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Promising regional outlook in 2018

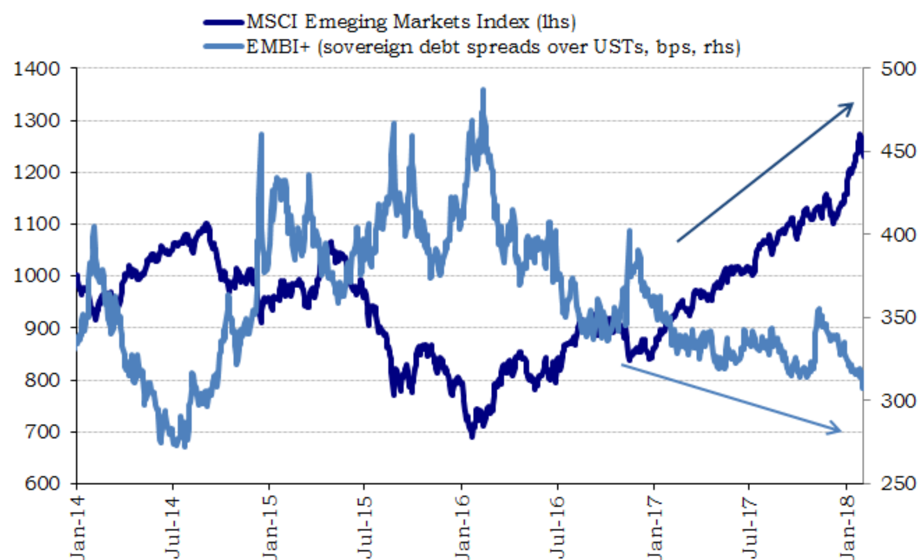
REGIONAL MACROECONOMIC & MARKET DEVELOPMENTS & OUTLOOK

- **Promising** regional growth prospects in **2018**, even though economies are about to or have already passed their **cyclical peak**
- **Real disposable incomes** are expected to continue rising at a lower speed providing support to **private consumption**
- The rise of **investments** is crucial for the **medium-term** growth prospects of the region
- **Limited** room for more **expansionary** policies in 2018
- **Regional assets** kick off year on positive footing
- **Emerging Market bourses** have rallied strongly so far this year, with main stock indices in the region of our focus having also firmed
- Most **CESEE currencies** gained ground in view of a weaker USD
- Local-currency **government bonds** underperform trailing the move in major core markets

COUNTRY FOCUS

- **Bulgaria:** Double rating agencies upgrade
- **Cyprus:** Solid fiscal performance despite Presidential elections
- **Romania:** NBR hiked the KPR for the first time in a decade
- **Serbia:** New credit rating upgrades in December amid improving macroeconomic fundamentals

EM assets extend early in 2018 their 2-year rally



Source: Eurostat, National Authorities, Eurobank Research

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I. Regional Macroeconomic & Market Developments & Outlook

Promising regional growth prospects in 2018; regional assets kick off year on positive footing

Regional growth prospects for 2018 look promising

High frequency data and the prospective national accounts releases of the last quarter of 2017 are expected to confirm that the economies of region may have had the best year in the post-Lehman period last year. The prospects for 2018 look promising as well. Even though, the economies are about to, or have already, passed their cyclical peak, growth prospects still look very good for most of the economies. Private consumption is expected to make a key-yet smaller than last year- contribution to GDP growth as real disposable incomes' growth is expected to decelerate reflecting labor market tightening, accommodative credit conditions and improved sentiment. A favorable external environment will allow those small open economies maintain their net exports contribution in check next year despite the uptick on the imports side.

The rise of investments is crucial for the medium-term growth prospects of the region

Nevertheless, it is going to be investments whose performance should make the difference both this year and in the medium-term. In order for this to happen, private sector will need to invest more to increase production capacity given that utilization rates are already at comparably high levels. More importantly, the region's EU funds absorption, which has failed to impress in the past two years for a number of reasons, is expected to accelerate providing a boost to public investments. The most obvious shortage of public investments is evidenced in infrastructure bottlenecks. Despite some progress, the region still scores relatively low in infrastructure rankings, due to lack in related public investment. On the other hand, the economies operate at or close to full employment. Thus, companies are increasingly confronted with labor force scarcity which constrains their output production and weighs negatively on the future growth prospects.

Despite some correction underway in early February, EM assets kicked off the year on a positive footing

Despite some correction underway in early February, emerging market (EM) assets have broadly kicked off the year on a positive tone, with most extending last year's gains. The risk environment has remained favorable in the onset of 2018 thanks to global growth optimism and a weaker USD. The majority of Emerging Market bourses have rallied strongly so far this year, with a positive view on corporate earnings and the rise in oil prices providing an additional boost. In spite of undergoing a 3.6% decline in early Feb amid higher core government yields, the broad MSCI EM index stretched a 2-year rally ending in January in the black with gains in excess of 8%. This is the index's best performance for January since 2012, while it also hit decade highs on the 29th. The main stock indices in the region of our focus have also firmed on a year-to-date (YTD) basis, with Bulgaria's SOFIX and Romania's BETI trading approximately 5% higher compared to their 2017 closing levels. In the FX markets, most CESEE currencies gained ground as the USD eased to 3-year lows in late January. Romania's leu has been amongst the region's outperformers trading ca 1% firmer YTD just below 4.63/€, receiving support from the inception of the Central Bank's rate hiking cycle early in 2018 amid increased overheating concerns and a rise in inflation. The Serbian dinar - which last year posed amongst the region's best performers amid improving domestic fundamentals –stood in early February not too far from a 3-year peak just below 118.00 hit a few days earlier. The Polish zloty reached a 2 ½ year peak near 4.1295/€ and the Turkish lira a 3-month high close to 3.7115/$ in late January. In the external debt markets, Emerging Market spreads versus USTs on the EMBI+ index tightened to 3-year lows near 307.4bps in early February mainly driven by the sell-off in USTs, reflecting the improvement in global risk appetite, despite total returns being negative on a year-to-date basis. Meanwhile, local-currency bonds have fared worse, with regional yields broadly trailing a concomitant rise in core government yields. Romania poses amongst the worst performers in the region, with the yield of 10-year paper standing 25bps higher from its end-2017 levels amid rising inflation and Central Bank monetary tightening.

Several risks lie ahead, which may weigh on appetite towards risky assets

Looking ahead, several risks may be identified going forward, which bear the potential of weighing on risk appetite. Namely, a more protectionist trade policy from the US, a sharper than expected slowdown in China, faster than anticipated increases in inflation and ensuing more aggressive than expected monetary policy normalization from major Central Banks, the progress of Brexit negotiations, geopolitical events and a heavy political calendar in EMs.

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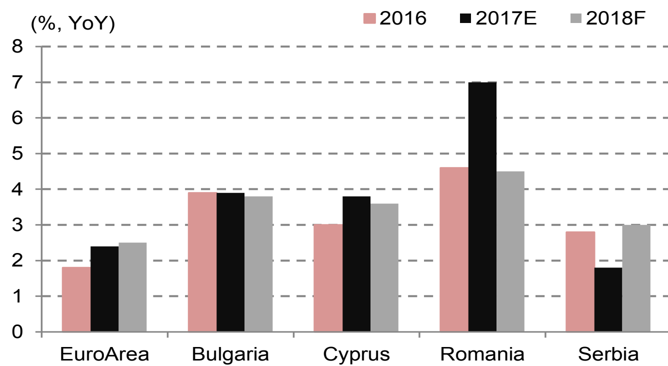
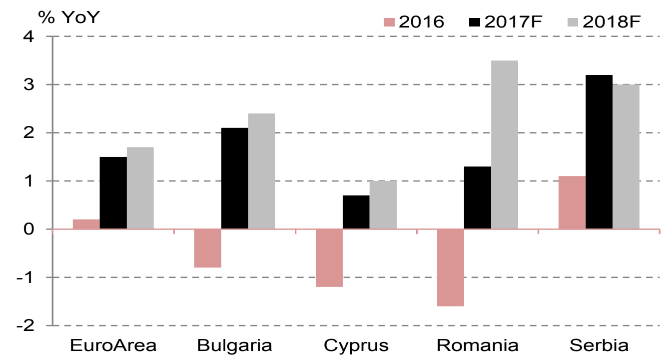
FIGURE 1: GDP Growth performance 2015-2018



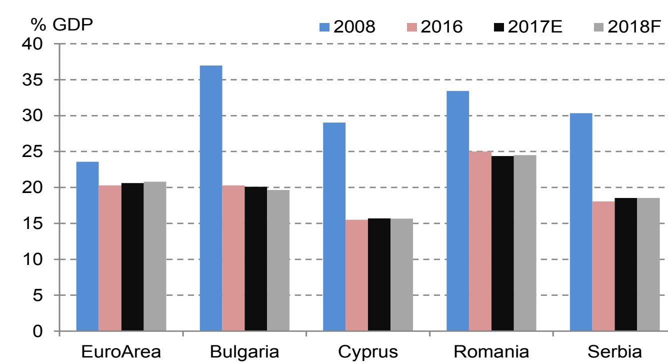
Source: Eurostat, National Authorities, Eurobank Research

FIGURE 2: Annual average inflation 2015- 2018



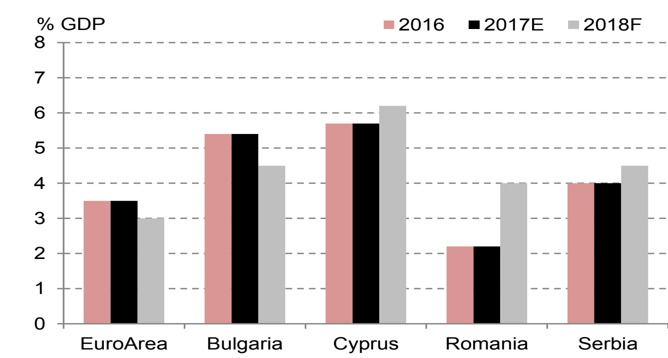
Source: Eurostat, EU Spring Forecasts, Eurobank Research

FIGURE 3: Investments to GDP ratios 2008 vs. 2018



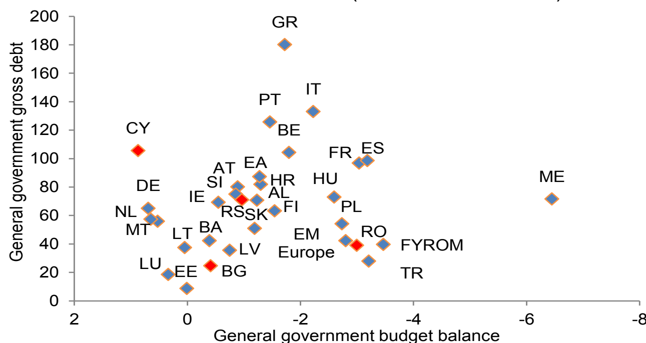
Source: IMF WEO, Eurobank Research

FIGURE 4: Current Account Balance (% of GDP)



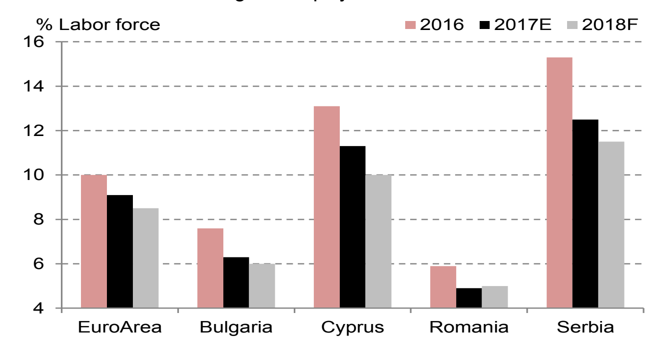
Source: Eurostat, National Authorities, Eurobank Research

FIGURE 5: Fiscal Balance & Public Debt (% of GDP, Cash basis) 2017



Source: IMF National Authorities, Eurobank Research

FIGURE 6: Annual average unemployment rates 2015-2018



Source: Eurostat, National Authorities Eurobank Research

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

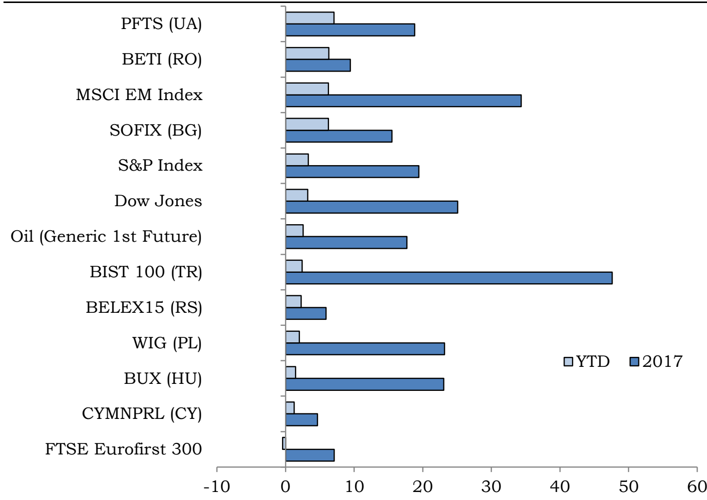


FIGURE 8: World & EM stock markets performance

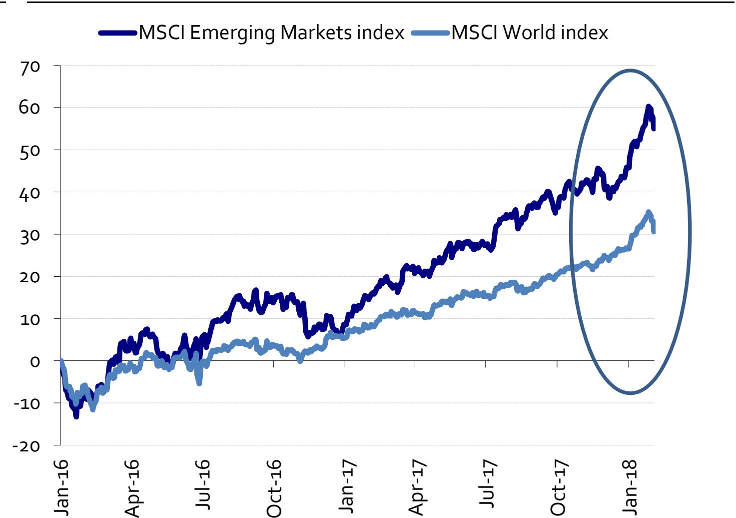


FIGURE 9: MSCI stock indices performance (by region)

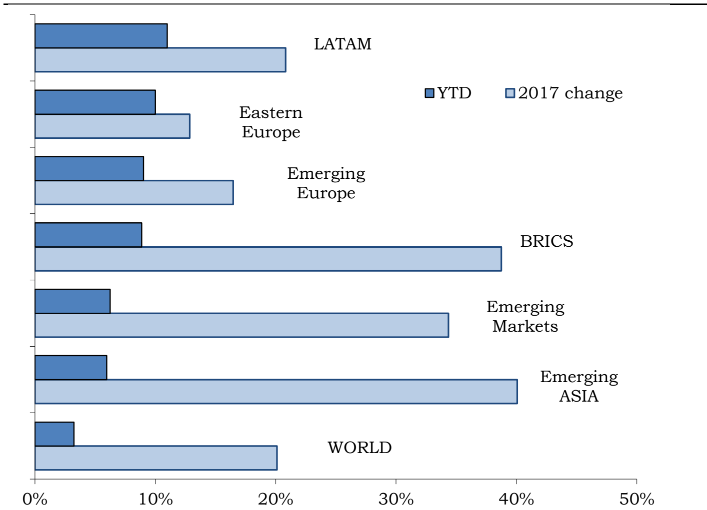


FIGURE 10: CESEE FX performance

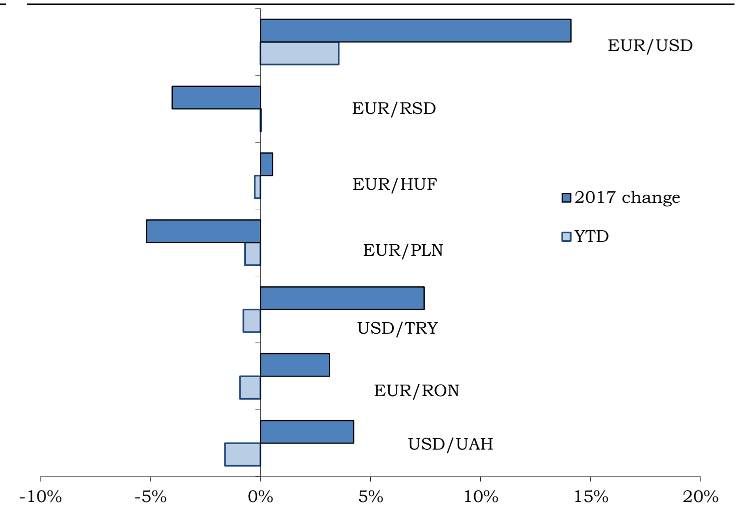
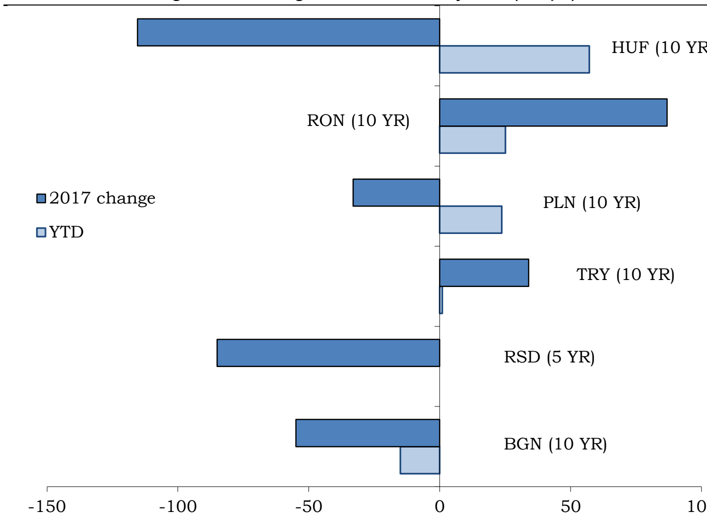
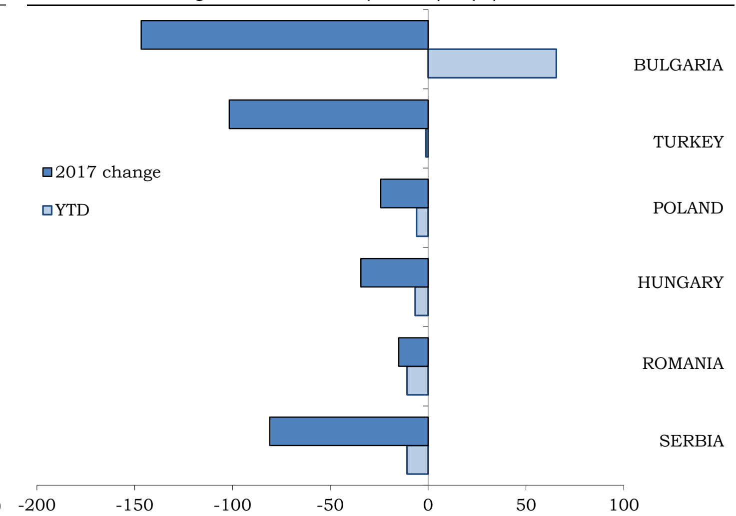


FIGURE 11: Change in CESEE government bond yields (in bps)



Source: Reuters, Bloomberg, Eurobank Research

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



Source: Reuters, Bloomberg, Eurobank Research

Trader's view

FX

Balance of risks skewed towards dinar appreciation this year

The Serbian dinar has remained relatively stable since the start of 2018. The EUR/RSD trading range has been between 118.15-118.90 in January, despite risks for dinar depreciation being skewed to the upside. The reason behind this resilience of the Serbian currency has been a number of National Bank of Serbia (NBS) interventions aimed at mitigating FX volatility. In total, the Central Bank sold €165mn of euros in the FX markets in order to support the dinar. With the NBS indicating resolute to mitigate depreciation pressures on the domestic currency below a certain level, many market participants changed their bearish view on the RSD. Interventions took place when the EUR/RSD moved towards the upper bound of the aforementioned monthly range, more specifically around the 118.80 level.

Looking ahead, potential for dinar depreciation this year appears limited. To the contrary, a lot of arguments support the case for a firmer dinar going forward. In more detail, strengthening economic recovery, which will contribute to a more balanced demand and supply of hard currency, implying relatively muted volatility on the EUR/RSD. Tax collection had steady growth of 3% in 2017 and will continue to improve in 2018 with the announcement of the Tax administration reform. The net inflow of foreign direct investment (FDI) rose to € 1.841bn (in the first nine months of 2017), from €1.456bn in the same period of the prior year. Also, projected Euro Area growth of 2.5% will greatly contribute to further expansion of FDI and positively contribute towards Serbia's trade balance (EU is the country's main trading partner). In the onset of the new year, the French VINCI Airports acquired a 25-year concession over Belgrade airport. For the first time in last few years, €501mn offer from the buyer surpassed expectations, proving Serbia's improving investments' allure. On top of that, credit expansion will likely continue as banks have significantly reduced bad loans from their portfolios over the last few years. In comparison, bad loans halved to 11% in 2017, compared to 22% in 2014. Increased demand for Serbia's government debt was confirmed early in 2018. The re-tapped 5Y RSD-denominated T-bond was 3-times oversubscribed with close to RSD 29bn of bids received from investors. Demand for EUR-denominated bonds also proved strong, with a 5Y paper auction being 1.6-times oversubscribed. Serbia plans to repay and not refinance the most expensive loans of its foregoing debt in 2018, the finance minister said recently. He also noted that Serbia now could borrow at interest rates of 1.5% or 2% instead of 8% previously paid. In comments made to local media earlier this year, he added that Serbia plans to reduce its debt –to-GDP ratio below 56.3% by 2020. That said, not all is rosy and risks to the dinar do lie ahead. Firstly, major Central Bank policies are central for Serbian assets' performance. Most importantly, the ECB's policy path; how fast the tapering process will unfold and when the first rate hike will be delivered after years of ultra-lose monetary conditions. Serbia's budget is still heavily burdened by subsides earmarked towards unprofitable state companies that are still in the process of restructuring. Last but not least, constant political and geo-political uncertainties that are coming to the forefront, with the Kosovo issue remaining in the spotlight. To sum up, the balance of risks appears to be skewed towards dinar appreciation, at least for the first half of the year. In the second half, the aforementioned improving fundamentals as well as potential for the inception of a monetary tightening cycle by the NBS - as inflation pressures build up in tandem with strengthening domestic demand – are also likely to provide support to the domestic currency.

Local rates

We prefer to remain on the sidelines on Bulgarian bond trades

Bulgarian local-currency bonds have stayed well supported since the beginning of 2018. The sovereign yield curve experienced a yield rise on both the short and long end, with a maximum spike of 7 and 11 bps, respectively. Meanwhile, the Bulgarian Ministry of finance offered for the first time ever BGN 100mn worth of 25 year BGN-denominated issue maturing in 2043. Despite interest from both prime dealers and institutional investors, the Ministry of Finance rejected all bids. Underperforming local-currency sovereign debt, Eurobonds have come under pressure so far this year, with yields having registered considerable spikes over the last month. Yields of paper maturing in 2027 and 2028 rose by 14 and 10%, respectively, approximately over last month. All in all, we currently believe that Bulgarian credit spreads are tight and valuations remain stretched, which is the reason why we prefer to remain neutral and not enter 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-)

Double rating agencies upgrade

The improvement in the country's external position is rewarded by sovereign rating agencies

In last December, both Fitch and S&P upgraded the long-term sovereign rating of Bulgaria by one notch in their respective ratings scale. More specifically, Fitch upgraded the rating from BBB- to BBB with a stable outlook. At the same time, Standard and Poor's upgraded the long-term sovereign rating from BB+ to BBB- placing Bulgaria at the investment grade for the first time since December 2014. According to S&P, the decision reflects primarily the solid improvement in external metrics, the expansion and diversification of the exports base and its' resilience to labor cost growth amid a rise in domestic savings. The solid external performance has strengthened the credit metrics and the economy is now more export driven and less leveraged than previously. The agency tied further positive rating action in the next 24 months upon a further reduction in the banking system's NPL (currently at around 12%) and a strengthening in fiscal performance beyond expectations. Separately, Fitch noted behind its upgrade decision the improvement of the external debt ratios which has led Bulgaria's external metric to outperform the majority of its BBB peers. Fitch anticipates the net creditor external position to strengthen further in the medium term and stay above the median of the BBB peers underpinned by strong current account surpluses. Fitch stressed that Bulgaria outperforms its peers, both in terms of the projected budget deficits and the general government debt to GDP ratio which will remain below 25% in 2017-2019. Risks are estimated as balanced and may stem from lower absorption of EU structural funds or slow credit growth.

The key to a more balanced growth path in 2018 depends heavily on investments performance

Having expanded by around 4% YoY in 2017, Bulgaria is now expected to expand by 3.8% YoY in 2018 registering another year of strong above-potential growth. The economy is expected to benefit from further labor market tightening, accelerating credit activity dynamics, a more expansionary fiscal policy stance, a vibrant export oriented manufacturing sector and an emerging tourism destination. The economy is operating at or close to full employment to the extent that companies are reportedly increasingly confronted with labor scarcity (the relevant % of companies in EU survey has climbed to 40% in Q4 up from only 13% in Q4-2013). The unemployment rate declined further down to 6.1% in Q3-2017 from 7.4% a year ago, the lowest level since Q1-2009. Fiscal policy is expected to be more growth-supportive provided that budget execution aligns with the 1% of GDP deficit target in 2018 vs. a 0.8% surplus in 2017. Credit to the non-government sector accelerated to 4.2% YoY last November vs. only 1.5% YoY in 2016, compared to -1.2% YoY in 2015. Financial institutions are now less reluctant to lend helped by abundant liquidity conditions, as heavy regulatory requirements are behind, and are still confronted by the negative interest rates on excess reserves. With capacity utilization standing at an all-time high, private companies will need to invest more in order to strengthen their productive capacity. In the past year, public investments fell short of expectations mirroring the inability of the caretaker government and the limited progress by the incoming government coalition to push for infrastructure projects implementation. Finally, investments are going to receive support from improved EU funds absorption which so far was low in the two years after the closing of the programming period 2007-2013.

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Bulgaria: Macro & Market Data

Macro indicators	2016	2017e	2018f
Real GDP (yoy, %)	3.9	3.8	3.8
Inflation (yoy%, avg)	-0.8	2.1	2.4
Fiscal Balance (%GDP, Cash basis)	1.6	0.8	-1.0
Gross Public Debt (%GDP, Cash basis)	27.8	24.5	24.1
Unemployment Rate (LFS, %)	7.6	6.3	6.0
Compensation of employees/head	3.9	4.1	4.5
Current Account (% GDP)	5.4	5.0	4.5
Net FDI (EUR bn)	0.6	1.0	1.0
Domestic Credit	**2014**	**2015**	**2016**
Total Credit (%GDP)	67.7	57.1	54.6
Private Sector Credit (yoy)	-8.2	-1.2	1.5
Loans to Deposits (%)	84.2	78.2	74.1
Financial Markets	**3M**	**6M**	**12M**
Policy Rate		(Currency Board)	
EUR/BGN	1.96	1.96	1.96

Sources: National statistics, Eurostat, IMF, Ecowin Reuters, Eurobank Research

FIGURE 13: GDP growth & Inflation 2000-2019

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

Solid fiscal performance despite Presidential elections

The incumbent President was re-elected in the second round renewing his mandate for another 5 year-term

Incumbent President Nikos Anastasiades, backed by the ruling right-wing DHSY, won, as was broadly anticipated, in the 2nd round of Presidential elections. He received 55.9% of the vote, securing another 5-year term in office. The runner up, Stavros Mallas, who was backed by left wing AKEL scored 44.01%. The voters' turn-out in the second round stood at 73.97%, a tad above the first round's historical low of 71.88%.

The budget execution has surpassed the most optimistic expectations ahead of elections

The general government recorded a surplus of 2.5% of GDP and a primary surplus of 4.9% of GDP in the first eleven months of last year. Taking into account an additional expenditure of 2% of GDP in the supplementary budget of the Ministry of Finance by the end of last year, the budget is still projected to end in a surplus above 1% of GDP in 2017, up from 0.4% of GDP in 2016 and a balanced position in 2015 (not including the Co-operatives capital injection). This year's budget plan targets a general government headline surplus of 1.3% of GDP and a primary surplus of 3.8% of GDP. The macroeconomic assumptions the budget is based upon are within reach: GDP growth is forecasted at 3%, the annual average inflation at 1%, unemployment at 9.5%. Total revenues are budgeted to increase by 4% YoY so as to reach 39.9% of GDP in 2018, down from a projected 40.5% of GDP in 2017. On the other hand, total expenditures are budgeted to increase by 3% YoY so as to reach 38.6% of GDP in 2018 down from a projected 38.8% in 2017. The budget foresees no new loosening initiatives besides those adopted last year. The main loosening measures and the associated fiscal impact (in percent of GDP) adopted in 2016-2017 were: (a) elimination of the tax on immovable property, with full effect from 2017 (0.5%); (b) expiration in 2017—as envisaged under the program—of the temporary solidarity levy on wages introduced during the programme period (0.4%); and (iii) hiring additional military personnel in 2016 (0.2%)

Under the current trajectory, public debt is expected to decline further

On November 6, 2017, the Ministry of Finance repaid part of a 3.0% loan held by the Central Bank of Cyprus. This early repayment amounts to €614.9mn plus €6.3mn accrued interest and represents a projected reduction of 3.2 ppts in the General Government Debt-to-GDP ratio. As this transaction is to be funded without any additional debt issuance by the already existing cash surpluses of the Government, it is projected to bring the debt-to-GDP ratio further down to 98.4% of GDP at the end of 2017, compared to 107.8% at the end of 2016. Provided that the headline surplus is sustained at 1.4% in 2019-2020, public debt is now expected to decline faster than previously envisaged in the Stability programme to 81.8% of GDP in 2020. More importantly, the projected cash reserves of the Government at year-end 2017 are estimated to fully cover the financing needs of 2018. Recall Cyprus 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 capital injection).

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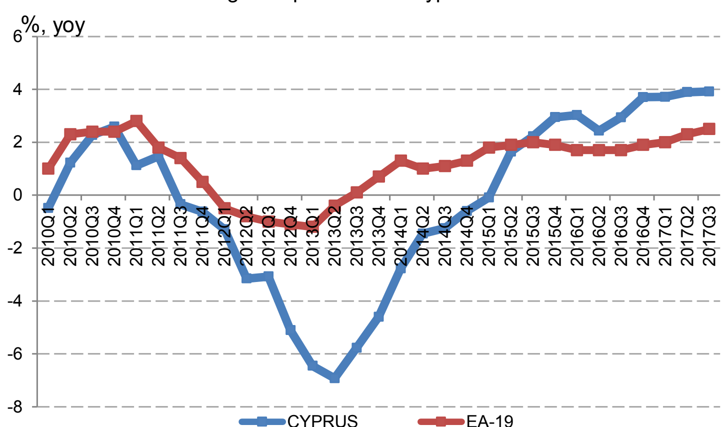
Cyprus: Macro & Market Data			
Macro indicators	**2016**	**2017e**	**2018f**
Real GDP (yoy, %)	3.0	3.8	3.6
HICP Inflation (yoy%, avg)	-1.2	0.7	1.0
Fiscal Balance (%GDP, Cash basis)	0.4	0.2	0.4
Gross Public Debt (%GDP, Cash basis)	107.8	104.0	99.7
Unemployment Rate (LFS, %)	13.1	11.3	10.0
Compensation of employees/head	-0.6	0.7	1.1
Current Account (% GDP)	-5.7	-5.4	-6.2
Terms of Trade (of Goods)	-0.4	0.2	-0.5
Domestic Credit	**2014**	**2015**	**2016**
Total Credit (%GDP)	353.5	360.8	308.3
Credit to Enterprises (%GDP)	148.1	151.5	125.3
Credit to Households (%GDP)	142.7	136.4	127.5
Private Sector Credit (yoy)	-2.3	-3.4	-11.0
Loans to Deposits (%)	133.4	136.6	112.6

Sources: National statistics, Eurostat, IMF, Ecowin Reuters, Eurobank Research

FIGURE 14: GDP growth performance Cyprus vs. EA-19 2013-2017



Romania (Baa3/BB+/BBB-)

NBR hiked the KPR for the first time in a decade

Headline inflation is expected to climb further higher in 1H-2018 on supply side factors and base effects

Inflation climbed to a new four year high in December. Consumer prices accelerated further to +3.3%YoY, driven by higher food prices on a monthly basis (+0.4% MoM/+4.1% YoY) up from 3.2%YoY in November close to the upper bound of the NBR's target interval (2.5+1%), coming in nearly in line with the market consensus. The adjusted Core CPI (excluding administered and volatile prices, alcohol and tobacco) climbed further to 2.4% YoY in December up from 2.3% YoY in November, the highest level since August 2013. The PPI (Producer Price Index) heated up to 4.4% YoY in November compared to 3.9% YoY in October vs. only 0.9% YoY in December 2016, driven by higher energy and intermediary goods' prices. Supply-side factors such as the new regulated price increase for energy tariffs (as of January2018) and the pass through from the upturn in oil prices globally, the lasting impact from the rise in excise fuel duties in 2H-2017 plus the base effects from the phasing out of the VAT rate cut as of January this year are going to maintain inflationary pressures high above 3.5% in 1H-2018.

NBR hiked the key policy rate by 25bps to 2% in the first monetary policy meeting of the new year. Further hikes are likely in the pipeline in order to tighten real monetary conditions

At its first monetary policy committee meeting of the New Year, NBR increased by 25bps the monetary policy rate to 2.00% for the first time in a decade. Moreover, the NBR maintained the interest rate corridor unchanged at 1% around the new KPR level, by raising the deposit facility rate to 1.00% from 0.75% and the lending facility rate to 3.00% from 2.75%. Finally, the MPC maintained unchanged the existing levels of minimum reserve requirement ratios on both RON- and FX-denominated liabilities of credit institutions. The Central Bank's move confounded a market consensus that was not entirely in favor of stable interest rates providing temporary support to the local currency and pushing government bond yields higher. The rates hike decision was not a complete surprise for us. In our past monthly publications, we have underlined that the timing of the first hike was approaching as inflationary pressures were building up despite the temporary slowdown last summer. Recall that, the NBR narrowed further the standing facilities corridor from ±125bps to ±100bps in last November on top of a similar decision in October taken in a step towards further policy normalization instead of hiking the KPR. Given the elevated price pressures-inflation is expected to overshoot the upper bound of the NBR interval for most of the year- we look for another 75-100bps on a cumulative basis delivered until the end of the year. In the media briefing thereafter, the NBR governor grounded its decision as a pro-active response against the increased inflation expectations in the beginning of the New Year. In addition, the Central Bank projects a higher inflation in the short-term than previously and more significant uncertainties related to the medium-term outlook. Moreover, he elaborated on the impact of firm liquidity management decision taken in the previous meeting in November so far explaining that the current interest rate corridor is sufficient enough to absorb excess liquidity and assessed the current money market rates as properly aligned with the current KPR level and sees an insignificant impact of the hike on rates. Finally, the NBR Governor reiterated his past comments favoring more FX flexibility in the near future.

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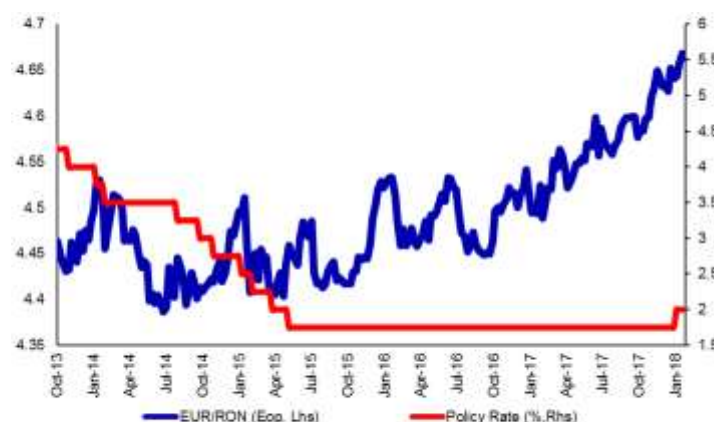
Romania: Macro & Market Data			
Macro indicators	**2016**	**2017e**	**2018f**
Real GDP (yoy, %)	4.8	7.0	4.0
Inflation (yoy%, avg)	-1.6	1.3	3.5
Fiscal Balance (%GDP, Cash basis)	-2.4	-3.0	-4.4
Gross Public Debt (%GDP, Cash basis)	39.1	40.5	41.7
Unemployment Rate (LFS, %)	5.9	4.9	5.0
Compensation of employees/head	10.3	9.5	6.5
Current Account (% GDP)	-2.2	-3.5	-4.0
Net FDI (EUR bn)	3.9	4.5	4.5
Domestic Credit	**2014**	**2015**	**2016**
Total Credit (%GDP)	44.4	43.9	41.2
Private Sector Credit (yoy)	-3.1	3.0	1.2
Loans to Deposits (%)	106.3	106.6	114.3
Financial Markets	**3M**	**6M**	**12M**
Policy Rate (Currently:1.75%)	2.00	2.50	3.00
EUR/RON (Currently:4.62)	4.64	4.65	4.70

Sources: National statistics, Eurostat, IMF, Ecowin Reuters, Eurobank Research

FIGURE 15: Monetary policy & FX rate 2013-2018



Serbia (Ba3/BB/BB)

New credit rating upgrades in December amid improving macroeconomic fundamentals

Real GDP picks up pace in Q4, bringing the 2017 reading to 1.8%

Serbia's Q4 GDP growth vindicated market expectations coming in at 2.5%YoY from 2.1%YoY in Q3, bringing the FY reading to 1.8%. The latter compares with real GDP growth of 2.8% in 2016. The breakdown of the data will be available at the end of Feb. However, last year's slowdown is mostly attributed to one-off factors, such as adverse weather conditions in the first half of the year, as very cold temperatures in the winter weighed on agriculture, construction, mining and energy, while a severe summer drought decimated crops. From the expenditure side, the recovery was mostly driven by strengthening private consumption. Looking ahead, growth is expected to gain momentum towards 3% this year amid strengthening private consumption as well as robust exports and investments. Increases in public sector wages and pensions are expected to boost household spending this year, while an improving business environment and low borrowing rates will likely support investments. Exports are seen remaining robust in view of a favorable external backdrop, but rising imports amid strengthening domestic demand will neutralize their positive input on economic activity.

New IMF deal likely to be PCI

The 36-month €1.2bn IMF Stand-By Arrangement (SBA) expires on Feb. 22 this year. According to recent comments by FinMin Dusan Vujovic, a new arrangement will probably be agreed before the summer and most likely entail the form of the non-financing Policy Coordination Instrument (PCI). A loan-free agreement echoes plausible as the government has already demonstrated throughout these three years under the SBA its own-financing capability, having treated the current programme as precautionary. Meanwhile, such a deal suggests continuation of reforms and provides a valuable policy anchor going forward. In this context, it is worth recalling the progress made under the current SBA. The economy has recovered from a triple-dip recession in 2009-2014, with economic activity having returned to positive growth readings from 2015 onwards. Real GDP growth reached an eight-year high of 2.8% in 2016, while last year's slowdown to 1.9% is largely attributed to temporary factors, such as adverse weather conditions, with the recovery expected to gain further momentum in 2018 on strong private consumption and investments. External imbalances have also improved, with the current account deficit having eased to a 15-year low of 3.1% of GDP in 2016 from a peak of 21.1% in 2008. Importantly, FDI inflows have remained robust over recent years, fully covering the CAD over the last two years. Furthermore, inflation has largely remained within or below the Central Bank's target since late 2013 and is expected to stay contained within the 3±1.5% tolerance band this year as well. The highlight of the improvement in Serbia's macroeconomic fundamentals has been the solid budget execution since 2015. The fiscal deficit of 6.6% of GDP in 2014 gradually narrowed to 1.3% of GDP by 2016 and is expected to have swung into an estimated surplus of ca 0.5% of GDP last year. As a result public debt has embarked on a declining trend, with the corresponding ratio to GDP having decreased as far as a 4-year low of 62.6% by November 2017 from a 14-year peak of 74.7% in 2015. Acknowledging these improvements all three major rating agencies have upgraded Serbia's sovereign credit ratings over the last three years. Fitch and S&P were the last to proceed to such action in December last year. Given that government finances continue to improve, external imbalances narrow further and economic activity picks up pace, new upgrades are possible in the months ahead.

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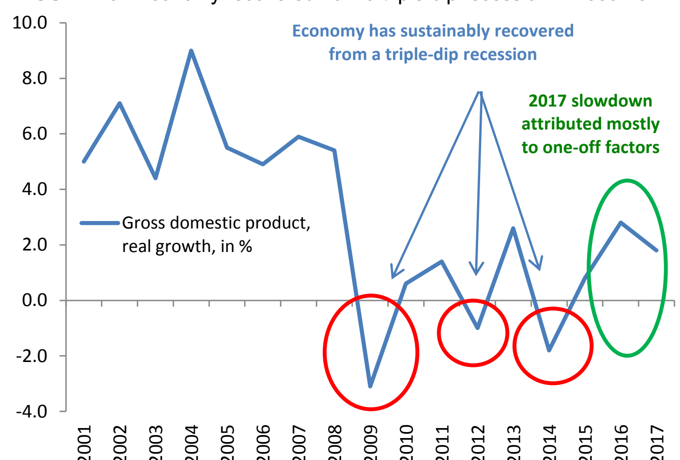
Serbia: Macro & Market Data

Macro indicators	2016	2017e	2018f
Real GDP (yoy, %)	2.8	1.8	3.0
Inflation (yoy%, avg)	1.1	3.2	3.0
Fiscal Balance (%GDP, Cash basis)	-1.3	0.5	-0.6
Gross Public Debt (%GDP, Cash bas	71.9	62.5	62.0
Unemployment Rate (LFS, %)	15.3	12.5	11.5
Wage growth (total economy)	2.5	0.9	3.2
Current Account (% GDP)	-3.1	-4.0	-4.5
Net FDI (EUR bn)	1.9	2.1	2.0
Domestic Credit	**2014**	**2015**	**2016**
Total Credit (%GDP)	61.0	62.3	63.6
Private Sector Credit (yoy)	0.5	3.3	5.6
Loans to Deposits (%)	102.5	99.0	92.0
Financial Markets	**3M**	**6M**	**12M**
Policy Rate (Current: 3.50%)	3.50	3.50	4.00
EUR/RSD (Current: 118.55)	117.00	115.00	116.50

Sources: National statistics, Eurostat, IMF, Reuters, Eurobank Research

FIGURE 16: Economy recovered from a triple-dip recession in 2009-2014



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