greenfield investments will bring additional FDI inflows in 2007. At the same time, with international investors looking more and more to external imbalances, we think that the C/A deficit will gain more importance in the development of the exchange rate. In our opinion, the probability of an important nominal appreciation of domestic currency in the next year is low. The exchange rate will continue to appreciate only in real terms and possible slightly in nominal terms, but at a substantially slower pace than in 2005 and 2006.

The reduction of inflation outpaced all expectations. The low increases in administered and volatile prices (fruits and vegetables) put the central bank on track to meet its inflation target in 2006 (5% with a band of +/-1%). The main risks for disinflation remain increases in administered prices, the current excess of aggregate demand, as well as the expected increase in the fiscal deficit to 2.5% of GDP (given the fact that government needs funds to finance infrastructure projects and to ensure cofinancing in projects implemented by European structural funds). However, a tight monetary policy is likely to allow the central bank to fulfil its inflation targets in 2007 (4% with a band of +/-1) and in 2008 (3.8% with a band of +/-1).

The high yields offered by domestic financial markets have drawn the attention of foreign investors over last two years, although in recent months the negative regional mood somewhat decreased their appetite for Romanian market. Foreign investors' opportunities to invest in financial instruments increased in September when the capital account was fully liberalized. The non-residents have now access to RON-denominated government securities (T-bonds and T-bills) and to FX instruments (forwards, swaps). Full liberalisation of the capital account is likely to increase the connection of Romanian market with the regional ones, as well as exchange rate volatility.

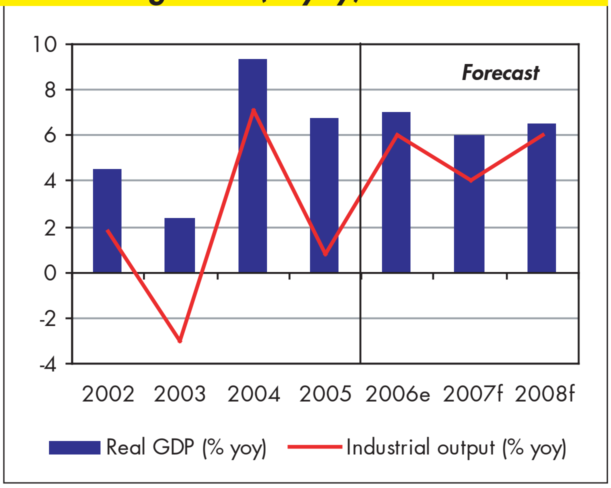
Key economic indicators and forecasts

	2002	2003	2004	2005	2006e	2007f	2008f
Nominal GDP (EUR bn)	48.5	52.6	60.8	79.3	95.1	110.1	125.4
Real GDP (% yoy)	5.1	5.2	8.4	4.1	6.6	5.5	5.0
Industrial output (% yoy)	6.0	3.1	5.3	2.0	5.5	5.5	4.5
Unemployment rate (avg, %)	10.2	7.6	6.8	5.8	5.7	6.0	6.0
Nominal industrial wages (% yoy)	23.6	19.5	23.0	16.8	14.0	14.0	12.0
Producer prices (avg, % yoy)	23.4	19.5	19.2	10.8	9.5	8.5	8.0
Consumer prices (avg, % yoy)	22.5	15.3	11.9	9.0	7.0	5.5	5.0
Consumer prices (eop, % yoy)	17.8	14.1	9.3	8.6	5.8	5.0	4.5
General budget balance (% of GDP)	-2.6	-2.2	-1.2	-0.8	-2.0	-2.5	-3.5
Current account balance (% of GDP)	-3.3	-5.8	-8.4	-8.7	-9.3	-8.8	-8.7
Official FX-Reserves (EUR bn)	5.9	6.4	10.8	16.8	19.0	20.0	21.2
EUR/RON (avg)	3.13	3.76	4.05	3.62	3.54	3.52	3.47
USD/RON (avg)	3.31	3.32	3.26	2.92	2.81	2.65	2.61

Source: Thomson Financial Datastream, wiiw, Raiffeisen RESEARCH

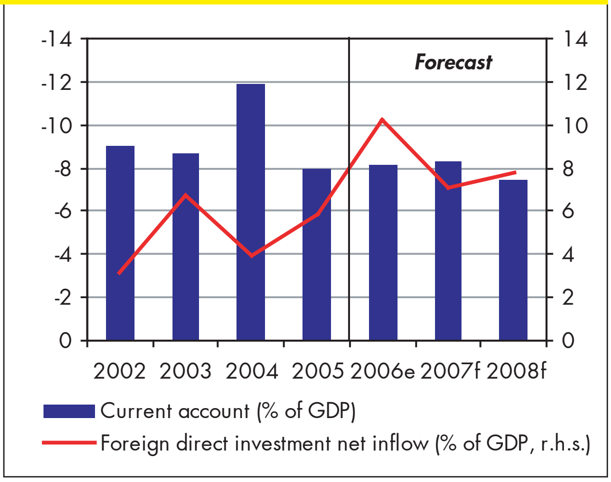
Bright lights of Serbia
Promising investment place

Real GDP growth (% yoy)



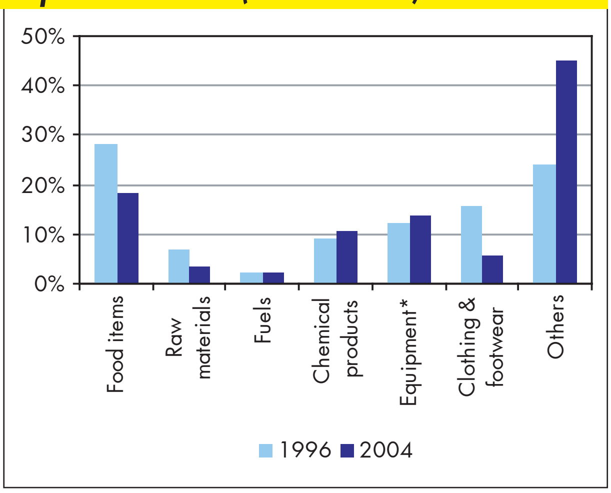
Source: Thomson Financial Datastream, wiiw, Raiffeisen RESEARCH

Current account and FDI inflows



Source: Thomson Financial Datastream, wiiw, Raiffeisen RESEARCH

Export structure (shares in %)



** machinery & transport*
Source: UNComtrade database, Raiffeisen RESEARCH

The National Assembly of the Republic of Serbia approved a new constitution (stating that the province Kosovo is an integral part of Serbia) by the end of September. A referendum will take place on 28-29 October. The new constitution needs support by 51% of all eligible voters to come into force. Moreover, the liberal "G17 Plus" party quit the ruling coalition over Serbia's failure to restore talks on closer ties with the European Union and to cooperate with The Hague tribunal (as war crimes fugitive Ratko Mladic has not been arrested so far). Serbia will finally hold an early election after the referendum (very likely in December). Rating agency Fitch has maintained a stable outlook for the Republic of Serbia owing to significant political risks, although the Serbian economy has exhibited remarkable economic performance, with GDP growth up 5.5% on average in the period 2001-2005.

The economy developed very handsomely in 2005 as well, reaching GDP growth of 6.8% with key drivers in financial intermediation, trade and transport. GDP increased by 6.7% in the first half of 2006 (6.7% in the first and 6.6% in the second quarter) compared to the corresponding period of the previous year. GDP growth drivers included transport (26.8%), financial intermediation (19.3%) and trade (7.5%). The category 'hotels and restaurants' showed a fall of 6.0%, whilst other services fell by 3.6%. According to the Ministry of Finance, the economy could grow between 6.5% and 8% in 2006, supported by higher industrial production, strong growth in the tourism and the transport sectors and fine agricultural output. Furthermore, GDP may grow by 6.5% on average through to 2009. Enhanced growth in the coming years is expected to be supported by stronger FDI (privatisation of state-owned companies, a license for a third mobile operator and greenfield investments). Amongst other things, key prerequisites for attracting stronger FDI include improvements in the legal environment and development of infrastructure. Under the National Investment Plan 2006-2011, plans call for the investment of substantial funds (from privatisation revenues largely coming from the MOBI 63 sale, budget surplus, IFI'S borrowings and the pre-accession loan from EU) in modernisation of the communication infrastructure and for the enhancement of economic development. All this together is expected to boost new investments, exports and economic growth.

Household consumption is hardly seen as the GDP driver, as the central bank is reinforcing measures to restrain consumer leading, which is seen as the one of the import and inflation drivers. Hence, the very restrictive monetary and fiscal policy in place have curbed inflation growth from 11.1% (cumulative 9-month 2005 rate) to 6.1% (cumulative 9-month 2006 rate). At the same time, the dinar appreciated against the EUR in nominal terms, rising 4.26% in the first nine months. The strong dinar suits the central bank well as a tool to rein in inflation. Our opinion is that yoy CPI should fall to the single-digit range. Under the new monetary framework, the central bank will target core inflation set between 7%-9% for end-2006, and 4%-8% for end-2008, using the 2-week repo rate as the main instrument. Due to the high level of euroisation, we believe that the central bank will continue to use significant mandatory reserve requirement as well.

The sizeable foreign trade imbalances, considered as the second major macroeconomic problem, improved in 2005. The trade deficit in the first eight months of 2006 amounted to EUR 3.61 bn, and compared to same period of 2005 (when it amounted to EUR 2.84 bn) it was up 26%. As in the previous period, the bulk of imports pertains to energy, iron and copper, but public and private spending is growing, the latter largely because the market is overloaded with consumer loans used for purchasing of usually imported appliances. Export drivers are privatized and restructured companies, food (vegetables, fruits, corn and sugar) and textiles (owing to the signed Agreement with EU on preferential status). Key export partners are Italy, Bosnia and Herzegovina and Germany) whereas import partners are Russia (oil and gas), Germany and Italy.

The largest investments in 2001-2004 came from privatisations in the tobacco industry, the steel industry, and cement, etc., whereas in 2005 the bulk came from the privatisation of banks. However, the government expects FDI to peak in 2006 at USD 3.6 bn largely coming from MOBI 63 sale for EUR 1.5 bn and privatisation of Vojvodjanska and Panonska banka (total receipts of EUR 0.51 bn). As the privatisation of the state-owned parts of the private sector as well as banking sector is nearing an end, we expect more leveraged growth, compared to the 2006. Nevertheless, privatisation of the 25% stake in oil industry of Serbia and the tender for third mobile operator (min offer EUR 320 mn) will certainly result in a significant amount.

Taking into account the very dynamic political environment, the Serbian economy has made considerable progress (launch of SAA negotiations, country upgrade from "B+" to "BB-", strong capital inflows and the positive effects of the structural reforms which have been initiated). Still, major political issues are co-operation with tribunal in Hague and resolution of the status of Kosovo. According to the World Bank and IFC "Doing business 2007 report", Serbia moved up 27 spots to 68th place in the world based on the how easy setting up businesses and obtaining licenses is, along with the complexity of tax and regulatory issues. In addition, Serbia is ranked 60th in terms of time needed to start a business, but only 110th with respect to the ease of property registration. According to the report, it takes 18 days to start a business in Serbia and 111 days to register property. In addition, the World Bank highly praised Serbia for simplifying customs procedures, introducing mediation as an alternative to the court system, and establishing the agency for licensing bankruptcy managers.

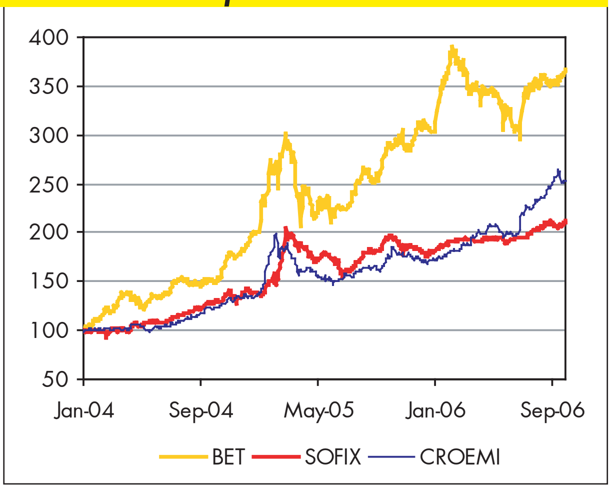
Key economic indicators and forecasts

	2002	2003	2004	2005	2006e	2007f	2008f
Nominal GDP (EUR bn)	16.8	18.0	19.7	21.1	24.5	28.3	32.2
Real GDP (% yoy)	4.5	2.4	9.3	6.8	7.0	6.0	6.5
Industrial output (% yoy)	1.8	-3.0	7.1	0.8	6.0	4.0	6.0
Unemployment rate (avg, %)	23.5	26.0	25.0	25.0	25.0	25.0	24.0
Nominal wages, whole economy (% yoy)	51.7	25.5	23.7	24.2	19.3	11.5	14.7
Producer prices (avg, % yoy)	8.8	4.6	9.1	13.1	12.0	9.0	9.0
Consumer prices (avg, % yoy)	19.5	11.7	10.1	16.5	13.1	8.8	7.8
Consumer prices (eop, % yoy)	14.8	7.8	13.7	17.7	10.0	8.0	7.0
General budget balance (% of GDP)	-3.1	-1.1	0.9	1.9	0.7	0.0	0.4
Current account balance (% of GDP)	-9.0	-8.7	-11.9	-8.0	-8.2	-8.3	-7.4
Official FX-Reserves (EUR bn)	2.2	2.8	3.1	5.0	7.2	8.3	10.6
EUR/CSD (avg)	60.8	65.3	72.6	82.9	85.7	84.9	83.8
USD/CSD (avg)	64.2	58.0	58.3	66.7	68.0	63.9	63.0

Source: Thomson Financial Datastream, wiiw, Raiffeisen RESEARCH

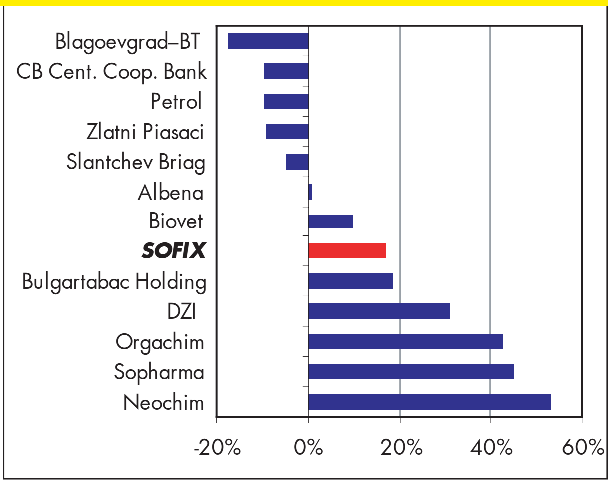
SEE stock exchanges
positive trend continues

South East European indices



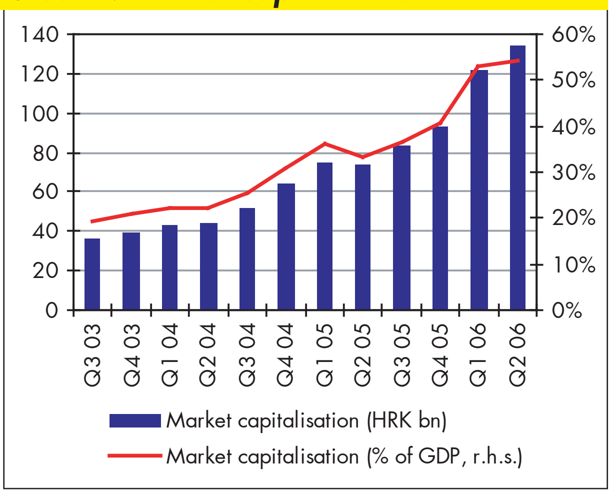
Source: Thomson Financial Datastream, ZSE, VSE, Raiffeisen RESEARCH

Performance YTD of SOFIX members



Values on 29 September 2006
Source: Bloomberg, Bulgarian Stock Exchange, Raiffeisen RESEARCH

Croatia: Market capitalisation



Source: ZSE, VSE, Raiffeisen RESEARCH

In addition to the well-known CEE markets, we would also like to shed some more light on the less well-known equity markets in South East Europe (SEE), because of the steadily increasing interest of many investors in this region. We have decided to cover all of the stock exchanges in this region, which are located in Bulgaria, Croatia, Romania, Serbia and - last but not least - in Bosnia and Herzegovina. Albania is an exception, because of the lack of a functioning equity market, as well as Macedonia because of the lack of a Raiffeisen branch in this country.

Bulgaria

The last eights months were extremely satisfying for investors on the Bulgarian Stock Exchange. The positive mood on the market since the beginning of the year drove both indices, the SOFIX and the BG40, higher, breaking new records.

Total turnover of the BSE-Sofia at the end of September amounted to EUR 792 mn, representing a 32% increase against H2 2005. The Bulgarian Stock Exchange registered the highest turnover in the communication sector, followed by the financial sector. The long-awaited Chimimport IPO - one of Bulgaria's biggest holding companies - has already been subscribed. The holding has issued over 11 mn new shares with a issue price of BGN 4 per share with the aim of raising the holding's capital to BGN 130 mn, which will make it the third largest listed company by market cap on the BSE-Sofia. As expected, the issue was oversubscribed by 2.5 times. The issue of shares of Chimimport AD will be listed for trading on the BSE-Sofia at the end of October.

The overall picture on the Bulgarian Stock Exchange remains positive. The listing of Chimimport and some of its non-public subsidiaries on the BSE would greatly increase the liquidity of the capital market. Other reasons are the expected better sales and profits for Q3 2006 of the major companies. The news that Bulgaria will join the EU on January 2007 is a historical moment and will have a positive impact not only on the capital market, but also on the economy as a whole. Forthcoming EU entry will give an additional boost to trading activity. Over the short term, we may witness some shares increasing in value due to the accession news, as well as the release of considerable funds from the Chimimport IPO. Nevertheless, in the long run we do not foresee any high magnitude change of the price levels on the stock exchange.

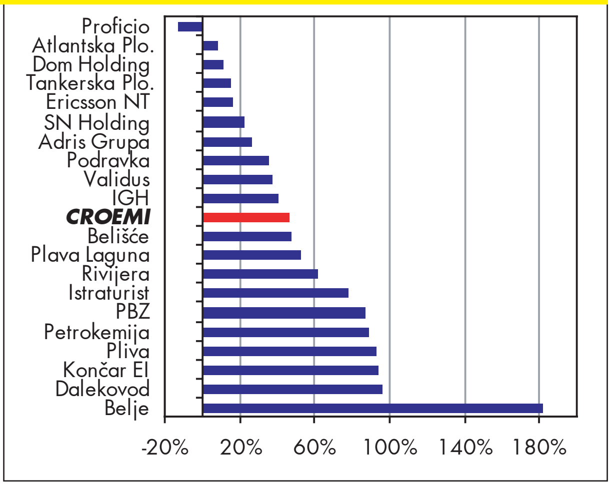
Croatia

During the first nine months of the year, the Croatian market, measured by the CROEMI index, realized a robust rise of 47%. The exceptional growth of the Croatian equity market can be ascribed to the bidding process for Pliva, the pharmaceutical company and Croatia's most liquid issuer. Actavis, a generic producer from Iceland, was the first to reveal its interest for the Croatian pharmaceutical giant, and Barr joined the "takeover battle" as Pliva's "white knight". The developments between these two rivals spread an optimistic vibe between investors and the market just kept on breaking records. With its offer of HRK 820 (EUR 110.9) per share which values Pliva at EUR 1.9 bn, Barr outbid its rival Actavis.
Market capitalisation of all shares traded in Q2 2006 totalled EUR 18.5 bn at end of June, about 54% of GDP. Total share turnover in Q2 amounted to EUR 0.6 bn, almost three times more than in the same year-ago quarter (i.e. +285% yoy). The most liquid share in Q2 was Pliva, accounting for 52% of total market turnover.
The expected P/E of CROEMI constituents for 2006, without Pliva, totals 18. As measured by the price/earning ratio, the Croatian market currently trades at a premium compared to its CEE peer markets (Hungary, Poland, Czech Republic).
In addition to the closing of the Pliva takeover story by the end of the year, the market is also looking forward to the public offering of 15% of INA shares. For 2007, further privatisation through IPOs is expected (Croatian Telecom). The two stock exchanges, Varazin and Zagreb, have started the long awaited process of consolidation and the merge is expected to finish next year. These events (IPOs and SX merger) should support further growth and development of Croatia's equity market

Romania

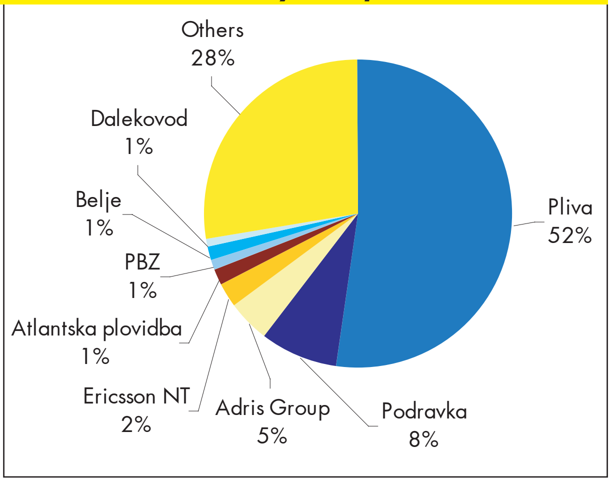
The Bucharest Stock Exchange (BSE) posted good performance so far in 2006, with the EUR-based BET index gaining 23.6% YTD. Market capitalisation went up by 24.2% YTD, on the back of share price appreciation almost across the board as well as new arrivals to the market, most important of which is Transelectrica. The EUR-based BET-FI (comprises five local investment funds) gained by impressive 191.1% in 2005, but has only posted a 7.8% increase so far this year, mainly due to uncertainties resulting from changing ownership limit legislation.

Performance YTD of CROEMI members



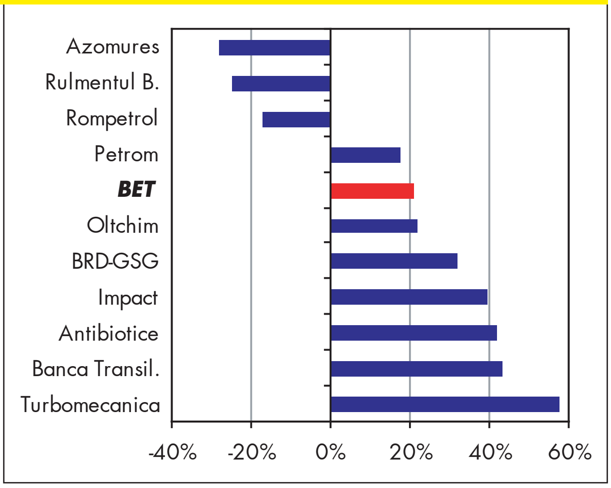
Values on 29 September 2006
Source: ZSE, VSE, Raiffeisen RESEARCH

Croatia: Turnover by companies



Source: ZSE, VSE, Raiffeisen RESEARCH

Performance YTD of BET members



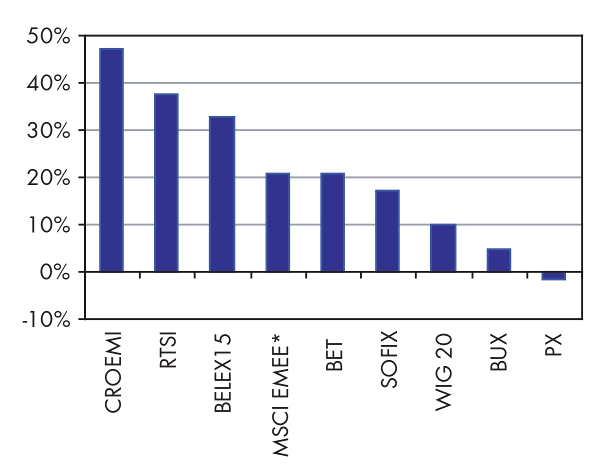
Values on 29 September 2006
Source: Reuters, Bloomberg, Raiffeisen RESEARCH

Romania: Breakdown of purchases/sales

	Residents/ Non residents	Purchases (EUR mn)	Sales (EUR mn)	Net (P-S) (EUR mn)
2003	Residents	168.2	189.8	-21.5
	Non residents	100.6	79.1	21.5
Total		***268.9***	***268.9***	
2004	Residents	399.0	472.7	-73.7
	Non residents	199.1	125.4	73.7
Total		***598.1***	***598.1***	
2005	Residents	1,549.7	1,678.3	-128.6
	Non residents	601.1	472.5	128.6
Total		***2,150.8***	***2,150.8***	
2006 ytd	Residents	1,151.1	1,222.7	-71.7
	Non residents	488.9	417.2	71.7
Total		***1,639.9***	***1,639.9***	

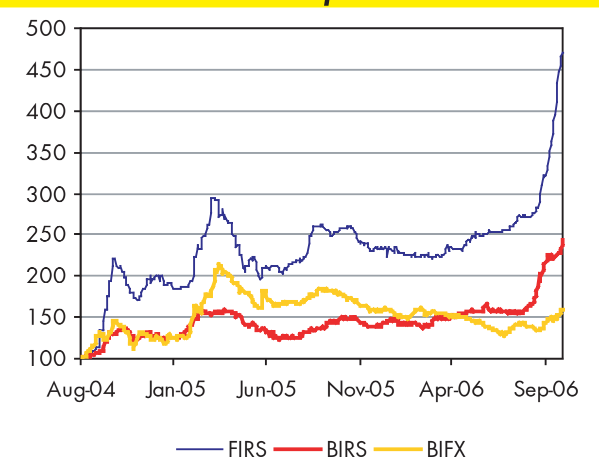
Source: BSE, Raiffeisen RESEARCH

CEE & SEE core indices - YTD performance



In local currency, values on 29 September 2006
** MSCI Emerging Market Eastern Europe*
Source: Bloomberg, Reuters, Raiffeisen RESEARCH

Bosnian indices in comparison



Source: Sarajevo Stock Exchange, Banja Luka Stock Exchange, Raiffeisen RESEARCH

The local stock exchange reacted to changes in international markets and proved that the BSE is increasingly correlated with both its peers in Central and Eastern Europe and the Western exchanges. On the positive side, Transelectrica, the national power grid company enjoyed a very successful IPO in June (oversubscribed by 6.5 times) and arrived on the stock exchange at the end of August.

In its last report, the European Commission recommended that Romania join the EU on 1 January 2007. This news did not have much impact on the capital market, as the development was expected and priced-in by market participants. Over the longer term, we believe that EU accession will provide a stable framework for sustained economic convergence. Financial assets should continue to benefit in this context, mainly as a result of robust inflows of funds.

The government's "program for a stronger capital market" kicked off successfully with Transelectrica. This should pave the way for more state-owned companies listing on the BSE. Early in 2007, we expect Transgaz, the national natural gas transporter to have its IPO. Following that, more utility companies are expected on the BSE, electricity and natural gas distributors, Romgaz, the state-owned natural gas producer as well as the Bucharest airport and the Constanta seaport. Separately, RomTelecom should have a dual-listing by end-2006.

Bosnia and Herzegovina

The capital market sector in Bosnia and Herzegovina is comprised of two exchanges operating independently, the Sarajevo Stock Exchange (SASE) in the Federation of BiH (FBiH) and the Banja Luka Stock Exchange (BLSE) in Republika Srpska (RS).

The turnover on all market segments of the SASE increased from EUR 230 mn in 2005 to EUR 278 mn in the first three quarters of 2006, representing an increase of 21%.

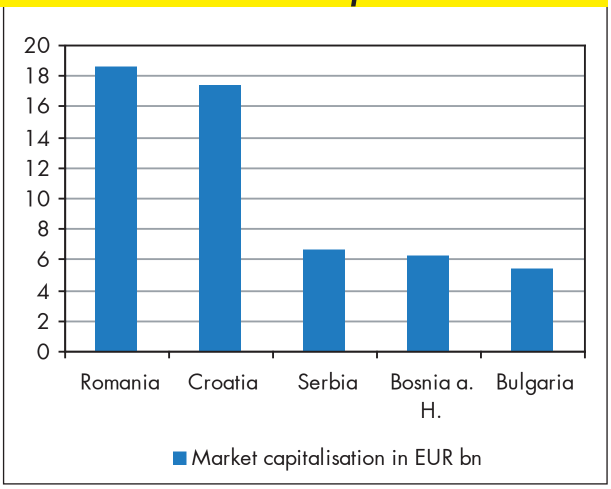
After stagnation of the market in the two first quarters of 2006, the market has been recovering during the last 2-3 months. Since the beginning of 2006, BIFX (investment fund index), which includes 11 funds listed on the SASE, has increased marginally (about 6%) by the end of September. SASX (index tracking the ten most liquid companies on SASE) increased 26% in the same period. Currently, the first IPO (ABS Banks) is taking place and should be finished by end-2006. Current market capitalisation amounts to approx. EUR 3.7 bn. The turnover on all market segments of the BLSE totalled EUR 161 mn in the first three quarters of 2006, up 64% on the total turnover in 2005. At the BLSE the stock exchange index (BIRS) has increased by 71% since the start of 2006. In the same period, the Investment Fund Index (FIRS) increased by 107% in 2006. The market is still rising as large amounts of foreign investors are entering the market. Current market capitalisation amounts to approx. EUR 2.5 bn. Furthermore, Telekom RS is going throughout process of privatisation and should be privatized by the end of 2006. Negotiations between the government of RS and potential buyers are taking place.

Serbia

In some respects, the Serbian equity market has a bright future. First, the equity market rise came to an abrupt halt in 2Q 2006 on rumours of rising inflation and the need to continue tightening monetary policy. The mood has grown hesitantly because of the macroeconomic outlook bearing negatively on the equity market. However, uncertainties are declining due to the first indication that Serbia's GDP will grow by 6.5%-7% in 2006. Considerable growth of around 11% in overall investments in 2006 is another encouraging sign of economic recovery. Furthermore, completed legal preconditions for the establishment of private pension and investment funds are opening the path for the advanced development of the local capital market.

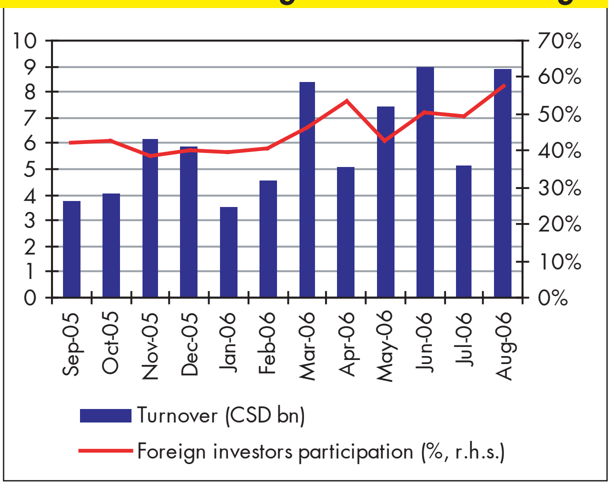
End of July brought daily hitting all time high values by both market indexes (Belex15 and Belexfm). The stock exchange was inflamed by Stada's takeover of Hemofarm and recorded positive trends although the largest market cap is leaving the market. But the news on Hemofarm was short-lived, as Komercijalna banka, the largest bank controlled by the state was introduced on the BSE shortly after. Furthermore, due to stiff competition on the market, the banking sector scored several secondary public offerings (SPOs) during Q3. On the rumours of the successful completion of the public offer of Univerzal banka in H1 2006, Agrobanka announced a SPO somewhere in August. Shares were 7 times oversubscribed, with proceeds amounting to app. EUR 15 mn. Finally, in September Privredna banka Belgrade announced the beginning of the subscription period. Along with fairly small public offers from the banking industry we are expecting the first massive public offer by Tigar Pirot to occur by the end of the year.

SEE countries: Market capitalisation



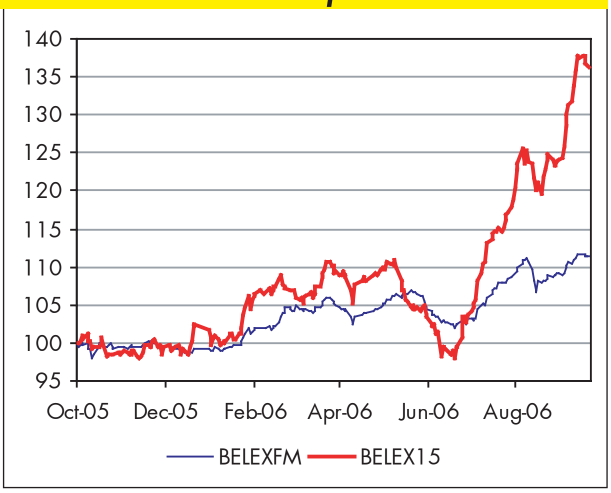
Values on 30 August 2006
Source: www.feas.org, Raiffeisen RESEARCH

Turnover on the Belgrade Stock Exchange



Source: Belgrade Stock Exchange, Raiffeisen RESEARCH

Serbian indices in comparison



Source: Reuters, Raiffeisen RESEARCH

Real GDP (% yoy)

Countries	2005	2006e	2007f	2008f
Poland	3.4	5.2	4.8	5.0
Hungary	4.1	3.9	2.5	3.0
Czech Rep.	6.1	6.0	5.0	5.5
Slovakia	6.1	6.8	7.1	5.5
Slovenia	3.9	4.0	3.5	3.8
CE	***4.3***	***5.2***	***4.6***	***4.8***
Croatia	4.3	4.5	4.0	4.5
Bulgaria	5.5	5.5	5.5	6.0
Romania	4.1	6.6	5.5	5.0
Serbia	6.8	7.0	6.0	6.5
Bosnia a. H.	5.5	6.0	5.5	6.0
Albania	5.5	5.5	6.0	6.5
SEE	***4.8***	***6.1***	***5.3***	***5.3***
Russia	6.4	7.0	5.5	6.0
Ukraine	2.6	5.5	5.0	5.0
Belarus	9.2	9.0	7.0	6.0
CIS	***6.1***	***6.9***	***5.5***	***5.9***
Turkey	7.4	5.0	5.5	7.0
EU-12	***1.5***	***2.5***	***1.8***	***2.3***
USA	3.5	3.4	2.4	3.0

Source: wiiw, Raiffeisen RESEARCH

Consumer prices (avg, % yoy)

Countries	2005	2006e	2007f	2008f
Poland	2.1	1.2	2.8	2.9
Hungary	3.6	3.8	6.6	4.1
Czech Rep.	1.9	2.9	3.2	3.0
Slovakia	2.7	4.6	2.8	2.0
Slovenia	2.5	2.8	2.4	2.6
CE	***2.4***	***2.3***	***3.5***	***3.0***
Croatia	3.3	3.4	2.8	2.9
Bulgaria	5.0	7.5	5.0	4.0
Romania	9.0	7.0	5.5	5.0
Serbia	16.5	13.1	8.8	7.8
Bosnia a. H.	3.6	6.9	6.0	5.0
Albania	2.4	2.5	3.0	3.3
SEE	***8.0***	***7.0***	***5.3***	***4.8***
Russia	12.5	10.2	8.8	7.0
Ukraine	13.5	8.2	9.5	7.0
Belarus	10.3	8.5	9.5	10.0
CIS	***12.5***	***9.9***	***8.9***	***7.1***
Turkey	8.2	9.2	7.2	6.1
EU-12	***2.2***	***2.3***	***2.3***	***2.1***
USA	3.4	3.7	2.9	2.6

Source: wiiw, Raiffeisen RESEARCH

Current account balance (% of GDP)

Countries	2005	2006e	2007f	2008f
Poland	-1.4	-1.8	-1.9	-2.0
Hungary	-7.4	-7.0	-6.5	-5.7
Czech Rep.	-2.1	-2.3	-2.4	-2.5
Slovakia	-8.6	-6.2	-3.7	-2.9
Slovenia	-0.9	-0.5	-0.6	-0.6
CE	***-3.0***	***-3.0***	***-2.8***	***-2.7***
Croatia	-6.3	-5.8	-5.6	-5.4
Bulgaria	-11.8	-14.5	-12.5	-10.0
Romania	-8.7	-9.3	-8.8	-8.7
Serbia	-8.0	-8.2	-8.3	-7.4
Bosnia a. H.	-22.5	-18.9	-17.5	-17.0
Albania	-8.7	-7.5	-6.5	-6.0
SEE	***-9.2***	***-9.5***	***-9.0***	***-8.4***
Russia	11.3	13.4	11.4	9.5
Ukraine	3.3	-3.0	-2.0	1.0
Belarus	1.6	-2.3	-2.8	-3.9
CIS	***10.3***	***11.5***	***9.8***	***8.3***
Turkey	-6.4	-6.6	-5.6	-5.2
EU-12	***-0.3***	***-0.5***	***-0.6***	***-0.6***
USA	-6.4	-6.6	-5.7	-5.5

Source: wiiw, Raiffeisen RESEARCH

General budget balance (% of GDP)

Countries	2005	2006e	2007f	2008f
Poland	-2.4	-3.0	-3.5	-3.5
Hungary	-7.5	-10.1	-6.8	-4.3
Czech Rep.	-2.6	-2.8	-2.8	-2.7
Slovakia	-2.9	-2.9	-3.0	-2.5
Slovenia	-1.8	-1.4	-1.3	-1.3
CE	***-3.3***	***-4.0***	***-3.7***	***-3.3***
Croatia	-4.1	-3.5	-3.5	-3.0
Bulgaria	2.4	3.0	2.0	1.5
Romania	-0.8	-2.0	-2.5	-3.5
Serbia	1.9	0.7	0.0	0.4
Bosnia a. H.	0.5	0.3	0.1	-0.5
Albania	-3.4	-3.0	-3.5	-3.5
SEE	***-0.7***	***-1.2***	***-1.7***	***-2.2***
Russia	7.7	6.8	5.0	3.9
Ukraine	-3.1	-4.5	-3.9	-3.0
Belarus	-0.2	-1.2	-1.5	-1.5
CIS	***6.5***	***5.6***	***4.0***	***3.1***
Turkey	-2.0	-1.8	-2.2	-2.0
EU-12	***-2.4***	***-2.4***	***-2.1***	***-2.0***
USA	-3.6	-3.9	-4.0	-3.7

Source: wiiw, Raiffeisen RESEARCH

Exchange rate EUR/LCY (avg)

Countries	2005	2006e	2007f	2008f
Poland	4.03	3.91	3.83	3.70
Hungary	248.4	267.9	268.8	261.6
Czech Rep.	29.8	28.3	27.4	26.8
Slovakia	38.6	37.6	36.5	36.0
Slovenia	239.5	239.6	239.6	239.6
Croatia	7.40	7.32	7.28	7.25
Bulgaria	1.96	1.96	1.96	1.96
Romania	3.62	3.54	3.52	3.47
Serbia	82.9	85.7	84.9	83.8
Bosnia a. H.	1.96	1.96	1.96	1.96
Albania	124.1	123.1	122.1	122.0
Russia	35.2	34.5	34.8	34.2
Ukraine	6.3	6.5	6.6	6.5
Belarus	2677	2704	2926	3245
Turkey	1.67	1.83	2.01	2.03
USA	1.24	1.26	1.33	1.33

Source: wiiw, Raiffeisen RESEARCH

Exchange rate USD/LCY (avg)

Countries	2005	2006e	2007f	2008f
Poland	3.24	3.05	2.88	2.78
Hungary	198.7	212.6	202.1	196.7
Czech Rep.	24.0	22.5	20.6	20.2
Slovakia	31.1	29.8	27.4	27.1
Slovenia	192.5	187.2	180.2	180.2
Croatia	5.95	5.81	5.47	5.45
Bulgaria	1.58	1.55	1.47	1.47
Romania	2.92	2.81	2.65	2.61
Serbia	66.7	68.0	63.9	63.0
Bosnia a. H.	1.57	1.55	1.47	1.47
Albania	99.9	97.7	91.8	91.7
Russia	28.3	27.4	26.2	25.7
Ukraine	5.1	5.1	5.0	4.9
Belarus	2154	2146	2200	2440
Turkey	1.35	1.45	1.51	1.53
EU-12	0.80	0.79	0.75	0.75

Source: wiiw, Raiffeisen RESEARCH

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Abbreviations

Currencies and countries

BAM	Bosnian Marka
BGN	Bulgarian Lev
CSD	Serbian Dinar
CZK	Czech Koruna
EKK	Estonian Kroon
HRK	Croatian Kuna
HUF	Hungarian Forint
LVL	Latvian Lats
LTL	Lithuanian Litas
PLN	Polish Zloty
RON	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
ytd	year to date
mn	million
bn	billion
LCY	Local Currency
GDP	Gross Domestic Product
C/A	Current Account
T/B	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)

Equity related

BET	Romanian stock index
BET-FI	Romanian investment fund index
BUX	Hungarian stock index
BELEX15/BELEXFM	Serbian stock index
BSE	Bukarest Stock Exchange
BSE-Sofia	Bulgarian Stock Exchange-Sofia
CROEMI	Croation stock index
PX	Czech stock index
RTSI	Russian stock index
SASE	Sarajevo Stock Exchange
SOFIX	Bulgarian stock index
VSE	Varazin Stock Exchange
WIG 20	Polish stock index
ZSE	Zagreb Stock Exchange
SX	Stock Exchange
P/E	Price earnings ratio

CE	Central European countries - Poland, Hungary, Czech Republic, Slovakia, Slovenia
CEE	Central and Eastern European countries
SEE	South East European countries - Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Romania, Serbia
CIS	European CIS (Commonwealth of Independent States) countries - Russia, Ukraine, Belarus

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