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REGIONAL ECONOMICS & MARKET STRATEGY MONTHLY

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Lower energy prices & ECB QE driving macro developments in the region

REGIONAL MACROECONOMIC DEVELOPMENTS & OUTLOOK

- **2015-2016 growth prospects** improving
- Decline of energy prices expected to have **multiple benefits** for economies in the region
- Most regional central banks **to remain accommodative** for the remainder of the year

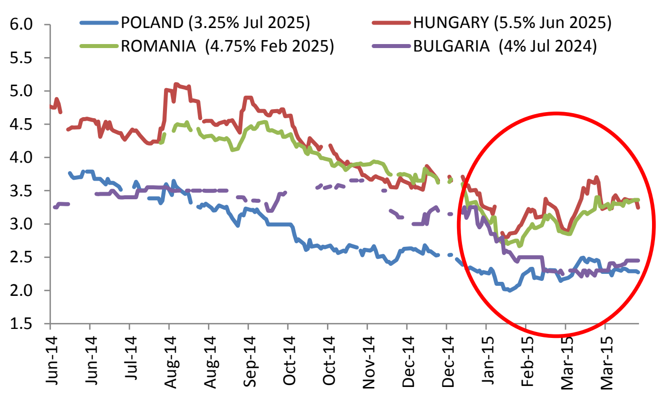
REGIONAL MARKET DEVELOPMENTS & OUTLOOK

- CESEE assets **rally** on ECB asset purchase program
- CESEE currencies **mostly firmer** year-to-date; sovereign debt rally favors
- ECB QE **to continue providing support** to regional asset markets, but risks linger

COUNTRY FOCUS

- **Bulgaria:** Modest fiscal consolidation on the cards, following last year's deterioration
- **Cyprus:** External sector headwinds threatening timid recovery prospects in 2015
- **Romania:** Sustained improvement in private consumption spending supports 2015 growth outlook
- **Serbia:** Fiscal position on the mend

Government bonds rally on ECB's QE



Source: Bloomberg, Reuters, Eurobank Research

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I. Regional Macroeconomic Developments & Outlook

Lower energy prices & ECB QE driving macro developments in the region

2015-2016 growth prospects to be far better for countries in the region than last year

The end of the first quarter of 2015 finds most regional economies far from catching up with their pre-crisis performance. Output growth dynamics broadly improved in 2014, but didn't live up to initial expectations for yet another year. Cyprus and Serbia are gripped in a painful recession for different reasons. Bulgaria is trapped in a low growth recovery path while Romania maintains its good growth momentum. On balance, growth prospects for most economies in the region appear to be improving this year and the next, assisted by strengthening consumption dynamics, increasing consumer and business confidence and favorable labor market developments. Meanwhile, the sharp decline in energy prices continues to keep inflation pressures at bay, supporting real disposable incomes and providing more flexibility to corporate and household balance sheets.

The decline of energy prices is expected to have multiple benefits for the economies of the region

The decline of energy prices is expected to benefit regional economies in multiple ways, especially as most of them are net oil importers. In particular, the four economies analyzed in this report have, on average, three times higher energy intensity than the EU-28. Lower energy prices keep inflation pressures subdued, assist budgetary performance by lowering government subsidies and, for major-oil importers, lessen external-sector vulnerabilities. Yet, despite the balance-of-payments support provided by the lower oil import bill, net exports' contribution to regional economic growth is likely to remain broadly unchanged relative to last year as export performance will continue facing important headwinds due to still anemic growth in the euro area and the recession in Russia.

Underinvestment is a key concern for the medium-term outlook of the region

One key concern is the lingering underinvestment in the region. In the majority of regional economies Investment spending as percent of GDP has been on a downward trend since 2008. The consequences of this may extend far beyond the short-term growth outlook, as subdued investment activity impacts on the capital stock and productivity and thus, undermines long-term growth prospects. In the aftermath of the crisis, capital inflows never reached their pre-crisis levels, domestic savings have been broadly insufficient to finance investment, EU funds absorption has been weak, access to international markets remains rather limited and financial intermediation continues to face important constrains due to high NPL ratios. Even though some of those issues have been addressed, regional economies need to accelerate structural reforms in order to generate sustainable growth.

Policy in the region will most probably remain accommodative in the period ahead

Policy accommodation by the ECB and earlier efforts to address macroeconomic imbalances have created a conducive environment for additional monetary policy in the region. Yet, available degrees of freedom on the monetary and fiscal policy front vary across regional economies, depending on country-specific fundamentals and pre-crisis legacies. Downside risks do exist, namely in view of the Russia-Ukraine conflict and the looming Fed interest rate hikes, which may put pressure on the external financing conditions.

Romania stands out of the pack for the second consecutive year in 2015

Bulgaria is expected to register another year of mediocre, below-potential growth in 2015. The negative impact from the banking crisis last June, potential delays in EU funds absorption and lack of meaningful structural reforms will probably have a negative carryover effect this year while there is limited room for fiscal policy accommodation. **Romania** is widely anticipated to stand out of the pack for a second consecutive year in 2015. Growth is driven primarily from consumption, thanks to subdued energy prices, positive real wage growth and improving credit dynamics. Furthermore, growth this year is expected to derive support from public investment. **Serbia** is expected to remain mired in recession in 2015, primarily due to weak domestic demand and the lasting impact from the catastrophic floods. Meanwhile, the tentative IMF agreement provides some leeway for the implementation of structural reforms and fiscal consolidation. Finally, **Cyprus** has made significant progress in consolidating public finances, normalizing domestic financial conditions and creating the conditions for the removal of capital controls. Yet addressing the thorny issue of foreclosures is still essential for the endorsement of the fifth review of the Cyprus adjustment programme by international creditors

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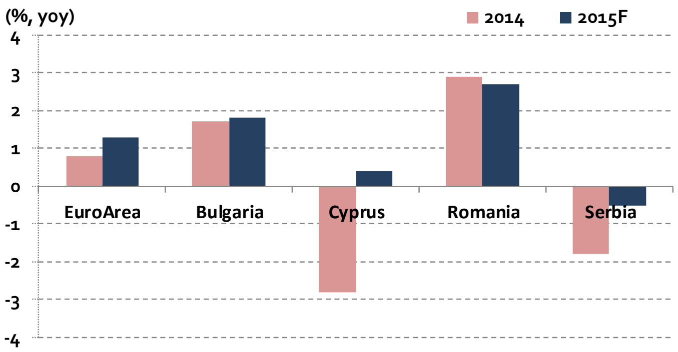
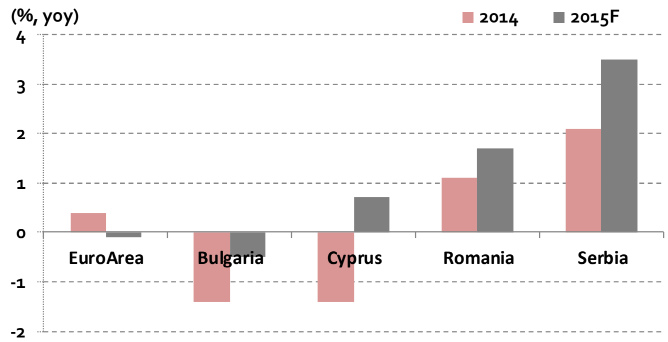
FIGURE 1: **Growth performance 2014 vs. 2015**



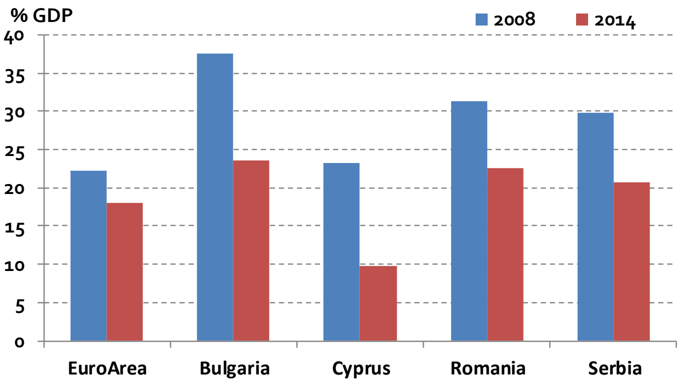
Source: Eurostat, National Authorities, Eurobank Research

FIGURE 2: **Annual average inflation 2014 vs. 2015**



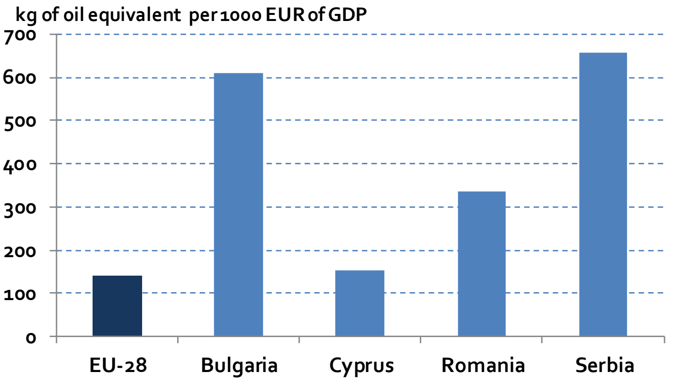
Source: Eurostat, National Authorities, Eurobank Research

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



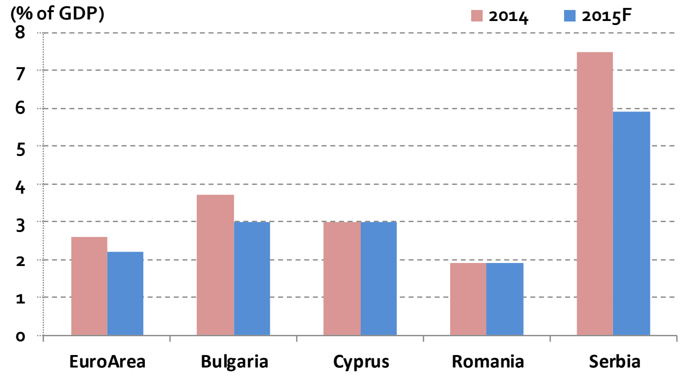
Source: IMF WEO, Eurobank Research

FIGURE 4: **Energy intensity of the individual countries, 2013**



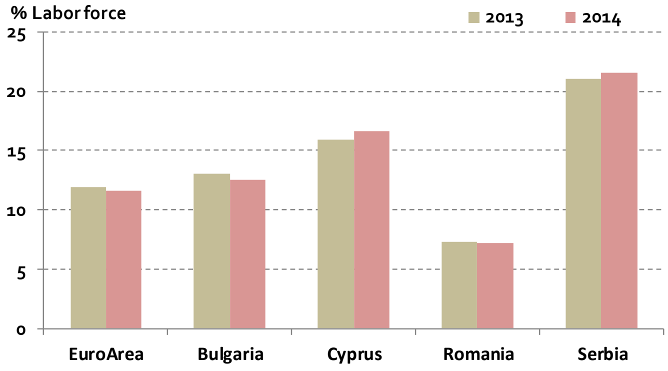
Source: Eurostat, National Authorities, Eurobank Research

FIGURE 5: **Fiscal Balance (% of GDP) 2014 vs. 2015**



Source: Eurostat, National Authorities, Eurobank Research

FIGURE 6: **Annual average unemployment rates 2013 vs.2014**



Source: IMF WEO, Eurobank Research

II. Regional Market Developments & Outlook

CESEE financial markets rally on ECB's QE

Most CESEE asset markets firm on ECB's QE

In a roller coaster of a ride witnessed in the first quarter of the year, CESEE markets eventually reversed an initially weak start into 2015, with the ECB's expanded assets purchases programme providing notable support. A low-inflation environment and monetary accommodation in a number of regional economies have also favored. Real GDP growth in Romania, Hungary, Poland and Turkey oscillated around 3% in 2014 and is expected to hover around these levels in the current year. Meanwhile, inflation pressures have been broadly subdued in recent months, with annual CPI rates moving into a negative territory in Hungary, Bulgaria and Poland.

CESEE stock markets mixed YTD, mostly influenced by domestic fundamentals

In CESEE stock markets the picture has been rather mixed, being mostly influenced by domestic fundamentals. In more detail, Hungary's BUX has staged a stellar performance over the first quarter of the year broadly outperforming its regional peers. This strong performance came on the back of improving domestic fundamentals that led into a one-notch upgrade (to BB+, with stable outlook) by S&P in late March, the first such upgrade of the said agency in five years. Hefty monetary easing over the last two years or so has also benefited domestic equities. On the flipside, Turkey's BIST 100 has posed as the region's worst performer amid concerns about the potential impact of the looming Fed rate tightening on foreign capital inflows in the country. Persisting geopolitical tensions in the Middle East and worries over the Central Bank's independence have also added to the index's negative trend.

CESEE currencies have broadly firmed this year, buoyed by a government bonds rally

These factors, along with recent rate cuts, have weighed heavily on the Turkish lira, which slid to a record low near 2.6480/USD in mid-March and, along with the Ukrainian hryvnya, bucked the positive trend in CESEE currencies over the first quarter of the year. Although regional Central Banks have delivered hefty monetary easing in recent months, CESEE currencies have been broadly firmer year-to-date, buoyed by the strong performance of local rates markets. In a similar vein, external debt markets in the region have recorded hefty gains so far this year, with EUR-denominated paper broadly outperforming the rest of the pack.

ECB's QE likely to continue providing support to regional assets in the weeks ahead but risks linger

Looking into the coming weeks, we anticipate the ECB's QE to continue providing support to CESEE asset markets. Regional currencies may also be supported by expectations that we are likely approaching the bottom of the monetary policy easing cycle in several regional economies. That said, the USD's upside momentum, which may continue in the months ahead, is likely to dent the allure of CESEE risk premia. Additional risks to the region's assets ahead lie in the face of potentially mounting geopolitical tensions, slower growth in China and, most importantly, a more aggressive Fed monetary tightening path. Assets of countries closely linked to the USD, such as Turkey, appear most vulnerable in this environment

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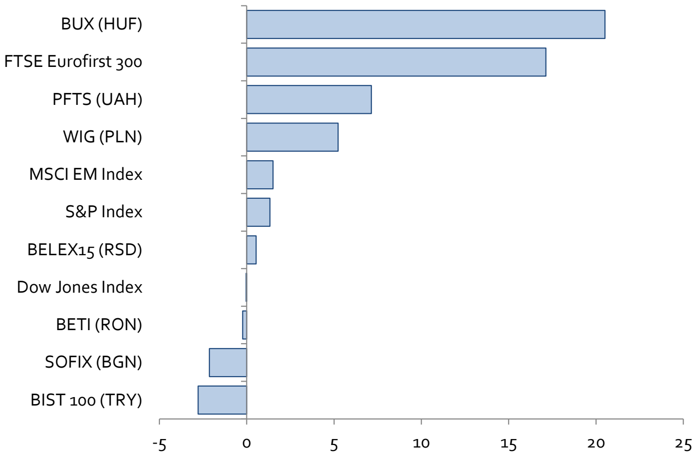
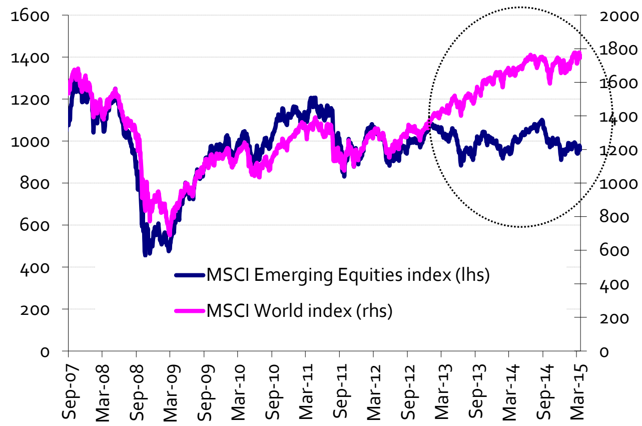
FIGURE 7: **Major world & CESEE stock markets %YTD performance**



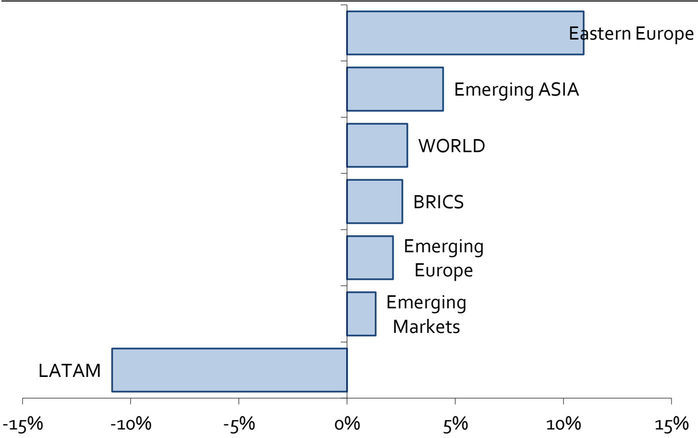
Source: Reuters, Bloomberg, Eurobank Research

FIGURE 8: **World & CESEE stock markets YTD performance**



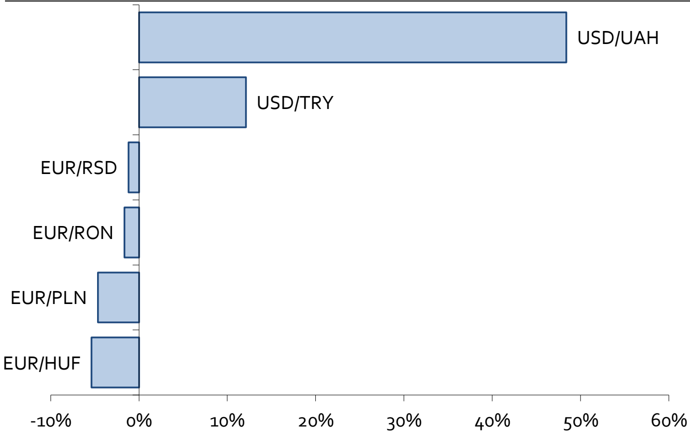
Source: Reuters, Bloomberg, Eurobank Research

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



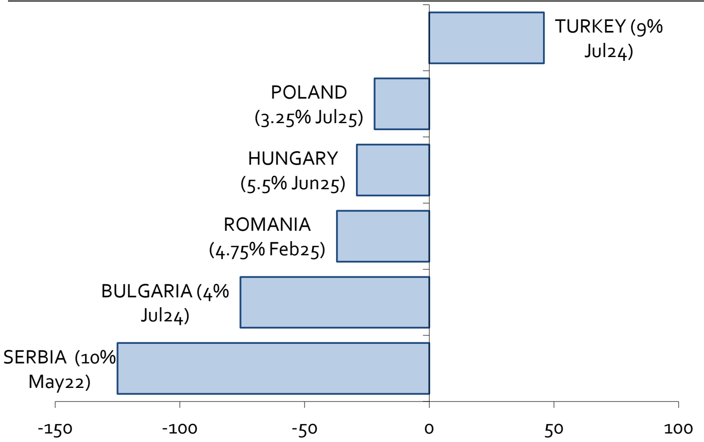
Source: Reuters, Bloomberg, Eurobank Research

FIGURE 10: **CESEE FX YTD performance**



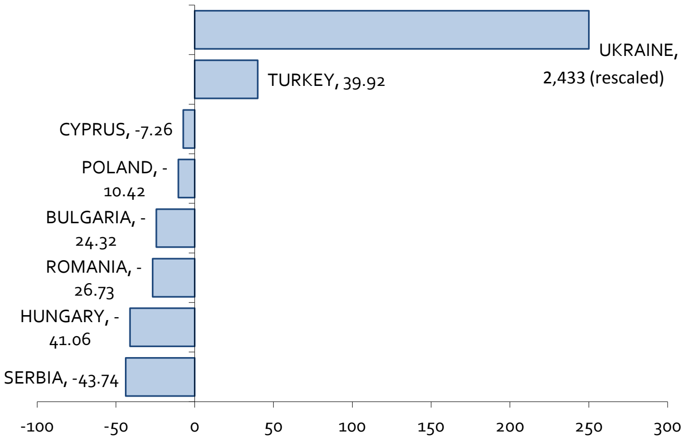
Source: Reuters, Bloomberg, Research

FIGURE 11: **YTD change in CESEE government bond yields (in bps)**



Source: Reuters, Bloomberg, Eurobank Research

FIGURE 12: **YTD change in 5-Year CDS (in bps)**



Source: Reuters, Bloomberg, Eurobank Research

Trader's view

FX

EUR/RSD is likely to remain range-bound in the short-term

The Serbian dinar has remained trapped within a range of 119.45-121.20 against the euro over the last month or so, with repeated Central Bank interventions at levels just below 120.00 capping upside pressures on the RSD. Notably, the Central Bank has bought ca €320mn so far this year to alleviate ongoing appreciation pressures on the dinar. These have been instigated by optimism about improving government finances and the recently struck €1bn 3-year IMF deal. Looking ahead, NBS is expected to continue intervening in the market in the coming weeks, broadly maintaining its current volume of FX purchases. On the other hand, a heavy issuance schedule of RSD-denominated T-bonds is likely to keep the market strongly EUR-offered. This deems the current trading range too narrow for any kind of profitable short term positions.

Local Rates

Bulgarian government bonds look very well supported and we remain rather positive in the weeks ahead

Bulgarian government bonds look very well supported and we remain rather positive in the weeks ahead in view of (i) decent demand for the recently placed EMTNs (Euro Medium Term Note) – both on the primary and secondary market – (ii) a very light calendar in the local primary market, (iii) outperformance of state revenues and budget balance in Q1 2015 and (iv) limited allocation of the EMTN program to local pension funds despite rumored bids totally around €500mn. Against this backdrop, we favor long positions in the 4-7 year sector for EUR-denominated paper, as this part of the curve registered some correction after the announcement of better-than-expected 7-year EMTN auction.

Short term RON rates likely to ease in late April on large MoF bond redemptions, a pick-up in government spending and the start of the new reserve period

With the local market being broadly priced in for further NBR liquidity-injecting operating, **short term RON rates** are likely to remain close to the monetary policy rate of 2.00% in the coming few sessions. However, a drop towards 0.50% cannot be excluded towards the end of the current month amid large MoF bond redemptions, a pick-up in government spending and the start of the new reserve period. Separately, government bonds are likely to consolidate around their current levels, with the longer part of the curve being most susceptible to developments in Greece. Bonds with maturities up to 5-years have some upside potential, once money market conditions ease back. Entering outright long positions in the June/July 2017 paper seems profitable strategy over a 1-3month horizon. Yet, we prefer to stay neutral at this point due to high funding costs.

Long end of T-bond curve to flatten further in view of looming rate cuts

In Serbia, ongoing appreciation pressures on the dinar evidenced over the last few weeks have significantly raised the prospect of further rate cuts in the two coming months. In our view, 25-50bps of additional monetary easing is on the cards in April/May. Against this backdrop, we expect the long end of the **government bond** curve to flatten further (on the last 2-year auction we saw a fall of 66 bps in the average accepted yield).

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III. Country Focus

Bulgaria (Baa3/BB+/BBB-)

Modest fiscal consolidation on the cards following last year's deterioration

The modest growth rebound continued in 2014

The full year output performance came at 1.7% in 2014 up from 1.1% in 2013. The main driver, final consumption, rebounded by +2.4%YoY in 2014 up from -1.3% YoY in 2013. Final consumption rebound was supported by solid gains in both private (+2.4%) and government spending (+5.8%), driven by rising real wages, rapidly declining energy prices, modest gains in employment and a loose fiscal policy. Gross fixed capital formation showed some improvement (+2.8% in 2014 vs. -0.1% in 2013) but it is still very far from its pre-crisis performance. On the negative side, the slow recovery in Bulgaria's main trade partner Euro Area had a negative impact on the net exports side. Exports' growth slowed down to 2.2% in 2014 from 9.2% in 2013. On the flipside, imports' growth decelerated marginally to 3.8% down from 4.9%, an illustration of the domestic demand recovery. Overall, the growth rebound would have been much higher had it not been for the financial sector turbulence in the 2H-2014, which weighted on spending and investment decisions.

Economic activity is off to a dynamic start in the first months of the year.

Sentiment and high frequency indicators show a continuous improvement trend since last October, as confidence is coming back and terms of trade benefit by the decline in energy prices and the favorable impact from the depreciation of the Euro. Indicatively, (i) the **Economic Sentiment Index (ESI)** improved from 96.7 in October 2014 to 103.8 in February 2015, coming back to the levels recorded in May 2014. Overall, ESI has restored fully the losses from the multi-month downward trend, which started in July when the banking sector crisis erupted. All subsectors (industry, services, retail, and consumer) recorded significant gains in the same period. (ii) **Industrial production** registered a +2%MoM/+1.6%YoY in January after gaining 1% MoM/+1.9%YoY in December on a seasonally adjusted basis. Export-led industries (textiles, plastic, metal equipment) recorded hefty gains. (iii) **Export volumes** rose by 7.4%QoQ in Q4, registering the strongest quarterly rebound since 2010 and (iv) **Unemployment** has improved by 1.5pps (11.4% in 2014). Employment showed the first signs of recovery after many years (46.4 thousands of jobs were added in 2014).

Modest fiscal consolidation is on the cards in 2015 after visible deterioration last year.

The fiscal deficit in cash terms widened to 3.8% of GDP in 2014 up from 1.8% in 2013 surpassing the Maastricht threshold for the first time since 2010. The underperformance of revenues (the revenues outcome were BGN1bn below the budget target) was a consequence of lower world energy prices, deflationary pressures on tax revenues and lower tax compliance. However, the fiscal outcome reflects primarily spending slippages from the electoral cycle and the bail-out costs from the banking sector. The electoral cycle was more or less expected to result in a surge in primary spending on public wages (+3.5%YoY), pensions (+7.5% YoY) and current spending (+8.7% YoY on subsidies) in an election year. On top, the recapitalization costs from the failure of the Corporate Commercial Bank (CCB) weighted in the fiscal position of the country. Looking ahead, the budget foresees a modest decline of the fiscal deficit in cash terms to 3% in 2015. The growth assumptions behind the budget appear rather conservative (GDP 2015:+0.8%) but unrealistic on the nominal prices (+1.5%) which has a direct impact on revenues. On the spending side, the headline figure assumes some spending restraint on public wages and a rise in the pensions age limit but the fragile government coalition may find it difficult to implement further fiscal consolidation measures. Allegedly, the budget execution in the first three months seems to downplay revenue concerns (tax revenues up by +12.5% YoY in Q1-2015) as a result of the improved tax collection.

Disinflationary pressures will most probably prevail in 2015 as well.

Bulgaria has entered a deflationary path since August 2013. Core inflation has been negative for 18 consecutive months, an illustration of weak domestic demand. Core inflation ended at -1.6% YoY in December 2014 after having declined to -2.6% YoY in November only to creep up to -0.8% YoY in February 2015. The sharp decline of energy prices in the world markets in Q4 has weighed further negatively on inflation dynamics. Thanks to higher fruit and vegetable prices as a result of the severe floods, the deflation of the food component of the consumer basket (35% weight) decelerated sharply in the first two months bringing the inflation rate further up at -0.5% YoY in February 2015 vs. -1.0% YoY in January 2015. Looking ahead, the depreciation of the Euro which feeds into imported prices and the administered prices hikes which came into effect since last October may be not enough to maintain inflation readings in positive territory. The negative output gap evidenced in core prices, the negative energy prices dynamics plus food-induced seasonality are likely to continue exerting downside pressures on inflation this year.

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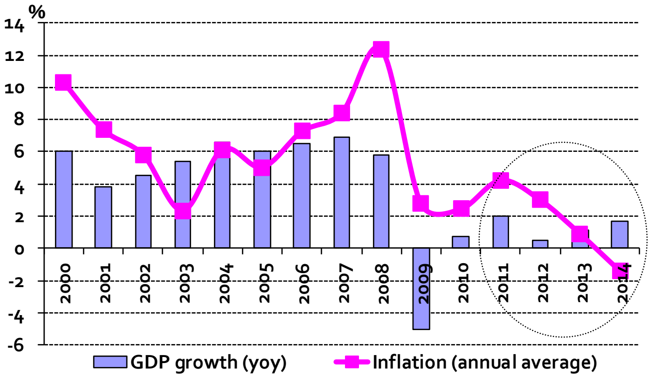
Bulgaria: Macro & Market Data

	2012	2013	2014	2015f
Real GDP (yoy%)	0.5	1.1	1.7	1.8
Final Consumption	2.9	-1.3	2.4	2.5
Gross Capital Formation *(Fixed)*	2.0	-0.1	2.8	1.5
Exports	0.8	9.2	2.2	3.0
Imports	4.5	4.9	3.8	2.0
Inflation (yoy%)				
CPI (annual average)	3.0	0.9	-1.4	-0.5
CPI (end of period)	4.2	-1.6	-0.9	0.3
Fiscal Accounts (%GDP) - *Cash Basis*				
General Government Balance	-0.4	-1.8	-3.7	-3.0
Gross Public Debt	18.3	18.6	27.7	31.0
Primary Balance	0.3	-1.0	-3.0	-2.5
Labor Statistics				
Unemployment Rate (LFS, %)	12.3	12.9	11.4	10.8
Wage Growth *(total economy)*	6.6	6.0	6.8	2.8
External Accounts				
Current Account (% GDP)	-1.1	1.0	0.0	-0.5
Net FDI (EUR bn)	1.1	1.4	1.3	1.5
FDI / Current Account (%)	284.3	Na	Na	
FX Reserves (EUR bn)	15.5	14.4	16.5	18.0
Domestic Credit	**2011**	**2012**	**2013**	**2014**
Total Credit (%GDP)	74.4	74.1	74.4	66.3
Credit to Enterprises (%GDP)	47.9	48.9	49.0	41.6
Credit to Households (%GDP)	24.6	23.6	23.7	22.3
FX Credit/Total Credit (%)	63.7	64.0	60.9	55.4
Private Sector Credit (yoy)	3.9	3.8	0.6	-6.3
Loans to Deposits (%)	104.0	99.4	92.1	90.2
Financial Markets	**Current**	**3M**	**6M**	**12M**
Policy Rate		Currency Board		
EUR/BGN	1.96	1.96	1.96	1.96

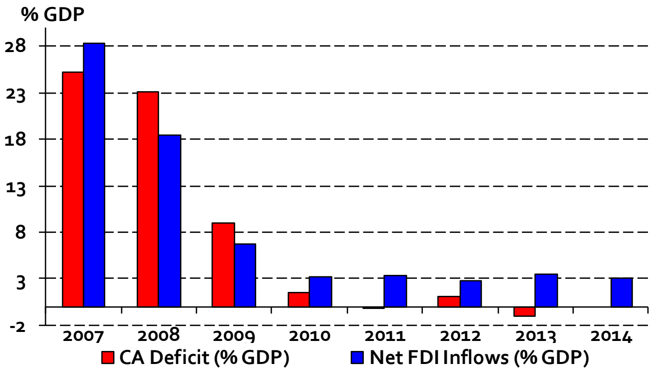
Source: National Sources, Eurostat, IMF, Eurobank Research

FIGURE 13: **GDP growth & Inflation 2000-2014**



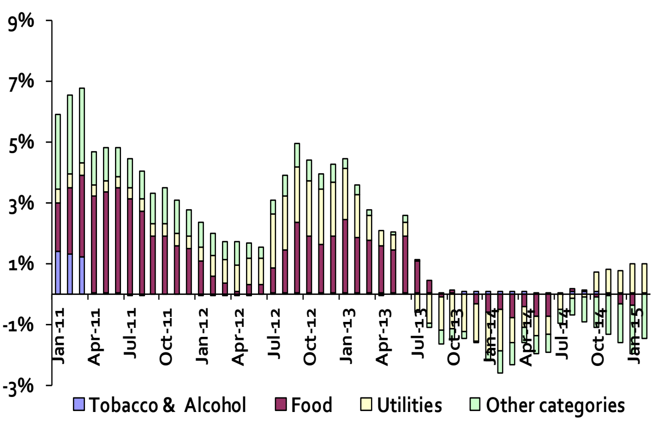
Source: National statistics, Ecowin Reuters, Eurobank Research

FIGURE 14: **CA Deficit & Net FDI inflows 2007-2014**



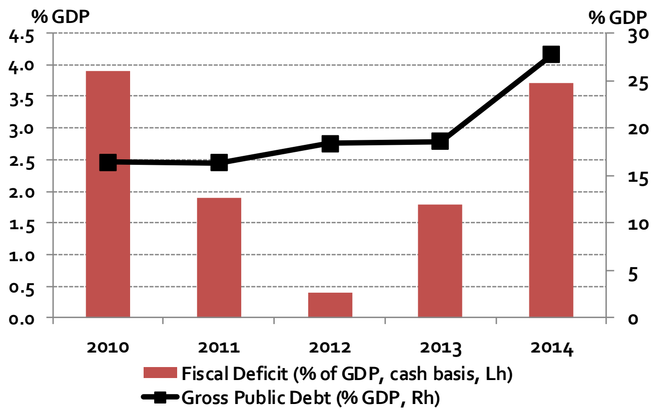
Source: National statistics, Ecowin Reuters, Eurobank Research

FIGURE 15: **Inflation dynamics 2011-2015**



Source: National statistics, Ecowin Reuters, Eurobank Research

FIGURE 16: **Fiscal deficit & Gross Public Debt 2010-2014**



Source: Eurostat, Eurobank Research

Cyprus ((P)B3/B+/B-)

External sector headwinds threatening timid recovery prospects in 2015

The economy showed further visible signs of stabilization in the last quarter.

Real GDP contracted by -0.6%QoQ/-2.0%YoY in Q4-2014 unchanged compared to -0.9%QoQ/-2.0%YoY in Q3-2014 but up from -0.5%QoQ/-4.6%YoY in Q4-2013. Overall, full year output contraction came at -2.3% in 2014, much lower than envisaged in the initial or the revised programme forecasts (-3.9% in the initial programme drafted back in May 2013 and -4.8% in the second and third review drafted in December 2013 and February 2014 respectively). The outperformance of consumption (-1.6% in 2014 vs. -5.8% in 2013) was the main driver behind the reading. Investments remained almost flat (+0.2% in 2014) after the sharp contraction in the previous two years (-30.0% in 2013 and -15.6% in 2012 respectively). As a result, the negative contribution of domestic demand improved substantially (from -10.1pps in 2013 to -1.3ppts in 2014). The rebound of the external sector subtracted another 1.0 ppt from growth in 2014 vs. a positive contribution of +4.7ppts in 2013. Exports rebounded by +3.0%YoY in 2014 up from -2.6%YoY in 2013. Imports expanded by +8.1%YoY in 2014 up from -13.6%YoY in 2013.

External sector headwinds may put the prospects of a timid recovery in 2015 at stake

Looking ahead, a timid recovery is on the cards in 2015. The official programme forecasts envisage real GDP to switch to positive growth rates in 2015 (+0.4% in the last programme review). In our view, the risk of flat growth or even a marginally negative performance is looming and threatens to prolong the recession into the current year as well. The main source of concern stems from the external sector headwinds. The negative spillovers from the unfolding recession in Russia and the Russia-Ukraine conflict cast shadow on the official projections of the external sector variables. The negative impact on the external sector is going to be reflected in the performance of the export-oriented sectors of professional services and tourism, which account for approximately 40% of GDP in total.

A package of measures aimed at fully restoring confidence in the banking system and stimulating the domestic economy has been announced

On the other hand, there are some valid reasons to be optimistic about the growth outlook in 2015. Lower energy prices, easing unemployment and credit conditions, stabilization in the banking sector and the financial market and strong fiscal consolidation effort (the general government balance in cash basis already ended in a surplus of 0.4% of GDP in 2014 switching from a deficit of 3.7% of GDP in 2013) are going to be domestic demand supportive. Finally, the President of the Cypriot Republic Nikos Anastasiadis announced a package of measures aimed at fully restoring confidence in the banking system and stimulating the domestic economy. The package includes (i) the full lift of capital controls effective from Monday April 6th, (ii) the deployment of extra €280mn for infrastructure projects from the budget (iii) the acceleration of the implementation of the EIB projects in Cyprus €162mn (iv) programs to subsidize employment worth €58mn and (v) measures in the area of urban planning aimed to stimulate real estate investments.

Addressing the issue of foreclosures is essential to push the program forward and put the economy back into the path of sustainable development.

The thorny issue of an effective assets foreclosure framework in line with the programme conditionalities was the reason for the incomplete endorsement of the fifth review of the Cypriot adjustment programme by international creditors. The fifth review was adopted on the staff level in last June, approved by the ESM board in early December but not endorsed by the IMF board. The parliament approved legislation that made the implementation of the foreclosures legislation conditional upon adopting the insolvency framework. The insolvency framework, a set of bills complementary to the foreclosures legislation, is designed to balance borrowers' rights with their obligations to lenders, offering them protection from foreclosure under certain circumstances.

As of early April, the Parliament was debating the last article of the legislation draft on insolvency. Linking the foreclosures bill with the insolvency framework may have helped partially cushion political reactions within the parliament, but has also delayed procedures putting the program temporarily off-track. Reforming the insolvency and foreclosure procedures is absolutely essential in order to restore credit growth. The new framework will provide banks the necessary tool for addressing strategic defaulters and allow for effective debt-restructuring, thus tackling the issue of non-performing loans (NPLs). Addressing NPLs is an issue of high systemic priority, given that they have already climbed above 50%. This is among the highest ratios following any recent banking crisis. Most of the NPLs originate from the downturn of the real estate market (mortgage or construction loans). More importantly, the new framework will put the program back on track in line with the requirements and provide access to further financing from the program.

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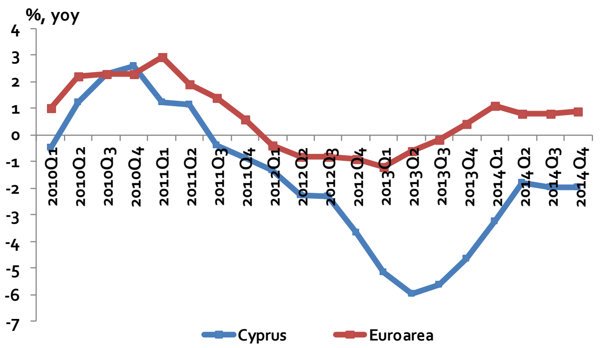
Cyprus: Macro & Market Data	2012	2013	2014	2015f
Real GDP (yoy%)	-2.4	-5.4	-2.8	0.4
Private Consumption	-0.7	-6.0	-1.2	-0.5
Public Consumption	-2.7	-4.9	-4.7	-0.9
Gross Capital Formation *(Fixed)*	-20.7	-17.1	-11.1	-1.6
Exports	-1.7	-5.0	0.3	2.0
Imports	-4.6	-13.6	-0.5	-0.1
Inflation (yoy%)				
HICP (annual average)	3.1	0.4	-1.4	0.7
HICP (end of period)	1.5	-1.3	-1.5	0.7
Fiscal Accounts (%GDP) - *ESA2010*				
General Government Balance	-5.8	-4.9	-3.0	-3.0
Gross Public Debt	79.5	102.2	107.5	115.2
Primary Balance	3.2	-1.9	-1.0	-1.0
Labor Statistics				
Unemployment Rate (LFS, %)	11.9	15.9	16.2	15.8
Wage Growth *(total economy)*	-0.8	-6.0	-4.6	0.2
External Accounts				
Current Account (% GDP)	-6.9	-1.9	-1.1	-0.8
Net FDI (EUR bn)	1.2	0.2	0.1	0.7
FDI / Current Account (%)	99%	53%	45%	550%
Domestic Credit	**2011**	**2012**	**2013**	**2014**
Total Credit (%GDP)	351.4	373.5	351.4	356.0
Credit to Enterprises (%GDP)	159.5	171.1	160.2	150.1
Credit to Households (%GDP)	138.8	138.9	140.0	143.5
Private Sector Credit (yoy)	4.8%	-0.5%	-6.0%	-3.2%
Loans to Deposits (%)	98.9%	103.3%	135.3%	133.5%

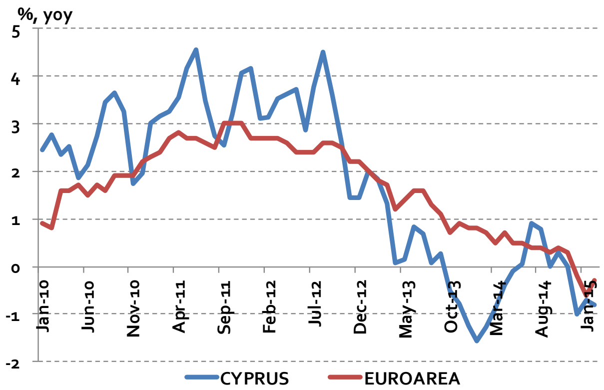
Source: National Sources, Eurostat, IMF, Eurobank Research

FIGURE 17: **Growth performance Cyprus vs. Euroarea 2010-2014**



Source: Eurostat, Eurobank Research

FIGURE 18: **HICP Cyprus vs. Euroarea 2010-2015**

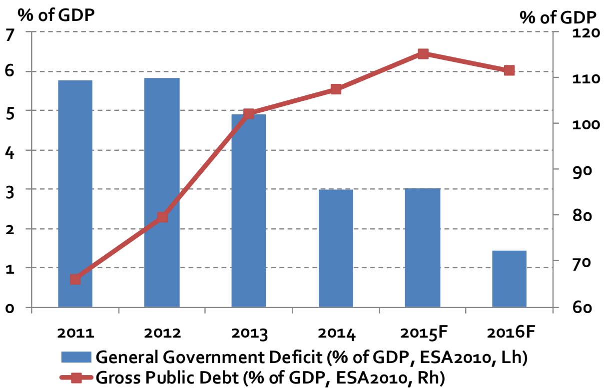


Source: Eurostat, Eurobank Research

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

Source: Bloomberg, Eurobank Research

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



Source: Eurostat, Eurobank Research

Romania (Baa3/BBB-/BBB-)

Sustained improvement in private consumption spending supports 2015 growth outlook

Output dynamics in 2015 will most likely remain close to those of last year driven by sustained improvement in private consumption and a turn-around in investments

GDP advanced by +0.5%QoQ/+2.6%YoY in Q4-2014 bringing the full year performance at 2.9% down from 3.4% in 2013. In terms of drivers, the main contribution switched from net exports in 2013 to private consumption in 2014. Robust wage growth - driven by the rise of the minimum wage (from 900 lei to 1050 lei in two stages) - combined with low inflation boosted consumer purchasing power throughout last year. In more detail, private consumption contributed 3.3 ppts, public consumption 0.3ppts, and net exports had zero contribution. On the negative side, investments continued to weigh subtracting 0.8ppts from the annual rate. Looking ahead, we anticipate GDP dynamics to remain close to those of 2014 with the switch to domestic demand vs. net exports to continue. We foresee GDP growth at 2.7% driven by sustained improvement in household spending, but we believe investments ought to pick up thanks to improved EU funds absorption, public investments spending, lax monetary and credit conditions and tax incentives provided by the reduction of social security contributions for employers plus the trimming of the special constructions tax.

Anticorruption campaign gains further momentum, dominating public focus and political agenda

The issue of combating corruption has received a lot of public attention in the last months. A number of high profile cases of politicians have been brought into justice, while the number of convictions last year was the highest in the post-Communist era. The prosecution of former tourism minister Elena Udrea last February, on corruption allegations was the most prominent investigation case initiated by the National Anti-Corruption Directorate (DNA) in 2015 up until the resignation of the Minister of Finance, Darius Valcov, on March 16th. The latest report under the Co-operation and Verification Mechanism, issued in last January, praised the efforts of authorities in that field and called for the momentum to be sustained during 2015 as well.

Tax reform plans raise concerns about fiscal policy in the medium term

Overall, the resignation of the Minister of Finance comes at a very inconvenient for the government time and only adds to concerns on fiscal policy. The proposal for tax reform presented in the cabinet included cuts in a number of tax rates (e.g. the VAT rate cut to 20% vs. 24%), change in tax procedures and the overall framework, but not any budget saving measures on the expenditure side enough to avert a significant increase in the fiscal deficit in 2016. The net impact (netting out of the positive side effects from the boost to growth, consumption, employment etc.) only for 2016 is expected to add around 1.7% of GDP to the headline deficit. The tax reform proposals have added to rating agencies' and market participants' concerns about potential fiscal slippages in an election year. A much looser fiscal stance over the medium term poses a downside risk on public finances which is credit negative from a rating agencies point of view and comes in contrast with government fiscal goals. Meanwhile, the fiscal deficit target in 2015 has been agreed with official lenders at 1.8% of GDP in cash terms (1.4% of GDP in ESA terms), almost flat versus the outcome of 2014.

NBR delivers another 25 bps rate cut in late March, probably the last one in this easing cycle

On March 31st, NBR decided to lower interest rates by 25bps down to 2.00% in line with the market consensus. At the same time, in an attempt to further strengthen the monetary policy transmission mechanism, NBR lowered the Lombard rate by another 50bps down to 3.75% and maintained the deposit rate unchanged at 0.25%, bringing down the interest rate corridor down by 25bps from 2.00% down to 1.75%. Overall, the benign inflation environment has allowed NBR to deliver 150bps of rate cuts since last August. Consumer prices have been on a downward trend throughout last year and early this year, reaching a new, post-1990 low in last February. In fact, inflation edged down to +0.3% MoM/+0.4% YoY in last February virtually unchanged from January, below the lower bound of NBR target interval (2.5% +1%) for a fifth month in a row. Inflation developments have been largely driven over recent months by lower commodity and energy prices, low imported prices and lower food prices reflecting the carry over effect from last year's bumpy agricultural harvest and the ban on exports to Russia. Yet, there are many chances that the move is the last of this easing cycle, as inflation is more likely to have bottomed out and is seen gradually rising in the 2H. Upside risks to our inflation forecast stem from the robust real wage growth - close to multi-year highs - which feeds into the consumption and unit labor costs plus the fiscal risks emanating from the recently introduced tax cuts. Even though inflationary pressures are still not there (Core 2: +1% in February), we anticipate NBR to become more reluctant to cut interest rates further taking into account uncertainties from the external environment. Meanwhile, we still anticipate the focus of the Central Bank to shift to the use of the minimum reserve requirements if needed. There is more room for NBR to reduce MMRs in order to reduce differential close to the EU levels (currently 10% and 14% for RON and FX denominated liabilities).

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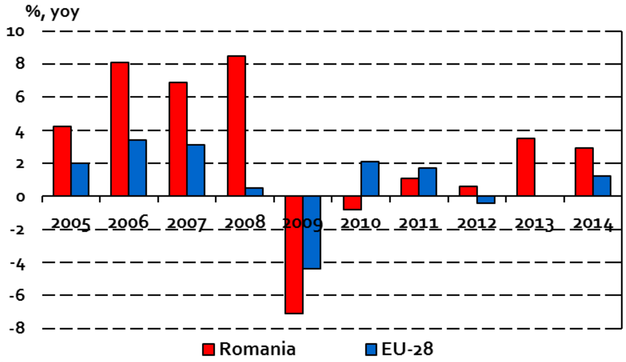
Romania: Macro & Market Data				
	2012	2013	2014	2015f
Real GDP (yoy%)	0.6	3.4	2.9	2.7
Consumption	1.0	0.4	3.0	4.0
Investment	0.1	-7.9	-3.6	2.0
Exports	1.0	16.2	3.5	5.5
Imports	-1.8	4.2	7.7	6.0
Inflation (yoy%)				
CPI (annual average)	3.3	4.0	1.1	1.7
CPI (end of period)	5.0	1.6	0.8	2.0
Fiscal Accounts (%GDP, Cash Basis)				
General Government Balance	-3.0	-2.2	-1.9	-1.9
Gross Public Debt (including guarantees)	37.3	37.9	39.5	39.1
Labor Statistics (annual avg,%)				
Unemployment Rate (ILO, % of labor force)	6.9	7.1	6.8	6.5
Wage Growth (total economy)	4.2	4.8	5.3	3.5
External Accounts				
Current Account (%GDP, BPM5)	-4.5	-0.8	-0.4	-0.5
Net FDI (EUR bn)	2.4	2.9	2.5	3.0
FDI / Current Account (%)	39.6	250.1	385.0	375.0
FX Reserves (EUR bn)	35.4	35.4	35.5	36.0
Domestic Credit *(end of period)*	**2011**	**2012**	**2013**	**2014**
Total Credit (%GDP)	52.7	52.0	47.0	44.4
Credit to Enterprises (%GDP)	20.7	20.3	18.0	15.7
Credit to Households (%GDP)	18.7	17.8	16.5	15.4
FX Credit/Total Credit (%, private)	63.4	62.5	60.9	56.2
Private Sector Credit (yoy)	6.6	1.3	-3.3	-3.1
Loans to Deposits (%)	142.5	133.9	118.4	106.3
Financial Markets	**Current**	**3M**	**6M**	**12M**
Policy Rate	2.00	2.00	2.00	2.00
EUR/RON	4.41	4.50	4.45	4.40

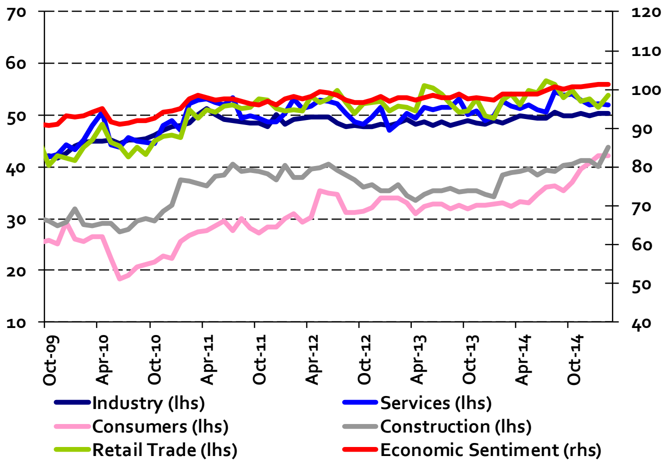
Source: National Authorities, EC, IMF, Eurobank Research

FIGURE 21: **Growth rates Romania vs. EU - 28 2005-2014**



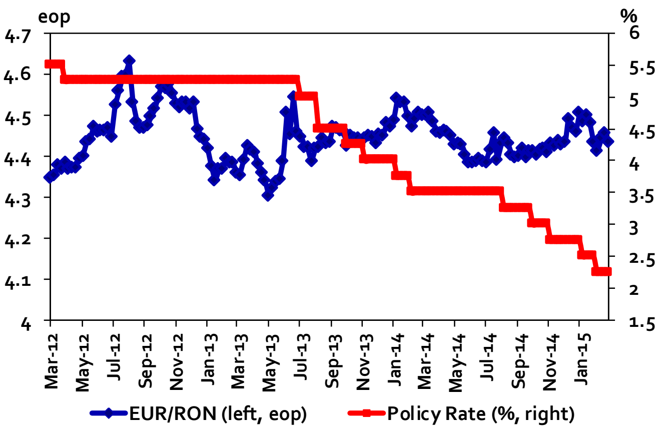
Source: Eurostat, Eurobank Research

FIGURE 22: **Sentiment indicators 2009-2015**



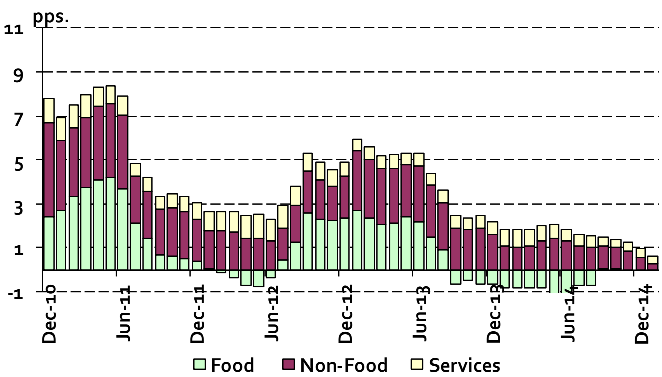
Source: Eurostat, Ecowin Reuters, Eurobank Research

FIGURE 23: **Monetary policy & FX rate 2012-2015**



Source: Bloomberg, Eurobank Research

FIGURE 24: **Inflation components 2010-2015**



Source: National statistics, Eurobank Research

Serbia (B1/BB-/B+)

Fiscal position on the mend

Domestic economy likely to remain in recession this year as well

Domestic economic activity slid into contraction (-1.8%) in 2014, on the back of weak external demand and last spring's floods, which heavily impacted the mining as well as energy sectors. The breakdown of the data showed that, domestic demand remained in contraction as fiscal consolidation weighed on both private and public spending. Exports posed, for the second year running, as the main contributor to growth, despite a sizable slowdown in the annual rate of increase to 1.6% from 7.4% in the prior year. Looking into 2015, the recession will likely continue – albeit at a slower pace – as domestic demand dynamics appear poised to remain lackluster against a backdrop of ongoing fiscal tightening. A negative carry over from last year's floods is also likely to weigh. Production at flood-impacted coal mines is unlikely to resume before May. This may be translated into an increase in the country's energy imports, which in turn will cap the expected positive contribution from net exports. On the other hand, their reconstruction is likely to provide some support to investment activity. A further recovery in the euro area and the waning impact of fiscal consolidation measures next year pave the way towards timid return to positive growth readings from 2016 onwards.

Early 2015 data suggest that government fiscal consolidation efforts pay off

Agreeing on the IMF precautionary arrangement, the government committed on pursuing fiscal consolidation, which primarily focuses on containing mandatory expenditure, curbing state aid and minimizing fiscal risks from state owned enterprises. Reducing pensions and civil servants wages has been the cornerstone of the fiscal reform that came into effect in Q4 2014. Under the IMF programme, the government targets a reduction in the consolidated budget deficit to RSD 232bn, or 5.9% of GDP in 2015 and to 3.8% of GDP by 2017 after the full-fledged reform process has been implemented. Indeed, Q1 2015 data showed the "Republic's" deficit figures way ahead of the planned shortfall of RSD 55bn, at just RSD 22bn, igniting early celebrations by the state officials. A closer look at the figures, however, reveals that the bulk of the "savings" are not the "real deal"; ca RSD 15bn in dividends paid out by the few profit-making state-owned enterprises were pushed forward to Q1 from year end. Also, state capital spending fell by ca. RSD 10bn in Q1, due to lax procedures and a lack of "investable" projects. On the other hand, one genuine positive sign was the augmented excise tax collection, especially on the tobacco and petroleum products (estimated at ca. RSD 5bn) thanks to recently implemented measures. That said, it may be possible that the budget deficit does end 50bps lower than the projected 5.9% by year end.

Recent fiscal developments and draft Nov 2012 MoU conditionality

After staying put on interest rates since November last year, the Central Bank (NBS) lowered its key policy rate by 50bps to 7.50% at its MPC meeting in March, in a move broadly in line with consensus. As noted in the accompanying statement, the IMF approval on the country's 3-year €1.2bn Stand-By Arrangement in late February, consistent fiscal consolidation and the launch of the ECB's QE programme, all argued in favour of resumption in NBS's monetary easing cycle. Also in support of the aforementioned, last year's economic contraction is likely to continue this year as well and inflation pressures have been largely subdued over recent months. On the latter, HICP came in at 0.8%YoY in February standing marginally above January's record low of 0.1%YoY and remaining below the target tolerance band of 4±1.5% for the 12th month running. Looking into the coming months, NBS is likely to continue easing monetary conditions in a cautious pace as it anticipates annual inflation to return within the target tolerance band around mid-year. In addition, fiscal consolidation as well as external risks linger, while the high level of Euroization impedes the functioning of the monetary policy transmission mechanism. For this year, we pencil in a further 50bps of rate cuts which are most likely to be delivered in Q2, before the Fed embarks on its rate tightening cycle.

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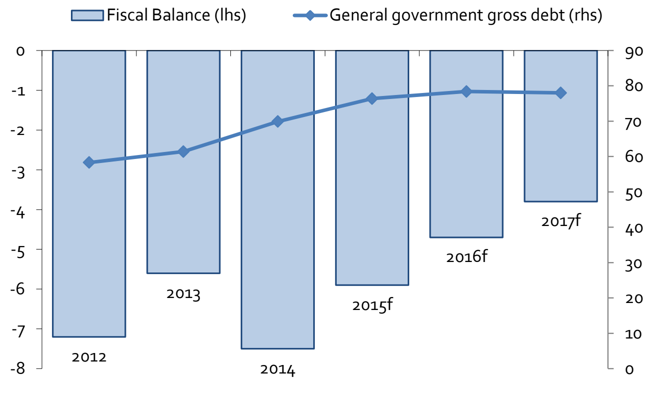
Serbia: Eurobank Forecasts				
	2012	**2013**	**2014**	**2015**
Real GDP (yoy%)	-1.0	2.6	-1.8	-0.5
Inflation (yoy%)				
HICP (annual average)	7.3	7.9	2.1	3.5
HICP (end of period)	12.2	2.2	1.7	4.2
Fiscal Accounts (%GDP)				
Consolidated Government Deficit	-7.2	-5.6	-7.5	-5.9
Gross Public Debt	58.3	61.4	69.9	76.4
Labor Statistics (%)				
Unemployment Rate (%of labor force, ILO)	24.6	23.0	19.7	19.0
Wage Growth *(total economy)*	8.9	5.7	2.0	0.0
External Accounts				
Current Account (% GDP)	-11.5	-6.1	-6.1	-4.7
Net FDI (EUR bn)	0.8	1.3	1.2	1.5
FDI / Current Account (%)	13.6	33.8	33.9	85.1
FX Reserves (EUR bn)	10.9	11.2	9.9	10.6
Domestic Credit	**2011**	**2012**	**2013**	**2014**
Total Credit (%GDP)	58	62.5	56.7	61.3
Credit to Enterprises (%GDP)	32.6	34.1	28.6	29.4
Credit to Households (%GDP)	17.7	18.3	17.4	18.7
Private Sector Credit (yoy%)	5.9	9.7	-4.5	-0.8
Loans to Deposits (%)	141.9	144.6	136.9	136.9
Financial Markets	**Current**	**3M**	**6M**	**12M**
Policy Rate	7.50	7.50	7.00	7.00
EUR/RSD	119.97	122.00	123.50	126.00

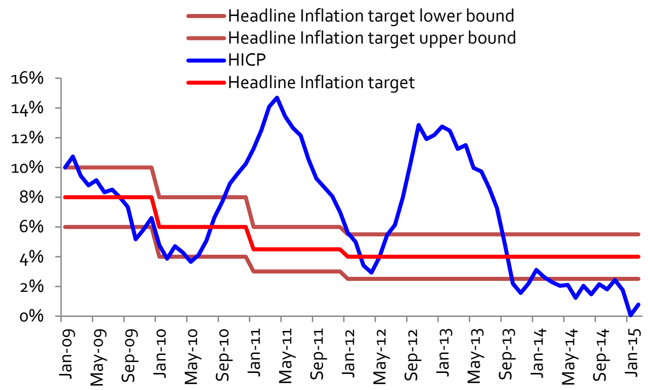
Source: National Authorities, EC, IMF, Eurobank Research

FIGURE 25: **Evolution of government finances (%GDP)**



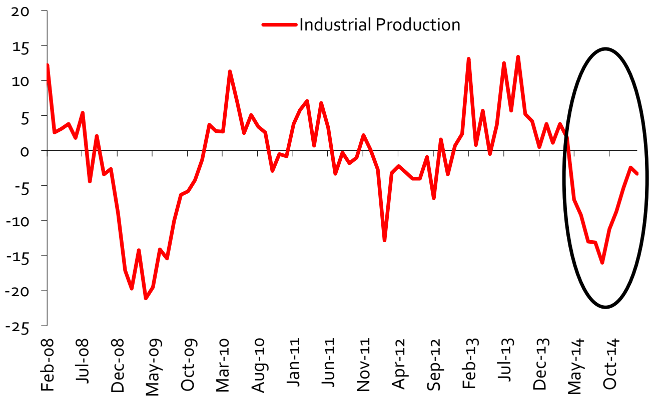
Source: National Authorities, EC, IMF, Eurobank Research

FIGURE 26: **Inflation well below NBS targets over recent months**



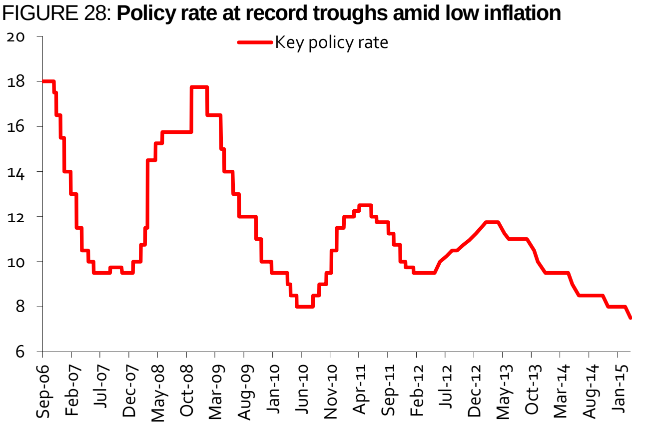
Source: National Authorities, Eurobank Research

FIGURE 27: **Industrial production severely hit by last year's floods (YoY%)**



Source: National Authorities, EC, IMF, Eurobank Research

FIGURE 28: **Policy rate at record troughs amid low inflation**



Source: National Authorities, EC, IMF, Eurobank Research

IV. Calendar of Data & Events

Key Data and Events, April - May, 2015				
Country	**Date**	**Indicator/Event**	**Median**	**Previous**
		April 2015		
SERBIA	April 9	MPC meeting	7.50%	7.50%
EU	April 15	ECB meeting & press conference		
ROMANIA	April 24	Fitch sovereign credit rating review		
CYPRUS	April 24	Fitch sovereign credit rating review		
US	April 28-30	FOMC meeting		
ROMANIA	April 9	Trade balance (Feb, EURmn)	N/A	-176.4
		Industrial production (%YoY, Feb)	3.4	3.4
BULGARIA	April 9-17	U/E rate (%, Mar)	N/A	11.0
ROMANIA	April 10	CPI (%YoY, Mar)	0.6	0.4
		Current account (Feb, EURmn)	N/A	554
SERBIA	April 14	HICP (%YoY, Mar)	N/A	0.9
BULGARIA		Trade balance (Feb, EURbn)	N/A	-0.4
	April 15	CPI (%YoY, Mar)	N/A	-0.5
SERBIA		Current account (Jan, EURmn)	N/A	-275
BULGARIA	April 17	Current account (Feb, EURmn)	N/A	-43.8
SERBIA	April 24	Real gross wages (%YoY, Mar)	N/A	-3.8
BULGARIA	April 28	Gross external debt (Feb, EURbn)	N/A	39
SERBIA	April 30	Industrial production (%YoY, Mar)	N/A	-3.3
		Trade balance (Mar, EURmn)	N/A	-367.6
		Retail sales (%YoY, Mar)	N/A	-0.8
		Current account (Feb, EURmn)	N/A	N/A
		GDP (Q1, %YoY, nsa, p)	N/A	-1.8
ROMANIA		ILO U/E rate (%, Mar)	N/A	6.4
BULGARIA		Budget balance (Mar, EURmn)	N/A	-105.5
		May 2015		
ROMANIA	May 6	MPC meeting	N/A	2
SERBIA	May 11	MPC meeting	N/A	N/A
ROMANIA	May 5	International reserves (Apr, EURbn)	N/A	34.3
		Retail sales (%YoY, Mar)	N/A	3.5
	May 7	Net wages (%YoY, Mar)	N/A	6.5
BULGARIA		International reserves (Apr, EURbn)	N/A	37.1
CYPRUS		CPI (%YoY, Apr)	N/A	-1.9
BULGARIA	May 8	Industrial production (%YoY, Mar)	N/A	2.3
		Retail sales (%YoY, Mar)	N/A	4.2
ROMANIA	May 11	Trade balance (Mar, EURmn)	N/A	N/A
BULGARIA		Trade balance (Mar, EURmn)	N/A	N/A
	May 11-15	U/E rate (%, Apr)	N/A	N/A
SERBIA	May 12	HICP (%YoY, Apr)	N/A	N/A
ROMANIA		CPI (%YoY, Apr)	N/A	N/A
		Industrial production (%YoY, Mar)	N/A	N/A
CYPRUS		HICP (%YoY, Apr)	N/A	-1.4
	May 13	GDP (Q1, %YoY, p)	N/A	-2
ROMANIA		GDP (Q1, %YoY, A)	N/A	2.7
BULGARIA		CPI (%YoY, Apr)	N/A	N/A
		GDP (Q1, %YoY, p)	N/A	1.3
ROMANIA	May 15	Current account (Mar, EURmn)	N/A	N/A
BULGARIA		Current account (Mar, EURmn)	N/A	N/A

SEE Bond Supply Calendar, April - May, 2015			
		April 2015	
ROMANIA	April 9	T-Bonds	RON 300mn
SERBIA	April 14	2Y floating T-Notes	RSD 10bn
ROMANIA	April 16	T-Bonds	RON 200mn
BULGARIA	April 20	2.3% 2025 T-Bonds	N/A
ROMANIA	April 23	T-Bonds	RON 400mn
SERBIA		3Y 10% (pa) T-Notes	RSD 50bn
		May 2015	
BULGARIA	May 11	T-Bonds	N/A
SERBIA	May 14	2-year 8% (pa) T-Notes	RSD 10bn

Source: National Authorities, Bloomberg, Reuters, Eurobank Research

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