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REGIONAL ECONOMICS & MARKET STRATEGY MONTHLY

April 2018

Bulgaria | Cyprus | Romania | Serbia

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Regional assets lose ground as risk sentiment sours

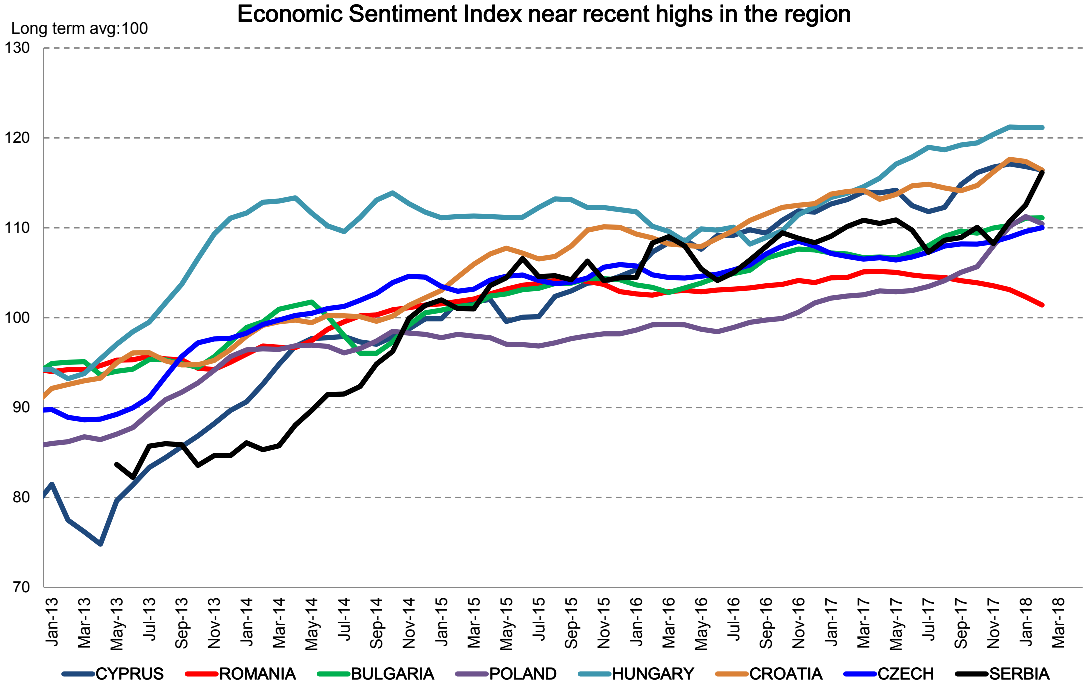
REGIONAL MACROECONOMIC & MARKET DEVELOPMENTS & OUTLOOK

- **Economic sentiment (ESI)** readings near recent highs across the region in **Q1-2018**
- **Regional** economies are about to, or have already, passed their **cyclical peak**
- Real disposable incomes are expected to continue rising albeit at a lower speed compared to last year, thereby providing support to **private consumption**
- The rise of **investments** is crucial for the **medium-term** growth prospects of the region
- **Different** inflation paths allow for **divergent** regional Central Banks' monetary policies
- **Regional assets** lose ground since mid-March on higher US Treasury yields, stronger US dollar, trade protectionism and geopolitical jitters
- **Regional currencies** remain little changed**, government bond yields** rise pressured by the increase in USTs
- **EM asset prospects remain positive** but risks lie ahead

COUNTRY FOCUS

- **Bulgaria:** Further labor market tightening in Q4
- **Cyprus:** Banking sector woes resurface
- **Romania:** NBR started liquidity absorption operations
- **Serbia:** Real GDP growth of 4.5%YoY in Q1, the highest in a decade

Economic Sentiment Index near recent highs in the region



Source: European Commission, Eurobank Research

Contents

I. Regional Macroeconomic & Market Developments & Outlook

Economic sentiment near recent highs in Q1-2018; regional assets lose ground as risk sentiment sours

Economic sentiment readings came out near recent highs for most of the regional economies in Q1-2018

The economic sentiment index (ESI) releases of Q1-2018 for most of the economies of the region were relatively strong. With the visible exception of Romania, economic sentiment releases for the economies of the region either reached new or stayed close to multi-month highs in the first months of the year on average. As ESI readings are highly correlated with economic activity, those readings reinforce our earlier views that regional economies are about to or have already reached their cyclical peak. So far, growth prospects still look very good for most of the economies in 2018. The outlook looks more challenging from a policymaking point of view, as lax monetary policies from both major and regional central banks have embarked on a normalization course which is expected to unfold fully in 2018. Yet, the rising trend of core and headline inflation metrics is uneven across the region allowing for different degrees of freedom in the respective CBs' monetary policies. The majority of CBs in the region maintain their cautiously accommodative stance. On the other hand, Romania is an outlier. NBR has already delivered two hikes of 25bps in the first two months of the year bringing the KPR at 2.25% and started liquidity absorption operations -- a de-facto tightening move -- given the inflation (expectations) jump.

EM assets lose ground since mid-March

Emerging market assets came under renewed pressure since mid-March amid higher US Treasury yields and a stronger US dollar. The occasional escalation of concerns over US trade protectionism and geopolitical jitters also weighed on risk sentiment. Idiosyncratic factors have been at play in some cases, while assets of developing countries' with large external vulnerabilities have been most hit.

Turkish assets hit on rising global risk aversion and idiosyncratic factors

In this context, new US sanctions against Russian companies/businessmen prompted a repricing of the country's assets in April. Turkish assets have fared worse than most of their EM peers over recent weeks, in view of elevated external financing requirements, high inflation in tandem with the lack of more aggressive Central Bank monetary policy response and heightened geopolitical risks. The lira hit a record low of 4.1920/$ in mid-April having shed circa 10% of its value YTD, while the main BIST 100 stock index has lost ca 7% in the last month and the 10-year benchmark bond yield hit lifetime highs near 13% in late April. Despite some recovery over the last few days in the wake of the announcement by President Erdogan of early presidential and parliamentary elections and new Central Bank monetary tightening delivered, Turkish assets remain amongst the worst performers in the EM space.

EM stocks mostly retreat erasing earlier YTD gains

Despite the recent rally in commodity prices supporting related shares, the broad MSCI EM index was poised to end April in the red for the 3rd month running, having fully erased hefty gains recorded earlier in the year. The index traded marginally higher than a 2 ½ month trough, with the latter achieved following an 11% decline from a decade peak hit in late January. Main indices in the countries of our focus were little changed over the last month or so, while on a year-to-date basis Romania's BETI was the main exception standing in the black with gains to the tune of 13.0% that were mostly recorded in Q1 2018. The index, which hit a decade high earlier in April, has likely been supported by higher-than-expected dividends while catching up with last year's EM rally, which it had lagged.

Regional currencies remain little changed, government bond yields rise

In the FX markets, regional currencies continued to trade little changed YTD, with ultra-loose monetary policies remaining mostly in place and acting against the region's strong growth prospects. The Serbian dinar remained range bound, with ongoing Central Bank interventions in the FX markets hindering any significant firming of the currency despite continuously improving macroeconomic fundamentals. In the sovereign debt markets, yields of both local and foreign currency-denominated paper have mostly risen lately pressured by the rise in US Treasuries.

EM asset prospects remain positive but risks lie ahead

Looking ahead, EM fundamentals remain positive overall. However, risks remain in the face of a faster than expected pace of monetary policy normalization by major Central Banks, geopolitical risks, trade protectionism policies, a sharper than expected slowdown in China and higher than anticipated inflation.

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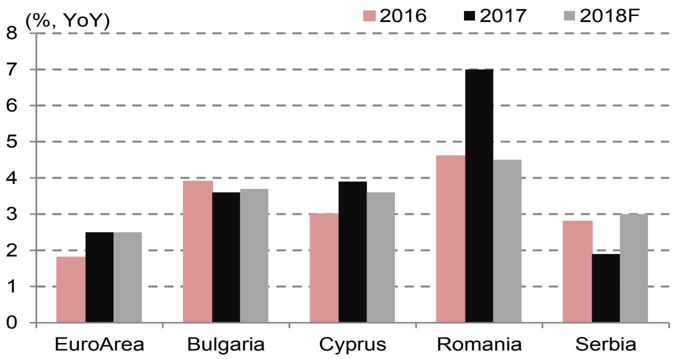
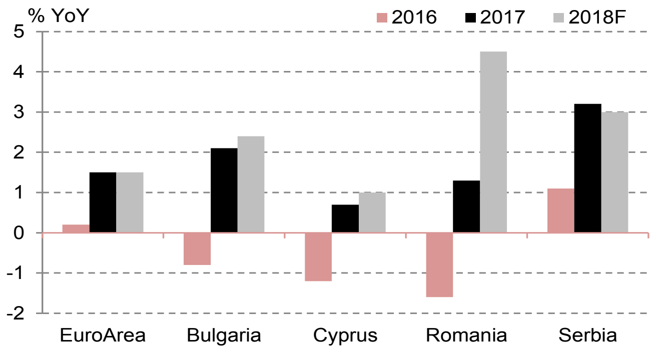
FIGURE 1: GDP Growth performance 2016-2018



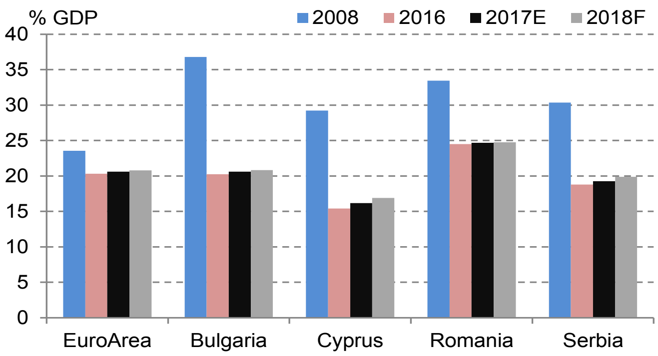
Source: Eurostat, National Authorities, Eurobank Research

FIGURE 2: Annual average inflation 2016- 2018



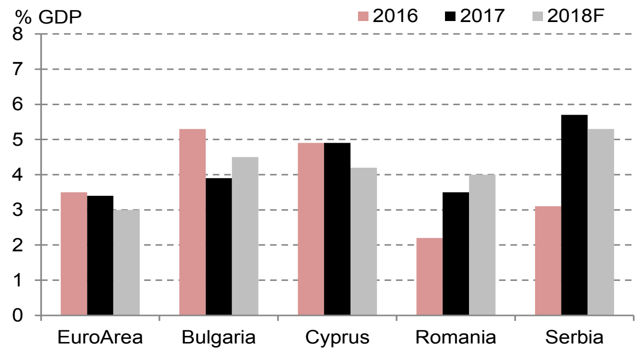
Source: Eurostat, EU Spring Forecasts, Eurobank Research

FIGURE 3: Investments to GDP ratios 2008 vs. 2018



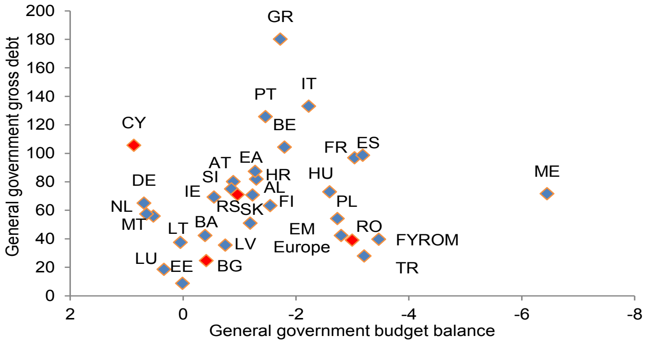
Source: IMF WEO, Eurobank Research

FIGURE 4: Current Account Balance (% of GDP) 2016-2018



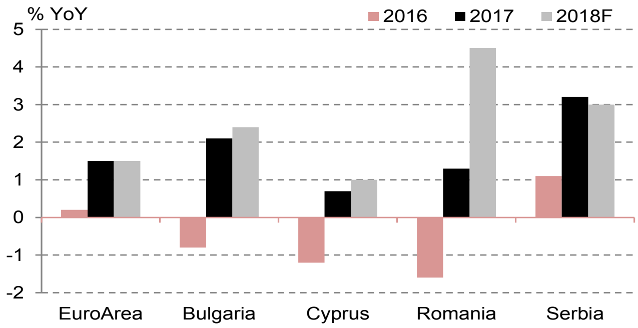
Source: Eurostat, National Authorities, Eurobank Research

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



Source: IMF National Authorities, Eurobank Research

FIGURE 6: Annual average unemployment rates 2016-2018



Source: Eurostat, National Authorities Eurobank Research

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

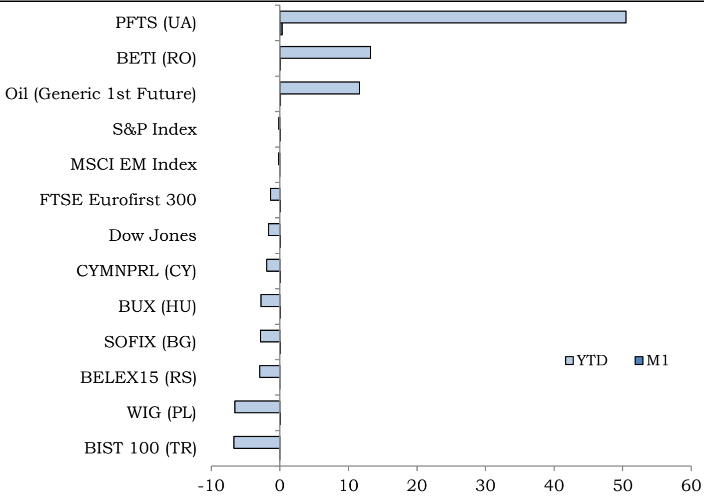


FIGURE 8: World & EM stock markets performance (rebased at 1/1/2016)

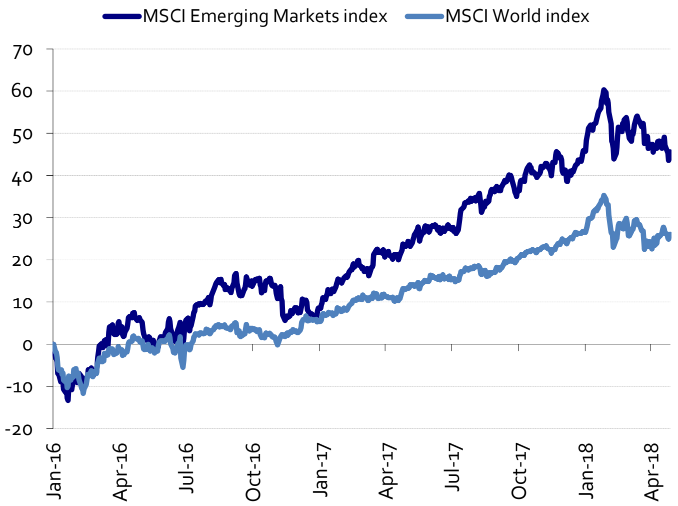


FIGURE 9: MSCI stock indices performance (by region)

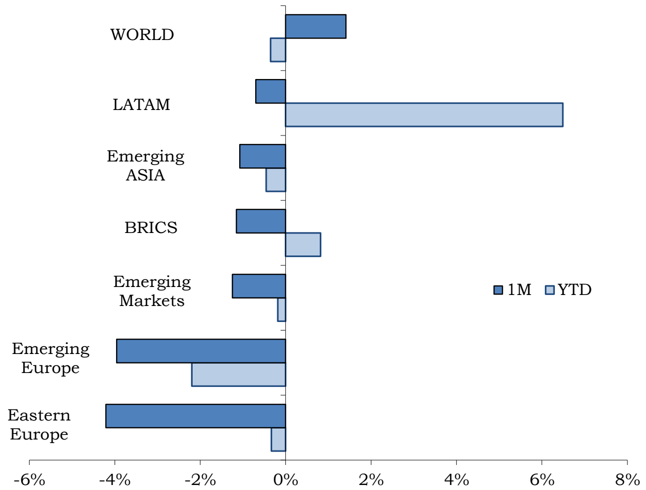


FIGURE 10: CESEE FX performance

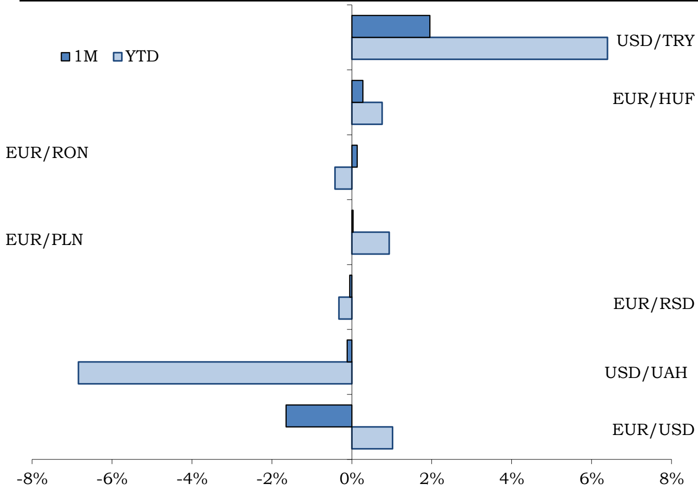
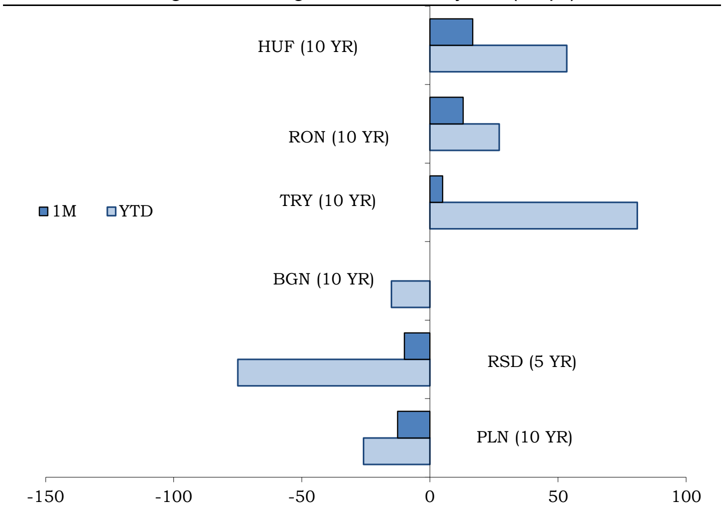
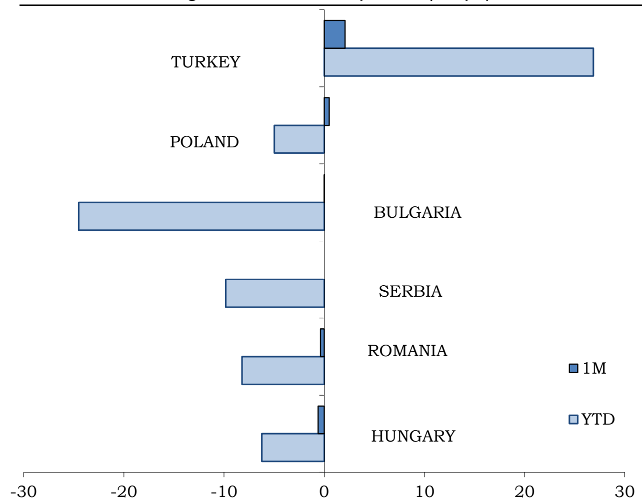


FIGURE 11: Change in CESEE government bond yields (in bps)



Source: Reuters, Bloomberg, Eurobank Research

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



Source: Reuters, Bloomberg, Eurobank Research

Trader's view

FX

Risks remain tilted towards further upside for the dinar

As has been the case so far this year, the EUR/RSD remained bound within a tight range over the last couple of months. The pair continued to hover around 118.00-118.60 in most of March and April as ongoing interventions by the National Bank of Serbia (NBS) hindered any attempt below the range's lower bound, which would have been otherwise justified by the country's improving domestic macroeconomic fundamentals. As part of its managed floating exchange rate regime, the Central Bank intervenes in the FX markets when it considers appropriate "in order to limit excessive daily oscillations in the foreign exchange market, contain threats to financial and price stability and safeguard an adequate level of foreign exchange reserves". In that respect, it has bought an amount slightly in excess of €700mn on a year-to-date basis in order to halt the dinar's upside momentum.

The macroeconomic improvement is compatible with a stronger dinar, in theory. However, recent history suggests that Central Bank interventions will most likely be extended in the weeks ahead, with the NBS continuing to have very active role in the FX market and the EUR/RSD remaining bound within tight ranges. That said, NBS is unlikely to stand against some fundamentally backed trend appreciation. However, a fast pace of dinar gains may trigger a more dovish policy shift (although its already stretched) given the recent weak inflation, which currently stands just below bottom of the official inflation target band.

Local rates

Further easing in Serbian bond yields cannot be ruled out

A similar quiet picture has also been evidenced over the last two months in Serbia's fixed income space. Trade in the front end of the yield curve appears very thin, with most investors appearing braced to "buy and hold". Along these lines, the recent Central Bank rate cuts appear to have had an impact mostly on paper with longer maturity, with the yield of the 10-year benchmark bond currently trading near 5.05% vs. 5.17% achieved on a primary action held on April 3rd. On the other hand, yield increases were observed at the belly of the curve, with the 5-year yield inching up to around 4.20% in late April to stand 5bps higher compared to that achieved at an auction of the same paper a few days earlier. In terms of the future rate path, we would not exclude another cut in the Central Bank's key policy rate, as we expect inflation to bottom out in April/May. This will especially hold should inflation ease further below the lower bound of the tolerance band target of 3.0+/-1.5%. That said, a move back within this range is likely to materialize late this year, which argues for stable interest rates in H2 2018.

Bulgarian local-currency bonds have stayed well supported since the beginning of 2018

Elsewhere, Bulgarian local-currency bonds have stayed well supported since the beginning of 2018. The corresponding yield curve experienced modest movements during April with the yield of the 8 year tenor increasing by 2.8 bps, while that of 9 year paper dropped by 2.6 bps. On the short end the 3 and 4 year yields dropped by 1.6 and 2.1 bps, respectively. The Bulgarian Ministry of Finance continued its recent policy and did not hold any auctions in April, while also not providing any indications of an offering in May.

FX-denominated government bonds

Meanwhile, Bulgarian Eurobond yields experienced strong increases over the last month or so

Meanwhile, Bulgarian Eurobond yields experienced strong increases across the board over the last month or so with the exception of the 2023 paper, which saw their yield dropping by 1.3 bps. The longest maturity, namely, the 2035 paper, continued to see its yield rising by a hefty 8.1 bps increase, while the 2024 and 2027 papers showed a more modest spike of 1.9 and 2.8 bps, correspondingly.

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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-)

Further labor market tightening in Q4

Labor market conditions tightened further in Q4-2017 to comparable levels back in 2008

Unemployment declined to 5.6% in Q4-2017 (down to comparable levels back in Q2-2008) vs 6.1% in Q3-2017 and 6.9% in Q4-2016. At the same, time employment has been expanding briskly by 5.1% YoY in Q4 vs. 5.2% YoY in Q3 compared to -1.7% YoY in Q4-2016. Overall, the economy has added another 133.5 thousand more jobs in 2017, the highest number in the post-Lehman period. From a sectoral point of view, the labor-intensive internationally non-tradable sectors such as construction (+19.5k), retail and whole sale trade (+26.6k) took the lead in job creation. Yet, tradable sectors such as manufacturing (+12.9k), agriculture (+17.3k), logistics (+14.4k) and accommodation services (+11.7k) recorded also sizeable gains. Although from a cross-country comparison, Bulgaria is still lagging behind its peers, the employment rate of people aged 20-64 climbed to 71.5% in 2017 against a national target of 76% in 2020, 3.6 ppts higher than in 2016 compared to only 63.0% in 2012. The economy is operating at or close to full employment (the relevant % of companies reportedly confronted with labor scarcity in the EU survey has climbed to 40% in Q4-2017 up from only 13% in Q4-2013). The labor market tightening has led wages to rally-albeit from a very low base-by 5.6% QoQ/+10.6% YoY in Q4.

Recent market talk and government officials' comments have focused on the probable Bulgaria's application for ERM2

The Minister of Finance, Vladislav Goranov, said in an interview that Bulgaria will apply for ERM2 by the end of June adding that there is public consensus on the necessity of Bulgaria's entry in the ERM2 and that there is no reason to postpone this step. The Minister also said that the current environment is more favourable for Euro Area enlargement as risks to the European economy are lower and its recovery is more advanced than the last time it allowed new members, i.e. the Baltic States. Finally, he pointed out that the government is ready to make the additional reforms or financial system adjustments, if required by the ECB, but will reject any attempts on the part of other EA members to treat Bulgaria unequally.

Although most of the nominal convergence criteria are currently satisfied, real convergence criteria are not

Joining the ERM2 mechanism for a period of at least two years is a formal prerequisite for Euroarea membership. In mid-June 2017, the incoming government of GERB had vowed to accelerate the application to ERM2 on top of the efforts by the caretaker government before the elections of late March2017. According to press reports of that time, Prime Minister Borissov had received support from both Chancellor Merkel and President Macron to go ahead with ERM2 application membership. Currently, Bulgaria fulfills most of the nominal convergence criteria for Euroarea entry. Real convergence criteria are not satisfied, although officially these are not part of the evaluation procedure. The living standards and productivity are the lowest in EU-28. The country is still subject to the Co-operation and Verification mechanism, which was set up in 2007 to monitor progress in the fields of judicial reform, corruption and organized crime. Factoring in the fast GDP growth trajectory in 2015-2018, GDP per capita in PPS terms will have only climbed to 50% in 2018. Finally, IMF in its latest Article IV report sees GDP growth moderating to 2.75% over the medium term, reflecting capacity constraints and unfavorable demographics.

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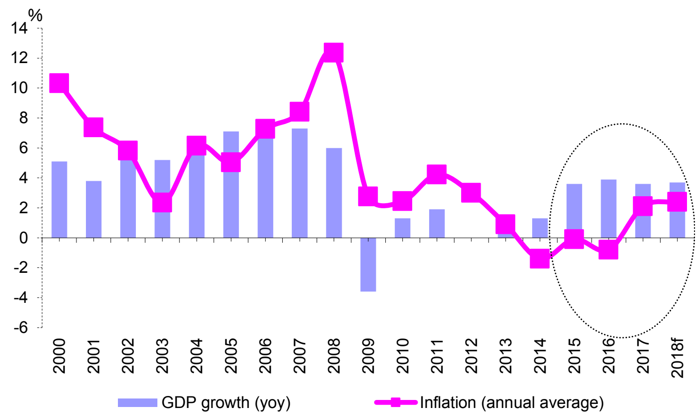
Bulgaria: Macro & Market Data

Macro indicators	2016	2017	2018f
Real GDP (yoy, %)	3.9	3.6	3.7
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)	27.4	23.9	23.5
Unemployment Rate (LFS, %)	7.6	6.3	6.0
Compensation of employees/head	3.9	4.1	4.5
Current Account (% GDP)	2.3	4.5	3.0
Net FDI (EUR bn)	1.1	1.0	1.0
Domestic Credit	**2015**	**2016**	**2017**
Total Credit (%GDP)	57.1	54.6	53.1
Private Sector Credit (yoy)	-1.2	1.5	4.8
Loans to Deposits (%)	78.2	74.1	73.1
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 2000-2018



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

Banking sector woes resurface

Market attention has turned to the rapidly evolving case of Cyprus Co-operative Bank (CCB) the second largest bank in terms of assets.

The State initiated the privatization of the Co-operative Bank (CCB) and placed a sizeable deposit in the bank to increase its liquidity. On March 19th, CCB provided access to a virtual data room in order to attract private investors. Recall, that CCB was the only bank which received €1.5bn state aid in 2013 plus another €175mn in 2015. On April 4th, Cyprus issued a number of 15-20Y government bonds of total nominal value of €2.35bn at market terms with the right for early redemption. Thereafter, the government placed a deposit of €2.5bn in the CCB and took in exchange €7.6bn in collateral (mostly NPEs) for the deposit. The transaction aimed at fully guaranteeing all deposits from any theoretical risk. Despite the intense restructuring efforts of the banks, the NPEs ratio still remains at relatively high levels, the second highest in the Euro Area behind Greece. The stock of NPEs declined by €3.2bn in FY2017 compared to €2.9bn in FY2016, bringing the stock of NPEs down by 24.5% between Dec2014-Jun2017. At the same time, total exposures decreased by €3.3bn (to €47.1bn in 2017), resulting in the ratio of NPEs to total facilities decline to 43.7% in Dec2017 compared to 47.2% in Dec2016. The NPEs as a percentage of GDP stood at 107.1% in Dec2017 down from 130.7% in Dec2016.

Following the last round of assessments, there remains a slight divergence of views between the rating agencies on the sovereign rating of Cyprus.

In late April, FITCH upgraded the long-term sovereign rating of Cyprus by one notch from BB to BB+ with a positive outlook. The rating agency cited the improvement in terms of external financing flexibility following the country's exit from the economic adjustment program in March 2016, which is evidenced in government's ability to tap international bond markets plus the large FDI inflows' increase in the construction, tourism, energy and education sectors, as the main driver behind its decision. 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 last year) and for Fitch (currently at BB+), three notches for both Moody's (currently at Ba3, last upgrade in late July last year) and DBRS (currently at BB Low, last upgrade in early June last year by two notches). Yet, rating agencies continue to assign a positive outlook in their Cyprus ratings.

The IMF mission visited Cyprus in late March for the second post-program monitoring (PPM) discussions

The IMF mission findings praised the sizeable improvement in macroeconomic and fiscal fundamentals, yet they emphasized that private sector indebtness and non-performing loans remain high. According to IMF, GDP growth is now expected to climb further to 4-4.25% in 2018. GDP growth is going to receive support from mainly foreign-funded, large construction projects, notwithstanding some deceleration in private consumption growth dynamics mirroring better households' compliance to their contractual debt obligations. Over the medium term, GDP growth is projected to ease to 2.5% as construction projects are gradually completed. Output growth reached a new post-Lehman high in 2017. Real GDP growth expanded by 3.9% YoY in 2017 up from 3.4% YoY 2016, compared to 2.0% YoY in 2015, and after three years of recession and a cumulative drop of 10.1% over 2012-2014. This is among the highest growth rates between Euro Area members (behind Ireland, Malta, Slovenia, Estonia and Latvia) and 1.7 times the average 2017growth rate in the Euro Area.

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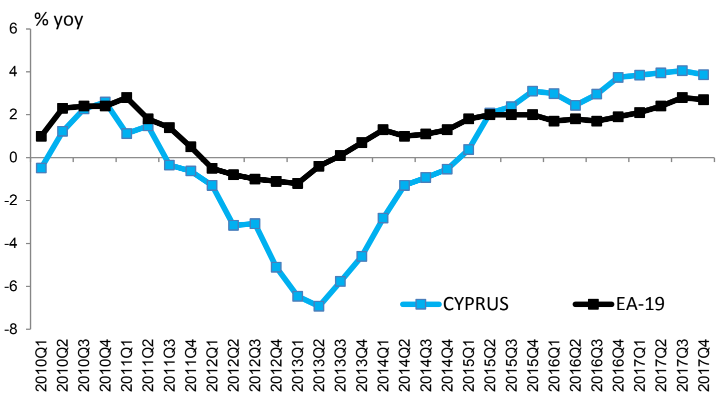
Cyprus: Macro & Market Data

Macro indicators	2016	2017	2018f
Real GDP (yoy, %)	3.0	3.9	3.9
HICP Inflation (yoy%, avg)	-1.2	0.7	1.0
Fiscal Balance (%GDP, Cash basis)	0.4	1.8	1.4
Gross Public Debt (%GDP, Cash basis)	107.8	97.5	105.0
Unemployment Rate (LFS, %)	13.1	11.1	10.0
Compensation of employees/head	-0.6	0.7	1.1
Current Account (% GDP)	-6.7	-6.2	-6.5
Terms of Trade (of Goods)	-0.4	0.2	-0.5
Domestic Credit	**2015**	**2016**	**2017**
Total Credit (%GDP)	360.8	308.3	267.3
Credit to Enterprises (%GDP)	151.5	125.3	107.8
Credit to Households (%GDP)	136.4	127.5	112.7
Private Sector Credit (yoy)	-3.4	-11.0	-7.1
Loans to Deposits (%)	136.6	112.6	103.9

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

FIGURE 14: GDP growth performance Cyprus vs. EA-19 2010-2017



Romania (Baa3/BB+/BBB-)

NBR started liquidity absorption operations

Headline inflation rallied to the highest level in five years in March

Consumer prices jumped to +5.0% YoY in March up from +4.7% YoY in February compared to 4.3% YoY in January, marginally higher than Bloomberg consensus. The monthly jump was mainly driven by higher non-food prices (+0.15% MoM/+6.6% YoY) reflecting the new regulated price increase for energy tariffs (as of Jan 2018) plus base effects from the phasing out of last year's VAT rate cut, thus making a 3ppts contribution to headline inflation. On top, food prices continued rising (+0.5% MoM/+4.0% YoY in March vs +0.6% MoM/+3.7% YoY in February) reflecting the upward trend of volatile fruits and vegetables. Finally, services expanded by +0.3% MoM/+2.9% YoY driven by higher utility and transportation prices. The reading on an annual basis is the highest in the last 5 years, so that headline inflation has penetrated the upper bound of the NBR's target interval (2.5+1%). The adjusted Core CPI (excluding administered and volatile prices, alcohol and tobacco) advanced further to 3.0% YoY in March up from 2.9% YoY in February, the highest level since June 2013, in an illustration of underlying demand side pressures. The PPI (Producer Price Index) has climbed up to 3.9% YoY in February compared to 3.4% YoY in December2017 vs. only 0.9% YoY in December2016, driven by higher energy and intermediary goods' prices.

NBR started liquidity absorption operations in mid-April, in order to tighten real monetary conditions further

The rising trend of core and headline inflation metrics is uneven across the region allowing for different degrees of freedom in the respective Central Banks' monetary policies. The majority of Central Banks in the region maintain their cautiously accommodative stance. On the other hand, Romania is an outlier in the region in terms of inflation metrics. NBR has already delivered 2 hikes of 25bps in the first two months of the year bringing the KPR at 2.25%- and surprised market expectations in the last meeting leaving it unchanged. In mid-April, NBR announced and held a one week tenor deposit tender for banks for the first time since Jan2011. The liquidity absorbing operation, mopped out RON18.7bn from the money market at a rate of 2.55%. The unanticipated move led money market rates and domestic bond yields to spike in response. The overnight deposit rate climbed to 1.55% a four month high, the yield on 2Y-bonds rose by 30 bps to 2.78% and RON strengthened close to 4.65/€. NBR has already delivered 2 hikes of 25bps in Jan-Feb bringing the KPR at 2.25%- and surprised market expectations in the April 4th meeting leaving it unchanged. As inflationary pressures have intensified, ceteris paribus, two more rate hikes looked unavoidable in our view in the next months. However, the liquidity absorbing operation, a de-facto monetary policy tightening tool could most probably be considered as a substitute for further rate hikes thus buying NBR more time to assess the situation.

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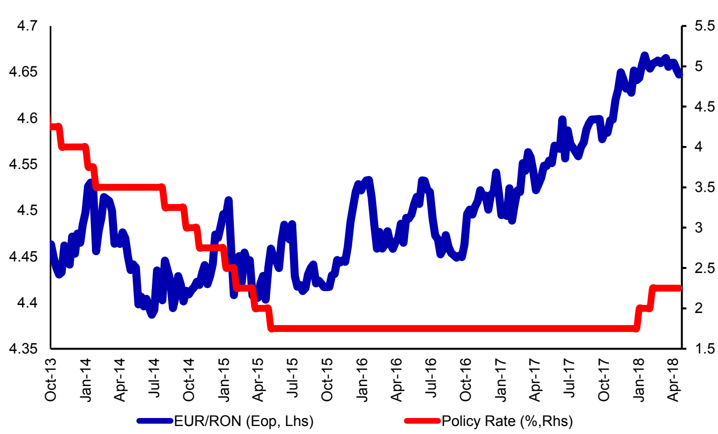
Romania: Macro & Market Data			
Macro indicators	**2016**	**2017**	**2018f**
Real GDP (yoy, %)	4.8	7.0	4.5
Inflation (yoy%, avg)	-1.6	1.3	4.5
Fiscal Balance (%GDP, Cash basis)	-2.4	-2.9	-3.5
Gross Public Debt (%GDP, Cash basis)	37.4	35.0	36.1
Unemployment Rate (LFS, %)	5.9	4.9	4.8
Compensation of employees/head	10.3	9.5	6.5
Current Account (% GDP)	-2.1	-3.4	-4.0
Net FDI (EUR bn)	4.5	4.6	4.2
Domestic Credit	**2015**	**2016**	**2017**
Total Credit (%GDP)	43.9	41.2	38.6
Private Sector Credit (yoy)	3.0	1.2	5.6
Loans to Deposits (%)	106.6	114.3	109.2
Financial Markets	**3M**	**6M**	**12M**
Policy Rate (Currently:2.25%)	2.50	2.50	3.00
EUR/RON (Currently:4.66)	4.70	4.70	4.75

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

FIGURE 15: Monetary policy & FX rate 2013-2018



Serbia (Ba3/BB/BB)

Real GDP growth of 4.5%YoY in Q1 the highest in a decade

Q1 GDP growth data outpaces expectations

As most recent high frequency macroeconomic data and sentiment indicators for Q1 2018 had suggested, economic activity kicked off the year on a positive footing, with real GDP growth of 4.5%YoY. The data outpaced a market median forecast of 3.1%YoY as well as the prior quarter's 2.5%YoY increase, recording the fastest rate of annual growth in a decade. It also marks a reversal of last year's H1 2017 soft patch that came primarily on the back of adverse weather conditions. In support of the aforementioned, annual growth in industrial production picked up pace on average in the first three months of the year, government spending also rose in January-February, while tighter labour market conditions were reflected via rising wages and employment early in 2018. Retail sales growth remained healthy and the Economic Sentiment Indicator (ESI) reached its highest level on record in April amid improving domestic macroeconomic fundamentals. All these positive trends will likely remain in place in the coming months, boosting domestic demand. Taking into account the strong Q1 GDP reading, risks to our full year 3%YoY forecast appear tilted towards the upside.

The dinar's recent strengthening and subdued inflation pressures provided leeway for another NBS rate cut in April

The National Bank of Serbia (NBS) cut the key policy rate by 25bps to a new record low of 3.00% at its meeting in April, confounding our and market expectations for stable rates. At the same time, the NBS Executive Board also decided to narrow the interest rate corridor from ±1.5 to ±1.25 percentage points, thus maintaining the deposit facility rate unchanged. The Committee's latest decision to reduce the key policy rate by 25bps follows a similar move in March and marks the second cut so far this year. Behind its decision, NBS cited weak inflationary pressures, anchored inflation expectations and a stronger than earlier anticipated slowdown in inflation over the last three months. Additionally, the MPC highlighted that the move will provide additional support to credit activity and economic growth. As also mentioned in the accompanying statement, headline CPI eased to 1.4%YoY in March, reaching the lowest level in 1 ½ years and sliding below the lowest bound of the 3.0±1.5% tolerance band that has been held since late 2016. Simultaneously, the corresponding core index (CPI excluding the prices of food, energy, alcohol and cigarettes) also decelerated in March, to a new record low of 0.8%YoY. Notwithstanding the aforementioned it is also worth noting the dinar's strength over recent months, which hit 3 ½ year highs just below 118.00/€ a few weeks ago, providing some indirect tightening effect on monetary conditions. Against this backdrop, the MPC noted that it anticipates inflation to stay around the current level in the months ahead and move closer to the target midpoint in 2019 on the back of strengthening domestic demand dynamics. Nonetheless, it reiterated several risks in the said statement, mostly external, such as "developments in the international financial market and movements of global primary commodity prices" as well as uncertainty of the future path of major Central Banks' monetary policies. That said, the Committee highlighted once again the domestic economy's resilience in the event of an adverse impact from these factors. Looking ahead, our baseline scenario is for the MPC to stay put on its monetary policy until year-end, as the recent retreat in inflation is mostly driven by temporary factors – namely, base effects – and is expected to eventually move higher as domestic demand dynamics improve further, labour market conditions remain tight and some fiscal loosening takes place in 2018, while external risks linger.

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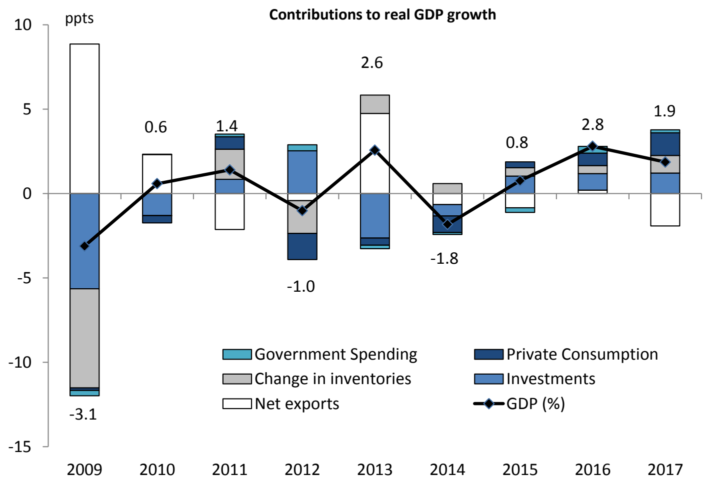
Serbia: Macro & Market Data

Macro indicators	2016	2017e	2018f
Real GDP (yoy, %)	2.8	1.9	3.0
Inflation (yoy%, avg)	1.1	3.2	2.5
Fiscal Balance (%GDP, Cash basis)	-1.3	1.2	-0.5
Gross Public Debt (%GDP, Cash bas	71.9	61.5	61.0
Unemployment Rate (LFS, %)	15.3	13.5	12.5
Wage growth (total economy)	2.5	0.9	3.2
Current Account (% GDP)	-3.1	-5.7	-4.5
Net FDI (EUR bn)	1.9	2.4	2.0
Domestic Credit	**2015**	**2016**	**2017**
Total Credit (%GDP)	62.3	63.6	60.5
Private Sector Credit (yoy)	3.3	5.6	3.6
Loans to Deposits (%)	99.0	92.0	95.0
Financial Markets	**3M**	**6M**	**12M**
Policy Rate (Current: 3.00%)	3.00	3.00	3.50
EUR/RSD (Current: 118.0)	117.00	115.00	116.50

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

FIGURE 16: Recovery driven by private consumption & investments



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