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his insightful comments*

Regional growth on solid footing in Q2-2017

REGIONAL MACROECONOMIC & MARKET DEVELOPMENTS & OUTLOOK

- **Q2-2017 second GDP estimates** confirm a solid footing for most of the economies of the region
- **Consumer spending revival** continues unabated driven by sustained sentiment gains, eased financial conditions, tighter labor markets and robust real wage dynamics
- **Regional assets extend gains** in Q3 2017
- Regional **bourses firm** trailing the rally in emerging and major global stock markets
- **Emerging external debt** markets extend rally firm; **regional currencies modestly weaken on idiosyncratic factors**
- **EM assets likely to remain range-bound** into year-end as developing-economies' fundamentals remain favorable but valuations are rich.

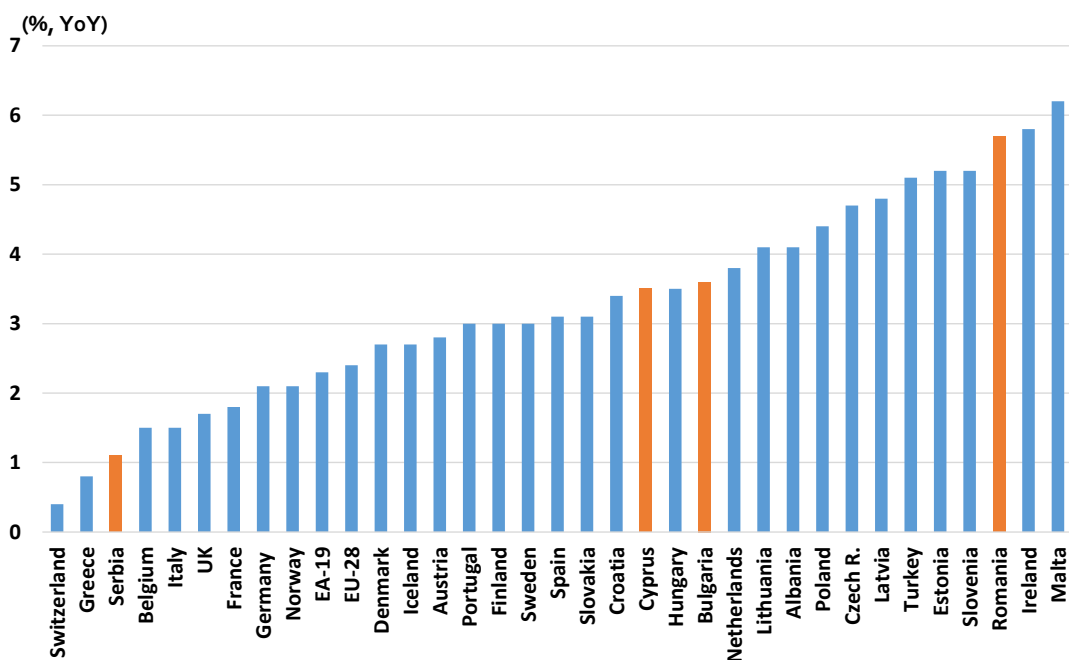
COUNTRY FOCUS

- **Bulgaria:** Credit activity has started accelerating
- **Cyprus:** New round of sovereign rating upgrades
- **Romania:** GDP growth outperformance in the second quarter
- **Serbia:** One-off factors in H1 2017 prompt downward revisions in full-year growth forecasts

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Regional economies on solid footing in Q2-2017



Source: Eurostat, National Authorities, Eurobank Research

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I. Regional Macroeconomic & Market Developments & Outlook

Regional growth on solid footing in Q2; most assets extend gains in Q3 2017

The economies of the region remained on solid footing in Q2 driven by robust private consumption dynamics The second GDP growth estimates for Q2-2017, released for most of the countries of our focus (Bulgaria, Romania, Cyprus), confirmed a solid footing for the region. Now that the detailed breakdown for all the economies is available, it would be fair to say that the private spending revival continued unabated despite local political-policy-making uncertainties plus the food prices induced spike of headline inflation, feeding a strong imports rise on the external side. Sustained consumer sentiment gains, eased financial conditions, tighter labor markets combined with robust real wage dynamics boost consumer spending, a trend that will most likely continue throughout 2H. On the negative side, the underperformance of EU funded projects maintained investment spending below expectations for yet another quarter, a trend that we anticipate to change in the 2H.

Emerging Market assets remain amongst the best performing classes so far this year Emerging market assets broadly extended their two-year rally in Q3. Despite some bouts of increased risk aversion that have prompted a squeeze on long EM positions, this class remains amongst the best performing so far this year. Support has mainly stemmed from developing economies' improving macroeconomic fundamentals, low interest rates globally, favorable EM valuations and the USD's weakness over the last few months. Importantly, the Fed's monetary tightening has proved less aggressive than feared a few months ago. Meanwhile, the ECB's stance remains accommodative. The ability of EM assets to withhold their gains has been primarily tested on a few occasions this year via increases in core government yields. Rising geopolitical tensions have also weighed on valuations at times. Reflecting the improvement in global risk appetite, EM external debt has rallied further in Q3, with corresponding spreads over USTs on the EMBI+ index having declined to a 3-year low of 315bps September while total year-to-date returns stood near 9% in the beginning of October.

Emerging market stocks end Q3 in the black for the 3rd quarter running, the longest such stretch since 2010; regional bourses trail behind In stock markets, the MSCI Emerging Markets Index ended September in the red amid persisting geopolitical tensions relating to news around North Korea, higher UST yields and a partial recovery in the USD. The latter two were driven by the US administration's tax reform proposal that is expected to boost growth in the world's largest economy and led to an upward repricing of expectations for further FOMC monetary policy tightening this year. Although September's 0.5% decline took some shine off the rally and snapped an 8-month stretch of gains – the longest since 2004 – the index reached new 3-year highs earlier that month and ended Q3 for the 3rd consecutive quarter in the black. Over the July-September period it recorded hefty gains to the tune of 7% and marked the longest rally since 2010. On a year-to-date basis it has spiked by 25%, nearly double the ca. 15% rise evidenced in the corresponding World index. LATAM and BRICs led the way higher in the EM space in Q3, while CESEE bourses trailed behind. Bulgaria's main SOFIX index was the only exception in the region and ended lower in September compared to June. However, the index still stands more than 17% higher year-to-date.

Emerging market currencies mostly firm; regional fx remains modestly weaker on idiosyncratic factors Most emerging currencies also firmed in Q3 thanks to improving risk sentiment. The MSCI EM Currency Index advanced by ca 2% in July-September, having amassed gains to the tune of 8% since the beginning of the year. The picture is somewhat different in CESEE, with most currencies standing modestly weaker in Q3 as well as compared to their levels in the onset of 2017. Idiosyncratic factors also remain at play. The Hungarian forint recently slid to a 4-month low near 312.50/€, a few days after the Central Bank launched a new round of monetary easing. The Polish zloty fell to a 6-month low close to 4.3320/€ weighed down by escalating tensions with the EU. The European Commission took further action in September in an infringement procedure against the country that was launched in July, deciding to send a Reasoned Opinion to the country regarding an overhaul of the Polish judiciary system. On the flipside, the Serbian dinar has backed the negative regional trend to hit a 3-year peak just below 119/€ in late September (for further details see Trader's view).

Good EM assets performance likely to continue towards year-end Barring any major shocks, EM assets are likely to remain range-bound into year-end as developing-economies' fundamentals remain favorable but valuations are rich. Downside risks may arise via renewed geopolitical tensions, higher core market rates, more hawkish than expected major Central Bank rhetoric and renewed concerns over China's growth.

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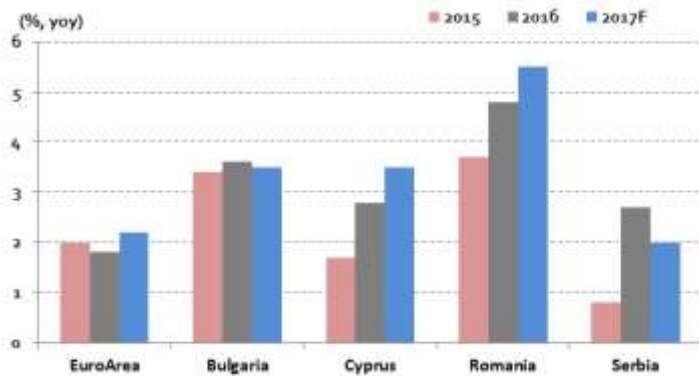
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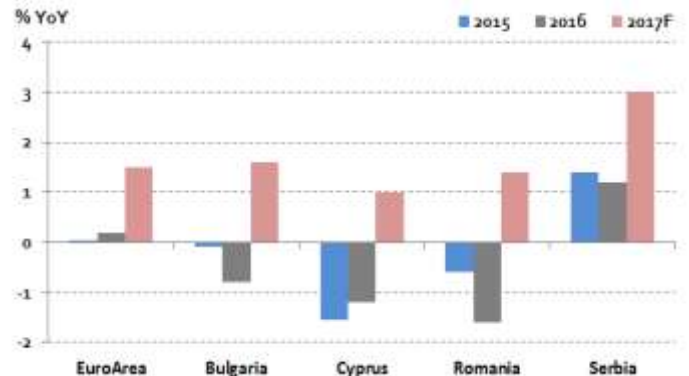
September 2017

FIGURE 1: GDP Growth performance 2015-2017



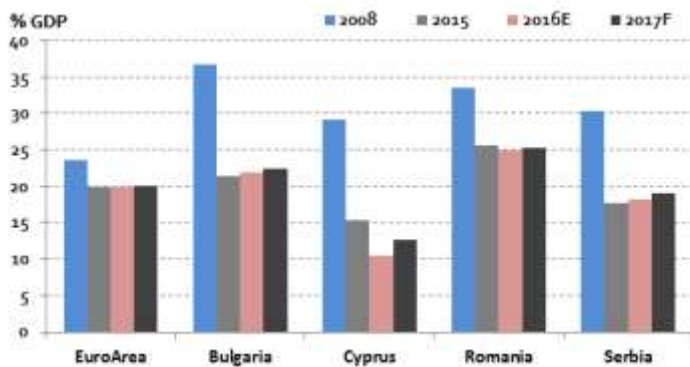
Source: Eurostat, National Authorities, Eurobank Research

FIGURE 2: Annual average inflation 2015-2017



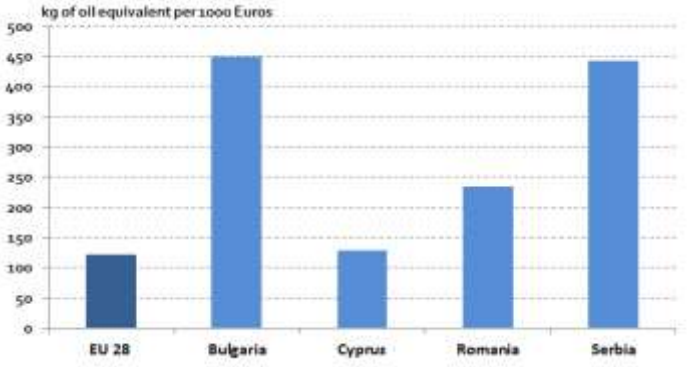
Source: Eurostat, EU Spring Forecasts, Eurobank Research

FIGURE 3: Investments to GDP ratios 2008 vs. 2017



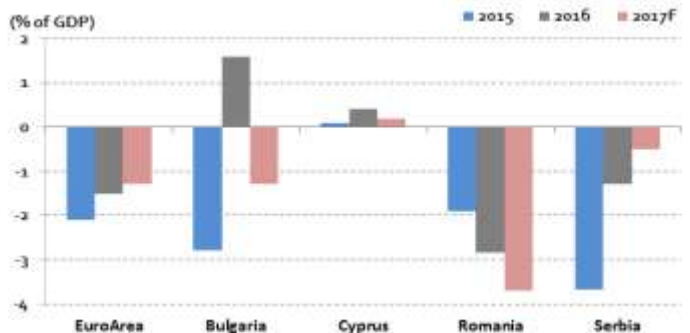
Source: IMF WEO, Eurobank Research

FIGURE 4: Energy intensity of the individual countries, 2014



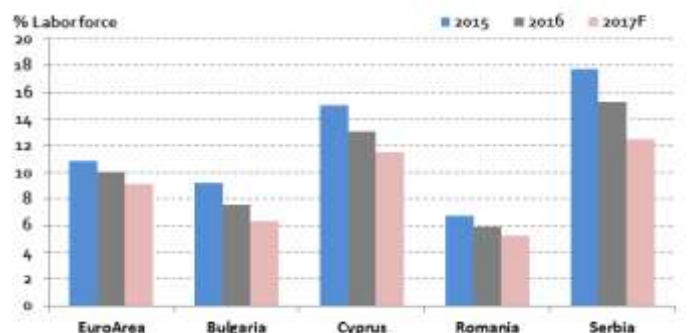
Source: Eurostat, National Authorities, Eurobank Research

FIGURE 5: Fiscal Balance (% of GDP, Cash basis) 2015-2017



Source: Eurostat, National Authorities, Eurobank Research

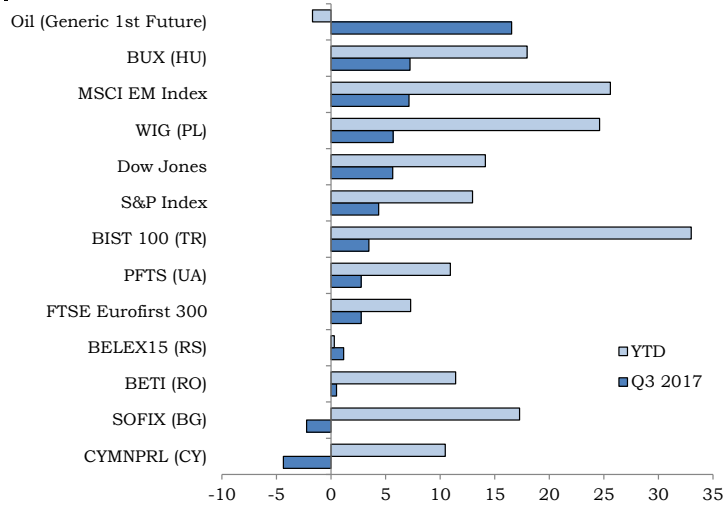
FIGURE 6: Annual average unemployment rates 2015-2017



Source: Eurostat, National Authorities Eurobank Research

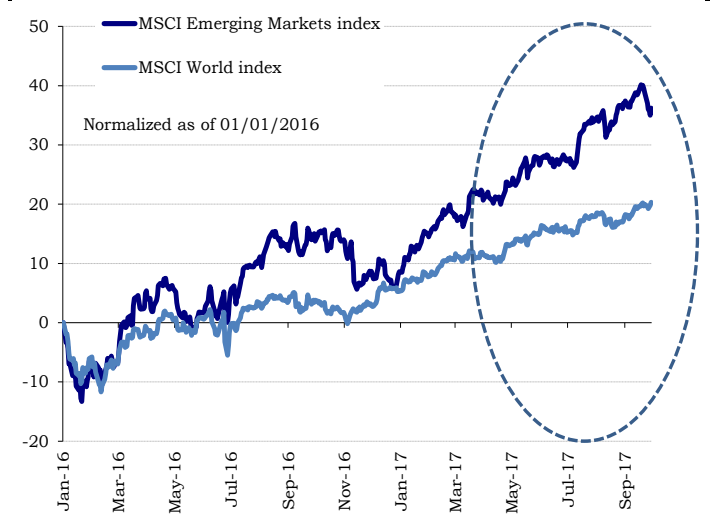
September 2017

FIGURE 7: Major world & CESEE stock markets performance (%)



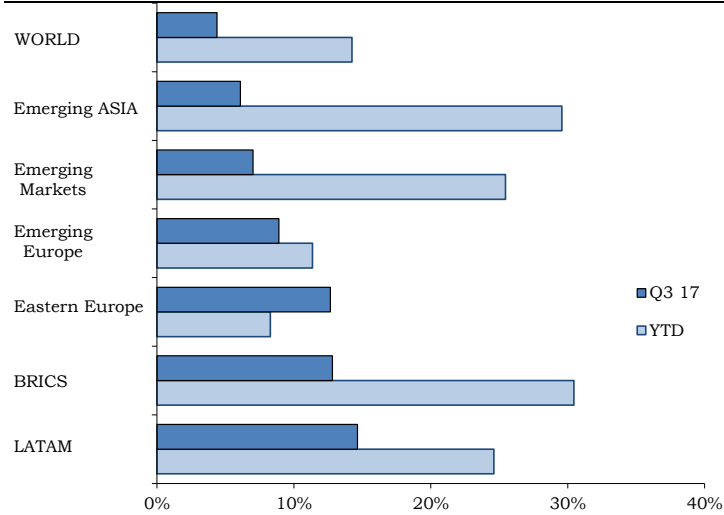
Source: Reuters, Bloomberg, Eurobank Research

FIGURE 8: World & EM stock markets performance



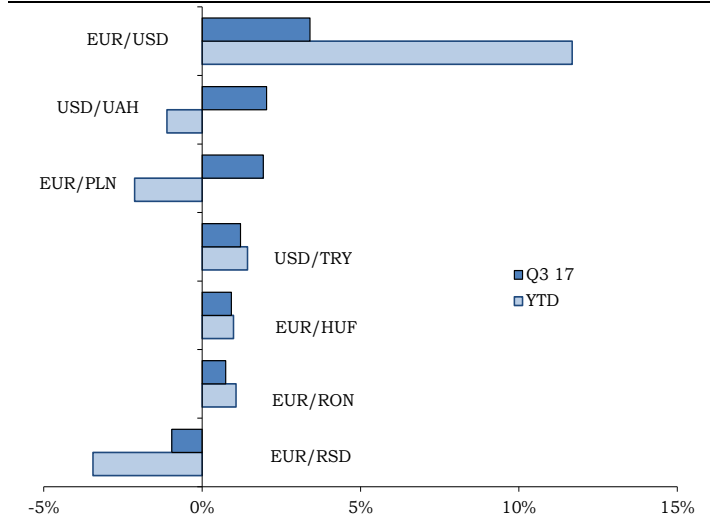
Source: Reuters, Bloomberg, Eurobank Research

FIGURE 9: MSCI stock indices performance (by region)



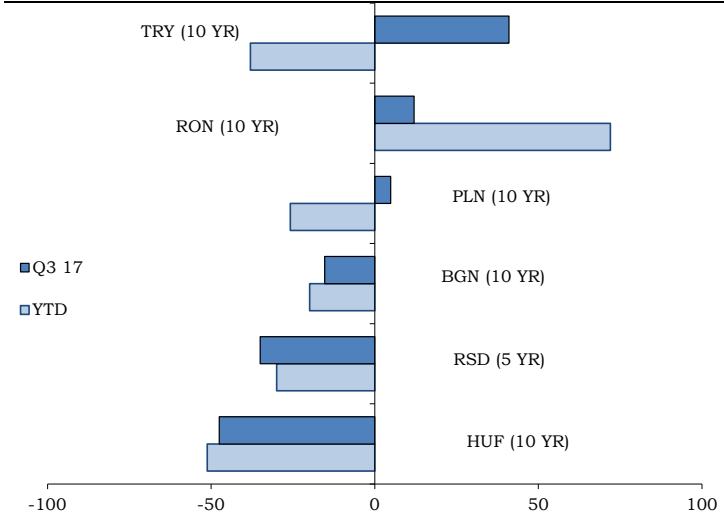
Source: Reuters, Bloomberg, Eurobank Research

FIGURE 10: CESEE FX performance



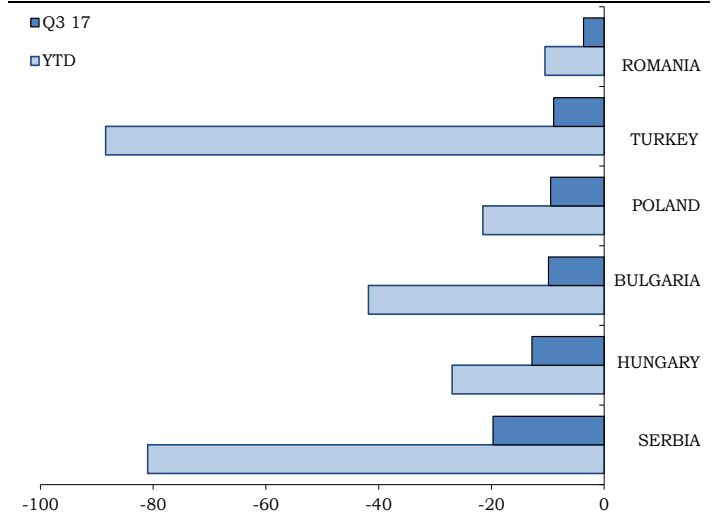
Source: Reuters, Bloomberg, Eurobank Research

FIGURE 11: Change in CESEE government bond yields (in bps)



Source: Reuters, Bloomberg, Eurobank Research

FIGURE 12: Change in 5-Year CDS spreads (in bps)



Source: Reuters, Bloomberg, Eurobank Research

Trader's view


FX

Long EUR/RSD positions appear favorable as the dinar's rally is likely to prove overdone

The dinar staged a truly impressive performance in summer period. The domestic currency has strengthened 1.15% against the euro since June and stands 3.5% firmer on a year-to-date basis, placed among the best performers in the EMEA space. On top of that, the National Bank of Serbia has bought €1.08bn over a period of five months to ease upside pressures and halt the dinar's rapid appreciation. Overall, the main drivers of this trend have been the strong credit expansion in the banking sector (0.9% QtQ rise of loans in corporate) and traditionally weak hard currency demand during summer lull. Remittances from abroad and steady demand for government bonds have also supported the dinar's rally.

However, intensified Central Bank presence near 119.00 recently, indicates that the EUR/RSD is likely to have reached a near-term bottom around that level. Also, demand for hard currency should re-emerge in the coming weeks, while a relatively thin bond auction schedule will keep foreign investors away from FX (in most cases they are funding their bond investment via pure FX position). All these factors argue in favour of a correction in the EUR/RSD pair ahead. Having said that, we prefer closing our earlier EUR/RSD short VS long 3M RSD bond and playing on a long side of FX from this point onward.

Central Bank efforts to halt and reverse the recent upward dinar trend could also materialize through another – though quite unexpected - key monetary policy rate cut. September's MPC decision to lower rate to 3.75%, in time when most of major Central Banks around the globe have already embarked on monetary tightening or are preparing to end QE programmes which could significantly impact FX. For time being, this decision appeared to have negligible impact on the RSD. Furthermore, economic activity slowed down for the second consecutive quarter in Q2 17, with real GDP growth coming in at a modest 1.3%, necessitating a downward revision in the IMF's full-year 2017 projection to 2.3% from 3.0% before. Along these lines, the dinar may eventually give back part of the gains achieved in last 5 months. Our baseline scenario is for the EUR/RSD to move towards 120.00 in 1-month time and inch further higher to 121.0 in 3-months.

Security	Position	Entry	Target level	Stop loss	Period
EUR/RSD	Long 	119.25	120.90	118.70	3-months

Local rates

We prefer to remain on the sidelines on BGN-denominated bonds ahead of the next ECB meeting, while up-side potential seems limited

Yields on the Bulgarian sovereign debt market continued to slide during the summer on the back of positive economic data and state budget surplus. The yield curve continued to bull-flatten, with 10-year sector spreads reaching levels of 65 bps versus benchmark swap rates. This bull run was further supported by the lack of supply on the primary market and abundant liquidity stored into the pension funds. We expect this trend to remain until the end of the year supported by the lack of new issuance on the primary market (up to BGN 300mn until year-end) and the improvement of state finance. That said, we would prefer to remain in the sidelines on the Bulgarian local-currency debt market as the current rally may eventually prove overdone and any potential up-side is likely to prove limited and would only be realizable in the very short term. Importantly, the expected announcement from the ECB governing council on the October 26th monetary policy meeting about the deadline for the current QE program represents a possible change in direction.

External debt markets

We prefer to remain on the sidelines on Bulgarian Eurobonds as credit spreads seem very tight & valuations stretched

Bulgarian Eurobonds followed the developments in the local market with the longest end of the yield curve, Bulgaria 35 being the biggest beneficiary of this price adjustment. At current levels, we deem Bulgarian credit spreads very tight and valuations stretched, hence we prefer to remain on the sidelines and not enter into any new positions.

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We would also like to the Eurobank Trading Team in Athens for its most valuable comments

II. Country Focus

Bulgaria (Baa2/BB+/BBB-)

Credit activity has started accelerating

Growth remained on track in Q2-2017, bringing the 1H-2017 at 3.6%, an inch up from 3.4% in FY2015

Real GDP expanded by +1.0% QoQ/+3.6% YoY in Q2-2017 vs. +0.9% QoQ/+3.5% YoY in Q1-2017 compared to +0.9% QoQ/+3.4% YoY in Q4-2016 and +0.9% QoQ/+3.5% YoY in Q2-2015. Despite the fiscal drag from lower public expenditure and the prevailing political uncertainty ahead of the early parliamentary elections in late April, final consumption expanded by +0.4% QoQ/+4.2% YoY in Q2-2017 vs. +1.9% QoQ/+4.3% YoY in Q1-2017 compared to +1.3% QoQ/+0.8% YoY in Q4-2016 up from +0.4% QoQ/+1.2% YoY in Q2-2016. The solid performance of consumption was driven mainly by sustained labor market improvement coupled with still high real wage growth, albeit the latter is decelerating due to the inflation spike in 1H (7.6% YoY in Q2-2017 vs. 7.4% YoY in Q1-2017 down from 8.5% YoY in Q4-2016). The unemployment rate declined sharply to 6.0% in Q2-2017, the lowest level since Q1-2009, as the economy adds new jobs in the areas of specialized business and IT services. In contrast, investments were in the red on an annual basis for the fifth consecutive quarter in Q2 (GFCF: +2.3% QoQ/-1.0% YoY in Q2 vs. -0.6% QoQ/-4.6% YoY in Q1). The decline mirrors the slow progress in infrastructure spending implementation during the transition period of the caretaker government plus the low EU funds absorption in the two-year period after the closing of the programming period 2007-2013. Finally, net exports had a negative contribution in Q2 (Exports: +6.5% YoY vs. +5.8% YoY in Q1 & Imports: +7.7% vs. +7.1% YoY in Q1) driven by the strong imports rise in response to private consumption dynamics. Overall, Bulgaria is expected to register a second consecutive year of strong-above potential- growth in 2017. Private consumption dynamics are broadly set to remain strong as the economy benefits from a more expansionary fiscal policy stance in the 2H, accelerated EU funds absorption in the coming quarters, an improving labor market, catching up wages, a vibrant export oriented manufacturing sector, an emerging tourism destination and a rebounding real-estate market.

Credit activity has started accelerating in Q3-2017 providing a further impulse to economic activity

Credit to the non-government sector has switched to positive territory since October 2016 and started accelerating in recent months. Credit to the non-government sector improved to 4.6% YoY in August, 4.5% YoY in July, 3.8% YoY in March, up from only 1.5% YoY in 2016, compared to -1.2% YoY in 2015 and -8.2% YoY in 2014. The data of 2014 reflect the dropping of assets of Corporate Commercial Bank (KTB) out of the official statistics in the aftermath of the bank run which eventually resulted in the bankruptcy of the fourth largest bank in terms of assets. Credit to households expanded briskly by 5.7% YoY in August, 5.5% YoY in July, up from 4.7% YoY in March, up from only 2.0% in 2016, compared to -1.3% YoY in 2015 and -1.6% YoY in 2014. Credit to the non-financial corporations increased by 2.8% YoY in August, flat vs. July, 2.5% in March, up from 2.0% in 2016 down from -1.7% YoY in 2015 and -11.6% YoY in 2014. On the other hand, non-government deposits expanded by +7.3% YoY in March, 2016 down from +10.6% YoY in 2015 but still up from +1.5% YoY in 2014. Deposits have fared strongly so far, despite declining interest rates, driven by solid households' savings and robust corporate sector deposits (11.1% YoY in August, 6.5% YoY in 2016, and 18.7% YoY in 2015). Having been subdued or in negative territory for a prolonged period of time, credit activity has embarked on a steadily increasing path providing a boost to economic activity. We anticipate this trend to continue as both demand and supply factors come into play. Financial institutions are now less reluctant to lend, as heavy regulatory requirements posed by the banking system-wide AQR and Stress test are behind, and are still confronted by the negative interest rates on excess reserves, introduced by the BNB in January 2016. The system's total loans-to-deposits ratio stood at 70.7% in July, one of the lowest in the SE Europe region. This, together with the high liquid assets ratio (36.6% in July), illustrates the increased funding capacity and strong liquidity position of the banking system.

Inflation picked up slightly in August after two consecutive months of decline

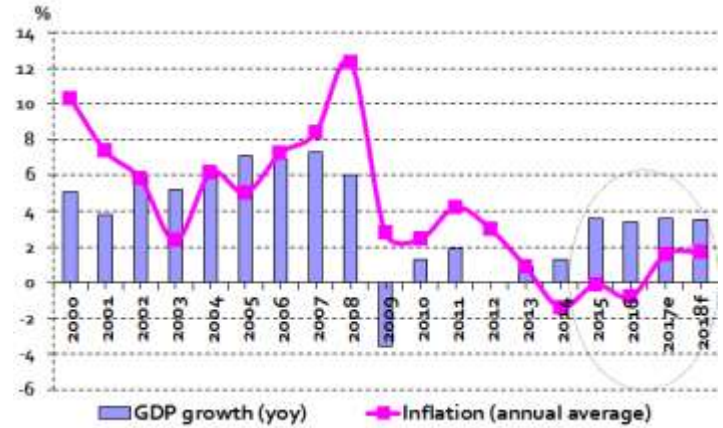
Consumer prices edged up to +0.6% MoM/+1.4% YoY in August, up from 0.3% MoM/1.3% YoY in July compared to only +0.6% MoM/+0.1% YoY in last December. As a result, the average annual inflation has now climbed to 1.1% YoY in 8M-2017, up from -0.8% YoY in 2016 and -0.1% YoY in 2015. Food prices, both the largest as well as the most volatile component of CPI, edged up to +0.0% MoM/+2.7% YoY in August up from -0.1% MoM/+2.5% YoY in July compared to a year to date peak at +0.9% MoM/+5.1% YoY in April. The main driver was the rise in the prices of vegetables and fruits. Driven by higher global energy prices in Q2-2017 and negative base effects, transportation prices climbed as much as +0.7% MoM/+8.3% YoY in April but have recently narrowed down to +1.1% MoM/-0.6% YoY in August vs. -0.5% MoM/-1.3% YoY in July. Looking ahead, even though consumer prices have most probably peaked in April, they are expected to fluctuate around these levels by year-end, reflecting elevated energy prices (Brent oil stood at 57\$/barrel, the highest level in the last 6M) and the adjustment of regulatory prices and excise hikes but also the positive impact from further normalization of volatile food prices. So far, there is little evidence to support that underlying consumption-driven inflationary pressures are building despite its improving dynamics.

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Bulgaria: Macro & Market Data				
	2015	2016	2017e	2018f
Real GDP (yoy%)	3.6	3.4	3.6	3.5
Inflation (yoy%)				
CPI (annual average)	-0.1	-0.8	1.6	1.7
CPI (end of period)	-0.4	0.1	1.5	1.9
Fiscal Accounts (%GDP, Cash basis)				
General Government Balance	-2.8	1.6	-1.3	-1.0
Gross Public Debt	25.7	27.8	24.5	24.1
Primary Balance	-2.4	1.9	-0.8	-0.6
Labor Statistics				
Unemployment Rate (LFS, %)	9.2	7.6	6.3	5.8
Compensation of employees/head	5.6	3.9	4.1	4.5
External Accounts				
Current Account (% GDP)	-0.1	5.4	3.5	3.0
Net FDI (EUR bn)	2.5	0.6	1.1	1.0
FX Reserves (EUR bn)	20.3	23.9	25.0	27.0
Domestic Credit	2013	2014	2015	2016
Total Credit (%GDP)	72.9	67.7	57.1	54.6
Credit to Enterprises (%GDP)	43.9	38.1	34.9	0.2
Credit to Households (%GDP)	21.7	21.0	20.8	2.0
FX Credit/Total Credit (%)	59.8	54.3	49.4	44.0
Private Sector Credit (yoy)	0.2	-8.2	-1.2	1.5
Loans to Deposits (%)	92.1	84.2	78.2	74.1
Financial Markets	Current	3M	6M	12M
Policy Rate		Currency Board		
EUR/BGN	1.96	1.96	1.96	1.96

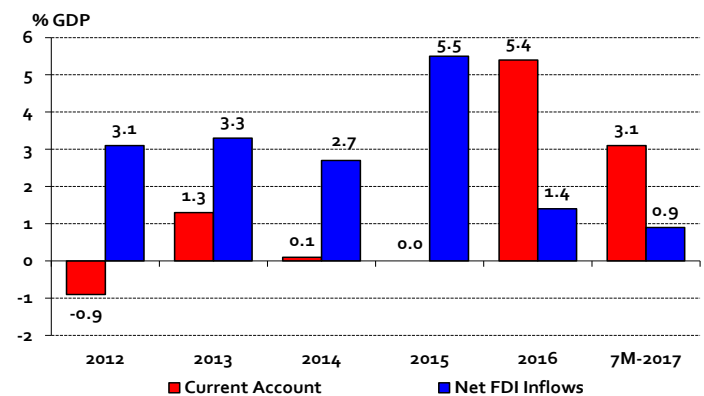
Source: National Sources, Eurostat, IMF, Eurobank Research

FIGURE 13: GDP growth & Inflation 2000-2018



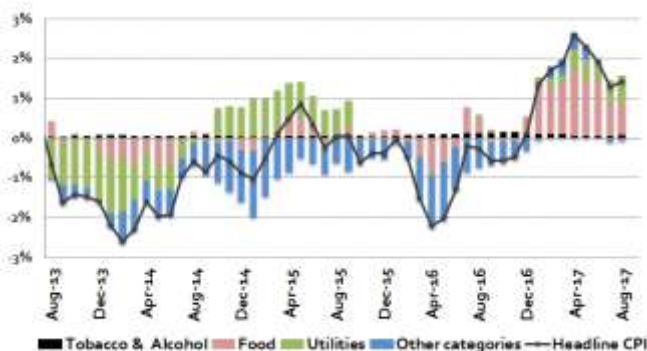
Source: National statistics, Ecwin Reuters, Eurobank Research

FIGURE 14: CA Balance & Net FDI inflows 2012-2017



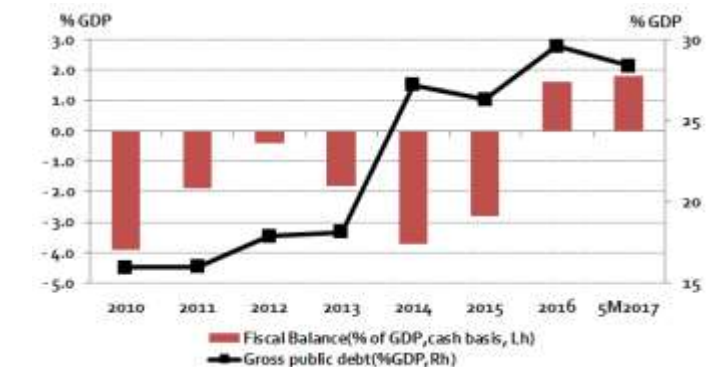
Source: National statistics, Ecwin Reuters, Eurobank Research

FIGURE 15: Inflation dynamics 2013-2017



Source: National statistics, Ecwin Reuters, Eurobank Research

FIGURE 16: Fiscal deficit & Gross Public Debt 2010-2017



Source: Ministry of Finance, Eurobank Research

Cyprus ((P) Ba3/BB+/BB-)

New round of sovereign rating upgrades

The 1H-2017 GDP growth performance at 3.6% YoY confirming that the economy is on a fast growth recovery track

After a three year recession in 2012-2014 and a cumulative drop of 10.5% of GDP, the economy expanded by +1.7% YoY in 2015, accelerated to +2.8% YoY in 2016 and is expected to further gain momentum to over 3% in 2017. Consistent with this projection, the 1H-2017 GDP growth performance stood already at 3.6% YoY. More specifically, the Q2-2017 GDP growth reading was the second strongest -after that of the first quarter- since 2008, amongst the highest in EA-19 and EU-28, and above EA-19 average for seventh consecutive quarter in a row. On a seasonally adjusted basis, growth expanded by 1.0% QoQ/3.5% YoY in Q2-2017 an inch down from 1.0% QoQ/3.7% YoY in Q1-2017 compared to 0.7% QoQ/2.9% YoY in Q4-2016 vs. 1.2% QoQ/2.8% YoY in Q2-2016. From a demand point of view, final consumption expanded strongly by +2.2% QoQ/+4.1% YoY in Q2-2017 up from +0.4% QoQ/+2.2% YoY in Q1-2017 compared to +0.6% QoQ/+2.8% YoY in Q4-2016, vs. +1.7% QoQ/+1.4% YoY in Q2-2016, making a +3.4ppts contribution to growth. As far as other growth components are concerned, lower imports of transportation equipment weighed heavily on the imports side (imports:-12.7% YoY vs. exports:+2.4% YoY), leading net exports' contribution to turn positive but also resulting in lower investment spending, thereby broadly offsetting the positive contribution of the external sector.

The economy's solid performance continued into the Q2-2017 with encouraging signs across most sectors, including the real estate sector

The consumption rebound continued in 1H-2017, driven by strong sentiment improvement, a flourishing tourism sector, improved labor market conditions, further property market stabilization, the impact from fiscal relaxation, and the further normalization of banking sector conditions. The strong sentiment improvement - the highest in EU-28 in the last three years- mirrors the lasting progress within the expired adjustment program. In turn, the Economic Sentiment Index (ESI) now stands very close to the levels prior to the international financial crisis. In addition, tourist arrivals grew by 14.7% YoY in Jan-Aug 2017, with the corresponding levels over that period heading for a new all-time record high in the history of the Republic. Similarly, tourism revenues expanded by 19.9% YoY in 1H-2017. Unemployment in seasonally adjusted terms resumed its downward trend, declining further to 10.8% in July 2017, down from 12.5% in March 2017 vs. 13.0% in July 2016. Finally, the number of real-estate market sale contracts has risen by 20% YoY in 1H-2017 (from 3,610 to 3,012). The reading of 843 in June 2017 only, was a new multi-year monthly high of the last six years. The Residential Property Price Index (RPPPI) recorded its first annual increase in Q1-2017 (+0.3% QoQ/+0.2% YoY) since 2009 (Central Bank of Cyprus).

Even though solid growth performance is expected to continue in 2017-2018, the risk of complacency is material

Even though Cyprus has made progress in a lot of areas, the risk of complacency following the exit from the Economic Adjustment Programme is material. On the domestic front, the reform momentum seems to have stalled ahead of the Presidential elections in 2018. Still, a handful of unfinished structural reforms need to progress in the areas of privatizations, public and health sectors, while addressing the challenges of a still high bad loans stock (NPEs ratio at 47% in Dec2016). Particularly, parliamentary approval of the Bill setting a cap on the public sector wage bill, essentially linking the expenditure expansion with the GDP growth performance, is still pending. As time moves on, it becomes increasingly unlikely the Bill will be voted into law ahead of next year's Presidential elections.

DBRS and Moody's were the last rating agencies to upgrade the sovereign rating of Cyprus in the current round of reviews

Both Moody's and DBRS upgraded the long-term sovereign rating of Cyprus Republic, now placing it three notches away from investment grade. On June 2, DBRS upgraded the rating by two notches (from B to BB low) with a stable outlook (trend). The upgrade reflects Cyprus' strong fiscal results over the past two years and declining imbalances in the private sector. The stable outlook reflects the substantial challenges still ahead despite the economic recovery, namely the high level of non-performing loans and the still high private sector debt. More recently, on July 28, Moody's upgraded the rating of Cyprus by one notch to Ba3 from B1 with a positive outlook. Moody's decision reflects two main drivers: First, improvements in economic resilience that have occurred over the past two years, which seem likely to continue in the medium term. Second, a consistent fiscal outperformance and a continuing favorable fiscal outlook. The decision to maintain a positive outlook reflects Moody's view that improvements in economic resilience and continuing fiscal outperformance are likely to be sustained, together with a reduction in the debt-to-GDP ratio, as well as a fall in the stock of non-performing loans held by the banks. On September 15, in line with expectations, S&P affirmed the long-term sovereign rating of Cyprus at BB+ but at the same time it changed the outlook from stable to positive. According to S&P, the positive outlook reflects that the agency could raise the ratings on Cyprus over the next 12 months if budgetary consolidation continues unabated, and the economy continues to recover toward pre-crisis output levels. It is worthwhile pointing out that S&P was the first rating agency to downgrade Cyprus to junk status in January 2012. As things stand now, the divergence of views between the rating agencies on the sovereign rating of Cyprus, remains. Currently, the distance from investment grade status is: one notch for S&P (currently at BB+, last upgrade in mid-March), three notches for Moody's (currently at Ba3), for Fitch (currently at BB-) and DBRS (currently at BB Low). The next round of reviews by the rating agencies is scheduled for autumn-winter of 2017: Fitch (Oct20, 2017), Moody's (Nov17, 2017), DBRS (Dec1, 2017).

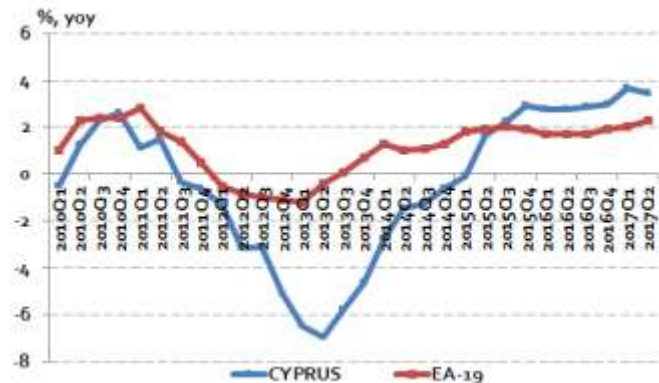
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Cyprus: Macro & Market Data

	2015	2016	2017e	2018f
Real GDP (yoy%)	1.7	2.8	3.5	3.1
Inflation (yoy%)				
HICP (annual average)	-1.5	-1.2	1.0	1.5
HICP (end of period)	-1.4	0.1	1.2	1.3
Fiscal Accounts (%GDP)				
General Government Balance	0.1	0.4	0.2	0.4
Gross Public Debt	107.5	107.8	104.0	99.7
Primary Balance	2.7	3.0	2.6	2.9
Labor Statistics				
Unemployment Rate (LFS, %)	15.0	13.1	11.5	10.0
Compensation of employees/head	-1.1	-0.6	0.7	1.1
External Accounts (% GDP)				
Current Account	-3.0	-5.7	-5.9	-6.3
Trade Balance (Goods)	-18.0	-21.2	-22.2	-22.9
Terms of Trade (of Goods)	3.2	-0.4	0.2	-0.5
Domestic Credit				
Total Credit (%GDP)	2013	2014	2015	2016
Credit to Enterprises (%GDP)	351.4	353.5	360.8	308.3
Credit to Households (%GDP)	160.2	148.1	151.5	125.3
Private Sector Credit (yoy)	140.0	142.7	136.4	127.5
Loans to Deposits (%)	-12.2	-2.3	-3.4	-11.0
	135.3	133.4	136.6	112.6

Source: National Sources, Eurostat, IMF, Eurobank Research

FIGURE 17: Growth performance Cyprus vs. Euroarea 2010-2017



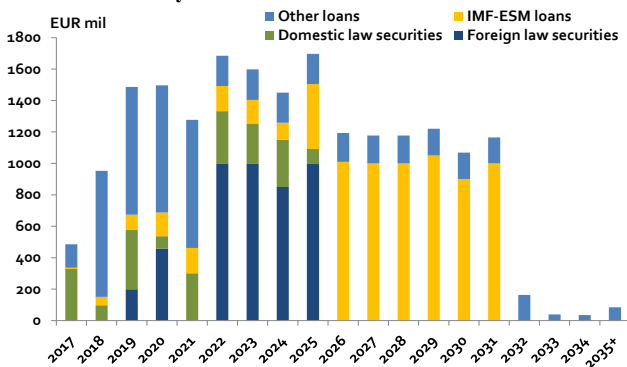
Source: Eurostat, Eurobank Research

FIGURE 18: HICP Cyprus vs. Euroarea 2011-2017



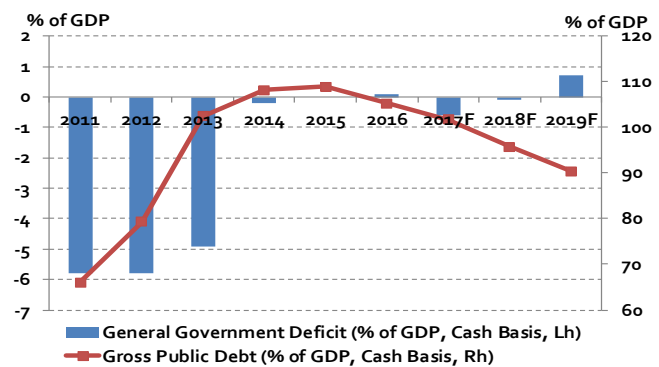
Source: Eurostat, Eurobank Research

FIGURE 19: Maturity Profile of General Government Debt



Source: PDMO, Eurobank Research

FIGURE 20: Fiscal deficit & Gross Public Debt 2011-2019



Source: Ministry of Finance, Eurobank Research

Romania (Baa3/BBB-/BBB-)

Swift end to the looming political crisis

Real GDP dynamics surpassed the most optimistic forecasts in Q2-2017

The revised estimate on the seasonally adjusted Q2-2017 GDP reading confirmed the flash estimate of +1.6% QoQ/+5.7% YoY, +5.9% YoY in unadjusted terms. The stronger than expected print-above analysts' call for +1.2% QoQ/+5.2% YoY- compares to +1.8% QoQ/ +5.7% YoY in Q1-2017 and +1.6% QoQ/+5.0% YoY in Q4-2016, up from +1.1% QoQ/+4.0% YoY in Q4-2015. From a demand point of view, private consumption jumped by +2.6% QoQ/+7.4% YoY in Q2 up from +4.3% QoQ/+7.1% YoY in Q1, driven by higher disposable income as a result of the VAT rate cut and the rapid rise in real wages plus the strong consumer sentiment readings, thus making a hefty contribution of 5.2ppts to growth. Gross fixed capital formation registered the first positive reading (+2.7% QoQ/+1.6% YoY) on an annual basis since Q2-2016. First of all, this is due to the subdued performance of investments in the 1H-2016, mirroring lower EU funds absorption throughout 2016, which has set a low starting base. The strong momentum in residential investment was broadly offset by the underperformance of the public investments program and the still low EU funds absorption. Nevertheless, both gross fixed capital formation and inventories still had a positive contribution of 0.6ppts and +1.3ppts respectively. On the downside, net exports had a negative contribution (-1.4ppts) mirroring the quarterly increase of imports (+2.1% QoQ/+9.3% YoY), which exceeded that of exports (+0.6% QoQ/+6.5% YoY). This was broadly expected as domestic demand recovery is accompanied by a recovery of imports. Overall, real GDP expanded by 5.9% YoY in 1H-2017 compared to 4.8% in 2016, outperforming regional peers for a fourth consecutive year and surpassing the most optimistic forecasts. Growth is largely driven by private consumption, financed by an overly expansionary fiscal policy, and leads to a revival of macroeconomic imbalances. Hence, the economy is driven close to, if not above, its potential growth rate at the expense of pushing government finances off consolidation track and deteriorating the external position (CAD17e: -3% of GDP).

Output outperformance is not enough to soothe concerns on the fiscal side

Overall, the consolidated government deficit in cash terms has reached RON6.5bn or 0.8% of the revised projected GDP in 8M-2017, double than the deficit of 0.4% of GDP registered in 8M-2016. Revenues' performance improved in August (+8.8% YoY), driven by improved VAT collection (+19.3% YoY in August), even though VAT revenues are usually not performing well during a summer month. On the other hand, total expenditures' expansion has reached double digit growth (+11.0% YoY). Spending in the areas of wages and social benefits is still on the rise (+21.4% YoY and +11.3% YoY respectively) as budget implementation incorporated the ruling coalition's electoral program for further generous hikes. Other key spending items, such as procurement for goods& services (+4.1% YoY), capital expenditure (-18.7% YoY) and debt servicing (-5.9% YoY) remained either relatively contained or declined respectively. The government has revised the budget in order to bring the revenues and expenditures figures closer to reality, maintained the fiscal deficit target of 3% unchanged, but also adopted compensatory measures-in line with our expectations- in order to maintain fiscal performance in check. Thus, the government increased excise taxes for fuels as of September (that will bring prices back to the levels of 2016) and also facilitated the distribution of additional dividends from the state-owned enterprises. Nevertheless, we still doubt if those will be enough to attain the target given the public expenses dynamics. If this proves to be the case, practice has shown that this usually results in the under execution of the public investments program (4.2% of GDP in 2017) at the expense of neglecting infrastructure.

Underlying inflationary pressures are building up despite the temporary slowdown of headline inflation in the summer

Inflation edged down to -0.2% MoM/+1.2% YoY in August, down from +0.3% MoM/+1.4% YoY in July, below market consensus expectations (0.0% MoM/+1.45% YoY). The decline was primarily due to the monthly decline in the volatile food component as a result of the increased supply from the summer harvest. As a result, food prices declined on a monthly basis by -0.9% MoM/+1.6% YoY, down from -0.4% MoM/+2.4% YoY in July driven by lower vegetables (-7.7% MoM) and fruit prices (-9.2% MoM). Meanwhile, non-food prices were up by +0.1% MoM/+1.6% YoY, compared to +0.9% MoM/+1.7% YoY in July, adding 0.6 ppts to the annual figure, reflecting the pass through of higher oil prices worldwide. On top, services' prices increased on a monthly basis by +0.2% MoM/-0.5% YoY in July vs. +0.1% MoM/-0.8% YoY driven by higher prices for urban transportation, rents and sewage services. Overall, underlying inflationary pressures are building up. The adjusted Core CPI (excluding administered and volatile prices, alcohol and tobacco) has already reached 1.6% YoY in July, the highest level since August 2013, up from 1.1% YoY in March and only 0.3% YoY in last December. The PPI (Producer Price Index) remained elevated at 3% YoY in July vs. only 0.9% YoY in last December, driven by higher energy and intermediary goods' prices. The regulated price increase for energy as of July and the prospective increase of excise duty for fuel in September are going to push the headline even higher at 1.9% (according to the revised NBR forecast) by year end. In any case, given the projected inflation trajectory and the elevated fiscal risks, it is highly likely that NBR will initiate the tightening cycle in Q4, most probably by increasing the interest rate corridor instead of the KPR, currently at 1.75%.

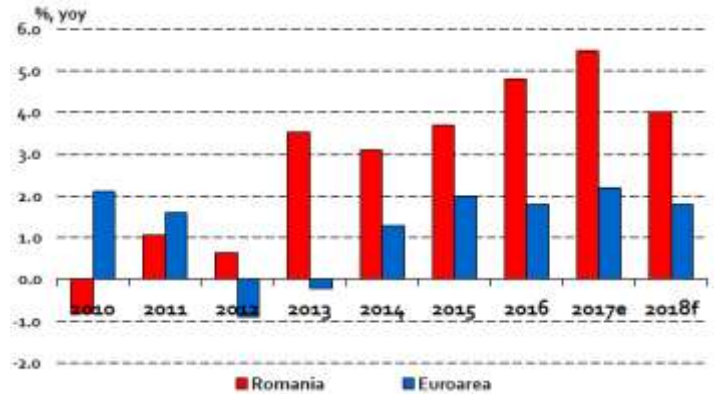
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Romania: Macro & Market Data				
	2015	2016	2017e	2018f
Real GDP (yoy%)	3.7	4.8	5.5	4.0
Inflation (yoy%)				
CPI (annual average)	-0.6	-1.6	1.4	3.1
CPI (end of period)	-0.9	-0.5	1.8	3.0
Fiscal Accounts (%GDP, Cash Basis)				
General Government Balance	-1.9	-2.4	-3.7	-3.8
Gross Public Debt (including guarantees)	39.4	39.1	40.5	41.7
Labor Statistics (annual avg, %)				
Unemployment Rate (ILO, % of labor force)	6.8	5.9	5.3	5.2
Compensation of employees/head	0.9	10.3	9.5	6.5
External Accounts				
Current Account (%GDP, BPM5)	-1.1	-2.2	-3.0	-2.8
Net FDI (EUR bn)	2.7	3.9	4.0	Na
FDI / Current Account (%)	157.1	93.8	72.7	Na
FX Reserves (EUR bn)	32.2	34.3	35.5	Na
Domestic Credit	2013	2014	2015	2016
Total Credit (%GDP)	47.0	44.4	43.9	41.2
Credit to Enterprises (%GDP)	18.0	15.7	15.5	13.4
Credit to Households (%GDP)	16.5	15.4	15.4	14.9
FX Credit/Total Credit (% private)	60.9	56.2	49.3	42.8
Private Sector Credit (yoy)	-3.3	-3.1	3.0	1.2
Loans to Deposits (%)	118.4	106.3	106.6	114.3
Financial Markets	Current	3M	6M	12M
Policy Rate	1.75	1.75	2.00	2.50
EUR/RON	4.58	4.62	4.65	4.65

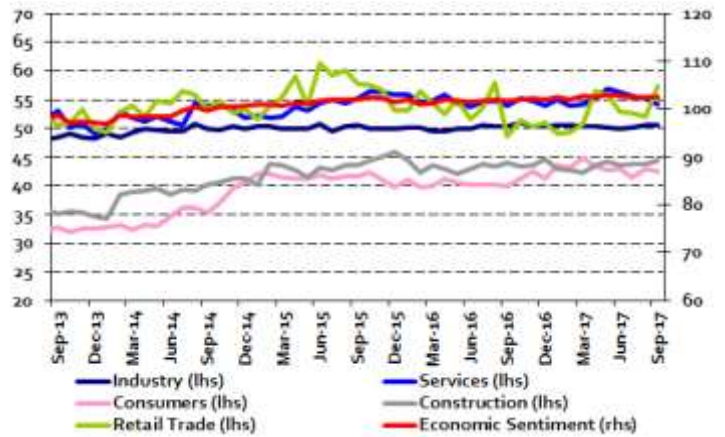
Source: National Authorities, EC, IMF, Eurobank Research

FIGURE 21: Growth performance Romania vs. EU28 2010-2018



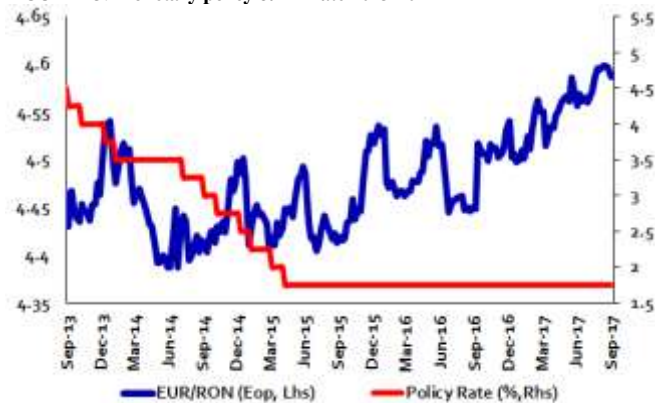
Source: Eurostat, Eurobank Research

FIGURE 22: Sentiment indicators 2013-2017



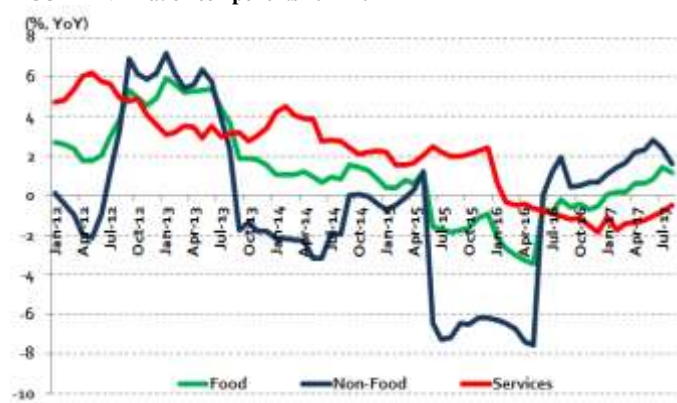
Source: Eurostat, Ecowin Reuters, Eurobank Research

FIGURE 23: Monetary policy & FX rate 2013-2017



Source: Bloomberg, Eurobank Research

FIGURE 24: Inflation components 2012-2017



Source: National statistics, Eurobank Research

Serbia (Ba3/BB-/BB-)

One-off factors in H1 2017 prompt downward revisions in full-year growth forecasts

Economic activity slows down in H1 2017 on adverse weather conditions

Final Q2 national accounts data confirmed that real GDP growth came in at 1.3% YoY, in line with the preliminary estimate. Albeit having slightly picked up pace from 1.0% YoY in Q1, the data indicates that economic activity in H1 2017 slowed down to 1.2% YoY from 2.9% YoY over the same period a year earlier and 2.6% in H2 2016. Adverse weather conditions in the first half of the year appear to have taken a significant toll on economic activity. From the production side, very cold temperatures in the winter weighed on agriculture, construction, mining and energy. Subsequently, the summer drought decimated crops and resulted in a 10.0% YoY decline in Q2 in agricultural activity that followed an 8.0% YoY plunge in Q1. The CESEE region reportedly endured one of the hottest and driest summers in years, with Serbia being amongst the countries hit the most. From the expenditure side, household consumption has gained momentum in H1 2017, while growth in investments and government expenditure slowed down. Strong imports dynamics (11.7% YoY in Q117 & 10.3% YoY in Q217), reflecting strengthening domestic demand and higher energy imports, counterbalanced the positive impact from robust exports' growth (9.7% YoY in Q117 & 11.5% YoY in Q2). High frequency indicators signal that the manufacturing – despite disruptions in energy output – and trade sectors continued to perform well in Q3. Industrial production rose by 5.6% YoY on average in July and August following average growth of 1.9% YoY in H1 2017. Retail sales rose by 4.3% YoY over these two months after a 3.6% YoY average advance in January-June 2017. Labour market conditions also remain firm, with net wages rising by an average of 4.1% YoY in July and August vs. 4.4% YoY over the first six months of the year. The unemployment rate fell to 11.8% in Q2, the lowest since 2014 when new methodology was introduced, while employment continued to improve. Nonetheless, the negative impact from the summer drought on agricultural output, electricity disruptions and a month-long strike in Fiat Chrysler Automobiles Serbia (FCAS), which ended in late July, are likely to continue having a negative impact in Q3 and suggest that the earlier official 3.0% real GDP growth forecast for the whole of the year is now out of reach. This was also acknowledged by PM Ana Brnabic, who expressed hopes for growth of 2.5% and announced government plans to adopt short-term measures. This unplanned expenditure is allowed by the ongoing fiscal consolidation and budget outperformance and is estimated to provide an additional impulse of 0.2-0.3% to GDP. The revised government growth forecast still remains rather optimistic in our view, due to the limited amount of time left in the remainder of the year. Also, the rather unrealistic assumption of growth of near 4% is required in each of the remaining two quarters in order to achieve full-year 2.5% figure. Even the IMF's 2.3% recently revised projection seems rather optimistic. Yet, we maintain our 3.0% forecast for 2018, as growth is likely to continue being supported by improving aggregate demand and recovering energy production, while this year's headwinds seem to mostly stem from one-off factors.

Central Bank resumes rate cutting cycle on weaker growth, stronger dinar

The recent slowdown in economic activity in tandem with a firmer dinar provided leeway to the National Bank of Serbia to resume cutting interest rates in September after more than a year of inertia. Confounding our and market expectations for stable rates, the Central Bank cut the key policy rate by 25bps to a new lifetime low of 3.75%. It had kept interest rates stable since July 2016, when it had last rendered a 25bps cut. Behind this latest decision, the MPC cited low inflation pressures arguing that the cut will provide an additional boost to credit and economic activity. Albeit, the less aggressive than earlier anticipated Fed monetary tightening and continuous accommodative ECB stance were probably also taken into account, the dinar's persistent appreciation over recent months is likely to have been among the most important factors in the latest MPC decision. The currency has appreciated by approximately 5% against the euro from lows hit in April and reached 3-year highs near 118/€ in September. The high level of Euroization in the economy impedes the monetary policy transmission mechanism, with the impact stemming from dinar fluctuations thus being augmented. The Central Bank has repeatedly intervened in the FX markets in order to halt the domestic currency's appreciation trend. So far this year, it has purchased more than €1bn in order to mitigate excessive daily FX fluctuations and effectively ease monetary tightening pressures as a result of a firmer dinar. Also supporting the case for September's cut, price pressures appear to be gradually easing of late. Headline CPI has moved within the target tolerance band of 3.0%±1.5 pps since October 2016 and reached a 4-year high at 4.0% YoY in April. However, the index pulled back towards 2.5% in August. Meanwhile, core inflation pressures remain relatively subdued, with CPI excluding food, energy, alcohol and cigarettes having slid to 1.5% YoY in August, while inflation expectations remain well anchored within the tolerance band. The Central Bank highlighted these developments in September's meeting, reiterating that it expects inflation to remain within the target tolerance band in the period ahead and further slowdown as of early 2018 on the back of favorable base effects. Yet, it acknowledged that the conduct of monetary policy requires caution amid ongoing uncertainty regarding movements in the international commodity prices and financial markets and cited risks surrounding the impact of diverging monetary policies pursued by major central banks on capital flows to emerging economies. The next MPC meeting is scheduled to take place on October 9. Given the deceleration in inflation, further monetary easing cannot be ruled out in the coming months. If so, it is likely to prove modest, as private consumption is on a recovery mode and external risks linger.

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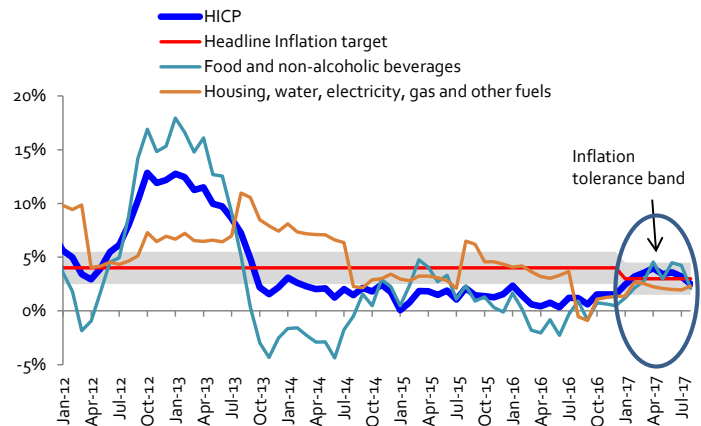
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Serbia: Eurobank Forecasts

	2015	2016	2017	2018
Real GDP (yoy%)	0.8	2.8	2.0	3.0
Inflation (yoy%)				
HICP (annual average)	1.4	1.1	3.0	3.0
HICP (end of period)	1.5	1.6	2.3	3.0
Fiscal Accounts (%GDP)				
Consolidated Government Deficit	-3.7	-1.3	-0.5	-0.6
Gross Public Debt	74.6	73.6	69.0	67.0
Labor Statistics (%)				
Unemployment Rate (%of labor force)	17.7	15.3	12.5	11.0
Wage Growth (total economy)	-2.1	2.5	0.9	1.5
External Accounts				
Current Account (% GDP)	-4.7	-4.0	-4.0	-3.9
Net FDI (EUR bn)	1.8	1.9	1.7	1.6
FDI / Current Account (%)	114.9	137.5	120.0	110.3
FX Reserves (EUR bn)	10.4	10.2	10.0	10.1
Domestic Credit	2013	2014	2015	2016
Total Credit (%GDP)	57.0	61.0	62.3	63.6
Credit to Enterprises (%GDP)	28.7	29.2	28.7	26.8
Credit to Households (%GDP)	17.4	18.6	18.7	19.9
Private Sector Credit (yoy%)	-4.8	0.5	3.3	5.6
Loans to Deposits (%)	113.8	102.5	99.0	92.0
Financial Markets	Current	3M	6M	12M
Policy Rate	3.75	3.50	3.50	4.00
EUR/RSD	119.10	120.00	121.50	122.00

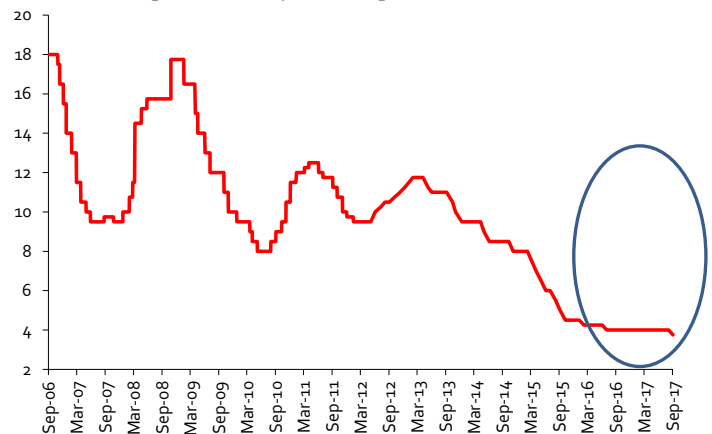
Source: National Authorities, EC, IMF, Eurobank Research

FIGURE 25: ... and, among other, relatively subdued inflation pressures...



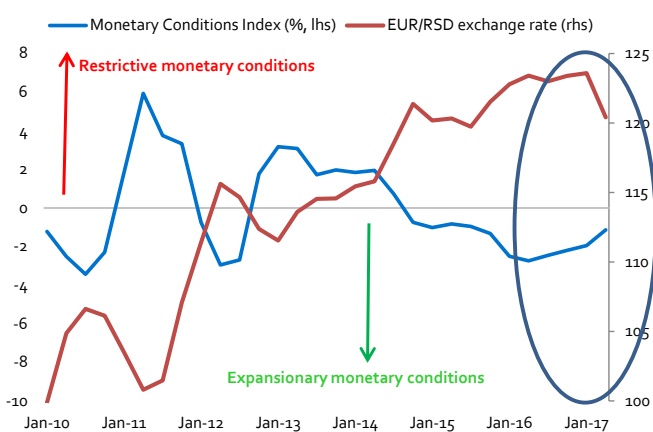
Source: National Authorities, EC, IMF, Eurobank Research

FIGURE 26: ... provided leeway for resumption of Central Bank rate cuts



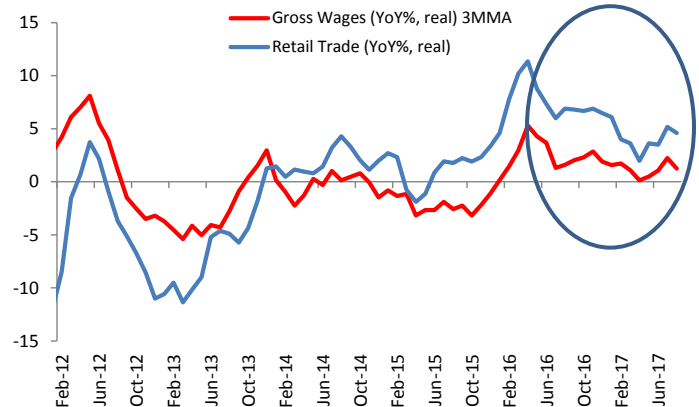
Source: National Authorities, Eurobank Research

FIGURE 27: Monetary tightening pressures instigated by firmer dinar...



Source: National Authorities, EC, IMF, Eurobank Research

FIGURE 28: Trade sector continued to perform well in Q3, while labour market conditions remain firm



Source: National Authorities, EC, IMF, Eurobank Research

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