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Flash GDP estimates suggest that the economies of the region remained on solid footing in Q2-2016

- A number of national statistics offices across the region released last week flash estimates of GDP growth for the Q2-2016. Among them, three economies of our focus Bulgaria, Romania, Cyprus and earlier this month Serbia published relative strong flash GDP estimates. Vindicating our and market expectations, those readings suggest that the economies of the region remained on solid footing in Q2-2016

- From a growth point of view, we still anticipate growth to accelerate in the economies of our focus compared to 2015. As things stand at this moment, it would be fair to say that 2016 is braced to prove another very good year for the region, most probably the best since 2008. Low direct trade, FDI and banking sector ties with UK help the economies of our focus cushion any negative short-term impact from BREXIT. On the other hand, the broader region is significantly exposed to a Euro area slowdown due to a UK exit, given the former's role as a key trade partner and a major capital flow generator for the region.

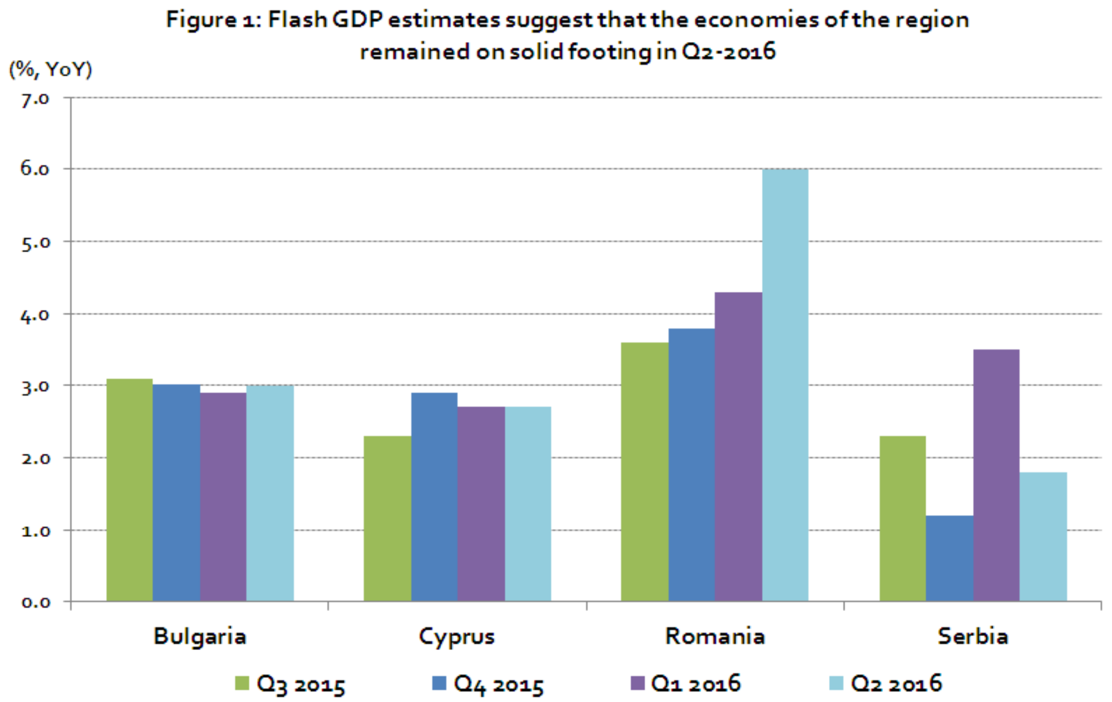
- Although we don't have a full detailed break-down for all the economies, domestic demand continued to be the main driver behind growth in Q2-2016. Lax monetary policies together with lower-on an annual basis- world energy prices continue to provide a positive boost on the growth momentum. Although this boost is destined to eventually fade away as energy prices normalize, it is poised to carry throughout 2016 as well; low energy costs keep inflation pressures subdued, supporting real disposable incomes and providing more flexibility to household, corporate, and sovereign balance sheets. 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.

- **Bulgaria**: Strong growth momentum was sustained in the second quarter and was accompanied by a visible improvement in labor market conditions. According to the flash estimate, real GDP expanded by +0.7% QoQ/+3.0% YoY in Q2-2016 compared to +0.7% QoQ/+2.9% YoY in Q1-2016 vs. +0.7% QoQ/+2.9% YoY in Q2-2015. As usual, there will be another estimate of the national accounts data published at a later stage and there will most probably be huge revisions and reallocations within the individual growth drivers' components. However, final consumption appeared to have made a very strong contribution to growth in Q2. Final consumption expanded by +0.4% QoQ/+2.0% YoY in Q2-2016 compared to +0.4% QoQ/+2.1% YoY in Q1-2016 vs. 0.5% QoQ/-0.1% YoY in Q1-2015. Rising real wages, improving consumer and business sentiment, declining energy prices on an annual basis-Bulgaria has the highest energy consumption intensity in EU-28- and further gains in employment were among the principal drivers of the spending recovery. The improvement of labor market conditions in 2015 and further in 1H-2016 has set the foundations for consumption to have a bigger weight on this year's GDP growth in Bulgaria. Unemployment has declined further to 7.2% in June, from 9.7% a year ago, as the economy adds more jobs in the labor-intensive areas of specialized services (Information & Communication, Logistics, and Business Services) compared to traditional industries like manufacturing, retail and wholesale trade, construction. As of June, the decline of unemployment in Bulgaria is the second highest in EU-28 after Cyprus. On the negative side, investments were in red for a second consecutive quarter in Q2 (GFCF: +0.4% QoQ/-4.5% YoY in Q2 down from -3.5% QoQ/-3.9% YoY). To some extent, the decline mirrors the negative base effects as a result of the increased EU funds absorption in the past year ahead of the closing of the programming period 2007-2013, as well as the fact that public investment spending is traditionally skewed to the last quarter of the year. Finally, net exports seem to recover after a poor reading in the first quarter (Exports: +2.0% YoY in Q2 vs. +0.3% YoY in Q1 & Imports: +2.2% in Q2 vs. -1.3% YoY) - and will most probably put an additional positive boost on growth in 2016 as well.

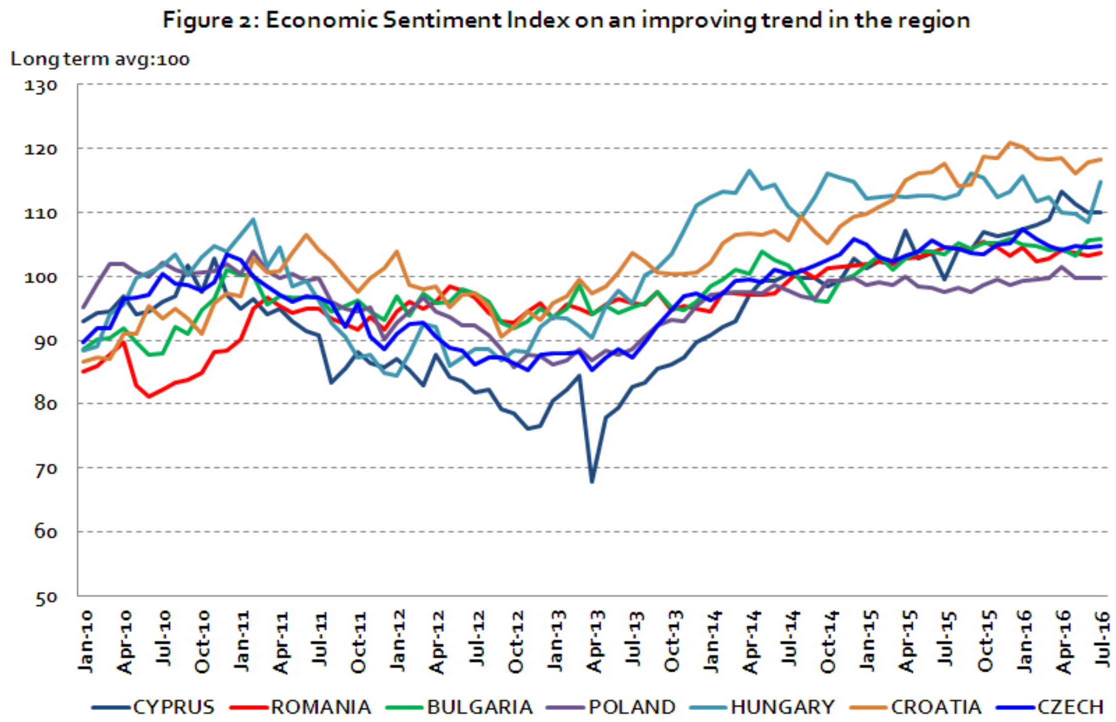
- **Cyprus:** The real economy continued to surprise positively in Q2. The flash estimate of the second quarter- the sixth consecutive positive on both quarterly and an annual basis after a three year recession- proves that the economy is finally out of the woods. On a seasonally adjusted basis, growth expanded by +0.7% QoQ/+2.7% YoY in Q2-2016compared to +1.0% QoQ/+2.7%YoY in Q1-2016 vs. +0.8% QoQ/+1.2% YoY in Q2-2015. Although the components of growth have not been known yet, it is highly likely that the consumption rebound has continued in Q2-2016. The consumption rebound is driven by the strong sentiment improvement mirroring the lasting progress within the economic adjustment program, a flourishing tourism sector (+21.2% YoY in tourist arrivals in 1H-2016), lower energy prices on an annual basis, lower unemployment (11.7% in June, the highest decline in EU-28 in the past twelve months), agents' expectations of further fiscal relaxation and a rise in real incomes. Despite BREXIT woes, the Economic Sentiment Index (ESI) stood in June near the new post-Lehman high in April. Cyprus has become the third country after Portugal and Ireland to have made a clean exit from the economic adjustment program in March 2016. After a three year recession in 2012-2014 and a cumulative drop of 10.5% of GDP, the economy expanded by +1.6% YoY in 2015 and is expected to further gain momentum to +2.5% YoY in 2016 above the most recent EU Commission Spring forecast of +1.7%. Still, after the parliamentary elections of May, a handful of unfinished structural reforms need to progress in the areas of privatizations, public and health sectors, while addressing the challenges of a still high NPLs stock. The banking system-wide NPEs ratio- a more conservative asset quality EBA methodology, which inflates NPLs numbers by including restructured loans for a probation period of at least 12 months-edged up to 49.7% in May 2016, up from 45.8% in December 2015, compared to 47.8% in December 2014.

- **Romania:** The second quarter flash GDP estimate was the positive surprise of the region, taking analysts by surprise. According to the release, real GDP on an unadjusted basis jumped to +6.0% YoY in Q2-2016 vs. +4.3% in Q1-2016 and +3.4% in Q2-2015. In seasonally adjusted terms, growth jumped to +1.5% QoQ/+5.9% YoY in Q2-2016 –above analyst call for +0.3% QoQ/+4.1% YoY-compared to +1.5% QoQ/+4.2% YoY, up from -0.1% QoQ/+3.7% YoY in Q2-2015. Although the components are yet to be known, it is high likely that growth has been primarily private consumption-driven. Despite the political fall-out, Romania stood out of the pack for a second consecutive year in 2015, and is expected to be a regional outperformer in 2016 as well. Growth dynamics are driven by a private consumption spending boom, fuelled by the unwarranted pro-cyclical fiscal stimulus ahead of the parliamentary elections scheduled for late 2016. Hence, the economy is driven close to, if not above, its potential growth rate at the expense of pushing government finances off consolidation track and deteriorating the external position. The current account deterioration is one of those warning signs that macroeconomic imbalances are reemerging as a result of the expansionary policy. The current account deficit jumped to 1.6% of GDP in January-May 2016 compared to a balanced position in the same period a year ago.

- **Serbia:** Real GDP growth decelerated to +1.8% YoY in Q2-2016 down from +3.5% YoY in Q1-2015. Nevertheless, the reading is still considered good news because it is compared with an expansion of +1.0%YoY over the same period of 2015, a -2.0%YoY contraction in Q1 2015 and growth of 0.8%YoY for the FY2015. Reflecting the ongoing improvement in domestic economic activity after the 2014 floods, it marks the fifth consecutive quarter of positive annual growth rates. The breakdown of the data and the QoQ print are not yet available and are scheduled for release on August 31. That said, last year's positive trends seem to have continued into 1H-2016, with the recovery likely to have been driven by investments and exports. Looking ahead, real GDP growth is expected to accelerate to around 2.5% this year according to the most recent IMF forecast. Investments are anticipated to continue leading the recovery in view of improving business climate and higher public capital expenditure. Lower primary commodities prices – compared to last year - are also likely to continue favoring gross fixed capital formation as well as private spending. Cheaper debt servicing costs and subdued inflation pressures will also likely provide an additional lift to disposable income. Growth in private consumption is expected to return to positive annual rates as the impact of fiscal consolidation gradually wanes and private sector employment recovers. On the other hand, the net exports' contribution will likely become more neutral as the recovery in domestic demand backs a concomitant growth in imports. Most recent macroeconomic data suggest that the economy remains in good shape despite some slowing. Industrial production has slowed down considerably in May - to 0.9%YoY down from double digit rates in previous months - but mostly as a consequence of low base effects in mining and energy production. Manufacturing, a larger contributor and a better gauge of business development, was up by 2.9%YoY in May and very solid (+6.7%YoY) for the 5M period.



Source: National Statistics, Eurobank Research



Source: European Commission, Eurobank Research

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