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The authors wish to thank Dr. Tasos Anastasatos, Deputy Chief Economist, for his insightful comments

A more challenging year for the region in 2017

REGIONAL MACROECONOMIC DEVELOPMENTS & OUTLOOK

- **Q3-2016 second GDP estimates** confirm that the economies of the region are on track to meet their FY projections
- **Private consumption in the driver's seat** on improved sentiment, rising real wages, firmer labor markets and low inflation
- A more **challenging** macro outlook in **2017** for the region: **Limited room** for further monetary and fiscal stimulus

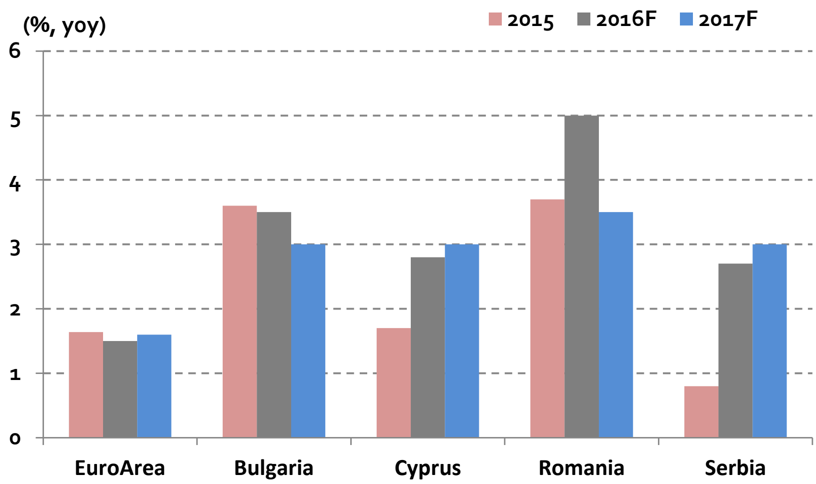
REGIONAL MARKET DEVELOPMENTS & OUTLOOK

- **European politics, Fed & ECB policies** to set the tone for regional financial markets in **2017**
- **Regional assets recover ground** after reaction to US election outcome/Italian referendum proves short-lived
- **Market volatility to rise** early next year

COUNTRY FOCUS

- **Bulgaria:** Growth speed to be maintained in 2017
- **Cyprus:** Sustained growth momentum in 2017
- **Romania:** A soft landing ahead in 2017
- **Serbia:** Economic recovery to pick up further pace in 2017

Regional growth dynamics to remain strong in 2017



Source: National Authorities, European Commission, Eurobank Research

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I. Regional Macroeconomic Developments & Outlook

A more challenging outlook for the economies of the region in 2017

Second estimates of GDP growth in Q3 and high-frequency indicators so far in Q4 across the region confirm that the economies are on track to meet their FY16 projections

A number of national statistics offices across the region released earlier this week second estimates of GDP growth for Q3-2016. Among them, the economies of our focus, Bulgaria, Romania, Cyprus, and Serbia earlier, have published estimates that confirmed that the economies are in relatively good shape and fully on track to meet, if not overshoot, their respective full year projections. The robust performance of agriculture and tourism made an additional positive difference in Q3 readings. As things stand at this moment, it would be fair to say that 2016 is braced to prove another very good year for the region, most probably the best since 2008. On average, consumer sentiment, services and retail trade are on an improving trend as consumers continue to benefit from rising real wages, firmer labor markets and low inflation. Thus, private consumption has taken over as the principal driver behind growth, while investments are constrained by lower EU funds absorption. Finally, the performance of net exports has been mixed. In most cases, the private consumption acceleration has been accompanied by a concomitant imports recovery, trimming the contribution of net exports.

The macroeconomic outlook of the region looks more challenging from a policy point of view in 2017.

On the one hand, we are concerned that the regional economies are about to or have already reached their cyclical peak. We have pointed out many times in our writings that the acceleration in regional GDP growth, at least in part, reflects lax monetary policies from both major and regional central banks plus the impact of lower energy prices on household-corporate and sovereign balance sheets. Given that energy prices are already on a normalization course and that interest rates in the region are already at historic lows, while a hike is looming on behalf of the US Fed, the room for further monetary easing is limited. At the same time, room for further fiscal policy relaxation varies across the region and is contingent upon pre-crisis legacies and idiosyncratic factors. In the economies of our focus, fiscal space is relatively limited as governments are either committed themselves to lower fiscal deficits (Bulgaria, Serbia) or have already stretched their budgets' capacity (Romania). On the other hand, there are still a number of international and pan-European developments that will have a carry-over effect throughout 2017 and will most probably reflect on the region's outlook as well: Brexit, Trump Presidency, a heavy elections calendar in core-European countries and the evolving refugee crisis to name a few.

In Cyprus growth is expected to accelerate to around 3% in 2017 driven by the ongoing private consumption rebound

At a country level, **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 low energy prices, an improving labor market, rising real wages, a vibrant export-oriented manufacturing sector and an emerging tourism destination. Although the economy has proved relatively resilient to multiple past internal and external shocks, there is a high degree of uncertainty how it could react to a prolonged period of domestic political uncertainty. In **Cyprus**, the strong sentiment improvement mirroring the lasting progress within the program, the flourishing tourist sector and the envisaged fiscal relaxation have set the foundations for growth to accelerate to around 3% in 2017-2018, up from a projected 2.8% in 2016 and only 1.7% in 2015. In that direction, the European Commission confirmed the fiscal targets of 2017 in the Draft Budgetary Plan, yet warned Cypriot authorities of deviations from the desirable structural fiscal target. Moreover, the risk of complacency is looming as the reform momentum seems to have stalled ahead of the Presidential elections in 2018.

A soft landing scenario is the most likely outcome for Romania in 2017

In **Romania**, a soft landing scenario is the most likely outcome in 2017. The incoming government, after the parliamentary elections scheduled for December 11th, will most probably need to adopt a more conservative stance in order to bring the projected fiscal deficit below 3% (assuming no policy change the deficit is expected to surpass 3.7% of GDP in 2017), which will have a material decelerating impact on the economy next year. Growth is largely driven by private consumption, financed by an overly expansionary fiscal policy, and leads to a revival of macroeconomic imbalances. In **Serbia**, we anticipate growth to accelerate further to 3% in 2017. There is a substantial unrealized upside potential in the economy provided that the momentum is sustained in reforms improving the business environment, prudent budget execution and thorough restructuring of state-owned enterprises. In contrast to its regional peers, growth is driven by net exports and investments (mainly FDI inflows). As a result, the investment ratio has now reversed its declining trend, which makes us optimistic on the medium-term growth prospects of the economy.

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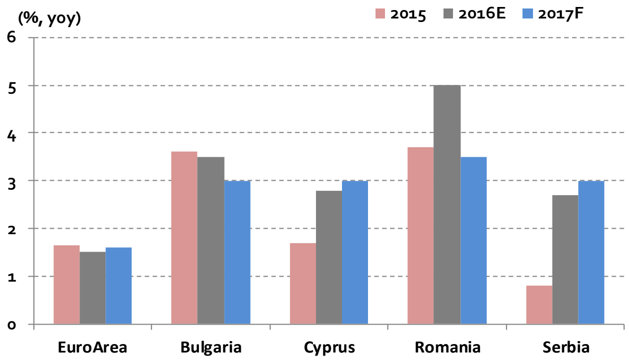
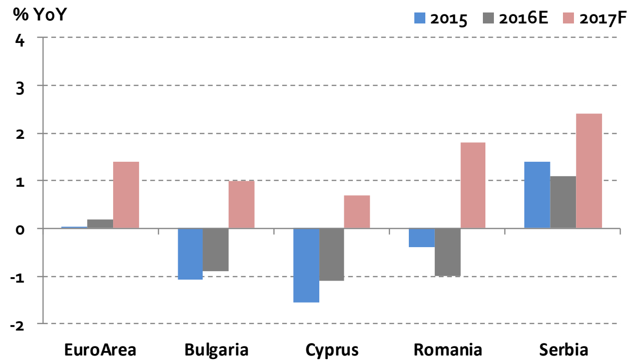
FIGURE 1: **GDP Growth performance 2015-2017**



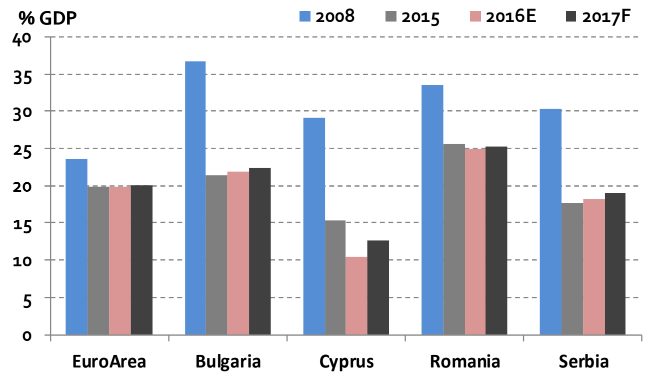
Source: Eurostat, National Authorities, Eurobank Research

FIGURE 2: **Annual average HICP inflation 2015- 2017**



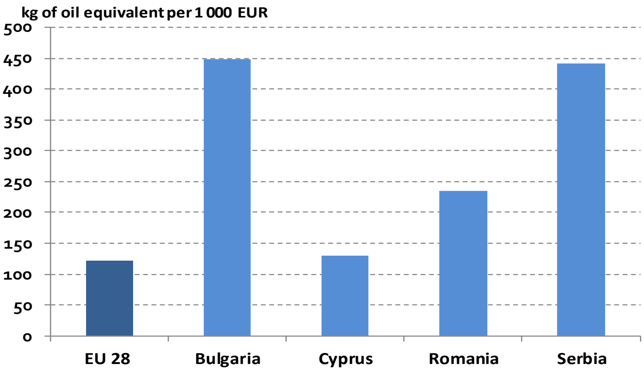
Source: Eurostat, EU Spring Forecasts, Eurobank Research

FIGURE 3: **Investments to GDP ratios 2008 vs. 2014**



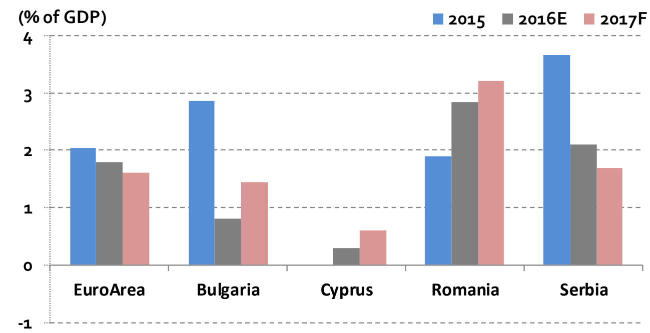
Source: IMF WEO, Eurobank Research

FIGURE 4: **Energy intensity of the individual countries, 2014**



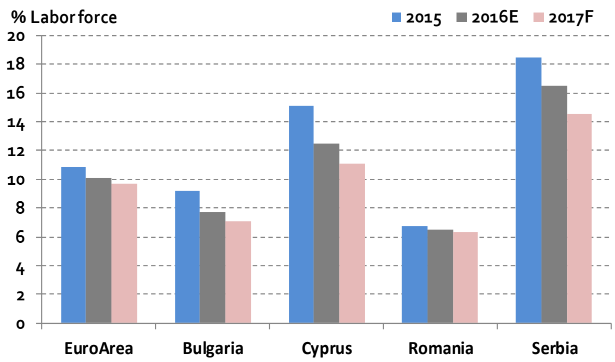
Source: Eurostat, National Authorities, Eurobank Research

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



Source: Eurostat, National Authorities, Eurobank Research

FIGURE 6: **Annual average unemployment rates 2014-2016**



Source: Eurostat, National Authorities Eurobank Research

II. Regional Market Developments & Outlook

European politics, Fed & ECB policies to set the tone for regional financial markets in 2017

Emerging market assets recover ground after reaction to US election outcome/Italian referendum proves short-lived

Pressures on emerging market assets following two key recent risk events, such as the US presidential election on November 8 and the Italian referendum on December 4, eventually proved rather short lived. Despite the initial jitters amid worries over US president-elect Trump's policies and increased political uncertainty in Italy after the rejection of the constitutional amendments plebiscite that led to the ensuing resignation of PM Matteo Renzi, EM markets recovered ground after last month's sell off. This up-move has been further assisted by December's ECB decision to expand its QE programme for 9 more months though to December 2017, although at lower volumes. It also marks a partial reversal of losses suffered since late October on the prevailing view about a more aggressive than expected Fed rate-tightening path ahead, which created upward pressures on UST yields and the USD and weighed on developing countries' assets by denting their higher yield allure. This shift in market consensus over the Fed's future monetary policy deliberations has been largely the result of the US Presidential elections outcome, as president-elect Donald Trump's expansionary fiscal plans are anticipated to boost growth and inflationary pressures. Adding to the latter component, the recent OPEC and non OPEC countries agreement, for a curb on oil production, is anticipated to push oil prices even higher and consequently exacerbate inflationary pressures globally.

Despite the recent increase in market volatility most EM assets are poised to end the year in the black

Putting aside the recent increase in market volatility, it is worth noting that the majority of EM assets are poised to end the year in the black on what proved to be a less aggressive monetary policy tightening path by the Fed, than originally feared. Ongoing monetary policy stimulus by other major Central Banks, thanks to a low inflation environment globally, further boosted EM assets. Idiosyncratic factors have remained at play. Such is the case of Turkey where domestic assets, particularly the lira, have been hit hard by persisting domestic political and macroeconomic worries. The government's pursuit of a constitutional overhaul that includes plans for a presidential system has stirred skepticism over power concentration. A string of bombings over recent months, which has increased security concerns domestically, and geopolitical tensions with neighboring countries have weighed on sentiment and are hurting tourism, one of the economy's main income pillars. Confirming that the domestic economic activity is poised for a slowdown this year, real GDP contracted by 1.8%YoY in Q3, marking the first annual decline in 7 years. The recent spike in oil prices following the OPEC agreement is likely to translate into higher external vulnerabilities and augment inflation pressures as Turkey is a net oil importer. Political pressure for monetary easing to support the slowing economy has raised concerns about undermining the Central Bank's independence.

Emerging stock markets firmed over recent weeks, with European bourses outperforming

Emerging stock markets have broadly firmed over recent weeks, with the MSCI Emerging Market index having reached a 1-month high in early December. Reflecting a good 2016 performance, the index stands ca. 10% higher year-to-date, while in September it reached a 1-year peak. Emerging European markets have staged an even better performance on comparably better macroeconomic fundamentals and relatively limited links to the US compared to their Asian and LATAM peers. In this context, countries of our focus, such as Serbia and Bulgaria, pose amongst the most notable outperformers year to date, but also since the recent sell off. Likewise, the MSCI Emerging Europe sub-index has rallied more than 10% since the mid-November accumulating YTD gains north of 30%. Russia, which has the highest weight on the index, has led the uptrend, as the country's MICEX index reached record highs in December on the back of recovering oil prices, improving economic growth prospects, optimism about the revocation of sanctions imposed in the context of the Ukraine crisis and M&A action. News that Exxon Mobil president and chief executive Rex Tillerson, considered to have personal ties with President Vladimir Putin, has been nominated to be the next US Secretary of the State, also boosted Russian assets. In a similar tone, the Hungarian BUX index hit record highs in December and is expected to end the year with another solid performance (+30%YTD) after last year's 44% rally. The index's rise follows a streak of sovereign credit rating upgrades earlier in the year amid improving macroeconomic fundamentals, fiscal position and growth outlook as well as narrowing external imbalances. Elsewhere, regional currencies are expected to finish the year little changed as ultra-accommodative central bank policies put a lid on any meaningful recovery. On the other hand, hefty monetary policy easing has provided support to regional local currency government bonds this year, though some profit taking has emerged since mid-November in tandem with the recent rise in UST yields.

CESEE currencies remain under pressure on monetary policy accommodation, government bonds weaken on higher UST yields

Market volatility to rise early next year

Market volatility is likely to rise early next year on uncertainty over the implementation of Trump's fiscal loosening policies and a cramped political events calendar in Europe. The Netherlands hold general elections (March), presidential elections are scheduled in France (April-May) and federal elections are due in Germany (Sept-Oct.). On a regional level, the political agenda includes likely snap general elections in Bulgaria (spring) and presidential elections in Serbia (April). ECB and Fed monetary policies will also set the tone for regional markets, with December's FOMC upward revision in the 2017 rate forecasts signaling the Committee's expectations for a more aggressive tightening path ahead. However, investors' hunt for yield and improved fundamentals compared to the 2013 taper tantrum will likely assist EM assets to withstand well any new bouts of risk aversion, with large scale selloffs likely to offer attractive entry levels.

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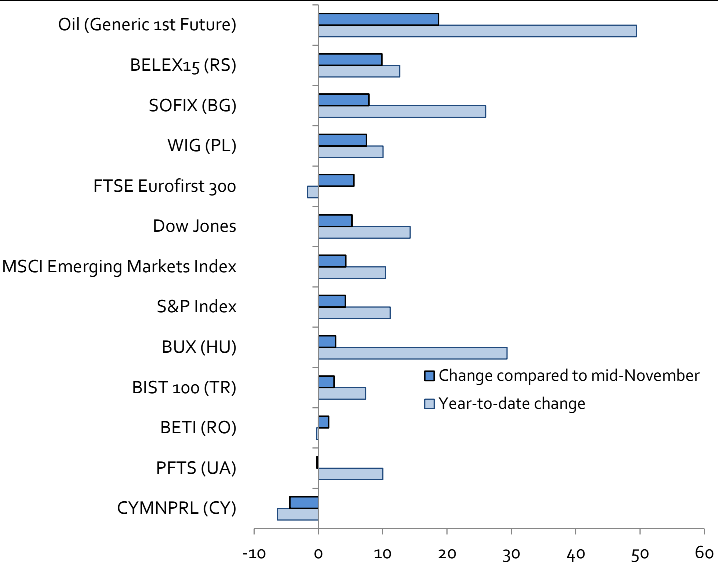
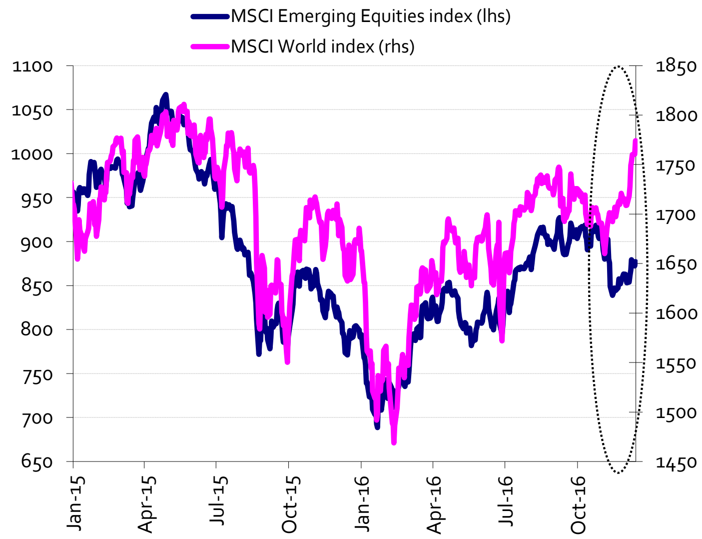
FIGURE 7: **Major world & CESEE stock markets performance (%)**



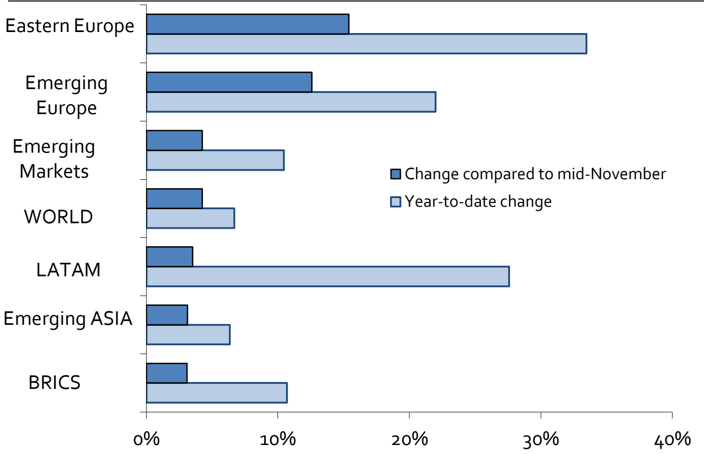
Source: Reuters, Bloomberg, Eurobank Research

FIGURE 8: **World & EM stock markets performance**



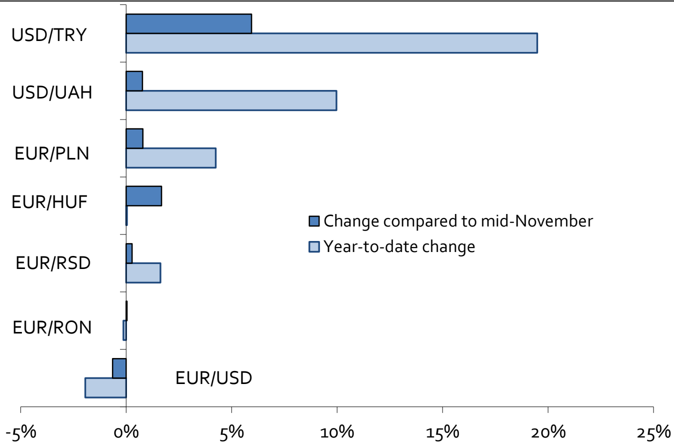
Source: Reuters, Bloomberg, Eurobank Research

FIGURE 9: **MSCI stock indices performance (by region)**



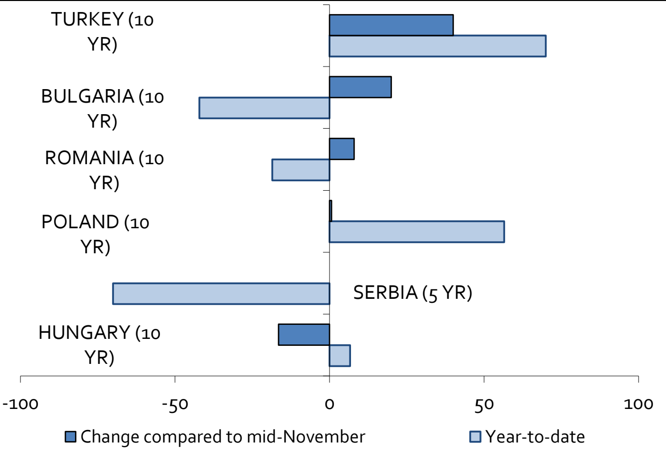
Source: Reuters, Bloomberg, Eurobank Research

FIGURE 10: **CESEE FX performance**



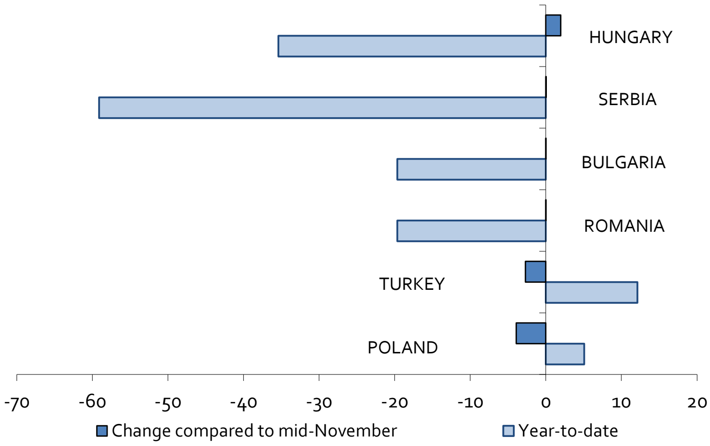
Source: Reuters, Bloomberg, Eurobank Research

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

Prefer to wait to build a stronger conviction of economic improvement before establishing new trade positions on the dinar

FX

The dinar appeared to be rather unfazed by the recent sell-off in EM. The reasons behind this rather robust performance are several. First, the domestic macroeconomic outlook remains particularly favorable. The general government deficit for 2016 is anticipated to come in at 2.1% of GDP vs. nearly 4.0% projected initially. The rate of unemployment rate has fallen to 13.8% (Q3 2016), from the 17.7% (Q4 2015). The current account deficit is projected to hit an all-time low close to 4% of GDP, having steadily declined since 2014 (6.1% of GDP). Exports far outpace imports; for the 10M period exports rose 10.1% while imports were only 5.1% higher on a year-on year basis. The export/import ratio is now at 77.8%, vs 74.3% a year ago. All this favorable data supports investors' sentiment towards the country's assets, hence having managed to keep the impact of the recent selloff on dinar limited. Secondly, interventions in the FX markets by the National Bank of Serbia appear to have also been behind the dinar's stable performance over recent weeks. Taking into account recent such action, a move significantly north of the EUR/RSD's current levels seems rather unlikely. Finally, along with good macro prints comes supportive bank credit activity which, in most cases, disburses loans in RSD but has EUR index clause. In this context, proprietary trading in EUR/RSD has been rough in 2016 as currency keeps floating within an extremely narrow range. This inclines us to take more pragmatic approach and consider building long term (carry trade oriented) RSD positions. Nonetheless, we would prefer to wait to build a stronger conviction that the improvement in macroeconomic developments continues before establishing new trade positions. The forthcoming presidential elections in May is a looming risk that may off-set our strategy.

Prefer to stay sidelined from local Bulgarian bonds

Local rates

Following a sharp deterioration in global risk sentiment in early November, the Bulgarian sovereign market managed to recover some ground over the last few weeks. The previous rise in yields was reversed by half to 15-30 bps in the mid-sector (4-8 years) as the domestic interbank market was buoyed by extra liquidity. The first weeks of December have proved rather quiet with no significant adjustments ahead of Christmas holidays. We don't expect Ministry of Finance to announce any last minute placement, leaving 2016 with 3 auctions in 3 and 10-year papers for a total of BNG 500mn held earlier in the year. Recall that, the MinFin anticipates a surplus of 3.9% of GDP at end-November. All in all, we would currently prefer to stay away from the local bonds as we find them rich compared to the BG Eurobonds. We think that prices will gradually adjust soon, and yields will match levels of the respective Eurobond tenors.

We continue to favour the 2023 Bulgarian Eurobond, but prefer to stay on the sidelines awaiting cheaper entry positions

External debt markets

Bulgarian Eurobonds came under pressure in November on domestic political uncertainty compounded with rising global yields. Foreign sellers, mainly, drove Bulgarian yields up in November, between 30 and 50 bps with curve steepening in the long-end. We expect volatility to persist in the short-term, but without anticipating sharp movements through to year-end. We continue to favour the 2023 Eurobond, but prefer to stay on the sidelines awaiting cheaper entry positions. Recall that, our previous recommendation of the said paper hit the recommended target of 1.0% in October with significant gains.

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We would also like to thank Costas Katsileros for his most valuable comments on the Regional Market Developments & Outlook

III. Country Focus

Bulgaria (Baa2/BB+/BBB-)

Growth speed to be maintained in 2017

General elections likely in spring next year

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The head of the Bulgarian Socialist Party (BSP), Korneliya Ninova, rejected earlier in December the option of forming a government after the leader of the ruling centre-right party Citizens for European Development of Bulgaria (GERB) and Prime Minister Boyko Borisov handed in his government's resignation in Parliament in the wake of the November Presidential elections that saw the defeat of his party's candidate. The BSP is currently the second largest party in parliament. Acting President Rosen Plevneliev may now hand the mandate to form a new government to one of the minor parliamentary groups, most possibly the Reformist bloc. If the latter also fails to form a government, in what currently appears to be the most likely outcome, the President will have to appoint a caretaker government until president-elect Rumen Radev takes office, as according to the Bulgarian Constitution the incumbent President is not allowed to dissolve the National Assembly during the last three months of his tenure. However, given that Rumen Radev will assume his responsibilities on January 22nd, it would be most sensible for the outgoing GERB-led government to remain in place, rather than to appoint a new administration that its mandate will expire in only a month's time. Along these lines, snap general elections, probably in spring, is the most likely scenario. If realized it will take place two years ahead of schedule and mark the country's return to national polls for the third time in four years.

Fitch assessed that the resignation of the Bulgarian government and the prospect of early elections early next year increase fiscal uncertainty for 2017.

Fitch assessed that the resignation of the Bulgarian government and the prospect of early elections early next year increase fiscal uncertainty for 2017. In addition, although parliamentary support for the draft suggests that the scope for dramatic fiscal loosening is limited, recent experience shows that over-expenditure is a risk to fiscal projections. Early elections were also held in 2014 and 2013 after coalition or minority governments became untenable. A pattern of unstable governments is a weakness for Bulgaria's BBB-/Stable sovereign rating, which Fitch affirmed in June. So far, the discretionary measures prescribed in the budget of next year are consistent with a fiscal deficit of 1% of GDP (in ESA 2010 terms) under the assumption that GDP growth in 2017 will fulfill the budget forecast of 2.5%. On the other hand, the budget execution so far has created that the fiscal target in 2016 will be overachieved. The consolidated budget surplus had reached +3.8% of GDP in Jan-Oct2016, compared to a +0.1% surplus in the same period a year ago.

Strong growth momentum was sustained in Q3-2016

According to the second estimate, real GDP expanded by +0.7% QoQ/+3.4% YoY in Q3 marginally down from +0.9% QoQ/+3.6% YoY in Q2-2016 compared to +0.8% QoQ/+3.4% YoY in Q1-2016. As usual, the revised estimate of the national accounts data published at a later stage was subject to huge revisions and reallocations within the individual growth drivers' components. Final consumption slowed down to +0.5% QoQ/ +0.2% YoY in Q3-2016 down from 0.5% QoQ/+1.2% YoY in Q2-2016 compared to -1.5% QoQ/+1.3% YoY in Q1-2016. On top, investments were in red for a second consecutive quarter in Q3 (GFCF: -0.9% QoQ/-1.8% YoY in Q3 down from -1.4% QoQ/-0.1% YoY in Q2). To some extent, the decline mirrors the negative base effects as a result of the increased EU funds absorption in the past year ahead of the closing of the programming period 2007-2013, as well as the fact that public investment spending is traditionally skewed to the last quarter of the year. Finally, net exports seem to recover further after a poor reading in Q1 (Exports: +9.5% YoY& Imports: +7.5% in Q3) - and will most probably put an additional positive boost to growth in FY16 as well. Overall, GDP growth now stands at 3.5% in 9M after the hefty revisions in the national accounts data and this is also broadly expected to be the FY16 reading. Bulgaria is expected to register a second consecutive year of strong-close to above potential-growth in 2017. Private consumption dynamics are broadly set to remain strong as the economy benefits from low energy prices, an improving labor market, catching up wages, a vibrant export oriented manufacturing sector and an emerging tourism destination.

Consumer prices remained flat on a monthly basis at +0.2% MoM/-0.6% YoY in October as food prices remained unchanged

Inflation remained flat at +0.2% MoM/-0.6% YoY in October vs. -0.5% MoM/-0.6% YoY in September, down from 0% MoM/-0.3% YoY in August. Food prices, both the largest as well as the most volatile component of CPI, remained virtually unchanged on an annual basis at -0.3% MoM/-0.3% YoY in October compared to 0.0% MoM /-0.3% YoY in September, down from -0.2% MoM/+1.2% YoY in August because lower prices for fruits and vegetables were broadly offset by the sharp rise of confectionery and coffee. World energy prices, despite their recent spike, are still lower on an annual basis, thereby driving transportation prices lower by-0.5% MoM/-2.8% YoY in October up from -0.3% MoM/-3.7% YoY in September vs. +0.5% MoM/-7.9% YoY in August. Looking ahead, inflation is expected to continue its gradual recovery in the coming months reflecting the dissipating impact of weak global energy prices. There is little evidence to support that underlying consumption-driven inflationary pressures are building despite its improving dynamics. Finally, inflation dynamics are also going to receive some support from the recent regulatory prices' adjustment in the water supply and the forthcoming one in the state energy sector.

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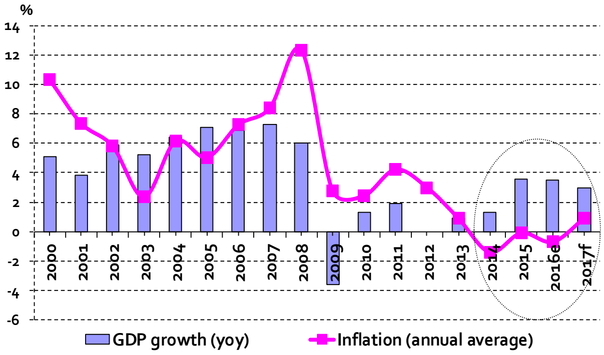
Bulgaria: Macro & Market Data				
	2014	**2015**	**2016f**	**2017f**
Real GDP (yoy%)	1.3	3.6	3.5	3.0
Inflation (yoy%)				
CPI (annual average)	-1.4	-0.1	-0.7	0.6
CPI (end of period)	-0.9	-0.4	-0.3	1.0
Fiscal Accounts (%GDP)				
General Government Balance	-3.7	-2.9	-0.8	-1.4
Gross Public Debt	27.7	26.7	29.7	26.3
Primary Balance	-3.0	-2.1	0.0	-0.2
Labor Statistics				
Unemployment Rate (LFS, %)	11.4	9.2	7.7	7.1
Wage Growth *(total economy)*	6.0	8.8	8.1	7.4
External Accounts				
Current Account (% GDP)	0.1	0.4	3.0	1.5
Net FDI (EUR bn)	1.3	1.6	2.0	1.5
FDI / Current Account (%)	Na	Na	Na	Na
FX Reserves (EUR bn)	16.5	20.3	21.0	22.5
Domestic Credit	**2012**	**2013**	**2014**	**2015**
Total Credit (%GDP)	72.3	72.9	67.7	57.1
Credit to Enterprises (%GDP)	44.1	43.9	38.1	34.9
Credit to Households (%GDP)	21.8	21.7	21.0	20.8
FX Credit/Total Credit (%)	63.1	59.8	54.3	50.6
Private Sector Credit (yoy)	3.0	0.2	-8.2	-1.2
Loans to Deposits (%)	99.4	92.1	84.2	78.2
Financial Markets	**Current**	**3M**	**6M**	**12M**
Policy Rate		Currency Board		
EUR/BGN	1.96	1.96	1.96	1.96

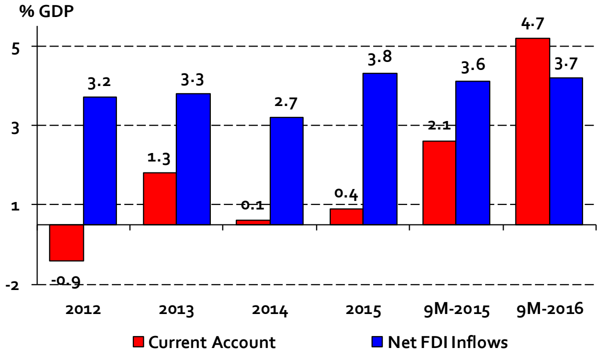
Source: National Sources, Eurostat, IMF, Eurobank Research

FIGURE 13: **GDP growth & Inflation 2000-2016**



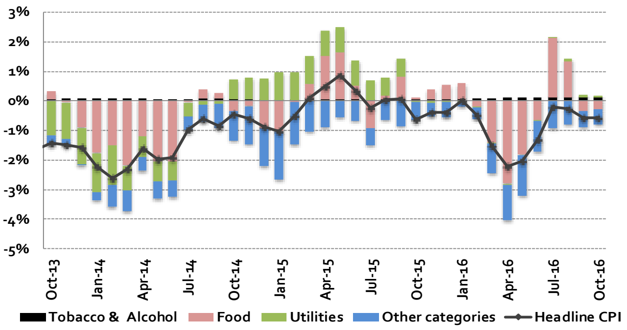
Source: National statistics, Ecowin Reuters, Eurobank Research

FIGURE 14: **CA Deficit & Net FDI inflows 2010-2016**



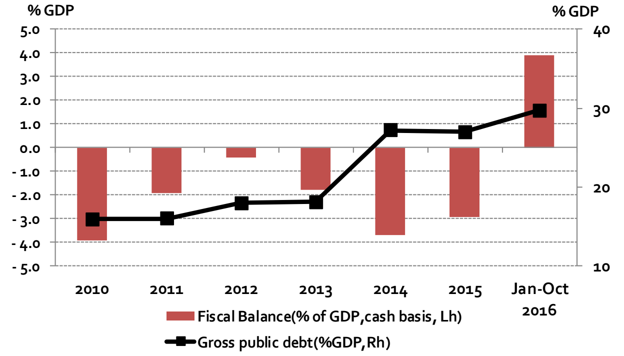
Source: National statistics, Ecowin Reuters, Eurobank Research

FIGURE 15: **Inflation dynamics 2013-2016**



Source: National statistics, Ecowin Reuters, Eurobank Research

FIGURE 16: **Fiscal deficit & Gross Public Debt 2010-2016**



Source: Eurostat, Eurobank Research

Cyprus ((P)B1/BB/BB-)

Sustained growth momentum in 2017

The economy's solid performance continued into the third quarter of the year

According to the flash estimate, GDP expanded by +2.9%/+2.8% YoY on a non-seasonally adjusted and seasonally adjusted basis respectively in Q3-2016. Real GDP growth marked the 7th consecutive positive reading on a both quarterly and annual basis after a three-year recession, confirming the economy is finally out of the woods. On a seasonally adjusted basis, growth accelerated to +0.7% QoQ/+2.8% YoY in Q3-2016 vs. +0.8% QoQ/+2.6% YoY in Q2-2016. The GDP growth rate of Q3 is among the highest in EA-19 and EU-28, both on a quarterly and an annual basis. Although the demand components of growth have not yet been released, it is highly likely that the consumption rebound continued into Q3-2016. The consumption rebound is driven by a strong sentiment improvement, mirroring the lasting progress within the economic adjustment program, a flourishing tourism sector (+18.8% YoY in tourist arrivals in 9M-2016), lower energy prices on an annual basis, lower unemployment (12.0% in September, having shown the highest decline in Euro area in the past twelve months), agents' expectations of further fiscal relaxation and a rise in real incomes. After a three-year recession during 2012-2014 and a cumulative drop of 10.5% of GDP, the economy expanded by +1.7% YoY in 2015 and is projected at +2.8% YoY in 2016.

In their most recent forecast updates, both the IMF and the EU Commission upgraded their projections of 2016 GDP growth, but point to a subsequent slight deceleration in 2017

According to EU Commission autumn forecasts, GDP growth is expected to ease in the next two years from its current reading. The report envisages GDP growth at 2.8% in 2016, 2.5% in 2017 and 2.3% in 2018, up from 1.7% in 2017 and 2.0% in 2018 in the spring forecasts. According to the most recent WEO Outlook of October, full year GDP growth is now projected at 2.8%, up from 1.6% in the April publication. GDP growth is expected to ease to 2.2% in 2017 and inch up to 2.3% in 2018. Given their past track record within the expired economic adjustment program, both organizations have tended to underestimate consistently GDP growth. In our view, both organizations underestimate the robust dynamics of the Cypriot economy, the lasting impact of the structural adjustment that was achieved and the magnitude of the prospective fiscal relaxation envisaged in 2017-2018. Ceteris paribus, we anticipate GDP growth to average 3% in 2017-2018. Risks to our forecast do exist. The downside risks stem from a resurfacing of core Euro Area political and sovereign crisis, given the heavy political calendar of next year, a more pronounced Euro Area - the main trade partner of Cyprus - growth slowdown or a more protracted and deeper recession in Russia - the second most important trading partner of Cyprus and a source of high-end tourism, the potential impact from Brexit and, finally, reform fatigue ahead of the forthcoming Presidential elections in 2018.

The European Commission confirmed the fiscal targets of 2017 in the Draft Budgetary Plan, yet warned Cypriot authorities of deviations from the desirable structural fiscal target

The draft budgetary plan (DBP) of next year-approved by the Council of Ministers on October 17th – confirmed the revision of the fiscal targets in 2017-2019. This is the first DBP after the graduation of Cyprus from its economic adjustment program in March 2016. The budgetary plan targets a headline deficit of €105.7mn, which translates into a deficit of -0.6% of forecasted GDP in 2017. This is a slightly higher deficit than the projected deficit of €52.5mn or -0.3% of projected GDP in 2016. Subsequently, the headline deficit is forecasted to decline to -0.1% of GDP in 2018 and turn into a surplus of +0.7% of GDP in 2019. A primary surplus of 2.8% GDP in 2015 goes down to a projected surplus of 2.2% in 2016, 2.0% in 2017, and then recovers to 2.5% in 2018 and even increases to 3.4% in 2019. Public debt, among the highest in EU-28 is declining as a percent of GDP and reaches the level of 96% in 2019 –compared to 90% in the Strategic Framework for Fiscal Policy of May2016- down from its peak of 108.9% in 2015. According to the latest Commission assessment, Cyprus's structural fiscal effort in 2017 will be -1.4% of GDP, whereas Cyprus is required to remain at the MTO of a structural balance of 0.0% of GDP.

The envisaged fiscal relaxation is going to provide a further boost to economic activity in 2017-2018 at the expense of reducing faster the high public debt ratio

The target for total revenues expansion has been set at +1.8% YoY in 2017, less than the projected nominal GDP growth. The budget framework foresees the abolishment of the special contribution levied on wages of the private and public sector, the abolishment of the immovable property tax, an anticipated drop in the dividends related revenues and the expected gradual decrease in VAT proceeds as a result of the amendments made in the legislative framework on the European level. On the other hand, total government expenditure is expected to rise by 2.5% YoY in 2017 driven by the lifting of the wage freeze in the public sector, the hiring of extra personnel in the areas of defense and security and an increase in the welfare benefits as a result of pension rises in the Social Insurance Fund in line with actuarial calculations. As a result, total expenditures are expected to reach 38.7% of forecasted GDP in 2017, down from a projected realization of 39.0% of GDP in 2016. Overall, Cyprus has performed an impressive fiscal adjustment in 2013-2014, which outperformed initial targets. A general government primary surplus of 2.6% of GDP in cash terms was already achieved in 2014, two years ahead of schedule vs. a primary deficit of -1.8% in 2013 and -2.9% in 2012. Accordingly, the general government deficit declined on a cash basis from -5.8% of GDP in 2012 and -4.9% of GDP in 2013 to only -0.2% of GDP in 2014, and to a balanced position in 2015 (not including the co-operatives bank recap).

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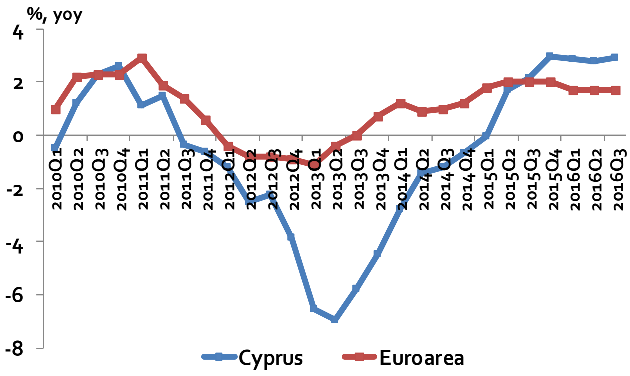
Cyprus: Macro & Market Data

	2014	2015	2016f	2017f
Real GDP (yoy%)	-2.5	1.7	2.8	3.0
Inflation (yoy%)				
HICP (annual average)	-0.3	-1.5	-1.1	0.5
HICP (end of period)	-1.0	-1.4	-0.6	0.8
Fiscal Accounts (%GDP)				
General Government Balance	-0.2	0.0	-0.3	-0.6
Gross Public Debt	108.2	108.9	105.6	101.7
Primary Balance	2.7	1.8	2.2	2.0
Labor Statistics				
Unemployment Rate (LFS, %)	16.1	15.1	12.5	11.1
Compensation per employee (%)	-3.5	-1.0	1.2	1.5
External Accounts (% GDP)				
Current Account	-4.4	-3.0	-2.8	-3.3
Trade Balance (Goods)	-16.0	-18.0	-19.7	-21.2
Terms of Trade (of Goods)	7.1	3.2	2.0	-0.3
Domestic Credit	**2012**	**2013**	**2014**	**2015**
Total Credit (%GDP)	371.6	351.4	353.5	360.8
Credit to Enterprises (%GDP)	170.2	160.2	148.1	151.5
Credit to Households (%GDP)	138.2	140.0	142.7	136.4
Private Sector Credit (yoy)	6.2%	-12.2%	-2.3%	-3.4%
Loans to Deposits (%)	103.3%	135.3%	133.4%	136.6%

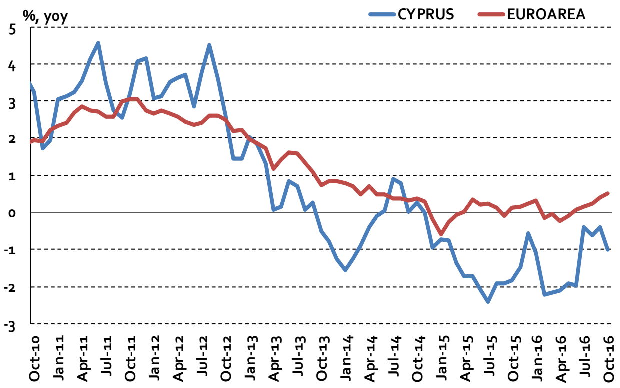
Source: National Sources, Eurostat, IMF, Eurobank Research

FIGURE 17: **Growth performance Cyprus vs. Euroarea 2010-2016**



Source: Eurostat, Eurobank Research

FIGURE 18: **HICP Cyprus vs. Euroarea 2010-2016**

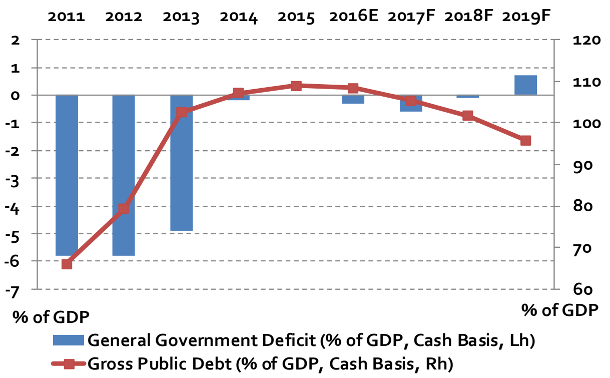


Source: Eurostat, Eurobank Research

FIGURE 19: **10Y Government Bond Yield (Initial Maturity)**

Source: Bloomberg, Eurobank Research

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



Source: Ministry of Finance, Eurobank Research

Romania (Baa3/BBB-/BBB-)

Soft landing ahead in 2017

The PSD-led government, the clear winner of the parliamentary elections held in December 11, will need to adopt a more conservative fiscal stance in the near future.

The Social Democratic Party (PSD) won the parliamentary elections on December 11th by a wide margin from its major opponent the National Liberal Party (PNL). PSD collected nearly 46% of the vote in both houses of parliament against approximately 20% for the PNL. Other parties that will represented in the next parliament include the Save Romania Union (USR), a newly formed party that accomplished to secure 8.6%, the Democratic Alliance of Hungarians in Romania (UDMR) with 6.2%, the ALDE (5.6%) and the People's Movement Party (PM) with 5.2%. An alliance between PSD-ALDE is almost a done deal as PSD fell little short of collecting absolute majority in the parliament seats. What remains to be seen is the person designated by the new alliance for the post of PM, as President Iohannis has vowed to appoint a nominee with no criminal record in line with the law requirement and both party leaders don't qualify for the PM post from that point of view.

A soft landing scenario for Romania is most likely in 2017

So far, growth dynamics were driven by a private consumption spending boom, fuelled by the unwarranted pro-cyclical fiscal stimulus ahead of the parliamentary elections scheduled for late 2016. 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. The current account deficit jumped to 1.6% of GDP in 9M2016 vs. 0.7% of GDP in 9M2015. All in, GDP growth came at 4.8% in the first three quarters of the year, little below our FY16 projection of 5%. Growth is expected to slow down to 3.5% next year. The incoming government, after the parliamentary elections scheduled for, will most probably need to adopt a more conservative stance in order to bring the projected fiscal deficit below 3% (assuming no policy change the deficit is expected to surpass 3.2% of GDP in 2017-18), which will have a material decelerating impact on the economy. Undoubtedly, the incoming government will need to back down on some of its generous pre-election pledges in order for Romania to avoid the EDP procedure.

The second estimate of the Statistical Service on the seasonally adjusted Q3-2016 GDP reading confirmed the output slowdown implied by the flash estimate release back in September.

According to the release of the Statistical Service, real GDP on an unadjusted basis slowed to +4.4% YoY in Q3-2016, down from +6.0% YoY in Q2-2016 vs +3.6% in Q3-2015. On a seasonally adjusted basis, growth slowed to +0.6% QoQ/ +4.6% YoY in Q3-2016, below analysts' call for +1.0% QoQ/+5.0% YoY, down from +1.5% QoQ/+5.8% YoY in Q2-2016, up from +1.8% QoQ/+3.7% YoY in Q3-2015.The Q3 GDP reading came out below market expectations, raising fresh concerns over the sustainability of the growth acceleration in 2016-17. Softer retail sales in Q3 had predisposed for a slowdown in the private consumption rally and thus a lower contribution to growth. After jumping by +3.3% QoQ/+10.4% YoY in Q2, private consumption slowed down to -1.5% QoQ/+6.1% YoY, making a contribution of 4.0pps to growth in Q3, down from 7.5 pps in the previous quarter. In addition, lower EU funds absorption compared to last year and lower QoQ public spending mirroring local elections in last June were most probably accountable for the contraction in investments on a quarterly basis (-6.5% QoQ). Nevertheless, gross fixed capital formation still expanded on an annual basis by +2.8% YoY, making a 0.8pps contribution to growth, which was only partially offset by the negative contribution of inventories (-0.2pps). On the other hand, net exports made a small negative contribution of -0.2pps, mirroring the flat quarterly performance of exports (+0.0% QoQ/+6.3% YoY) vs. the small decrease of imports (-3.0% QoQ/+6.7% YoY).

The Constitutional Court postponed its ruling on the CHF loan conversion law until January 18th

The Constitutional Court decision was based on the grounds that it needs more time to make an assessment on the case taking into account its recent ruling on the Debt Discharge Law ("Datio in Solutum"), which reduced the scope of eligibility and potential impact of the law, thus paving the way for a similar ruling on the CHF loan conversion law. The new law allows borrowers to convert their CHF denominated loans into RON at historical exchange rates. The final draft law provides for no threshold for the outstanding amount balance, debt-to-income service ratio or the contract date of the loan, and it includes those who had already benefited from a loan reconversion in other currency or from a restructuring of their loan. As of September, loans denominated in currency other than € or RON stood at RON 5.8bn or 5.1% of the retail portfolio. The NBR has recently assessed that the law, if implemented in its current version, will incur RON 2.4bn (0.3% of GDP) losses for the banking system. Even though the amount looks manageable, the risk is concentrated on three banks which are most likely to take 70% of the hit. The capital adequacy of two of them, which are non-systemic, is expected to decline below the regulatory minimum threshold.

NBR is becoming increasingly aware of the fiscal risks for the economy

The minutes from the recent NBR policy meeting in November-released for the second time-suggest that the decision to leave the key policy rate unchanged at 1.75% was unanimous. Both external and internal factors compel NBR to maintain a wait and see mode. Firstly, global environment uncertainties stemming from the heavy election calendar in Europe are elevated, keeping financial markets on the edge. In addition, domestic risks-both political and fiscal- are also on the rise stemming from the initiatives of the parliament to provide pre-election further public wage hikes and tax cuts. Finally, NBR left its inflation 2016-17 year end forecasts almost unchanged in the November report (-0.4%/+2.1% vs. -0.4%/+2.0%) vs. those in the August report.

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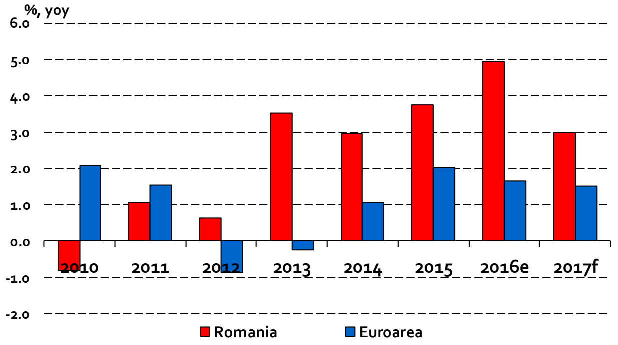
Romania: Macro & Market Data				
	2014	**2015**	**2016f**	**2017f**
Real GDP (yoy%)	3.1	3.7	5.0	3.5
Inflation (yoy%)				
CPI (annual average)	1.1	-0.6	-1.8	1.5
CPI (end of period)	0.8	-0.9	-0.4	2.0
Fiscal Accounts (%GDP, Cash Basis)				
General Government Balance	-1.9	-1.9	-2.8	-3.7
Gross Public Debt (including guarantees)	39.5	39.1	40.5	42.6
Labor Statistics (annual avg,%)				
Unemployment Rate (ILO, % of labor force)	6.8	6.7	6.5	6.3
Wage Growth (total economy)	7.6	8.4	12.5	5.0
External Accounts				
Current Account (%GDP, BPM5)	-0.4	-1.1	-3.0	-3.2
Net FDI (EUR bn)	2.5	2.7	3.0	3.5
FDI / Current Account (%)	385.0	157.1	58.8	60.8
FX Reserves (EUR bn)	32.2	32.2	33.5	32.0
Domestic Credit (end of period)	**2012**	**2013**	**2014**	**2015**
Total Credit (%GDP)	52.0	47.0	44.4	43.9
Credit to Enterprises (%GDP)	20.3	18.0	15.7	15.5
Credit to Households (%GDP)	17.8	16.5	15.4	15.4
FX Credit/Total Credit (%, private)	62.5	60.9	56.2	49.3
Private Sector Credit (yoy)	1.3	-3.3	-3.1	3.0
Loans to Deposits (%)	133.9	118.4	106.3	106.6
Financial Markets	**Current**	**3M**	**6M**	**12M**
Policy Rate	1.75	1.75	1.75	2.00
EUR/RON	4.45	4.50	4.50	4.40

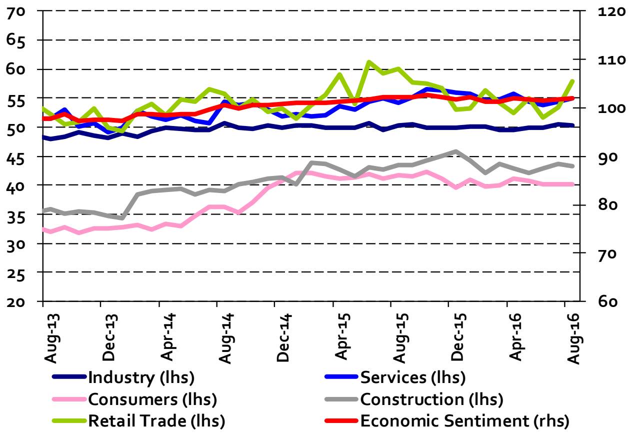
Source: National Authorities, EC, IMF, Eurobank Research

FIGURE 21: **Growth performance Romania vs. EU28 2010-2016**



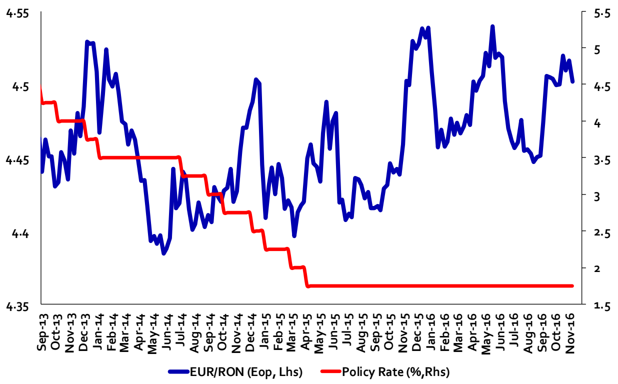
Source: Eurostat, Eurobank Research

FIGURE 22: **Sentiment indicators 2013-2016**



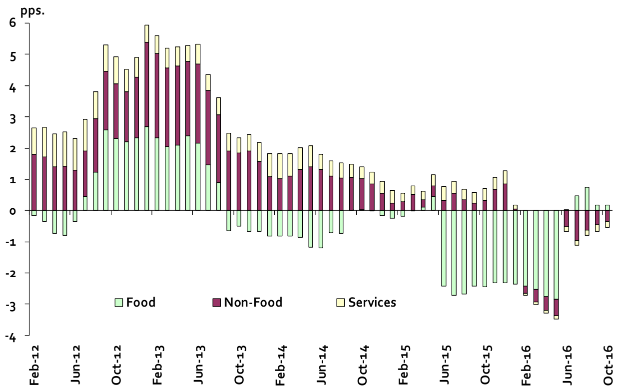
Source: Eurostat, Ecowin Reuters, Eurobank Research

FIGURE 23: **Monetary policy & FX rate 2013-2016**



Source: Bloomberg, Eurobank Research

FIGURE 24: **Inflation components 2011-2016**



Source: National statistics, Eurobank Research

Serbia (B1/BB-/B+)

Economic recovery to pick up further pace in 2017

Last year's positive economic activity trends broadly continued through to Q3 2016…

According to the final quarterly national accounts data for Q3 2016 released yesterday, real GDP growth was revised marginally higher to 2.6%YoY from a flash estimate of 2.5%YoY reported in late October. The data follows a downwardly revised reading of 1.9%YoY in Q2 2016 and, despite picking up pace in Q3, remained below growth of 3.8%YoY marked in the January-March period. However, the said slowdown is mostly attributed to favorable base effects in Q1 2016. Furthermore, Q3 is the sixth consecutive quarter of positive annual growth rates after the 2014 floods, which pushed the domestic economy into recession. From the production side, the agricultural (+10.9%YoY) and construction (+8.5%YoY) sectors registered the highest contributions in Q3 2016, with wholesale and retail trade (+3.7%YoY) and financial activities (+4.2%YoY) following suit. Annual growth in manufacturing returned to a positive territory of 1.2% after a 0.4% decline in the prior quarter, but remained well below that of other sectors as well as compared to readings recorded over the Q2 2015-Q1 2016 period. From the expenditure side, data confirmed that last year's positive trends broadly continued through to Q3 2016. In support of the aforementioned, net exports and investments continued to provide the highest input in domestic economic activity, with exports growth of 10.5%YoY outpacing a concomitant increase of 5.9%YoY in imports and gross fixed capital formation picking up pace to 6.2%YoY from 4.4%YoY a quarter earlier. At the same time, household final expenditure grew by 0.5%YoY, halving from 1.0%YoY in Q2, but marked the fifth consecutive quarter in the black. Likewise, government spending decelerated to 1.2%YoY from 4.0%YoY. Looking ahead, economic activity is expected to accelerate to around 2.7% for the whole of this year and overshoot earlier official estimates for growth slightly below 2.0% as well as a modest recovery of 0.7% recorded in 2015. A further pick up in domestic economic activity towards 3.0% is penciled in for 2017. On top of private investment and net exports, which are expected to repeat their current strong performance, private consumption is expected to recover further, after several years of being a drag on growth. It is expected to provide more meaningful support to overall economic activity next year, driven by real wage growth and the positive fiscal impulse emanating from the targeted rise in public wages and pensions.

… while prospects for 2017 appear even more encouraging

Impressive fiscal performance continues this year

The impressive fiscal consolidation witnessed since late 2014 has continued so far this year. This progress was also acknowledged by the IMF upon the completion of the 6th review mission to Serbia in November. Stronger than previously anticipated revenues and expenditure within program targets assisted in a reduction in the general government deficit to an expected 2.1% of GDP this year, according to official projections, from 3.7% of GDP in 2015. Reflecting the size of the improvement, these two figures compare with a 6.6% of GDP shortfall in 2014. The strong fiscal performance continued unabated in the first ten months of 2016. As of end-October, the general government budget had recorded a small surplus. However, a few guarantees payments to faltering SOE's to be executed in December, along with some seasonal expenses will bring the annual gap to 2.1% of GDP for the whole of the year, some 2pps below initial projections. The Budget Law 2017, which was adopted by the National Assembly in early December, envisions a record low deficit of 1.7% of GDP; while output is projected to rise to ca. 3%. In this context, public debt/GDP ratio is likely to embark on a declining trend, ahead of schedule, after peaking this year.

Credit rating upgrades on the cards on improved macroeconomic fundamentals

Following a wave of rating downgrades in 2012-2014, all three major rating agencies appear to be acknowledging over recent months the ongoing improvement in Serbia's domestic macroeconomic fundamentals witnessed over the last couple of years. It is worth noting that external imbalances have also been reduced a great deal as well in recent years. In 2016 exports have been rising faster than imports (10.1% vs. 5.1% YoY) thus reducing the trade deficit by 9.1%YoY in the January-October period. Consequently the current account deficit will probably come in below 4.0% of GDP this year, vs. double digits in 2012, the smallest reading in a decade. Moreover, the deficit is expected to be fully covered by FDIs. Along these lines, S&P revised higher in January the country's outlook to Stable from Negative, while affirming its "BB-" rating in July 2016. Moody's changed its outlook on Serbia to Positive from Stable in mid-March, also affirming the country's "B1" rating. Fitch was the first agency to proceed with an upgrade on Serbia's sovereign rating, revising in June one notch higher its Long-Term Foreign and Local Currency Issuer Default Ratings (IDR) to "BB-" from "B+" with Stable outlook. The corresponding ratings of both S&P and Fitch currently stand one notch higher than that of Moody's. Therefore an upgrade by the latter in the near future could be expected, especially bearing in mind the aforementioned macroeconomic improvements, which became even more apparent in the second half of the current year. Provided that the current drive for structural reforms and fiscal consolidation is maintained, further credit rating moves should not be excluded in the foreseeable future.

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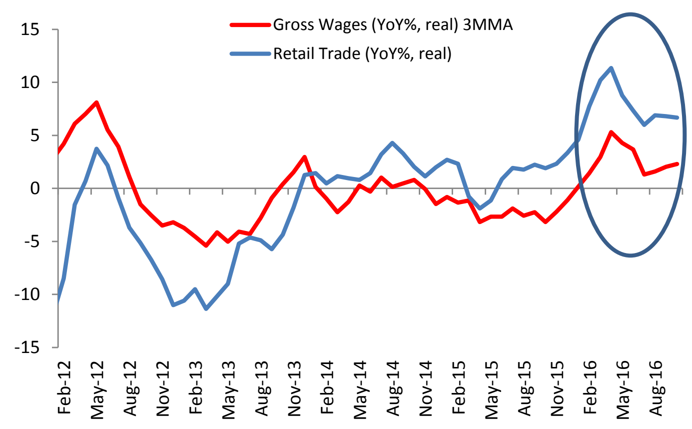
Serbia: Eurobank Forecasts	2014	2015	2016	2017
Real GDP (yoy%)	-2.0	0.8	2.7	3.0
Inflation (yoy%)				
HICP (annual average)	2.1	1.4	1.0	2.1
HICP (end of period)	1.8	1.6	1.5	2.5
Fiscal Accounts (%GDP)				
Consolidated Government Deficit	-6.6	-3.7	-2.1	-1.7
Gross Public Debt	68.4	75.4	74.1	72.5
Labor Statistics (%)				
Unemployment Rate (%of labor force)	19.4	17.7	13.2	14.5
Wage Growth *(total economy)*	-1.5	-2.1	2.8	3.0
External Accounts				
Current Account (% GDP)	-6.0	-4.7	-4.1	-3.9
Net FDI (EUR bn)	1.2	1.8	1.8	2.0
FDI / Current Account (%)	60.0	114.4	128.5	143.6
FX Reserves (EUR bn)	9.9	10.4	9.8	10.0
Domestic Credit	**2012**	**2013**	**2014**	**2015**
Total Credit (%GDP)	62.8	57.0	61.5	63.6
Credit to Enterprises (%GDP)	31.2	26.1	25.0	25.0
Credit to Households (%GDP)	18.2	17.4	18.7	19.6
Private Sector Credit (yoy%)	9.5	-4.8	0.5	3.2
Loans to Deposits (%)	126.9	114.1	111.8	112.6
Financial Markets	**Current**	**3M**	**6M**	**12M**
Policy Rate	4.00	4.00	4.00	4.00
EUR/RSD	123.30	123.80	124.20	125.50

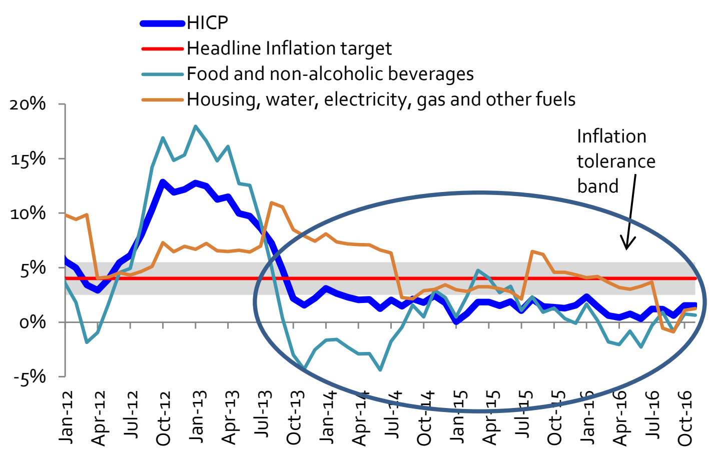
Source: National Authorities, EC, IMF, Eurobank Research

FIGURE 25: **Private consumption and wage growth remain robust (3MMA)**



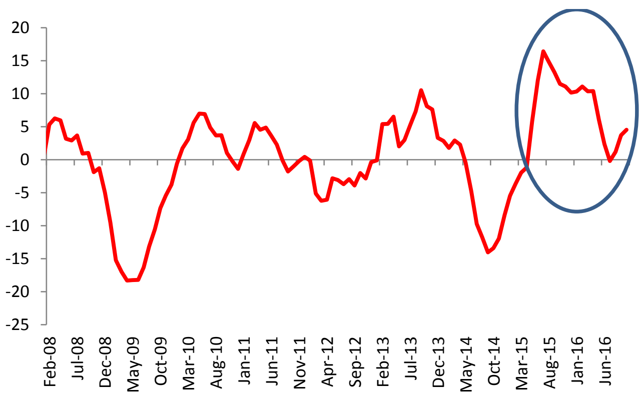
Source: National Authorities, EC, IMF, Eurobank Research

FIGURE 26: **Inflation remains below NBS target for more than two years**



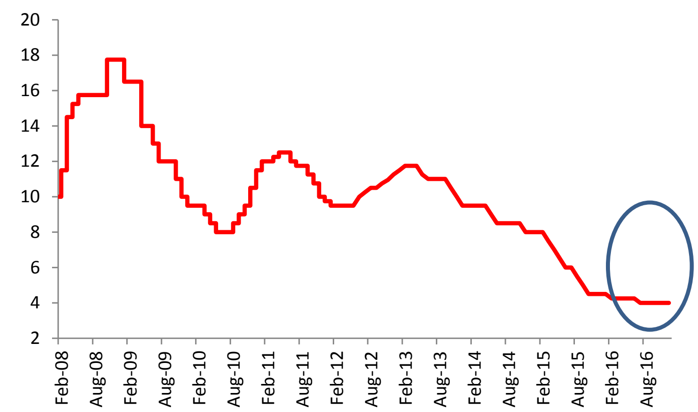
Source: National Authorities, Eurobank Research

FIGURE 27: **Growth in industrial production rebounds after seasonal factors' slowdown (3MMA YoY %)**



Source: National Authorities, EC, IMF, Eurobank Research

FIGURE 28: **NBS holds fire for 5th month running in December**



Source: National Authorities, EC, IMF, Eurobank Research

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