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

Risk-on mood supports regional assets in early 2017

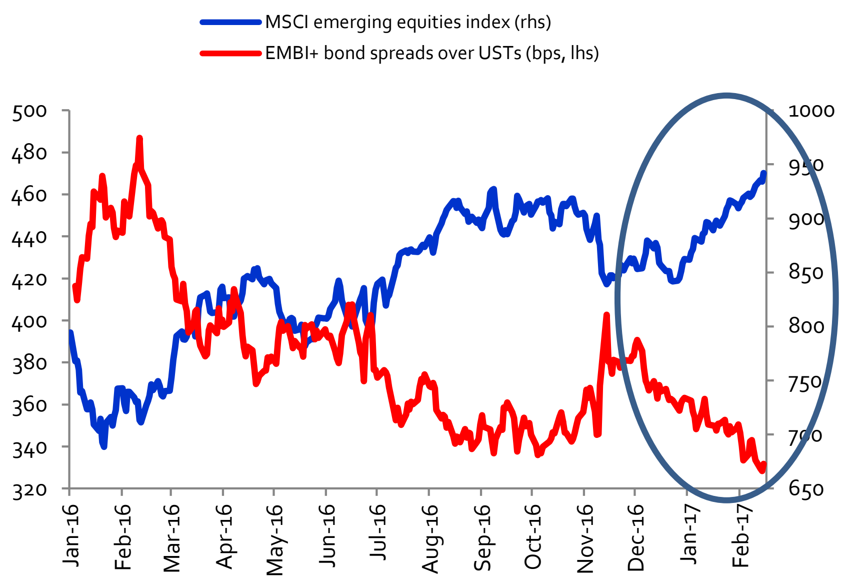
REGIONAL MACROECONOMIC & MARKET DEVELOPMENTS & OUTLOOK

- **Q4-2016 flash GDP estimates** confirm that the economies of the region are in good shape
- **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
- **Emerging market stocks** as well as **external sovereign** and **corporate debt** have broadly extended last year's gain
- The positive tone spread over to **regional assets**
- Most **EM currencies** firmed; but, in the CESEE space have been little changed, with country-specific factors remaining largely at play
- **Risks this year are particularly elevated** due to a cramped political events calendar in Europe, uncertainty over new US administration's policies, ECB and Fed monetary policies to remain in the forefront

COUNTRY FOCUS

- **Bulgaria:** Strong finish for the economy in the past year
- **Cyprus:** Banking sector deposits increase for the first time since 2013
- **Romania:** Fiscal risks on the rise
- **Serbia:** Real GDP growth to accelerate further in 2017

Emerging market equities rally in tandem with improving risk sentiment



Source: Bloomberg, Eurobank Research

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I. Regional Macroeconomic & Market Developments & Outlook

Q416 flash GDP confirmed positive prospects for countries of our focus; regional assets retain a firm tone

Flash estimates of GDP growth in Q4 across the region confirmed that the economies are relatively in good shape

GDP growth flash estimates for Q4-2016, recently released for the countries of our focus (Bulgaria, Romania, Cyprus, and Serbia), confirmed that these economies are in relatively good shape and broadly met their respective full year projections. 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. Looking ahead, the macroeconomic outlook of the region looks more challenging from a policy point of view in 2017. 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 the Fed tightening cycle has already kicked off for about a year now, the room for further monetary easing is relatively limited. At the same time, the room for further fiscal policy relaxation varies across the region. 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 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.

Emerging market stocks as well as external sovereign and corporate debt have broadly extended last year's gain

Capital flows towards emerging market assets appear to have remained strong in the onset of the new year. Emerging market stocks as well as external sovereign and corporate debt have broadly extended last year's gains. Trailing the rally in major global bourses developing nations shares have received strong support by the prevailing perception that US President Trump's expansionary fiscal plans will boost growth in the world's largest - and by implication the global - economy. The initial reaction to Trump's victory stirred a retrenchment of flows into emerging market assets. Investor optimism though over global growth prospects took centre stage, while concerns over the new administration's protectionist policies were placed on the backburner. The improved growth outlook has also overshadowed concerns that higher US interest rates will dent the appetite for currently higher yielding emerging market assets. Improving macroeconomic prospects (e.g. in Russia and Brazil) and somewhat easing political jitters (e.g. Turkey after the July 2016 failed coup attempt) have also provided some relief. With many countries heavily relying on commodity exports, the recent rise in prices has also favored related equity markets. To this end, the MSCI Emerging Markets index recently spiked to near 2-year highs after recording the best January - and so far February - performance in five years. The index has recorded a +10% YTD performance. The positive tone has spread over to CESEE assets, with Poland's WIG (at decade highs) and Turkey's BIST 100 (at 2-year highs) leading the region's recovery with gains of the order of 13%. The main stock indices in Romania and Bulgaria also followed closely, while Serbia's BELEX15 has lagged the rally. Along similar lines, in the external debt markets, spreads over USTs currently trade at their tightest levels since 2014, while YTD total returns have increased by approximately 3%.

Most EM currencies firmed; but, in the CESEE space have been little changed, with country-specific factors remaining largely at play

Most emerging market currencies have also firmed despite the USD's up-move earlier in the year. In the CESEE space, currencies have been little changed so far this year, with country-specific factors remaining largely at play. Central Bank interventions in the FX market in Serbia continue to keep the EUR/RSD within tight ranges, despite recently build depreciation pressures on the dinar. Elsewhere, increased domestic political jitters pushed the Romanian leu to a 7 ½ month high (4.5530/€) in February after the government adopted an emergency decree – it later repealed - easing anti-corruption legislation which stirred street rallies against the ruling coalition. The Turkish lira slid to record lows of 3.94/$ in mid-January before reversing some ground partly thanks to the Central Bank's liquidity tightening measures. The currency has come under pressure on deteriorating growth prospects, geopolitical tensions in the country's boarders, increased domestic security concerns following recent terror attacks and worries over the Central Bank's independence amid calls for monetary easing by high level politicians while inflation stands well above target. Adding to the lira's woes have been government-backed constitutional changes, envisioning the transition to a presidential system that will effectively give the President executive powers that have stirred concerns over power concentration. These developments have also been reflected on the country's deteriorating sovereign credit ratings, which now stand in junk territory by all three major rating agencies after a series of downgrades over recent months. Looking ahead, we reiterate that risks this year are particularly elevated in view of a cramped political events calendar in Europe and uncertainty surrounding the new US administration's policies. ECB and Fed monetary policies will also remain in the forefront.

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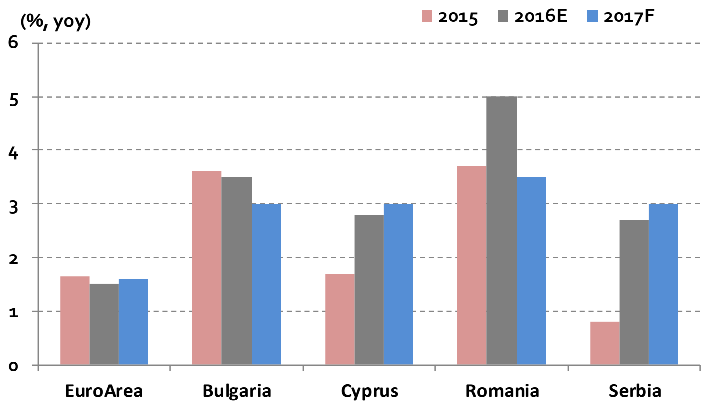
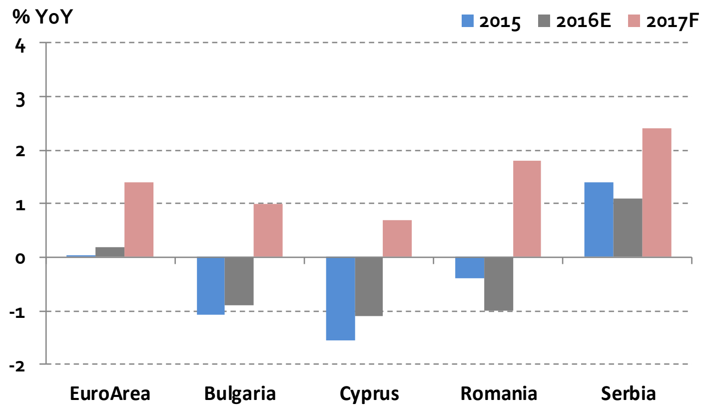
FIGURE 1: **GDP Growth performance 2015-2017**



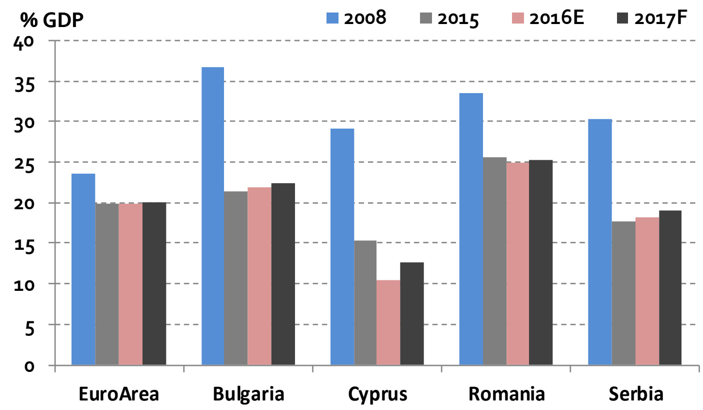
Source: Eurostat, National Authorities, Eurobank Research

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

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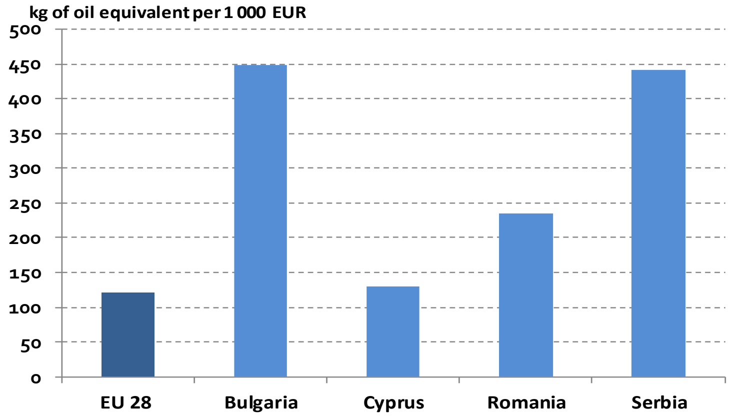

Source: Eurostat, National Authorities, Eurobank Research

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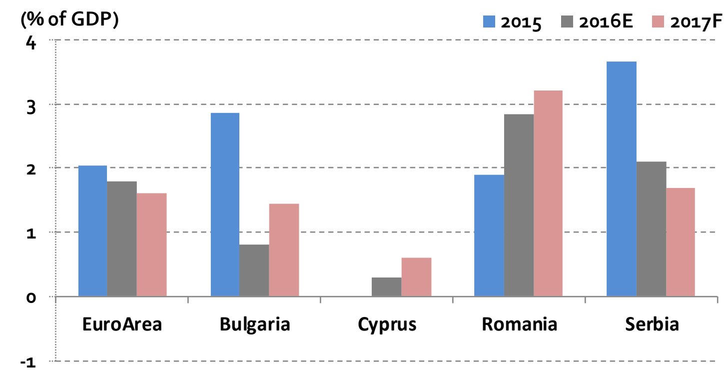
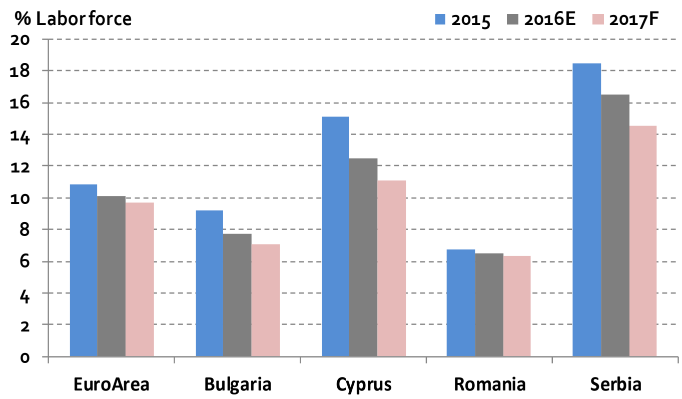


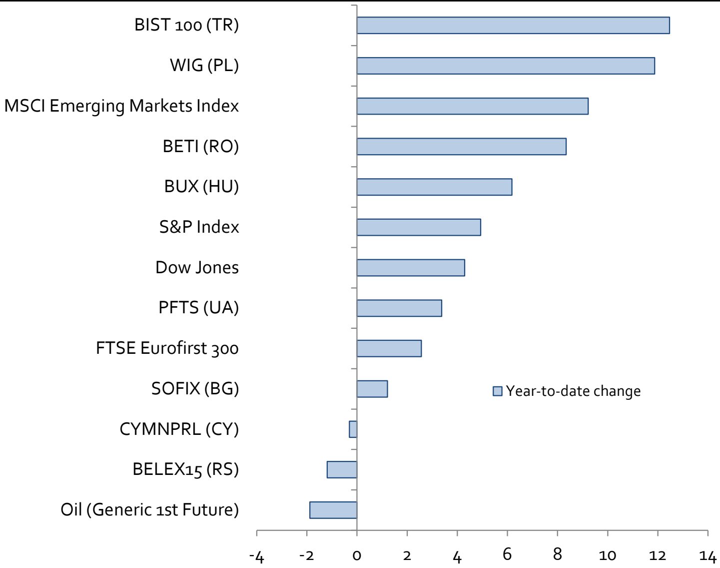
Source: Eurostat, National Authorities, Eurobank Research

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



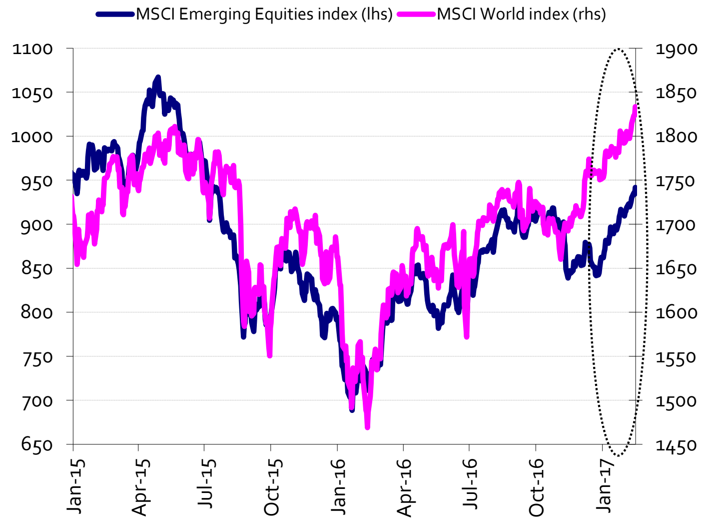
Source: Eurostat, National Authorities Eurobank Research

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

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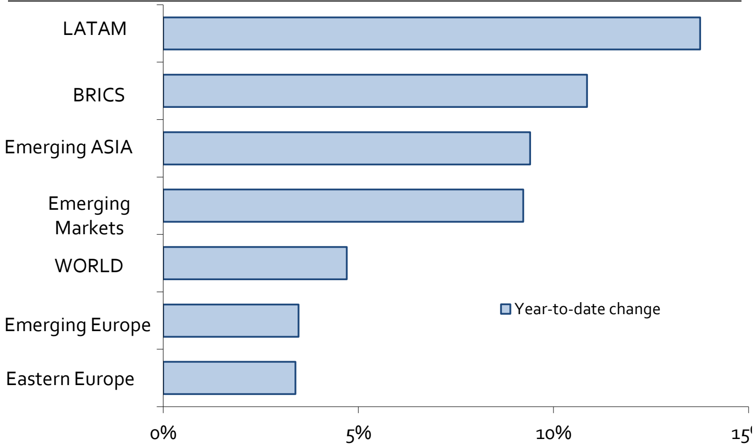
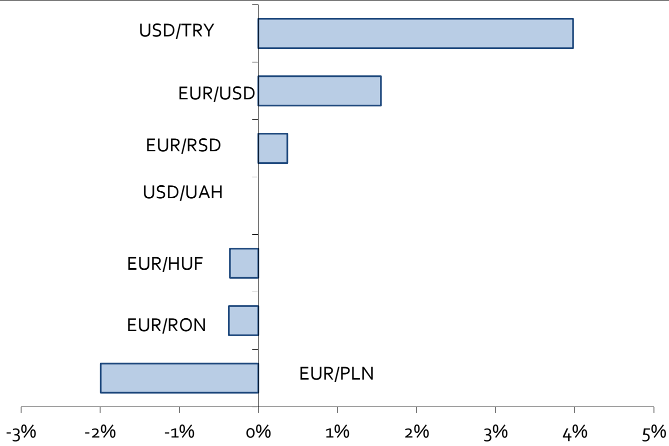


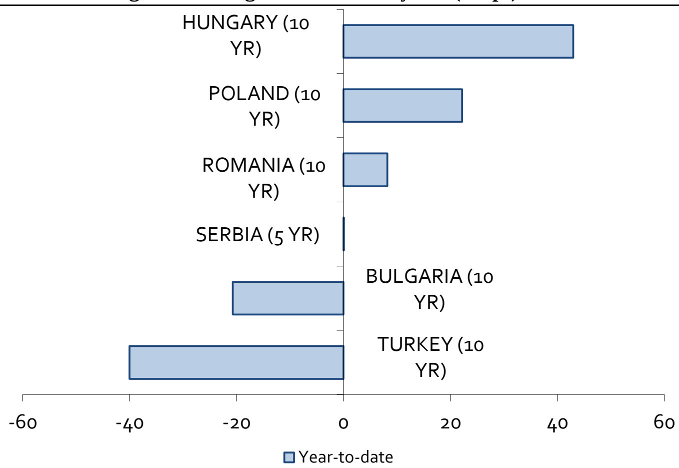
Source: Reuters, Bloomberg, Eurobank Research

FIGURE 10: **CESEE FX performance**



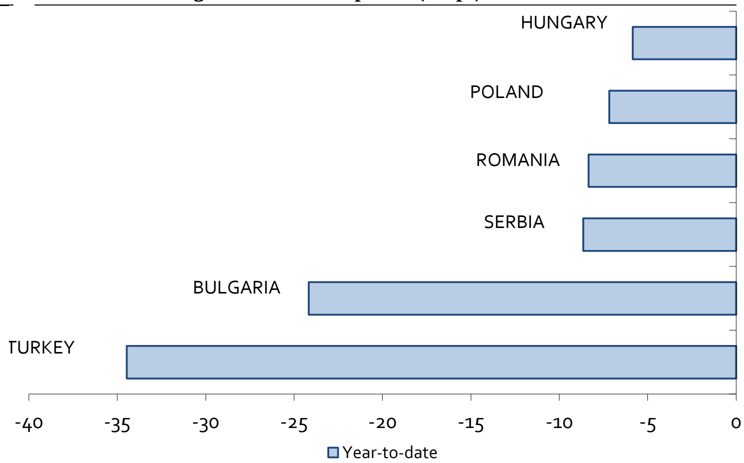
Source: Reuters, Bloomberg, Eurobank Research

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

II. Country Focus

Bulgaria (Baa2/BB+/BBB-)

Strong finish for the economy in the outgoing year

Snap elections date is finalized for March 26th

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As expected, the incoming President Rumen Radev dissolved the parliament in January 27th and appointed a new caretaker government. The caretaker government under the leadership of Prime Minister Ognyan Gerdzhikov is tasked to lead the country into snap elections on March 26th. Although the polls have not been a reliable predictor of the past elections results, this time it is highly likely that the elections will be a tight race between the ruling GERB and the BSP. If that happens, the winner will most probably have no absolute majority in the new parliament, making other minor parties' weight in the process of government formation more important

Growth remained on track in Q4-2016, bringing the FY2016 at 3.4%, an inch down from 3.6% in FY2015

According to the flash estimate, real GDP expanded by +0.9% QoQ/+3.1% YoY in Q4 compared to +0.7% QoQ/+3.4% YoY in Q3 and +0.9% QoQ/+3.8% YoY in Q4-2015. As usual, there will be another estimate of the national accounts data published at a later stage and there will likely be huge revisions and reallocations within the individual growth drivers' components. Despite negative base effects and the fiscal drag in Q4 from lower public expenditure, final consumption expanded by +1.3% QoQ/+0.9% YoY in Q4 up from +0.2% QoQ/+0.2% YoY in Q3 vs. +0.7% QoQ/+5.9% YoY in Q4-2015. Sustained labor market improvement coupled with positive real wage growth (9.4% YoY in 2016 vs. 9.9% YoY in 2015) supported consumption recovery throughout 2016. The unemployment rate declined further to 7.1% in 2016 vs. 9.2% in 2015 (7.1% in Q4 down from 8% in Q4-2015) as the economy adds new jobs in the areas of specialized services. In contrast, investments were in red for a third consecutive quarter in Q4 (GFCF: +1.2% QoQ/-1.5% YoY in Q4 vs. -0.9% QoQ/-1.8% YoY in Q3). 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. Finally, net exports seem to recover further after a poor reading in the 1H (Exports: +9.3% YoY in 2H vs. +3.0% YoY in 1H & Imports: +7.7% in 2H vs. +1.8% YoY in 1H) - and will most probably put an additional positive boost on growth in 2016 as well. Bulgaria is expected to register a second consecutive year of strong-above potential- growth in 2017.Private consumption dynamics are broadly set to remain strong as the economy benefits from a more expansionary fiscal policy stance, accelerated EU funds absorption in the new programming period, an improving labor market, catching up wages, a vibrant export oriented manufacturing sector and an emerging tourism destination. Yet, although the economy has proved relatively resilient to multiple past internal and external shocks, there is a high degree of uncertainty about how it could react to a prolonged period of domestic political uncertainty**.**

The budget execution outperformed the target by a wide margin in 2016

The consolidated government accounts in cash terms recorded a surplus for the first time since 2008. The surplus came at BGN 1.5bn or 1.6% of projected GDP in 2016 significantly above the 2% deficit target, up from a deficit of BGN2.9bn in 2015 or 2.9% of GDP. Total revenues expanded by 5.4% YoY, outperforming the 2.5% YoY target, helped by the overperformance of tax revenues (+8.2% YoY or 103.5% of the annual plan) and non-tax revenues (+11.9% YoY) mirroring the conservative growth assumptions of the previous budget, improved tax collection as a result of the effort to combat smuggling and the rise in excise tobacco taxes. In contrast, grants – funds reimbursed by EU-declined by -20.3% YoY driven by the lower EU funds absorption as a result of the closing of the previous programming period. The latter is also the main driver behind the expenditures underperformance. Total expenditures were down by -6.3% YoY reaching only 93.3% of the annual plan driven almost entirely by lower capital expenditures spending (down by -43.6% YoY or 3.5 ppts of GDP). Looking ahead, the budget of 2017 envisages a deficit of -1.4% of GDP at the consolidated government level. Even though the macroeconomic assumptions, upon the budget is built, early parliamentary elections in next spring and the probability of a policy regime change or an unstable new government have increased fiscal uncertainty for 2017 and budget execution risks given the previous experience of 2013-2014.

Inflation in December entered positive territory for the first time since September 2015.

Consumer prices rallied to +0.6% MoM/+0.1% YoY in December, up from 0.0% MoM/-0.5% YoY in November compared to +0.2% MoM/-0.6% YoY in October. As a result, the average annual inflation came at -0.8% YoY in 2016 compared to -0.1% YoY in 2015. Food prices, both the largest as well as the most volatile component of CPI, jumped to +0.9% MoM/+1.3% YoY in December up from -0.1% MoM/-0.2% YoY in November compared to -0.3% MoM/-0.3% YoY in October. The main driver was the rise in the prices of vegetables and fruits. Reflecting the normalization of global energy prices in Q4-2016, the deflation in transportation prices narrowed down to only +1.9% MoM/-0.6% YoY in December vs. -0.2% MoM/-1.3% YoY in November compared to a year low of +1.2% MoM/-11.5% YoY in last May. Looking ahead, inflation is expected to continue its gradual recovery in the coming months reflecting the impact of rising world energy prices and the adjustment of regulatory prices and excise hikes. So far, there is little evidence to support that underlying consumption-driven inflationary pressures are building despite its improving dynamics.

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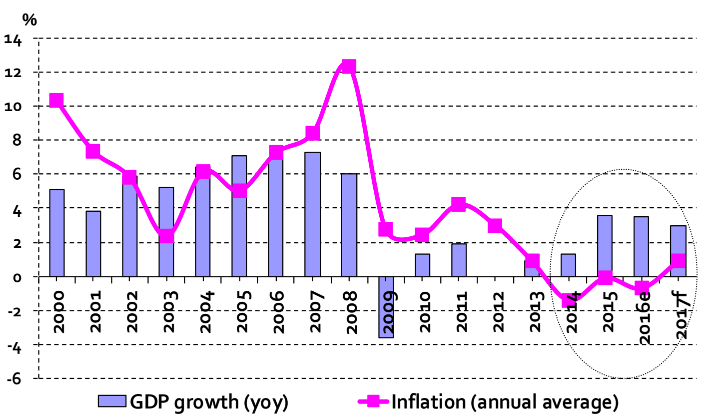
Bulgaria: Macro & Market Data

	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

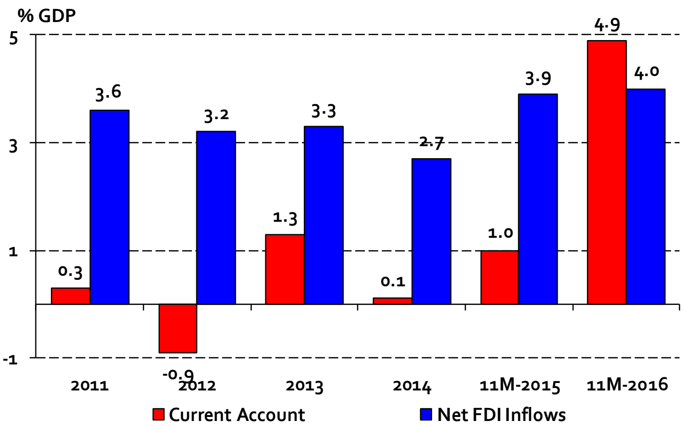
Source: National Sources, Eurostat, IMF, Eurobank Research

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



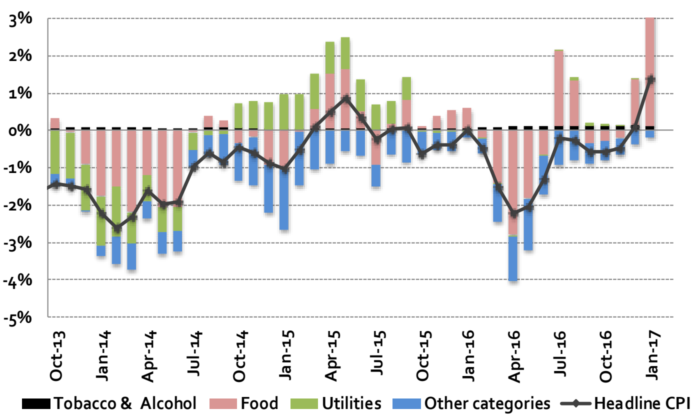
Source: National statistics, Ecowin Reuters, Eurobank Research

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



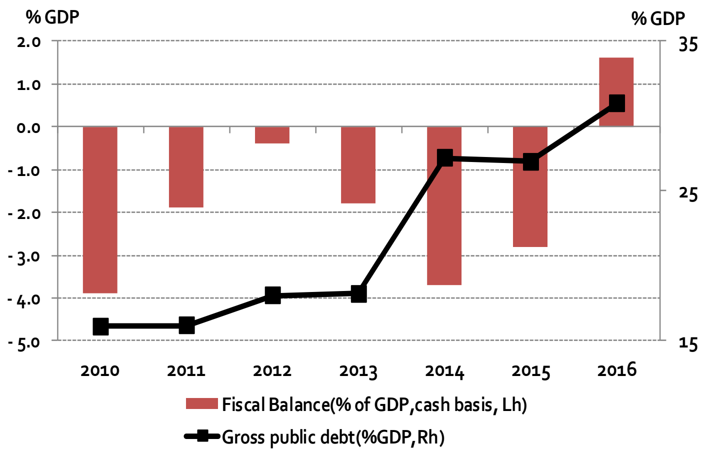
Source: National statistics, Ecowin Reuters, Eurobank Research

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



Source: National statistics, Ecowin Reuters, Eurobank Research

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



Source: Ministry of Finance, Eurobank Research

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

Banking sector deposits increase on an annual basis for the first time since 2013

The stock of banking sector deposits recorded the first increase on an annual basis for the first time in three years

The outstanding amount of deposits increased to €49bn in December 2016, up from €46bn in end 2015, 47bn in 2013 and 70.2bn in 2012. The increase was driven by the rise of the resident deposits segment by 3.7bn (from 32.9bn in 2015 to 36.5bn in 2016). Non-resident deposits decreased by 0.6bn (from 13.1bn in 2015 to 12.5bn in 2016). This reflects the combined effect of an increase in the segment of other Euro area resident deposits but also a decrease in the deposits stock of non-residents of the rest of the world. The segment of other Euro area residents increased from 2.7bn to 3.2bn (registering an increase by €0.5bn in 2016 for a second consecutive year in a row on top of 0.8bn in 2015). The deposits of the non-residents from the rest of the world declined further by 1.1bn down to 9.2bn in 2016 vs. 10.4 n in 2015.

Reliance on ELA funding eliminated in January

Cyprus had been making extensive use of ELA funding since October 2011. On the way to the dramatic events of March 2013, the dependence on ELA funding - a contingency liability on the sovereign balance sheet- grew over time to peak at €11.4 bn in March 2013. The ELA funding of Laiki Bank was folded into the Bank of Cyprus when they merged into one entity. However, the shareholders' capitals increase, the disposal of overseas operations, the redemption of the Laiki Bank's recapitalization bond and the steady increase of domestic deposits resulted in the swift decline of ELA funding and its full repayment in January 2017, while the regular financing from ECB operations stood at around €0.6bn.

The NPEs ratio is still very high despite the intense restructuring efforts of the banks

The stock of non-performing exposures (NPEs) declined by €2.6bn in the first ten months of the past year, bringing the cumulative decline to 11.9% in the period December 2014-October2016. The decline in NPEs reflects three main factors: increased repayments, the migration of successful restructurings to performing facilities after the completion of the observance period plus write-offs and settlements through immovable property exchange. On the other hand, the stock of total loans decreased by €8.6bn during the same period bringing the cumulative decline to 13.3% in the period December 2014-October 2016. The ratio of NPEs increased to 49.5% in October2016 compared to 45.8% in December2015 and 47.8% in December2014. The deterioration in the ratio does not mirror a further rise in the size the euro value of non-performing loans but rather the ongoing private sector deleveraging, which impacts the size of total loans in the denominator of the NPE ratio. Based on the EBA conservative definition a restructured NPE is still classified as an NPE for a probation period of at least 12 months, even if it is serviced without incurring new arrears. As a result, a large fraction of the restructured loans are still classified in NPEs (€10.1bn out of €13.6bn in October2016). The NPEs ratio in Cyprus is the highest in the Eurozone and among the highest historically recorded following a banking crisis, as in Ukraine (1998) or Iceland (2008). Most of the NPEs originate directly or indirectly from the downturn of the real estate market (mortgage or construction loans).

Banks have demonstrated mixed performance in the achievement of their restructuring targets in Q3-2016.

The Central Bank uses a set of four indicators to monitor the compliance of the banks in the NPEs restructuring process. In its statement the Central Bank noted that there is an over-performance of the target for the first indicator ("Proposed sustainable solutions") and a smaller over-performance for the third indicator ("Loans that have been restructured and present arrears of less than 8 days") pointing to the huge effort that is being made in sustainable restructuring of loans in arrears over 90 days. Specifically, the target for the first indicator was set at 14.6% and the actual realization was 18.7%. The target for the third indicator was 72.4% whereas the actual realization was 72.7%. However, the biggest under-performance was observed in the second indicator ("Concluded sustainable solutions") whose target was 15% and the actual realization was 10.2%. A smaller under-performance was observed for the target of the fourth indicator ("Loans that presented arrears of 31-90 days at the beginning of the quarter but by the end of the quarter do not present any arrears"), which was 44% whereas the actual realization was 41.3%

A historic record for the tourism industry in 2016 with 20% increase in arrivals

The positive momentum for the tourism industry continued in the last month of 2016. Tourist arrivals expanded by 12.2% YoY in December 2016 to 87,927, up from 78,348 in December 2015. The month of December was the eighteen consecutive month with a positive rate of increase on an annual basis. Overall, tourist arrivals increased by +19.8% YoY to reach 3.2mn in FY2016 vs. 2.7mn in FY2015, setting an all-time record high in the history of the Republic. According to the Cyprus Tourism Organization, the outgoing year was "a landmark year which will remain in history as the most successful year compared with any previous seasons". A double digit increase was recorded across all markets. A sharp increase of +48.9% YoY, +50.9% YoY, +23% YoY and +36.2% YoY was recorded in tourist arrivals from Russia, Israel, Ukraine and Lebanon in the same period. Tourist arrivals from traditional markets such as Germany (+10.5% YoY) and UK (+11.2% YoY) faired also relatively well. In addition, tourism revenues expanded robustly by +12.7% YoY in Jan-Oct 2016 to €2.2bn, up from €1.98bn compared to the same period last year.

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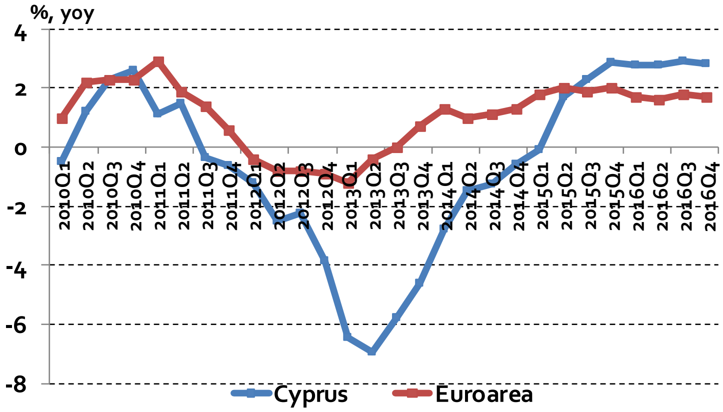
Cyprus: Macro & Market Data

	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%

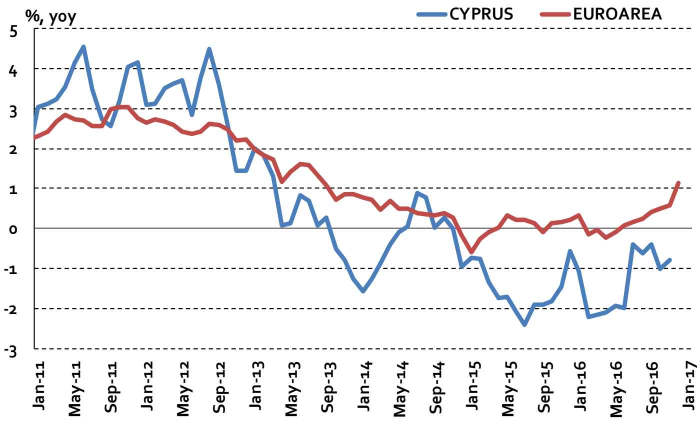
Source: National Sources, Eurostat, IMF, Eurobank Research

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



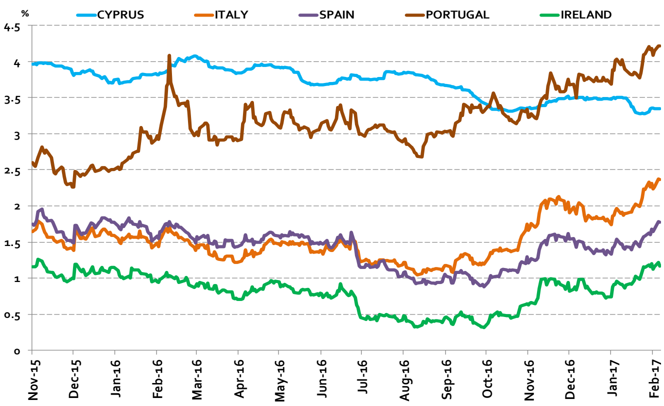
Source: Eurostat, Eurobank Research

FIGURE 18: **HICP Cyprus vs. Euroarea 2010-2017**



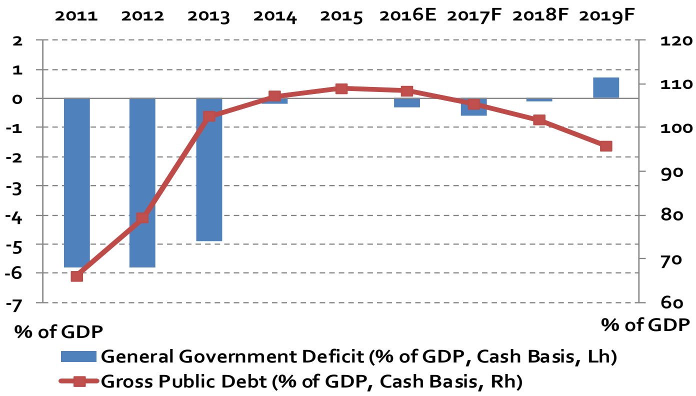
Source: Eurostat, Eurobank Research

FIGURE 19: **10Y Generic Government Bond Yield**



Source: Bloomberg, Eurobank Research

FIGURE 20: **Fiscal deficit & Gross Public Debt 2011-2016**



Source: Ministry of Finance, Eurobank Research

Romania (Baa3/BBB-/BBB-)

Fiscal risks on the rise

The current political cycle has come to an end but the political noise may have not

In line with expectations, the winner of the December parliamentary elections, the Social Democratic Party (PSD) formed an alliance with Alliance of Liberal Democrats (ALDE). Mr. Sorin Grindeanu, designated by PSD, assumed the post of the Prime Minister, after President Iohannis refused to appoint the party leader because of his criminal record. The PSD-ALDE coalition cabinet, consisting of 27 ministries, came in office in early January. The coalition controls 174 out of 329 seats in the chamber of deputies and 76 out of 136 seats in the senate. Although a safe parliamentary majority is good for government stability, it does not necessarily mean the end of political noise. Among its initial announcements, the incoming government has pledged to reform the judiciary in a move that could be seen as a setback against the anti-corruption drive and may bring them at odds with EU institutions and the President. Secondly, the new cabinet has announced a number of new expansionary measures, including raising public wages and pensions further in order to fulfill its generous electoral promises; it pledged to maintain fiscal deficits under control by raising additional revenues from growth and improved tax collection. So far, growth dynamics were driven by a private consumption spending boom, fuelled by the unwarranted pro-cyclical fiscal stimulus, pushing the economy above its potential.

The main macroeconomic assumptions of this year's budget are overly optimistic. We see risks to the budget execution

This year's budget is built upon the macroeconomic assumptions of a +5.2% rate of GDP growth, a +1.4% average inflation, a nominal GDP of RON 815.2bn, a 4.3% employment increase, a fiscal deficit target of 2.96% of GDP in cash basis terms or 2.99% in ESA2010 terms in 2017. Revenues are forecasted to expand by 13.9% YoY in order to reach 31.3% of projected GDP. Expenditures are forecasted to increase by 15.2% YoY to reach 34.2% of projected GDP. The budget incorporates the ruling coalition's electoral program for generous public sector wage hikes and further tax cuts effective from the beginning of the year. As a result, the public sector wage bill is expected to rise further, from 7.3% of GDP in 2017, to 7.9% in 2016, while the pension expenditures plus other social transfers are forecasted to reach 11% and 3.8% of GDP in 2017, up from 10.8% and 2.1% in 2016 respectively. Public investments are expected to reach 4.2% of GDP in 2017, provided that the program is fully implemented, up from a realized 3.9% in 2016. Overall, the additional expenditure on pension and public wage pledges adopted by the incoming government are expected to generate another 1.1% of GDP (around RON9bn) of additional fiscal stimulus on top of the announced 1.2% tax cuts package. The package includes the cut of the headline VAT rate to 19% from 20%, the reduction of excises for fuels, the removal of the tax on special constructions and the tax exemption of reinvested profits. Under a no policy change assumption, the fiscal deficit is expected to swell to over 4% of GDP in 2017, well beyond the 3% threshold, up from a projected 2.4% in 2016 and only 1.5% in 2015. Assuming this risk materializes, the incoming government may be inclined to adopt a more conservative fiscal stance in H2 that may have a negative impact on this year's growth dynamics. Ceteris paribus, the structural deficit is going to climb to 2.9% of GDP in 2017-2018 and decline only to 2.6-2% in 2019-20, up from only 0.5% in 2015, off the MTBO target track.

The Constitutional Court postponed its ruling on the CHF loan conversion law for the second time until February 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.

Inflation remained in negative territory in December for an eighteenth month in a row.

Inflation edged higher to +0.2% MoM/-0.5% YoY in December vs. +0.1% MoM/-0.7% YoY in November, in line with revised official forecasts. The monthly spike was driven by the increase in the volatile components of food (vegetables +1.8% MoM, fruits +1.1% MoM and eggs: +6.8% MoM) as well as fuels prices (+1.6% MoM). The adjusted Core CPI (excluding administered and volatile prices, alcohol and tobacco) declined to +0.3% YoY in December, down from +0.5% YoY and +0.6% YoY in November and October respectively, still depressed by the previous headline VAT rate cut (from 24% to 19%). On the other hand, HICP at constant taxes ended at 1.9% in December compared to 1.6% in November. The minutes from the policy meeting in early January -suggest that NBR continues to be on wait-and-see mode, leaving the key policy rate unchanged at 1.75%. There are still a number of elevated risks, both internal and external, that NBR is increasingly aware of and will specify the timing of the initiation of monetary policy tightening. On the external front, there is a still high degree of uncertainty about the impact of President Trump policies and a heavy election calendar in the markets of core Europe. On the domestic front, NRR has taken note of increasing fiscal risks for the economy stemming from the pro-cyclical expansionary policies, providing further post-election public wage hikes and tax cuts.

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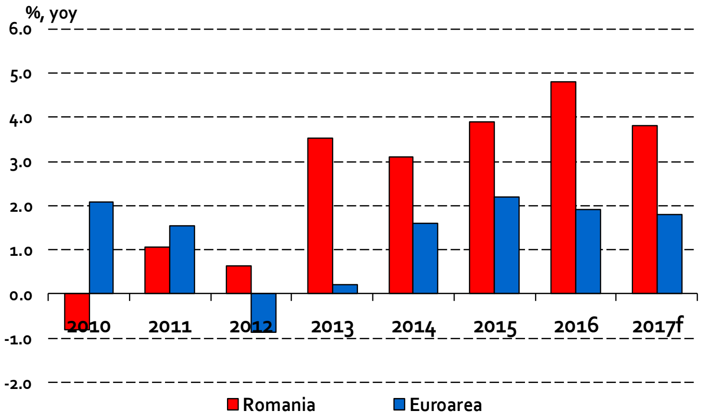
Romania: Macro & Market Data				
	2014	2015	2016f	2017f
Real GDP (yoy%)	3.1	3.7	5.0	3.5
Inflation (yoy%)				
CPI (annual average)	1.1	-0.6	-1.8	1.5
CPI (end of period)	0.8	-0.9	-0.4	2.0
Fiscal Accounts (%GDP, Cash Basis)				
General Government Balance	-1.9	-1.9	-2.8	-3.7
Gross Public Debt (including 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

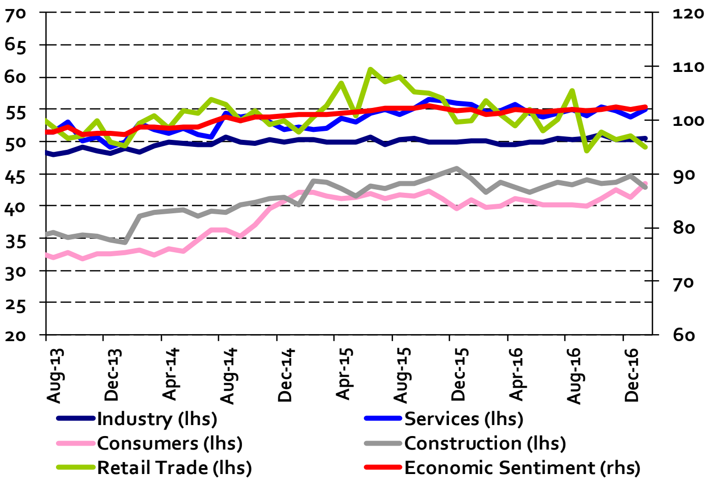
Source: National Authorities, EC, IMF, Eurobank Research

FIGURE 21: **Growth performance Romania vs. EU28 2010-2017**



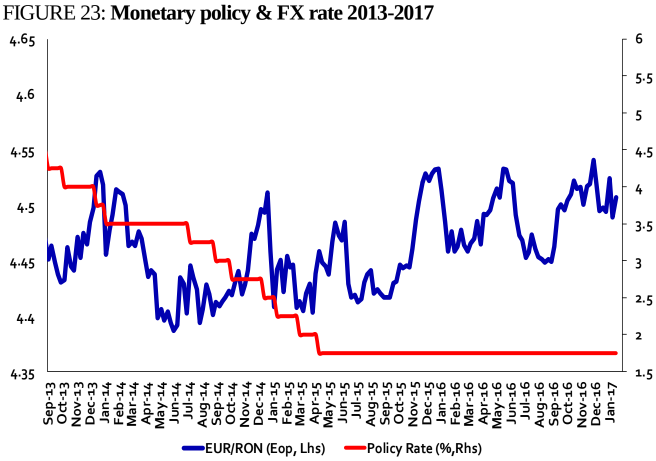
Source: Eurostat, Eurobank Research

FIGURE 22: **Sentiment indicators 2013-2017**



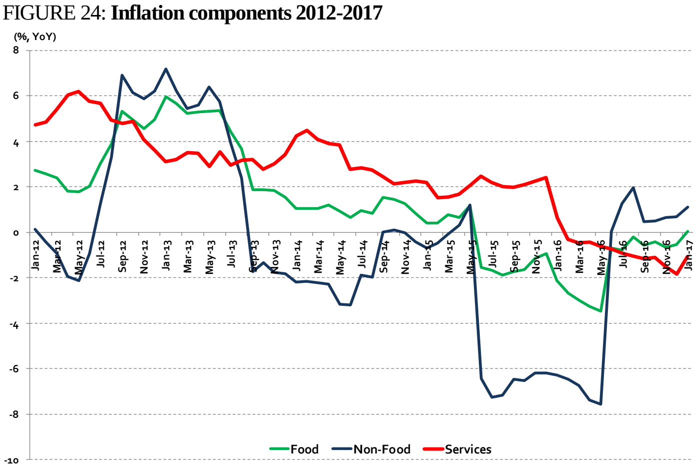
Source: Eurostat, Ecowin Reuters, Eurobank Research

FIGURE 23: **Monetary policy & FX rate 2013-2017**



Source: Bloomberg, Eurobank Research

FIGURE 24: **Inflation components 2012-2017**



Source: National statistics, Eurobank Research

Serbia (B1/BB-/BB-)

Real GDP growth to accelerate further in 2017

Presidential elections loom in spring; prospect of snap general polls also speculated

Serbia is braced for presidential elections scheduled for this spring. The actual date has not yet been set, but unofficial reports suggest that the vote is likely to take place on April 9th. Ending weeks of speculation, the leadership of the ruling Serbian Progressive Party (SNS) announced in mid-February that Prime Minister Aleksandar Vucic would be nominated as the party's candidate in the election deciding against supporting the candidacy of incumbent president and founder of the party Tomislav Nikolic. Prime Minister and SNS leader Vucic enjoys strong popular support and, according to opinion surveys, he could win the election in the first round. Although the President's position is largely ceremonial, the fact that the election is based on popular vote grants a high level of influence over national politics. Therefore, in order to preserve governing continuity, it is essential for the ruling SNS party to win the ballot. Another possible scenario currently being speculated by the media is the prospect of snap general elections that would be held in tandem with the presidential poll. It is argued that merging the two election processes would likely produce twofold positive results that would strengthen the SNS's mandate, motivating the Progressives' supporters to vote in favor of their presidential candidate and renew its four-year government tenure. Despite the fact that this would be the fourth parliamentary election in five years, it is does not appear to bear risks for significant changes in the domestic political landscape. To that end, the opposition appears to still be fragmented and weak and is unlikely to pose a threat to the ruling coalition alliance.

Real GDP growth came in at 2.7% last year; 2016 positive trends expected to continue this year

Overall, economic activity figures remained fairly positive in the last quarter of 2016. Real GDP growth came in at 2.5%YoY in Q4 2016, marking the 7th consecutive quarter of positive annual growth after floods-induced recession in 2014. Full-year growth is estimated at 2.7% in 2016, having accelerated from 0.8% in 2015. The breakdown of the data is not yet available. However, investments likely remained among main growth drivers, assisted by strong FDI inflows, while private consumption is also seen on the rebound thanks to improved labor market conditions and increased consumer lending. Recently released higher frequency data have also proved supportive. Industrial production grew by 4.7% last year, while the manufacturing component, which accounts for ca. 70% of total industry, rose by ca. 5.4%. The most positive signals came from trade data last year, where exports growth of 11.5% strongly outpaced that of imports (6.1%), pushing the overall deficit ca 9% narrower compared to a year earlier. The latter will likely be translated in a record low current account shortfall near 4.0% of GDP. Labor market conditions also appear to be on the mend, with the LFS rate of unemployment having fallen, from 17.7% in Q3 2015, to 13.8% over the same quarter a year later. Gross wages finally began to improve in 2016 after three years of declines, with a rise of 2.5% in real terms being fully attributed to the private sector. Nonetheless, wages are still only at the 2008 levels and amongst the lowest in Europe. All in all, economic activity is anticipated to gain further momentum in 2017 as last year's positive trends are expected to continue and private consumption is anticipated to recover further on real wage growth and targeted increases in public wages and pensions.

General government deficit outperforms fiscal target in 2016; interest rates likely to remain stable this year

Fiscal consolidation continued unabated last year. The general government deficit (% of GDP) amounted to 1.4 in 2016, significantly outperforming both initial and revised targets of -4.0 and -2.1, respectively, and narrowing from the prior two years' shortfalls. Revenues rose by 8.7%YoY to 43.8% of GDP mostly thanks to better-than-anticipated growth dynamics and improved tax collection. At the same time, expenditure remained rather constrained, registering a 3.0%YoY increase to 45.2% of GDP. Fiscal consolidation is anticipated to slowdown as of this year, but at current levels the deficit bodes well for further reduction in the public debt. Notably, the latter decreased in 2016 (73.5% of GDP) for the first time in nearly a decade. With regards to MPC developments, the National Bank of Serbia (NBS) kept in February the benchmark rate at the 4.00% record low for the 7th month running. The MPC delivered in July last year the latest cut under the current monetary easing cycle, which started in May 2013. Since then, the amount of cumulative rate easing rendered totals 775bps, with the cycle appearing to have already reached a trough. Supporting the Central Bank's said monetary policy accommodation, inflation pressures have remained subdued over the last three years. Headline CPI (at 1.6%YoY in December) has remained firmly below the 2.5-5.5% target band since early 2014 thanks to previously low global commodity prices, a restrictive fiscal policy and a negative output gap. However, it is anticipated to return within the new official tolerance band of 1.5-4.5% early this year as global oil prices rise further, aggregate demand recovers and inflation rises internationally. At the same time uncertainties lie ahead, both in the domestic as well as the international environment constraining the prospect for further rate easing. Namely, the monetary policy paths that will be pursued by leading Central Banks, which affect global capital flows, and the looming presidential election in Serbia this spring may prove sources of heightened volatility in Serbian markets. The aforementioned risks in tandem expectations that inflation will rise but remain within the target tolerance band this year argue in favor of stable interest rates in 2017.

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Serbia: Eurobank Forecasts

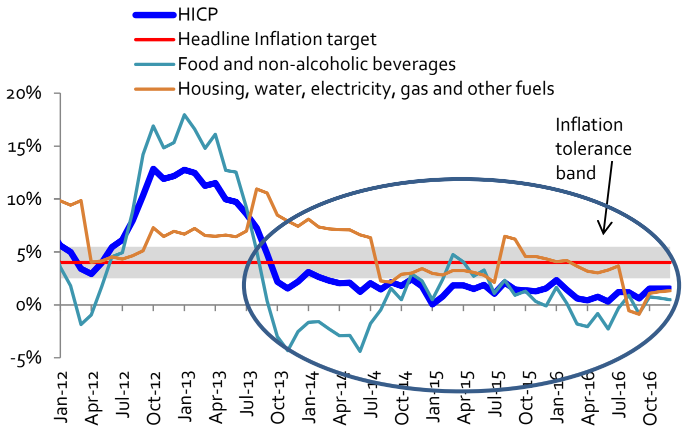
	2014	2015	2016	2017
Real GDP (yoy%)	-2.0	0.8	2.7	3.0
Inflation (yoy%)				
HICP (annual average)	2.9	1.9	1.2	2.1
HICP (end of period)	1.7	1.5	1.6	2.5
Fiscal Accounts (%GDP)				
Consolidated Government Deficit	-6.6	-3.7	-1.4	-1.3
Gross Public Debt	70.4	74.7	73.5	72.3
Labor Statistics (%)				
Unemployment 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: **Recovery in private consumption and wage growth continues (3MMA)**

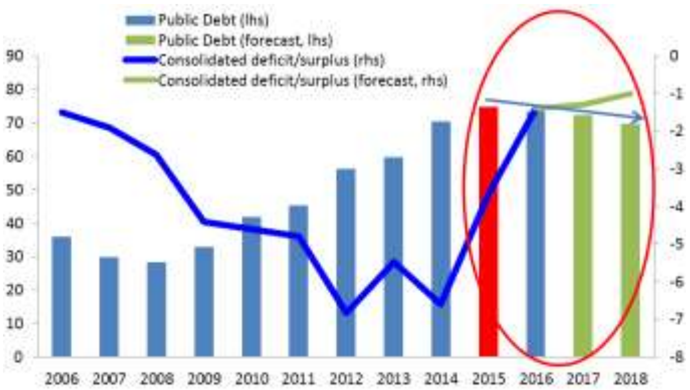
Source: National Authorities, EC, IMF, Eurobank Research

FIGURE 26: **Inflation pressures remained subdued last year as well**



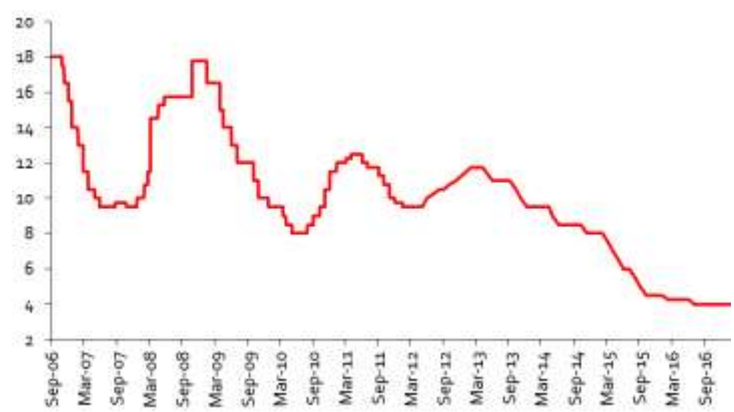
Source: National Authorities, Eurobank Research

FIGURE 27: **Serbia's fiscal position on the mend (% of GDP)**



Source: National Authorities, EC, IMF, Eurobank Research

FIGURE 28: **Key policy rate at 4.00% record low, with current cycle appearing to have reached a trough**



Source: National Authorities, EC, IMF, Eurobank Research

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