CEE Insights

Fixed Income and Foreign Exchange

Looking ahead this week…

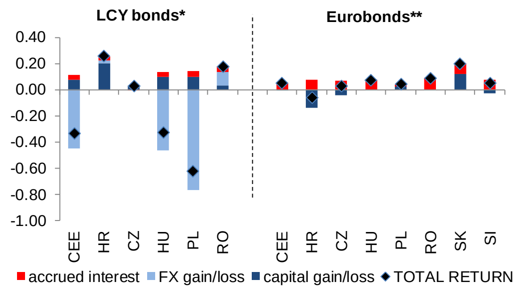
Monday	Tuesday	Wednesday	Thursday	Friday
SK: Unemployment **HU:** C/A Balance	**SI, PL**: Employment and Wage Statistics	**HU**: Wages **PL**: Retail Sales, Industry, Producer Prices	**RS**: C/A Balance **SI**: Producer Prices	

Click for: this week's detailed releases/events, market forecasts, macro forecasts

Romania has postponed the vote on the CHF loan conversion bill to this week. The decision to convert is a done deal, and abolishing the previous CHF 250k cap also seems likely. However, given that the news has been out for more than a week now and that the central bank talked about allowing banks to use its FX reserves, pressure on the leu could wane. Otherwise, the week will be rather uninteresting in terms of macro releases. Only Poland will be worth watching, as the country is going to release employment and retail sales statistics, which are important, as we see downside risks for growth in Poland vs. the official forecasts, posing risks to the fiscal balance as well. In Croatia, final details around the new HDZ-MOST government are to be settled this week, but the most important issues (for markets) are already clear, so we do not see a strong market impact from this news. The ECB Council meeting this week could be rather important for CEE FXFI markets, however.

In case you missed it last week…

- Vote to enable conversion of CHF loans at historical costs postponed in Romania to this week
- Inflation surprised strongly to downside in Serbia; slightly to downside in Hungary, Romania and Czech Republic; came in as expected in Slovakia and surprised to upside in Croatia
- NBS left base rate unchanged as expected at 4% in Serbia
- Fitch stressed progress in forming government in Croatia eases near-term political risks
- For other events last week, please check respective countries: HR, CZ, HU, PL, RO, TR, SI, SK, SR



On Radar

Several CEE countries have recently adopted or are considering adopting laws that should provide some debt relief to debtors or speed up debt resolution. The latter one, especially given that courts are extremely sluggish, could be seen as desirable if the new institutional framework tries to bypass courts or puts procedures on a fast track. However, retroactivity is a big issue in many cases, as it significantly erodes creditor rights and the rule of law. Dropping the key initiatives for existing mortgages and FX conversions at off-market rates are among the moves. In order to reduce moral hazard, such extreme solutions should be restricted to limited cases – loans that are overdue for a long time and for which there is no chance of being paid back. We see that Poland is struggling to find a meaningful version of its FX conversion plan and thus 'only' FX spread repayment seems to be the sole viable solution on the way. (For further details, see the next page.)

Retroactive FX loan conversion and drop in key initiatives reduce creditor rights, while new consumer protection laws try to institutionalize and speed up debt resolution/rescheduling

Retroactive laws, sluggish courts are biggest blows to creditor rights in CEE

‘Have creditor rights been strengthened or weakened in CEE countries in recent years?’

Croatia: Investor protection in Croatia was one of the hottest topics in the last couple of years and the overall picture is relatively blurry. On one hand, introduction of pre-bankruptcy (out-of-court) settlements in 2013 and changes to a bankruptcy law implemented in 2015 brought some improvements, which are reflected in the Doing Business data. On the other hand, the forced conversion of CHF loans significantly shook investors' confidence, as the Croatian government deliberately endangered EU laws and enforced the principle of retroactivity in the legal system. However, according to statements from the PM's cabinet and Ministry of Finance, the new Croatian government should have a ‘pro-investor’ orientation.

Czech Republic: No major changes in creditor rights have taken place recently in the Czech Republic, at least regarding existing loans. This is probably because credit quality has not been as big of an issue as in other countries and there is little political pressure to interfere in (existing) creditor rights. However, there are some changes in terms of new credits - namely, the Mortgage Credit Directive has been transposed into Czech law this year, which will put a greater administrative burden on creditors and bring new rights for debtors, e.g. early repayment of loans.

Hungary: Since the financial crisis hit Hungary, the financial sector has been struggling with increasing NPL stock and the hindering measures taken by the government. Even though there has been some consolidation in the relationship between the government and financial sector recently, as the tax levy was cut in 2016 and the moratorium on evictions was lifted this March, banks might remain reluctant to increase their lending activity, especially in mortgages, not just because the demand of households may be lackluster, but due to the uncertain business environment and unpredictable legislative processes. The latter two are underpinned by the competitiveness rankings from the WEF, as the strength of investor protection and efficiency of the legal framework in settling disputes in Hungary is quite far behind.

Poland: Despite the worsening investment climate in Poland, creditor rights seem to be well protected. According to the Global Competitiveness Index, Poland scores high in such categories as the strength of investor protection (ranking 32 out of 140) and legal rights (24 out of 140), while Doing Business points out that the recovery rate has been continuously growing and stands at 58.3 cents on the dollar. Furthermore, pro-business amendments in the New Bankruptcy Law (in force since January 2016) should solve the main drawbacks of the bankruptcy process, such as lengthy procedures and their high costs. Although the government feels willing and committed to help FX borrowers, fully-fledged FX conversion is unlikely, while the return of FX spreads to debtors seems to be the major part of the relief program.

Romania: Romania has witnessed a string of legal initiatives aimed at strengthening debtors' rights ahead of December parliamentary elections. A law that enables retail customers to return real estate collateral to banks in exchange for writing-off their loans entered into force in May and more than 4,000 people have taken advantage of it so far. This week, the Romanian Parliament could vote on a law on the conversion of CHF loans at the historical FX rate. The personal insolvency law will enter into force at the end of October and should allow people to postpone the payment of debts for a period of five years, based on a judicial reorganization plan. The payment discipline of retail banking clients has been significantly better than that of corporate customers, with the NPL ratio at 9.1% in December 2015 for private individuals and 26.2% for non-financial companies.

Serbia: Although the overall business environment in Serbia has improved in recent years, we still see a lack of progress in the legislation related to investors' rights and protection. Doing Business data for 2016 shows that Serbia kept a relatively low 73rd place in enforcing contracts and fell from 49th to 50th in resolving insolvency. Similarly, WEF data indicates that property rights stayed unchanged at relatively low levels (3/7), while the legal rights index even worsened slightly. However, with draft changes and amendments to the Bankruptcy Law and an active NPL resolution strategy (which should be implemented during the year), we could see some improvements ahead, but strong efforts are still needed.

Slovakia: The World Bank reports cite law enforcement as a vital area for improvement. Their 2015 findings on contract enforcement show that the average time taken to resolve a dispute was 705 days in Slovakia, as opposed to the OECD average of 538.3 days. Recently, the Ministry of Justice presented legislative changes that simplify the personal bankruptcy procedure and should unburden the courts. According to the Ministry of Justice, there were 32tsd personal bankruptcy requests in the Czech Republic in 2015, but just 391 in Slovakia. The changes will allow more people to return to normal life via personal bankruptcy or a repayment calendar, but only once in 10 years. Some potential for moral hazard may exist, but it is fairly limited.

Slovenia: Slovenia is one of the top performers in the CESEE region when looking at GCI and DB data related to investors' rights, as the strength of investor protection is at relatively high levels (GCI rank 14) and the legal framework seems to be stable and predictable. In recent years, Slovenia has made additional progress on all fronts, with the biggest improvements recorded in resolving insolvency procedures (time and recovery rates) and efficiency of the legal framework in settling disputes. Looking forward, we expect the government to keep this track record and we will probably see additional gradual improvement in this institutional quality sphere.

Looking ahead

Date	Time	Ctry	Release	Period	Erste	Survey	Prior	Pre Comment
17. Okt.		**SK**	**Unempl. Rate**	Sep	***9.42%***		9.4%	*Unemployment rate is expected to decrease only marginally in September*
	8:30	**HU**	**CA Balance (m)**					
	9:00	**CZ**	**PPI y/y**	Sep	***-2.6%***	*-2.7%*	-3.4%	*Oil price decline negatively affected PPI; however, its negative impact is gradually diminishing*
18. Okt.	10:30	**SI**	**Unempl. Rate**	Aug	***10.7%***			*Stabilization on labor market seen continuing in August, with unemployment rate remaining below 11% mark*
	14:00	**PL**	**Wages y/y**	Sep	***4.5%***	*4.6%*	4.7%	*Wages should sustain robust growth*
	14:00	**PL**	**Employment y/y**	Sep		*3.1%*	3.1%	
19. Okt.	9:00	**HU**	**Wages y/y**	Sep	***5%***	*5.3%*	5.1%	*Fast-paced growth of nominal wages should continue as labor market has become tight*
	14:00	**PL**	**Retail Sales y/y**	Sep	***5.7%***	*5.8%*	5.6%	*Retail sales to sustain robust pace of growth, supported by fiscal loosening and high disposable income of households*
	14:00	**PL**	**Ind. Prod. y/y**	Sep	***2.4%***	*3.6%*	7.5%	*We expect positive but rather moderate growth of industry, confirming rather weak economic activity in 3Q16*
	14:00	**PL**	**PPI y/y**	Sep	***0.2%***	*0.2%*	-0.1%	*Producer Price Index should remain in positive territory and slowly increase*
20. Okt.		**RS**	**CA Balance (m)**	Aug			-24.8 m	
	10:30	**SI**	**PPI y/y**	Sep				

Sources: Bloomberg, Reuters

Major markets

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- Markets will watch this week's ECB Council meeting very closely. The focus will be on the future course of the ECB's monetary policy and especially on any hints concerning the duration of the current asset purchase program. We expect the ECB to agree on an end to asset purchases in the current amount in March, followed by a continuous reduction of monthly purchases starting in April. The ECB Council is unlikely to make such a far-reaching decision already at the coming meeting, however. Rather, we expect ECB President Draghi's statements to remain roughly unchanged compared to the September meeting and thus no adjustment of the purchase program.
- The Council could be more concrete concerning the change to the specifications of its asset purchase program. The most restricting self-imposed limits are the yield level of -0.4% down to which the ECB buys assets and the issue/issuer limit of 33%. Depending on the level of the yield curve, the 33% limit could already be reached for German (and Dutch) government bonds by the end of the year. To avoid such a situation, the most likely step seems a change in the distribution of purchases among sovereign issuers. This would decrease the share of German bonds to the benefit of - among others - Italian bonds. Politically, this would be debated strongly among Council members; nonetheless, the easy implementation speaks in favor of this option. Another possibility for the ECB would be to increase the issue and issuer limits. However, the ECB wanted to avoid becoming a dominant bond holder in the past, and this argument still holds true.
- Last week's released data for industrial production in August exceeded market expectations. When compared to July, industrial production rose 1.6%. It is encouraging that the positive impulses did not just come from Germany (+3.1% m/m), as Italy's industrial production rose 1.7% m/m. In total, the level of industrial production in the Eurozone in 2Q16 thus far stabilized when compared to 3Q16.

Croatia

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- September inflation landed above our expectations, with the decline in the headline figure slowing to -0.9% y/y (vs. -1.5% y/y in August). On a monthly level we saw a strong 1.1% uptick in the CPI trajectory, which was mainly driven by seasonally higher clothing and footwear prices amid the arrival of new collections, while higher transport prices also added to the m/m increase. Looking ahead, we continue to see the pace of deflation gradually moderating towards the end of the year, with the base effect and stabilized domestic demand outlook offsetting still subdued cost-side pressures.
- We saw no major moves on the markets – yields on the bond market maintained steady development, with the 10Y LCY curve moving a notch above 3.10%, while the exchange rate remained practically unchanged on a weekly basis, i.e. the EUR/HRK remained above the 7.50 mark.

Czech Republic

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- Headline inflation arrived at -0.2% m/m and 0.5% y/y in September. The negative m/m development was influenced by seasonal effects and prices of food and beverages.
- In line with expectations, the share of unemployed (methodology of the Ministry of Labor and Social Affairs) came in at 5.2% in September, from the 5.3% reached in August. The unemployment rate remains very low, which supports household consumption, retail sales and the central government budget.
- There were several comments from the Czech National Bank that were in line with its current stance. The CNB staff is working on the new forecast now (the next meeting is on November 3).
- The current account deficit reached CZK 0.7bn in August, due to a deficit in the primary income balance. The surplus of the balance of goods and services was compensated for by high dividends on direct investment.

Hungary

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- The headline CPI inflation rate accelerated to 0.6% y/y in September from August's -0.1% figure. Core inflation edged up to 1.4% y/y, and remained in the range of between 1.2 and 1.5%, a range in which the core figure has been floating since 2Q15. In an annual comparison, food prices rose by 0.8%, tobacco and alcoholic beverages by 2%, clothing by 0.2%, durable goods by 0.2%, services by 1.3%, while household energy prices remained flat. Fuel prices decreased in an annual comparison by 3.9% y/y; however, due to the excise duty increase, fuel prices rose by 3% m/m.
- Despite earlier expectations, the Debt Management Agency did not announce any relevant change in its policy at the press conference held on Friday morning. ÁKK CEO Barcza emphasized that the share of FX debt in the government's total debt will decline to 26% by the end of the year. Total debt could stand at 73-74% of GDP, helped by the stronger forint, lower budget deficit and EU funds inflow. Retail debt financing cannot be seen as expensive, according to him, as this does not increase external debt. As for FX issuance, Barcza said that, after the recent rating agencies' upgrades, issuing Eurobonds in euro makes sense, as taking next year's redemption into consideration (EUR 2-3bn), this will not increase the FX share in total debt. He added that any Eurobond issuance this year is not a base scenario, but returning to this market in the coming years could be a rational decision.

Poland

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- The final CPI figure arrived at -0.5% y/y (0.0 m/m) in September. Easing deflation supports a stable policy rate scenario and we do not expect the MPC to change its stance any time soon.
- The financial market watchdog evaluated the costs of the FX bill proposal (assuming a return of FX spreads) at PLN 9.3bn. Next week, the presidential proposal as well as two others will be discussed in the parliament. We do not expect that any solution assuming FX conversion will be passed.

- Current account deficit widened in August to EUR 1047mln (from July's deficit of EUR 635mln) as trade deficit widened to EUR 509mln driven by particularly strong import growth.
- Venice Commission criticized the July overhaul of Constitutional Court. Polish government is not likely to respect that opinion accusing Venice Commission of being politically biased.

Romania

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- Inflation fell to -0.6% y/y in September, from -0.2% y/y in August, pointing towards extended weakness in consumer prices. In m/m terms, inflation was negative (-0.1%) due to cheaper food items. We have revised downwards our average inflation forecast to -1.6% in 2016 and 1.2% in 2017 (-0.2pp for both years) and think the NBR has good reasons to maintain a loose monetary policy in 2016-17. The first 25bp hike in the key rate could be delivered only in 1Q18.
- Bloomberg cited NBR Deputy Governor Voinea as saying that Romania does not need to tighten monetary policy because growth has not become unsustainable. Speaking about leu depreciation, Voinea said local banks bought euros to strengthen their FX positions ahead of legislative changes that enable CHF-indebted clients to convert their loans at historical FX rates. He added that leu depreciation has not so far been that significant.
- The final vote on the law enabling the conversion of CHF loans at historical costs was postponed this week, due to the lack of a quorum in the parliament. According to the proposed version, clients could convert loans below CHF 250,000. In a separate event, the Constitutional Court postponed until October 27 its verdict on the law, which enables retail clients to return real estate collateral to banks in exchange for writing off loans. The law was challenged at the Constitutional Court by the banks.

Serbia

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- September 2016 CPI came in below all expectations, landing at 0.6% y/y, with falling food and oil prices playing the key dragging role. Despite obvious deflationary pressures, the NBS decided to remain on hold and keep the key rate unchanged at 4% and await clearer signals from the FED. Looking forward, we expect a better economic and fiscal performance, stable FX developments and low inflation expectations.
- On the bond market, we saw no major developments, as the benchmark RSD 2022 yield remained relatively flat (5.64%), while EUR/RSD developments continued to reflect appreciation pressures, prompting the NBS to attempt to tame them by buying EUR 15mn on the FX market.

Slovakia

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- The government approved an increase in the minimum wage from the current EUR 405 to EUR 435 next year. It also approved some legislative changes regarding social insurance. The maximum base for calculating social insurance levies will increase from the current 5x to 7x the average wage. However, this group of higher income earners will be compensated with better sickness benefits (the maximum base will increase from 1.5x to 2x the average wage) and slightly higher pensions. The changes are to come into force as of 2017.

- Deflation became milder in September, meeting our expectations of a 0.5% y/y fall (+0.1% m/m) in consumer prices. The softer deflation was helped by a less-pronounced fall in transport and energy prices, as well as good annual growth in service prices. Core inflation reached 0.1% y/y, as it returned to positive territory.
- After July's plunge caused by the timing of this year's summer breaks at the major car plants, August IP growth reached 17.5% y/y (28.1% m/m) and exceeded expectations. Car manufacturing was the key growth driver, as it increased by 44.5% y/y. Still, overall average IP growth for July-August was lower this year than in 2015. We expect IP to keep growing at good rates, averaging 4-4.5% this year.
- August also brought a rebound in foreign trade dynamics. Exports grew by 18.4% y/y while imports increased by 15.8% y/y. The foreign trade balance was positive at EUR 216.1mn, a bit below our expectations. Overall, net exports should contribute positively to GDP growth.
- Construction production marked the sixth consecutive month of negative growth in August, falling by 9.7% y/y. This is partly due to base effects from last year's EU funds-driven growth.

Slovenia

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- Following strong retail trade output (4.8% y/y), the remainder of the short-term data for August also aligned with a favorable pattern – on the industrial production side, we saw further robust growth of 6% y/y, which was backed by practically every sector of production. The preliminary trade balance data also revealed positive developments, with exports showing stronger growth dynamics and speeding up to 9.4% y/y, while imports also gained momentum and expanded by 5.1% y/y. We see the August data fitting in well with our expectations.
- Yields on the bonds market continued to display a steady footprint, with the benchmark yield (EUR 2025) still moving around the 0.50% mark.

Capital market forecasts

Government bond yields	current	2016Q4	2017Q1	2017Q2	2017Q3
Croatia 10Y	3.10	3.00	3.00	3.00	3.10
Czech Rep. 10Y	0.30	0.34	0.36	0.34	0.36
Hungary 10Y	2.99	2.75	2.67	2.59	2.51
Poland 10Y	3.03	2.90	3.00	3.20	3.30
Romania10Y	3.02	2.85	2.85	2.85	2.85
Slovakia 10Y	0.42	0.40	0.45	0.50	0.55
Slovenia 10Y	0.54	0.70	0.70	0.80	0.90
Serbia 7Y	5.64	5.50	5.50	5.50	5.50

3M Money Market Rate	current	2016Q4	2017Q1	2017Q2	2017Q3
Croatia	0.88	0.70	0.70	0.70	0.70
3M forwards		-	-	-	-
Czech Republic	0.29	0.29	0.28	0.28	0.27
3M forwards		0.32	0.28	0.25	0.26
Hungary	0.87	0.75	0.70	0.65	0.60
3M forwards		0.79	0.76	0.76	0.77
Poland	1.72	1.68	1.68	1.68	1.68
3M forwards		1.77	1.77	1.77	1.78
Romania	0.68	0.65	0.65	0.65	0.65
3M forwards		0.58	0.73	1.03	1.45
Serbia	3.50	3.50	3.50	3.50	3.50
3M forwards		-	-	-	-
Eurozone	-0.31	-0.25	-0.25	-0.25	-0.25

FX	current	2016Q4	2017Q1	2017Q2	2017Q3
EURHRK	7.51	7.60	7.65	7.55	7.60
forwards		7.53	7.56	7.58	7.61
EURCZK	27.03	27.02	27.02	27.02	27.02
forwards		26.98	26.92	26.84	26.74
EURHUF	305.2	314.0	315.0	315.0	315.0
forwards		305.9	306.6	307.3	308.2
EURPLN	4.30	4.33	4.29	4.31	4.27
forwards		4.32	4.34	4.37	4.39
EURRON	4.51	4.51	4.50	4.50	4.50
forwards		4.52	4.53	4.54	4.55
EURRSD	123.1	123.5	123.5	124.0	124.0
forwards		-	-	-	-
EURUSD	1.10	1.10	1.12	1.14	1.16

Key Interest Rate	current	2016Q4	2017Q1	2017Q2	2017Q3
Croatia	0.50	0.50	0.50	0.50	0.50
Czech Republic	0.05	0.05	0.05	0.05	0.05
Hungary	0.90	0.90	0.90	0.90	0.90
Poland	1.50	1.50	1.50	1.50	1.50
Romania	1.75	1.75	1.75	1.75	1.75
Serbia	4.00	3.75	3.75	3.75	3.75
Eurozone	0.00	0.00	0.00	0.00	0.00

Macro forecasts

Real GDP growth (%)	2015	2016f	2017f	2018f
Croatia	1.6	2.2	2.0	2.3
Czech Republic	4.6	2.6	2.6	3.0
Hungary	2.9	2.1	2.8	2.6
Poland	3.6	3.1	3.3	3.4
Romania	3.8	4.5	3.2	3.3
Serbia	0.8	2.6	2.9	3.2
Slovakia	3.6	3.3	3.1	3.5
Slovenia	2.3	2.1	2.3	2.6
CEE8 average	**3.5**	**3.1**	**3.0**	**3.2**

Average inflation (%)	2015	2016f	2017f	2018f
Croatia	-0.5	-0.9	1.0	1.4
Czech Republic	0.3	0.6	2.0	1.9
Hungary	-0.1	0.4	1.7	2.7
Poland	-0.9	-0.6	0.9	1.4
Romania	-0.6	-1.6	1.2	2.0
Serbia	1.7	1.3	2.4	3.1
Slovakia	-0.3	-0.6	0.7	2.0
Slovenia	-0.5	-0.1	1.3	1.9
CEE8 average	**-0.4**	**-0.4**	**1.3**	**1.8**

Unemployment (%)	2015	2016f	2017f	2018f
Croatia	16.3	15.2	14.6	14.0
Czech Republic	5.1	4.2	4.3	4.2
Hungary	6.8	5.3	4.8	4.5
Poland	10.6	9.3	8.7	8.5
Romania	6.8	6.7	6.8	6.7
Serbia	17.7	16.6	16.0	15.6
Slovakia	11.5	10.0	9.3	8.4
Slovenia	9.0	8.0	7.5	6.9
CEE8 average	**9.3**	**8.2**	**7.8**	**7.5**

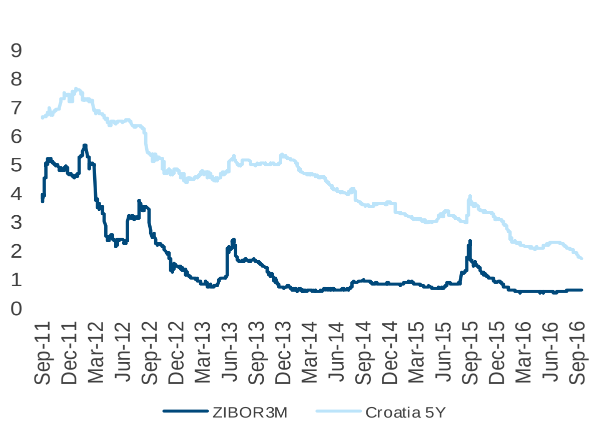
Public debt (% of GDP)	2015	2016f	2017f	2018f
Croatia	86.7	86.6	85.7	84.7
Czech Republic	40.3	37.2	36.0	36.4
Hungary	75.3	75.1	74.3	72.8
Poland	51.5	51.9	52.4	52.1
Romania	38.4	40.4	41.8	42.3
Serbia	75.9	74.5	73.8	72.3
Slovakia	52.9	52.7	52.5	51.7
Slovenia	83.4	80.6	80.0	78.6
CEE8 average	**53.8**	**53.5**	**53.4**	**53.0**

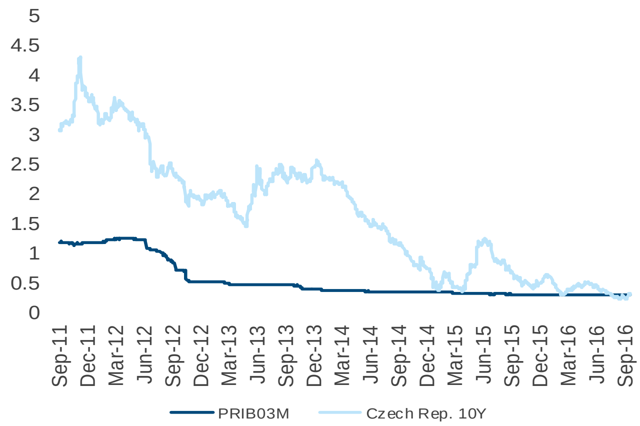
C/A (%GDP)	2015	2016f	2017f	2018f
Croatia	5.1	2.6	1.4	0.3
Czech Republic	0.9	1.9	1.4	1.1
Hungary	4.4	5.8	4.5	4.2
Poland	-0.2	-0.3	-0.7	-0.9
Romania	-1.1	-2.2	-2.5	-2.7
Serbia	-4.8	-4.6	-4.8	-5.0
Slovakia	-1.3	0.6	1.2	2.3
Slovenia	5.2	6.5	6.0	5.4
CEE8 average	**0.5**	**0.7**	**0.2**	**0.0**

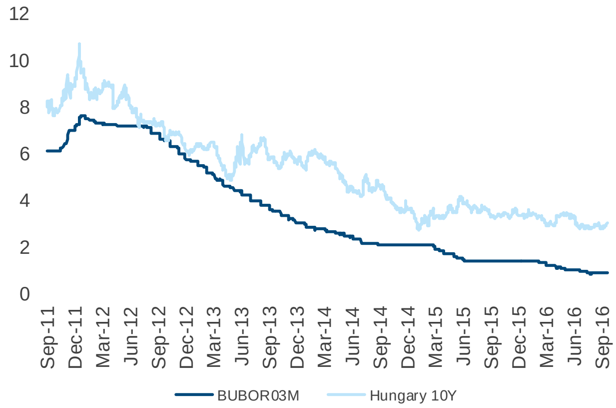
Budget Balance (%GDP	2015	2016f	2017f	2018f
Croatia	-3.2	-2.2	-2.4	-2.4
Czech Republic	-0.4	0.5	0.2	-0.2
Hungary	-2.0	-2.2	-2.7	-2.5
Poland	-2.5	-2.7	-3.0	-2.8
Romania	-0.7	-2.9	-3.0	-3.0
Serbia	-3.8	-2.3	-2.1	-1.8
Slovakia	-3.0	-2.2	-1.5	-1.2
Slovenia	-2.9	-2.5	-2.2	-1.8
CEE8 average	**-2.0**	**-2.1**	**-2.3**	**-2.2**

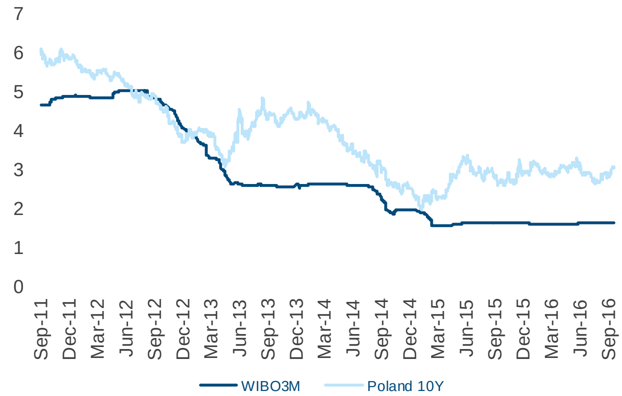
Note:*Information on past performance is not a reliable indicator for future performance. Forecasts are not a reliable indicator for future performance.

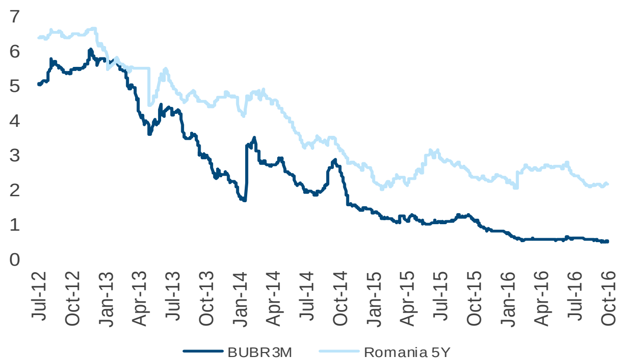
Appendix

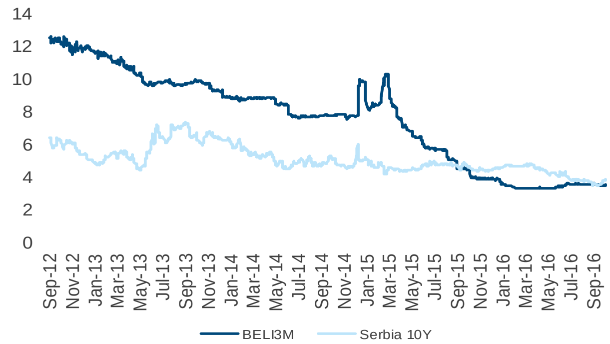


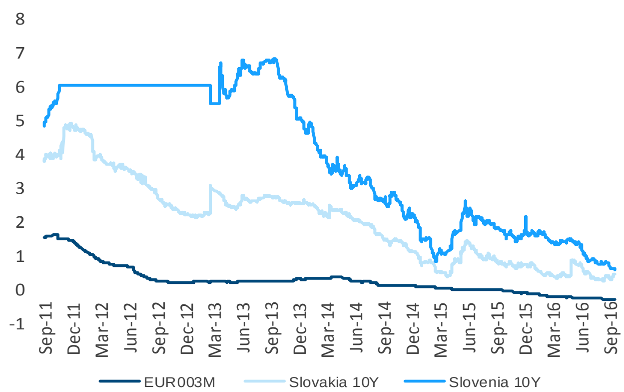












Note:*Information on past performance is not a reliable indicator for future performance. Forecasts are not a reliable indicator for future performance.

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1100 Vienna, Austria, Am Belvedere 1
Head Office: Wien
Commercial Register No: FN 33209m
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