Wermuth Asset Management GmbH

Mainzer Landstr. 47
60329 Frankfurt am Main
Tel.: +49 – 69 -95 92 54 78
Fax: +49 – 69 - 95 92 54 79

www.wermutham.com

Golikovsky per., 15
Moscow 119017
Tel: + 7 495 10 10 772
Fax: + 7 495 10 10 774

11 October, 2007

Macroeconomic comments by Dr. Dieter Wermuth to the article "IMF warns on Eastern Europe" by Sam Jomes as of 10 October, 2007:

Original article:

IMF WARNS ON EASTERN EUROPE
Posted at 04:54 by Sam Jones

According to the IMF's latest World Economic Outlook, released Wednesday, the economies of Eastern Europe are "vulnerable". Eastern Europe is the only area singled out in the report as at genuine risk from fluctuations in capital investment. The IMF draws comparisons with the Asian financial crisis in the 1990s. Although most emerging markets today have strong current account positions and big currency reserves, Eastern Europe, warns the IMF, is an exception. "Unlike in other regions...net capital inflows have been accompanied by a deteriorating external position".

Comments by Dr. Dieter Wermuth: I have to say that the main risk is indeed that the heavy borrowing in low-interest Western currencies may now bring the chicken home to roost. The combination of strong economic growth after and before EU membership of countries such as Hungary, Poland, Romania or Bulgaria und huge capital inflows, both in form of foreign direct investment (the benign kind) and financial capital imports has resulted in large current account deficits. In other words, there has been a significant increase in these countries' foreign liabilities. As Western banks have been significantly tightening their lending standards as well as raising interest rates, the accumulation of further debt has become difficult and expensive.

Especially those Eastern banks which have focused on consumer lending will be facing a significant increase in default rates. The saving grace for many of them is that they are owned by Western banks which will probably bail them out. The others will be in genuine trouble. Expect major exchange rate adjustments - which would eliminate a large portion of these countries' capital imports, and would be a blow to West European exporters. By definition, imbalances can not last forever. We will now see the correction.