
Outlook.

Anticipated Economic Performance.

LBBW anticipates economic revival in the global economy in 2010. Both key global leading indicators and hard macro-economic facts bear witness to a recovery of the global economy.

The recovery observed since summer 2009 is likely to continue thanks to the support of monetary and fiscal policy. According to LBBW, the year as a whole is expected to bring economic growth in real terms of 1.4% for Germany, approximately 1% for the euro zone and 3.2% for the USA. A relapse into recession is therefore unlikely at present, although there can be no talk as yet of a self-sustaining upturn given the stimulation provided by fiscal and monetary policy.

In addition, the risks for 2010 must also be kept in mind. According to estimates given by the ECB in its Financial Stability Review of December 2009, banks in the euro zone are once again faced with the prospect of write-downs of EUR 187 billion, of which between EUR 50 billion and EUR 75 billion is attributable to loans at German banks according to the Bundesbank. Although there is no evidence as yet of a supply-driven credit crunch, the risk is still hovering above the economy. The reduction in debt of private US households constitutes a further burden. In the period between 1997 and 2007, the increase in private consumption contributed 82% to overall economic growth in the USA. The largest national economy in the world is no longer likely to be able to rank amongst these key driving forces over the next few years. Even the recovery of the US real estate sector, which until recently had been regarded by many as stable, is proving to be doubtful, as the latest market data show. It is generally believed that the current recovery will only continue on a sustainable basis once the emergency fiscal and monetary policy measures have been brought to an end. Past experience of recessions, which go hand in hand with financial crises, give just cause for a certain amount of skepticism. Past experience and analyses carried out by the IMF show that financial market and banking crises have considerable long-term effects on the real economy. Even after seven years, a return to the growth trend seen prior to the start of the crisis had still not been achieved on average.

Industry and Competitive Situation.

The banking sector is likely to be faced with another challenging year in 2010.

The economic recovery expected, which will be cautious at the very least, is likely to brighten the outlook in the lending business little by little. However, the risk provisions of institutions in 2010 are once again expected to be at a high level as, according to past experience, economic recovery only makes itself felt in the lending books of banks with a time delay. The positive general conditions for net interest income are likely to continue in essence. In particular in the wake of economic recovery growing demand for credit may be expected. However, it is uncertain whether the write-ups and trading profits generated in the past year will be sustained.

The restructuring processes being carried out in the banking sector will continue in 2010. In the wake of the increasing implementation of EU subsidy resolutions and the planned changes to the regulatory environment, development is likely to gain in momentum.

The new regulatory framework is likely to restrict growth and profitability in the sector in the coming years. Even though the finer details are only likely to become clear over the course of the year, it is to be expected that the capital requirements of institutions will increase as a result of the new regulations.

The LBBW Group's Business Strategy and Opportunities.

In December 2009, the European Commission gave its final approval for the capital increase and the risk shield for LBBW, without an in-depth investigation. Thanks to this decision, the future business model and restructuring plan have been ratified in full by the EU. The restructuring plan approved by the European Commission sets out the main future cornerstones of the business model. For the LBBW Group, 2010 and 2011 will be characterized by the implementation of the planned measures.

The realignment of the business model primarily involves a stronger concentration on the regional core business with customers and associated growth prospects. The credit substitute business will be cut back and further opportunistic business activities will be scaled back significantly. Furthermore, the international network and the investment portfolio are to be streamlined. Focusing on these aspects will lead to a reduction in total assets of around 40% compared with the end of 2008.

In order to carry out the planned reduction in administrative expenses of EUR 700 million, the strict implementation of cost-cutting measures will be necessary, bringing with it considerable savings in material expenses and a reduction in the workforce.

LBBW still expects difficult overall conditions for the financial sector in 2010, and thus also for LBBW. Nevertheless, the LBBW Group still anticipates a considerable improvement in its results. Administrative expenses will be reduced as early as 2010 thanks to the initial positive effects of the cost-cutting measures. These are set to be implemented by the end of 2012, meaning that the planned savings will be fully recognized in profit or loss from 2013 onwards. A slight easing in allowances for losses on loans and advances is expected in view of the tentative recovery of the economy. However, allowances for losses on loans and advances will continue to be at a comparatively high level in 2010. A conservative risk policy will continue to be adhered to in the future. A further recovery in net income for the year is anticipated in 2011. In subsequent years, LBBW expects that the reduction in silent partners' contributions and profit participation rights as a result of the loss participation in the 2009 fiscal year will be reversed thanks to profits, and that deferrals on interest payments will be caught up with. In addition, LBBW will continue with its prudent liquidity and funding policy.

The focus of LBBW's investments in 2010 will be based on the implementation of the restructuring plan and the further development of the business model, and primarily concern investments in IT. The capital resources of LBBW are seen as adequate thanks to the capital increase and the effect of the risk shield, as well as the planned reduction in weighted risk assets, and are around the same level as other German banks. The anticipated reforms of regulations will also have an impact on LBBW.

LBBW sees particular planning risks in the event that the financial markets prove unstable once more, leading to effects including significant spread widening in the credit substitute business, increasing funding costs or a return to an extremely high level of expenses for allowances for losses on loans and advances in the traditional lending business.

The following sections will look into the planned development of the **operating segments** of the LBBW Group over the next few years.

In the **Corporates** segment (corporate customers), there will be the opportunity in the next few years to expand the principal bank function as a result of competitors retreating from this area. At the same time, demand for loans and investment and export financing on the part of SMEs will increase significantly once again from 2010 onwards. Following the slump in export financing in 2009, a return to growth is expected in future, depending on the degree to which the global economy recovers. The need for export protection has increased. In the real estate business, the growth trend surrounding residential properties is expected to weaken, albeit not to as drastic an extent as the collapse seen in the USA and Great Britain. In future, LBBW's corporate customer

business will focus on SMEs in the core markets of BW-Bank, Rheinland-Pfalz Bank and Sachsen Bank. This business will be expanded further, thus leading to stable income in the LBBW Group. Services provided to large customers will in future be restricted to selected customers in German-speaking countries. The real estate financing business will focus on the core markets of Germany, the USA and Great Britain in future, where it will concentrate on selected property categories. LBBW will offer a wide range of financing and additional products and services for this purpose.

The **Retail Clients** segment (private customers) is expected to continue turning away from bond-oriented commission products in favor of traditional deposit banking. The security aspect is clearly a priority for customers. The securities business will only begin to increase again once the financial markets have fully stabilized. In deposit banking, strong competition and thus a continued squeeze on margins is to be expected. In the administrative area of Stuttgart, LBBW will continue to ensure the provision of banking products to private customers under the BW-Bank brand. The business with high net worth customers is concentrated on the markets of Baden-Württemberg, Rhineland-Palatinate and Saxony.

In the **Financial Markets** segment, a certain level of caution is apparent, particularly in the case of complex and high-risk structures. Should volatility and economic development return to normal, equity and credit products will become more attractive again. Structured capital market products with a low level of complexity will show a return to growth. In future, LBBW's non customer-driven proprietary trading will decline further and there will be an even stronger focus on the customer business. On the one hand, customers will be offered equity, interest, money market, foreign exchange and commodities products. On the other, LBBW will enable its core customers to access the capital market through the placement of equity and debt financing.

In the business with **Savings Banks**, LBBW will continue to act as a central bank to the savings banks in its core markets. Here, the aim will be the continued intensification of collaboration in the contractual service partnership, which also features a collaboration partnership in the areas of liquidity and funding. Based on the economies of scale that can be achieved with services, the savings bank business constitutes an integral element in the division of tasks in the Sparkassen-Finanzgruppe.

Overall, the LBBW Group sees itself as being well equipped for the future thanks to the planned adjustments to its business model. Its business policy will continue to focus on the principle of sustainability and prudent, sound economic management. LBBW will continue to be available to trade and industry in the future as an efficient and reliable partner. In view of the ongoing high level of volatility on the markets, it is not possible at present to make a reliable profit forecast for the 2010 fiscal year.
