

Ioannis Gkionis

Research Economist
Eurobank Ergasias
+30 210 3331225
igkionis@eurobank.gr

Galatia Phoka

Research Economist
Eurobank Ergasias
+30 210 3718922
gphoka@eurobank.gr

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Deputy Chief Economist, for
his insightful comments*

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Solid regional growth in Q4:15 spurs optimism for 2016 prospects

REGIONAL MACROECONOMIC DEVELOPMENTS & OUTLOOK

- **Strong finish** for the region in Q4-2015 despite **headwinds in the EM space**
- **Sustained low world energy prices** provide a positive, albeit probably smaller than last year, boost on growth momentum in 2016
- **Economic sentiment** in the region in the first two months of 2016 still at its highest or close to the highest level since 2008

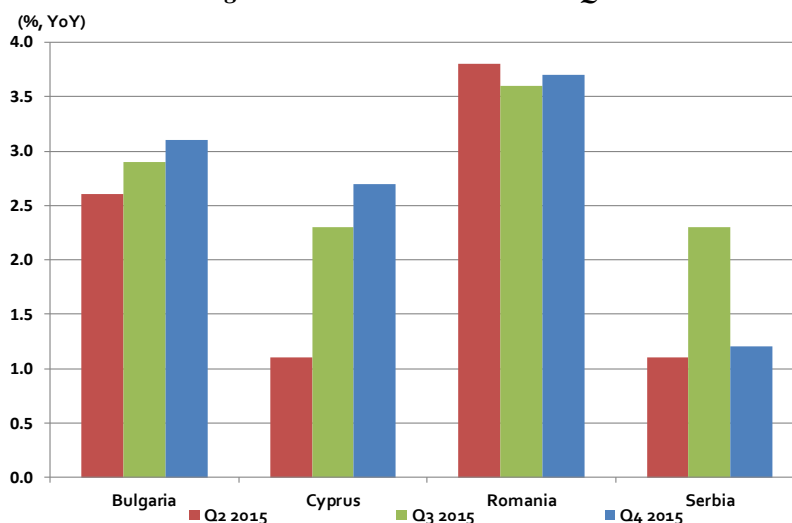
REGIONAL MARKET DEVELOPMENTS & OUTLOOK

- Despite some improvement in global investor sentiment, **February proved to be yet another month of increased market volatility** and risk aversion
- **Regional currencies** remained supported by expectations for further ECB stimulus, healthy growth prospects
- **Local-currency government bonds** retained a firm tone on subdued inflation pressures, ECB easing

COUNTRY FOCUS

- **Bulgaria:** Economy ended the previous year on a strong note
- **Cyprus:** Economy out of the woods
- **Romania:** Surprise inflation reading in January
- **Serbia:** Delays in this year's fiscal consolidation measures likely ahead of the snap general elections

Solid growth momentum sustained in Q4-2015



Source: National Statistics, Eurobank Research

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I. Regional Macroeconomic Developments & Outlook

Strong finish for the region in the last quarter of 2015

Headwinds to the global economic outlook have increased stemming from concerns about the US economy

Fresh concerns about the developed economies' prospects, coming primarily from disappointing consumer data in the US, have sparked a new round of fears of a significant- higher than envisaged before- slowdown in the global economic outlook and have put the growth forecasts for a number of economies in question. In addition, negative spillovers from the Chinese growth slowdown via the commodity markets continue to pose a serious problem for commodity producers in the EM space. As a result, data coming out from EM space continue to disappoint, while a divergence between the economic prospects of commodity exporters and importers is becoming more prominent. For the time being, the growth prospects of the Euroarea –the main trade partner and primary generator of capital flows for the region- have remained unscathed. Yet, the tightening of the financial conditions in the Euroarea has created expectations of further action on behalf of ECB. At the same time, the US Fed, having delivered the first interest rate hike back in December, is now seen at a wait and see mood well beyond March. In any case, the ability of the Central Banks to stimulate growth through monetary policy has increasingly come in question.

Despite increased EM space concerns, the region made a strong finish in Q4-2015, while the sentiment data coming out up until now in the new year support cautious optimism for new year's growth prospects

A number of national statistics offices across the region released earlier this month flash estimates of GDP growth for Q4-2015. Among them, Bulgaria, Romania, Cyprus and, earlier this month, Serbia published flash estimates more or less in line with our expectations. Those readings confirm our earlier FY forecasts stipulated in the previous editions and serve as a reminder that there are few winners' economies in the EM space. From a growth point of view, it would be fair to say that 2015 has been a very good year for the region, most probably the best since 2008. Although we do not have a full detailed break-down for all the economies, domestic demand has been the main driver behind growth in Q4. Lax monetary policies together with low 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 on in 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. Even though the economic sentiment data published in February disappointed for the region as a whole as a result of lower manufacturing confidence, in the economies of our focus, the indicator is at its highest or still relatively close to the highest level since 2008, as consumers benefit from rising real wages, firmer labor markets and low inflation.

Bulgaria expanded at the highest rate since 2011, driven primarily by the increased government spending ahead of the closing of the EU funds programming period 2007-2013

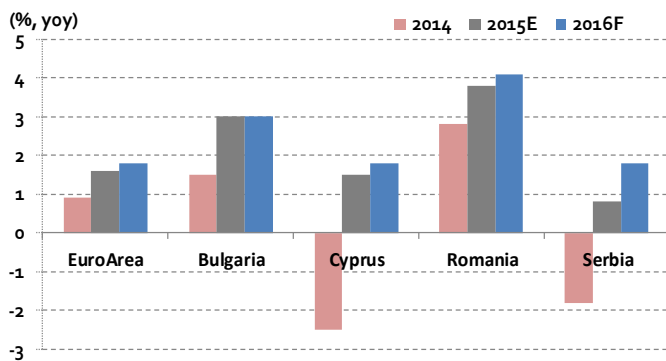
On a country level, **Bulgaria** expanded by +3.1% YoY in Q4, the highest rate since Q2-2011, driven primarily by the increase in government spending, which in turn is related to an increased EU funds absorption ahead of the closing of the programming period 2007-2013 by year end. Having the highest energy consumption intensity in EU-28 and a very high exposure to the Euro area via trade and capital flows, Bulgaria will most probably continue to benefit the most from low world energy prices and the ongoing Euro area recovery. However, the fragmented multi-party government led by GERB survived its first vote of no confidence motion, an illustration of the lingering political risks we were alluding to in our previous report. **Cyprus** accelerated to +2.7% YoY in Q4, driven most probably by the ongoing consumption recovery, which brings the full year growth estimate at +1.6% YoY in 2015, after a three year recession in 2012-2014. The count-down for Cyprus' successful graduation from the economic adjustment program in March has already started. Yet, the conditionality of the last program review is not fully fulfilled yet, as the approval from the parliament of the corporatization of CYTA is still pending, which has decreased the probability of a clean exit. In any case, even though the economy has turned page, the post-MoU era is still full of challenges.

Inflationary pressures in Romania are building faster than in its regional peers, prompting the Central Bank to send hawkish messages to the markets

Romania registered another quarter of robust domestic demand-driven growth in Q4-2015, which brought the FY2015 growth at +3.7%. Yet, inflation surprised to the upside in January. Despite the continuous energy prices slump and the negative base effects from fiscal easing, inflationary pressures in Romania are building faster than in its regional peers, making the Central Bank to send hawkish messages to the markets that could also translate into earlier than expected action in the monetary policy front. **Serbia** slowed to +1.2% YoY in Q4 on weaker than in the previous quarter net exports and investment activity. Having expanded by +0.8% in FY2015, the economy is gradually trying to find its way onto a new growth path while not having recovered fully from the catastrophic floods in spring 2014. In the run up to early parliamentary elections in late April, the precautionary IMF agreement is on track, allowing for further fiscal consolidation, but a stronger push for structural reform is still missing.

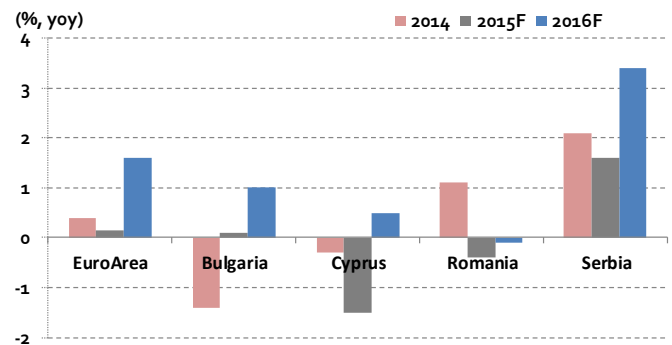
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FIGURE 1: Growth performance 2014-2016



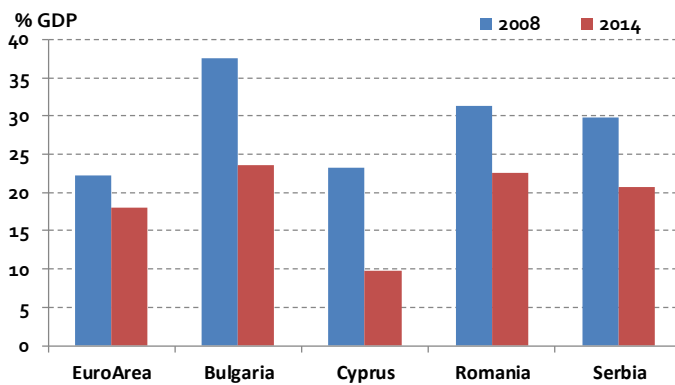
Source: Eurostat, National Authorities, Eurobank Research

FIGURE 2: Annual average inflation 2014-2016



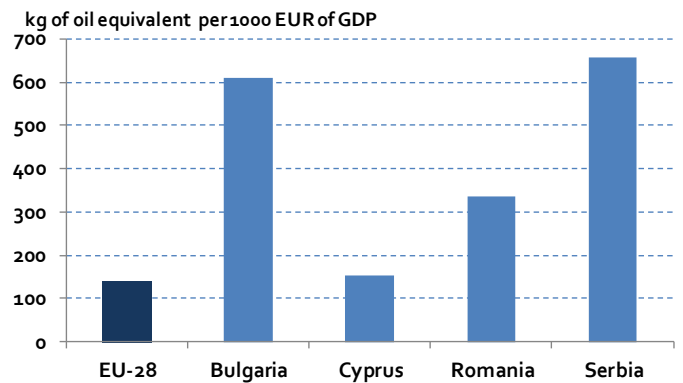
Source: Eurostat, National Authorities, Eurobank Research

FIGURE 3: Investments to GDP ratios 2008 vs. 2014



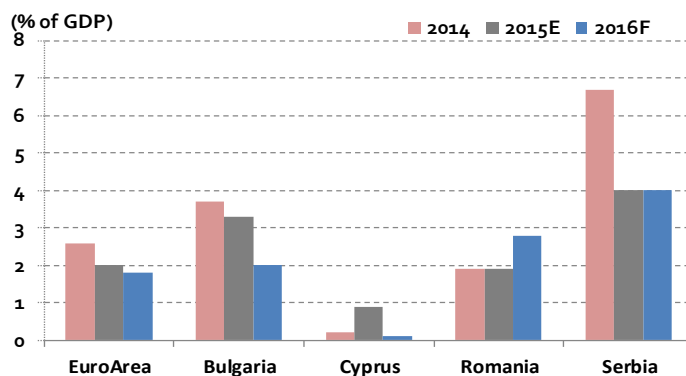
Source: IMF WEO, Eurobank Research

FIGURE 4: Energy intensity of the individual countries, 2013



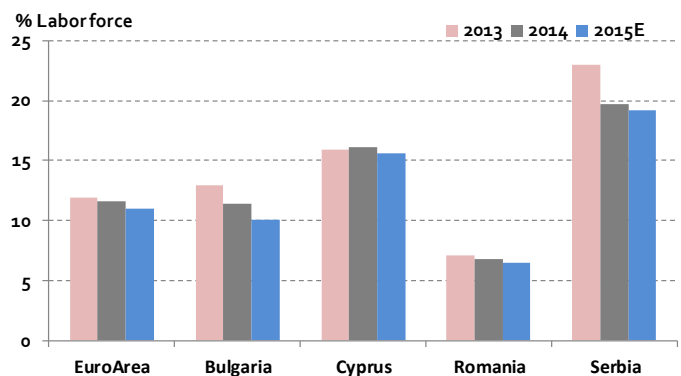
Source: Eurostat, National Authorities, Eurobank Research

FIGURE 5: Fiscal Balance (% of GDP, Cash basis) 2014-2016



Source: Eurostat, National Authorities, Eurobank Research

FIGURE 6: Annual average unemployment rates 2013-2015



Source: Eurostat, National Authorities Eurobank Research

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II. Regional Market Developments & Outlook

Despite some improvement in global investor sentiment, February proved to be yet another month of increased market volatility and risk aversion

Market volatility remained high in February Despite some modest improvement in global investor sentiment since late January, February proved to be yet another month mired in bouts of increased market volatility and risk aversion. Early into the month concerns mounted about the prospects of the European banking sector. Meanwhile, investor worries that world Central Banks are running out of ammunition to support global growth, were reflected in the limited impact in global financial markets of the decision by the Bank of Japan to introduce negative interest rates for the first time ever. Volatility in global oil prices and China-related jitters also continued to play a key role in the performance of emerging market assets. That said, scaled back expectations for another Fed rate hike within this year and the increased prospect for further ECB stimulus as early as the March 10th monetary policy meeting provided some support to risk sentiment, as did the timid recovery witnessed in global commodity prices since the middle of the month.

MSCI EM index ended in a negative territory for the 4th month running Against this backdrop, the MSCI Emerging Markets index finished February in marginally negative territory (-0.3%), closing in the red for the fourth consecutive month and posting year-to-date losses of approximately -7%. Despite that, the index stands about 8% higher from its 6 ½ year low, hit in late January, a few weeks after the beginning of the Fed's rate tightening cycle. In this environment, CESEE bourses put a mixed performance in February, with the majority of the indices in the region recording modest loses. Overall, CESEE as well as regional assets have remained broadly supported compared to their global developing-country peers on the back of healthier economic growth prospects, hopes for further ECB stimulus and broadly accommodative Central Banks' monetary policies. Falling oil prices also favor oil-importing markets, such as most CESEE countries, and bode well for maintaining inflationary pressures subdued. At the same time, they support reducing external vulnerabilities, especially in those countries where energy consumption is heavily based on imports.

Regional currencies remained supported by expectations for further ECB stimulus, healthy growth prospects Mounting expectations for further ECB stimulus action and healthy growth prospects in the CESEE space, as well as in the region of our interest, have provided support to the respective currencies. Although most ended the month little changed, the Polish zloty and the Romanian leu stand out as the most notable outperformers in February, as economic activity remained robust (Poland 3.6% & Romania 3.8% YoY annual GDP growth in 2015). Against this backdrop, the EUR/PLN traded near a 7-week trough, at 4.3390, by the end of the month, while the EUR/RON hit a 2-month low at 4.4470 on February 17th. Notably, the zloty has fully recovered the losses from the January sell off, post the unexpected S&P decision to cut Poland's sovereign credit rating by 1-notch to BBB+ with Negative Outlook, on the back of concerns of the new government's policies on the independence of the country's institutions. On the flipside, the Serbian dinar slid to a 1-year low of 123.70/EUR in late February, primarily on the back of strong corporate demand, prompting repeated Central Bank interventions in the FX markets in order to support the currency.

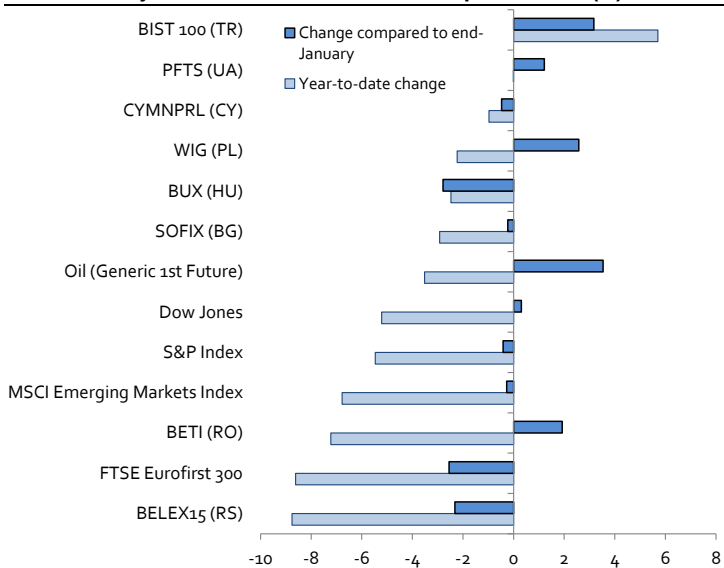
Local-currency government bonds retained a firm tone on subdued inflation pressures, ECB easing Elsewhere, CESEE local-currency government bonds remained well supported in view of persistently subdued inflationary pressures and revived expectations for further Central Bank easing, as well as further ECB QE. Serbian paper led the gains in February following January's correction. The latter was likely related to profit taking following last year's impressive performance, as well as to supply side concerns ahead of large auctions due in the coming weeks. In more detail, the yield of the 10.00% May 2022 slid by ca 40bps to 7.36% on the month, while the corresponding yields of Hungary's 5.50% June 2015, Poland's 3.25% July 2025 and Romania's 4.75% February 2025 fell by 20 to 26bps.

Volatility in global financial markets is likely to resurface Looking ahead, volatility in global financial markets is likely to increase anew, especially if the ECB disappoints easing expectations on March 10th or the pace of the Fed's rate-tightening path proves faster than anticipated. Volatility in commodities prices, renewed global growth concerns and China-related jitters will also likely remain at play. The prospect of revived geopolitical tensions is another factor to watch for. On a regional basis, a heavy elections' calendar in the region this year also bears risks in the face of potential fiscal slippages and escalation of political uncertainty.

Galatia Phoka (gphoka@eurobank.gr)
(+30) 210 371 8922

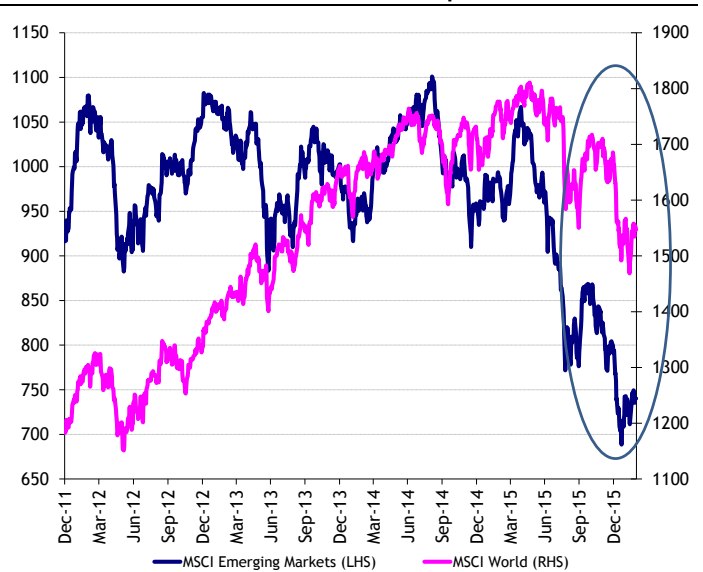
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FIGURE 7: Major world & CESEE stock markets performance (%)



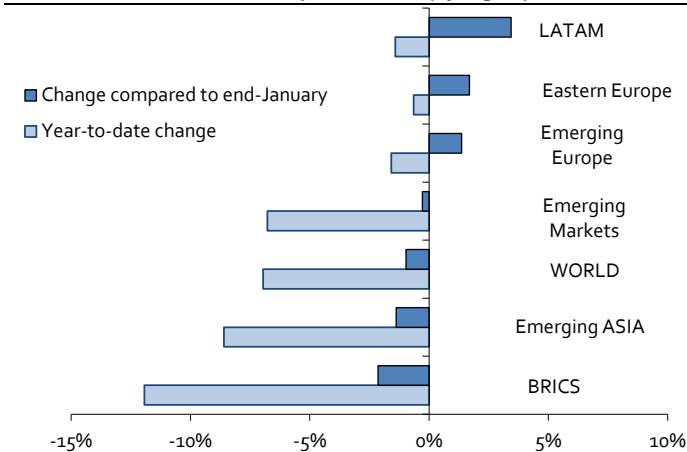
Source: Reuters, Bloomberg, Eurobank Research

FIGURE 8: World & CESEE stock markets YTD performance



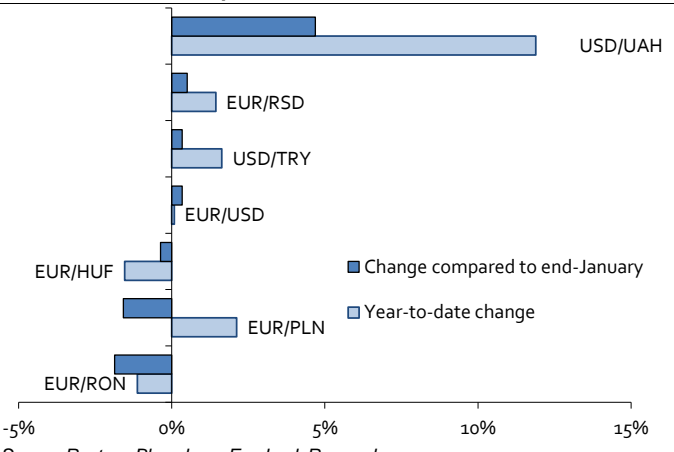
Source: Reuters, Bloomberg, Eurobank Research

FIGURE 9: MSCI stock indices performance (by region)



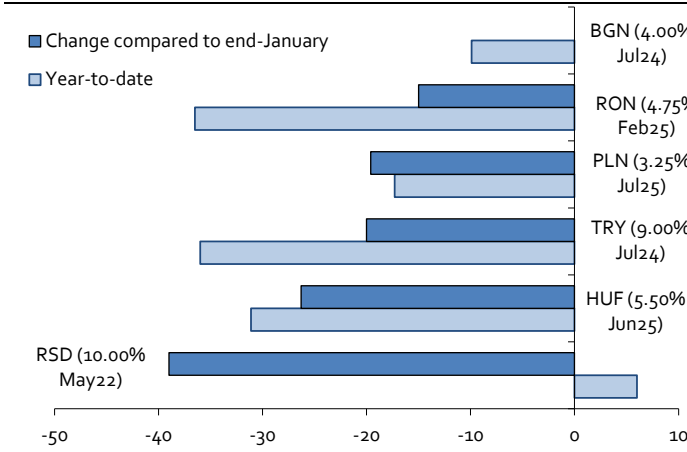
Source: Reuters, Bloomberg, Eurobank Research

FIGURE 10: CESEE FX performance



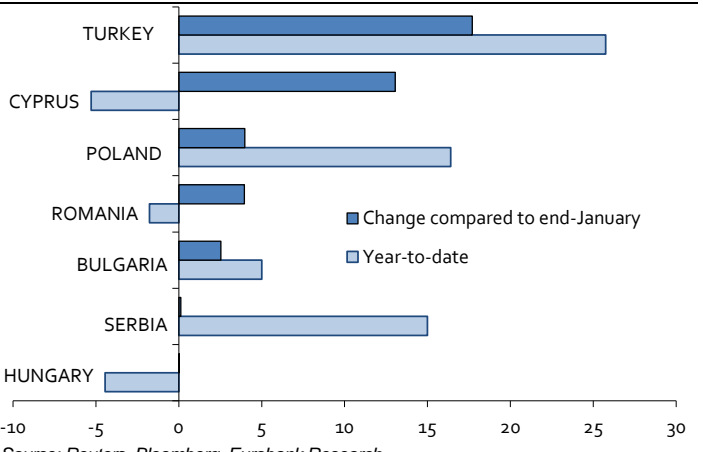
Source: Reuters, Bloomberg, Eurobank Research

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

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Trader's view

FX

We prefer to stay sidelined on the dinar

In the last report, we expressed our belief that the EUR/RSD pair would move lower in the short-term. We were right, partially. The pair was heading towards our first objective (122.00) but the National Bank of Serbia overturned this downtrend with its decision to intervene and stop any further strengthening of the domestic currency. In view of heightened market volatility and repeated Central Bank interventions from either side of the EUR/RSD's recent range, we expect range trading to prevail in the coming weeks. In this context, we anticipate the EUR/RSD to remain bound within 122.50-123.00 over the next month or so, with a rise towards 123.00-124.00 in a 3-month horizon. In this environment and taking into account a potential escalation of market volatility in the way to the upcoming snap national elections we would prefer to stay sidelined on constructing any new positions on the dinar.


Local rates

Prefer to stay underweight on local government bonds

Since rumors on new Eurobond issue started spreading in mid-February in **Bulgaria**, local government bonds came under pressure in the 6-10 year sector, where yields increased by 25-35bps back to their November levels. Instead, the short and mid-term papers stayed supported as banks continued to place extra liquidity. We expect further steepening of the curve in the coming weeks. The auction calendar is likely to remain empty in March ahead of a planned Eurobond issue in that month. However, the lower overall supply in the primary market for this year would drive more competition among investors in upcoming auctions. Along these lines we would prefer to stay underweight on local government bonds.

Long ROMGB positions appear favorable amid ample liquidity and attractive carry

In **Romania**, ample RON liquidity in the market in tandem with a favorable macroeconomic growth outlook for Romania in the short-term suggest that long positions on Romanian local currency paper appear favorable. High liquidity is expected to be present in the markets in the coming months, while the carry of those bonds seems more than attractive.

Security	Position	Entry	Current level	Target	Stop loss
ROMGB 2025	Long 	3.40%	3.46%	3.10%	3.65%

External debt markets

Stay neutral in the long-end of the curve due to high market uncertainty and in view of the Eurobond issuance

Bulgarian Eurobonds, on the other hand, experienced a more limited correction in February, with corresponding yields up by 10bps compared to their end-January levels. We favor the mid-term sector in the Bulgarian Eurobond market as it appears underpriced compared to regional peers, such as Romania. Nonetheless, we prefer to stay neutral in the long-end of the curve at this point due to high global market uncertainty and wait until the Eurobond issuance to specify any targets. Rumor has it, that the Finance Ministry plans to sell EUR 2bn on international markets in March, most likely in two tranches of 10 and 15/20 years. Yields are expected at circa 2.80% for the 10-year paper and 4% for the 20-year one, net of issuance premium.

Vessela Boteva (VBoteva@postbank.bg)
+359 (2) 8166 491

Romulus-Daniel Georgescu (Romulus-Daniel.Georgescu@bancpost.ro)
+4021 3656292

Zoran Korac (zoran.korac@eurobank.rs)
+381 11 206 5821

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III. Country Focus Bulgaria (Baa2/BB+/BBB-)

Economy ended the previous year on a strong note

The economy picked up pace in the last quarter of 2015, growing at the strongest rate since Q2-2011.

According to the flash estimate, real GDP growth accelerated at +0.8% QoQ/+3.1% YoY in Q4-2015, up from +0.7% QoQ/+2.9% YoY in Q3-2015 vs. +0.6% QoQ/+1.8% YoY in Q4-2014. 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. Final consumption expanded by +0.7% QoQ/+2.5% YoY in Q4-2015 up from +1% QoQ/+1% YoY in Q3-2015 vs. -0.8% QoQ/+1.1% YoY in Q4-2014, making a very strong contribution to growth in Q4. The spending recovery was mainly driven by the increase in government spending mirroring the increased EU funds absorption ahead of the closing of the programming period 2007-2013 by year end. In addition, rising real wages, improving sentiment, declining energy prices -Bulgaria has the highest energy consumption intensity in EU-28- and further gains in employment must have helped private spending gain more speed in Q4. On the external sector, exports decelerated sharply in Q4 (+0.7% YoY in Q4, down from +5.8%YoY in Q3), outpacing that of imports' (+1.7% YoY in Q3 vs. +3.3% YoY in Q2). On the positive side, investments entered in positive territory after four consecutive quarters in the red (+1.4% YoY in Q4, down from -0.4%YoY in Q3). The released flash estimate brings full year output performance at an estimated +2.8% in 2015, up from +1.6% in 2014.

Sustained labor market recovery is expected to support further consumption recovery in 2016

The labor market conditions improved further in Q4-2015. Unemployment declined to 7.9% of the labor force in Q4-2015, down from 8.3% in Q3-2015 compared to 10.6% in Q4-2014. The improvement was driven by solid employment growth (+2.4% yoy in Q4, 72k more jobs), the strongest growth rate recorded in the last eight quarters. Overall, the average unemployment rate declined to 9.2% in 2015, down from 11.4% in 2014, as growth translated to an additional 50.5k jobs in 2015 on top of 46.5k jobs added in 2014. Labor intensive industries in the areas of specialized services (Information & Communication, Logistics, and Business Services) have taken the lead in job creation from traditional industries like manufacturing, retail and wholesale trade, construction. Employment expectations have remained strong throughout Q4, pointing to a further tightening in the labor market in 2016. The labor market improvement has set the foundations for the recovery of consumption, more visible in the 2H-2015, that will most probably extend in 2016 as well.

The annual EU Commission report urged once again authorities to accelerate progress in the reform of the judiciary and the fight against corruption and organized crime

The annual progress report under the Cooperation and Verification Mechanism (CVM) acknowledged that Bulgaria "took some important steps to put reform back on the agenda" after a period of political instability, but the translation of two strategies for reform prepared last year into "concrete and tangible progress" will be "a major challenge for 2016". In addition, the report findings took note of the partial successes, such as the adoption of constitutional amendments to the reform of the Supreme Judicial Council, but also setbacks of key steps, such as the rejection of a draft law for the establishment of an anti-corruption body. However, the report assessed that the slow progress in tackling high-level corruption and organized crime cases continues to erode public confidence in the ability of the Bulgarian authorities to deliver justice. Finally, the EU Commission urged Bulgaria to accelerate progress on implementing recommendations-many of them already contained in the previous year's report-on the reform of the judiciary and the fight against corruption and organized crime.

Full year budget execution undershoots the revised official target in 2015

The consolidated government deficit in cash terms came at BGN2.9bn in 2015 or 2.9% of GDP, comfortably below the revised target of 3.3%. Total revenues expanded by 9.5% YoY outperforming the +1.5% YoY target, helped by the overperformance of grants (+24.7% YoY) as a result of the improved EU funds absorption but also improved tax revenues collection (+7.9% YoY). Total expenditure was up by +6.8% YoY driven by a post-crisis high of capital expenditures and EU funds related spending, as current spending on wages, pension and procurement remained constrained. The fiscal deficit in cash terms had widened to 3.8% of GDP in 2014, up from 1.8% in 2013, surpassing the Maastricht threshold for the first time since 2010, primarily reflecting spending slippages from the electoral cycle and the bail-out costs from the banking sector. Looking ahead, the consolidated government deficit target is set at 2% in 2016. Although the headline number implies significant consolidation effort, the government anticipates improved revenues from EU reimbursements for spending in the past year, concession revenues from the Sofia airport, while additional buffers could emerge from higher than last year's budget flexibility on the discretionary spending side.

Ioannis Gkionis (igkionis@eurobank.gr)

(+30) 210 337 1225

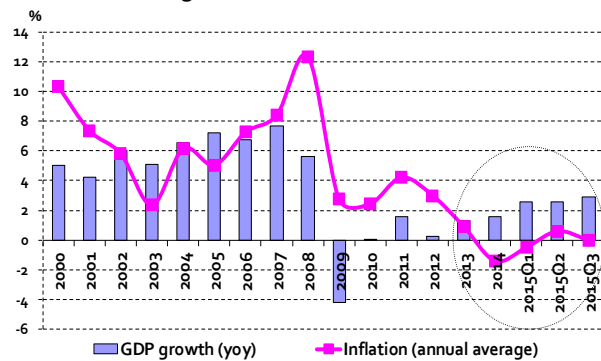
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Bulgaria: Macro & Market Data

	2014	2015	2016f	2017f
Real GDP (yoy%)	1.6	2.8	2.6	3.1
Inflation (yoy%)				
CPI (annual average)	-1.4	-0.1	1.0	1.5
CPI (end of period)	-0.9	-0.4	1.2	2.0
Fiscal Accounts (%GDP)				
General Government Balance	-3.7	-3.3	-2.0	-1.4
Gross Public Debt	27.7	26.7	29.7	31.1
Primary Balance	-3.0	-2.0	-1.1	-0.4
Labor Statistics				
Unemployment Rate (LFS, %)	11.4	9.9	9.1	8.5
Wage Growth (total economy)	6.8	7.5	7.0	
External Accounts				
Current Account (% GDP)	0.9	1.5	1.0	0.5
Net FDI (EUR bn)	1.3	1.5	1.5	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

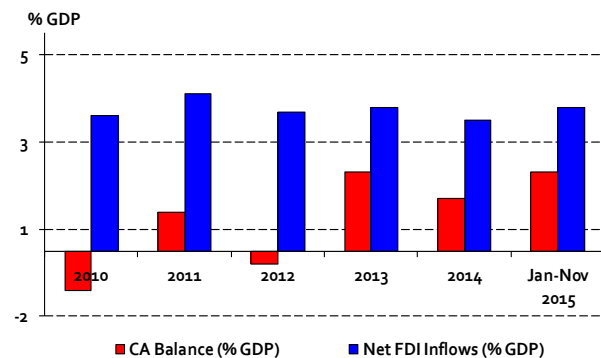
Source: National Sources, Eurostat, IMF, Eurobank Research

FIGURE 13: GDP growth & Inflation 2000-2015



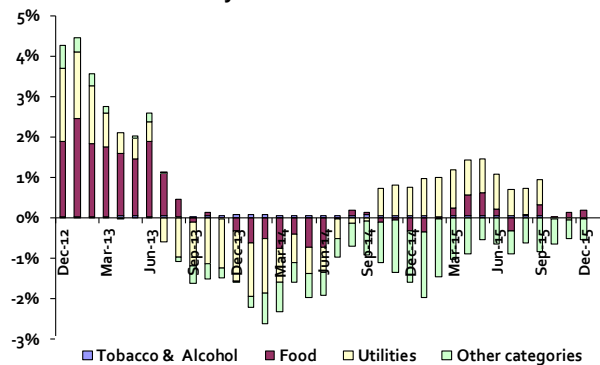
Source: National statistics, Ecowin Reuters, Eurobank Research

FIGURE 14: CA Deficit & Net FDI inflows 2010-2015



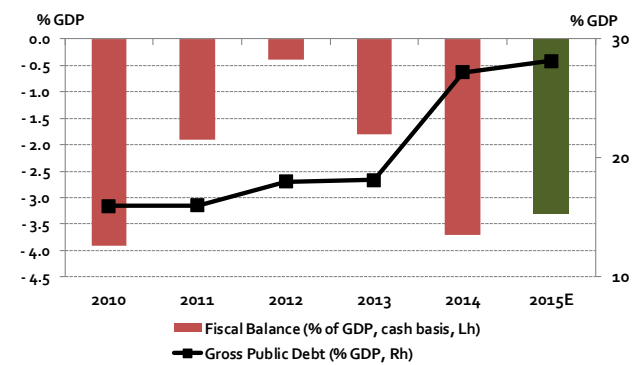
Source: National statistics, Ecowin Reuters, Eurobank Research

FIGURE 15: Inflation dynamics 2012-2015



Source: National statistics, Ecowin Reuters, Eurobank Research

FIGURE 16: Fiscal deficit & Gross Public Debt 2010-2015



Source: Eurostat, Eurobank Research

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

Economy out of the woods

After a three year recession in 2012-2014 the economy expanded by +1.6% YoY in 2015. Growth is expected to gain further momentum to 2% in 2016

The flash estimate of the last quarter- the fourth consecutive positive one on both quarterly and an annual basis after a three year recession- is an illustration that the economy is finally out of the woods. On a seasonally adjusted basis, growth accelerated further to +0.4% QoQ/+2.7% YoY in Q4-2015, up from +0.5% qoq/+2.3% yoy in Q3-2015, compared to -0.1% qoq/-1.6% yoy in Q4-2014. In the full year 2015, growth expanded by +1.6% YoY, a notch higher than the revised government projection, compared to -2.5% in 2014, -5.9% in 2013 and -2.4% in 2012. Although the components of growth are not known yet, it is highly likely that the consumption rebound has continued in Q4-2015, driven by sentiment improvement as a result of strong compliance with programme's conditionalities, lower energy prices, lower unemployment and a rise in real incomes. Looking ahead, we anticipate growth to gain further momentum in 2016 as lower energy prices, the lagged effect from Euro depreciation, the lack of additional fiscal austerity measures and a flourishing tourism sector are expected to provide more support to consumption's recovery and net exports.

The count-down for Cyprus' successful graduation from the economic adjustment program in March has already started

If authorities satisfy the conditionalities of the last program review with respect to the approval from the parliament of the corporatization of CYTA -the telecom public utility- Cyprus will become in March the third country after Portugal and Ireland to have made a clean exit from its economic adjustment program. The issue is highly politically sensitive and has received a lot of public attention ahead of the parliamentary elections in next May. More importantly, time is running out for the endorsement of the review in the next Eurogroup in early March. Overall, Cyprus has already made use of €7.3bn up until now out of a total €10bn available in the program. Although the disbursement of the last ESM tranche is not absolutely necessary as market access has been restored, at a comparably higher cost than that of official lending the endorsement of the review will send a positive signal to the markets allowing for a further improvement in the cost of funding. More importantly, it will allow the ECB to provide a waiver for government bonds to be eligible for Euro system financing after Cyprus' graduation from the program, even though the sovereign rating of Cyprus is still below investment grade, despite rating agencies' upgrading. Cyprus has made the fastest come-back to international markets among other Euroarea programme countries tapping the international markets three times (June 2014, April 2015 and October 2015).

Even though the economy has turned page, the post-MoU era is full of challenges for Cyprus

After a sharp output decline in 2012-2014, it is apparent that Cyprus has entered a new growth path. Cyprus has made significant adjustment progress within the programme in a number of areas, including but not limited to, restoring the health of the banking sector, a complete lift of capital controls, fixing of public finances and addressing earlier macroeconomic imbalances. In any case, even after the prospective parliamentary elections of May a handful of unfinished structural reforms in the areas of privatizations, public administration and the health sector need to proceed. In addition,, the challenges of the still high NPLs stock and high ELA exposure (€3.5bn in January 2016 or 19.7% of projected GDP, down from €11.4bn in March 2013) need to be addressed, while maintaining high primary surpluses. To ensure sustainable growth in the medium-term, there is still need for a comprehensive post-MoU growth strategy. Such a strategy should rely on the key comparative advantages of Cyprus, including the low corporate tax rate, the key geostrategic position of the island in the Mediterranean Sea, the facilitation of international business, quality human capital.

Asset quality remains a key challenge for the domestic banking sector, even though the pace of loans' restructuring has picked up in recent months

Addressing the high NPLs ratio remains a key challenge for the banking sector. 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- declined to 46.1% in October 2015, compared to 47.8% in December 2014. The ratio remains relatively high, among the highest following any recent banking crisis. Yet, the pace of loans restructuring, an essential tool for the resolution of NPLs, has picked up in the last months of 2015. The amount of loans restructured climbed from €1bn in Q1-2015 to €1.2bn in Q2-2015, further to €1.4bn in Q3-2015, and reached €1.18bn already in the two month period October-November 2015. As a result, a large fraction of the restructured loans falls into the 12-month probation period and are still classified in NPEs (39% in Nov2015 vs.33% in Dec2014). On a more positive note, according to the Central Bank data, 78% of the fixed-term loans which were restructured between 1 January 2014 and 30 November 2015 abide by the new repayment schedule agreed as part of the restructuring process. The pace of restructuring is anticipated to accelerate in the coming months, now that more incentives are in place for borrowers and lenders, namely the foreclosures and insolvency framework are in full force.

Ioannis Gkionis (igkionis@eurobank.gr)

(+30) 210 337 1225

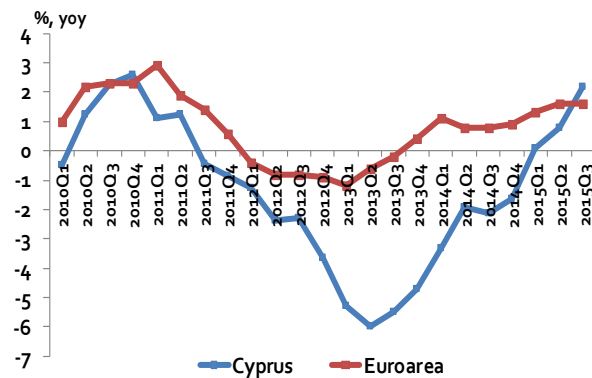
February 2016

Cyprus: Macro & Market Data

	2014	2015f	2016f	2017f
Real GDP (yoy%)	-2.5	1.6	2.0	2.5
Inflation (yoy%)				
HICP (annual average)	-0.3	-1.5	0.2	0.6
HICP (end of period)	-1.0	-1.4	0.6	1.3
Fiscal Accounts (%GDP)				
General Government Balance	-0.2	-1.5	0.0	0.8
Gross Public Debt	108.2	109.0	99.8	95.7
Primary Balance	2.8	1.5	2.5	3.0
Labor Statistics				
Unemployment Rate (LFS, %)	16.1	15.6	14.5	13.2
Wage Growth (total economy)	-4.7	-0.8	1.1	1.4
External Accounts (% GDP)				
Current Account	-4.6	-4.7	-4.4	-3.8
Trade Balance (G&S)	0.7	1.5	2.0	1.9
Net FDI	4.1	-0.7	-6.2	-1.3
Domestic Credit				
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%

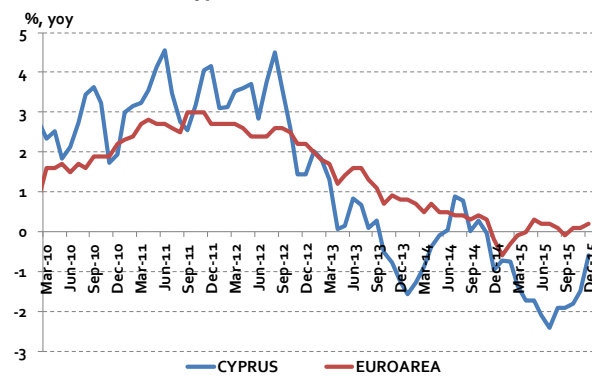
Source: National Sources, Eurostat, IMF, Eurobank Research

FIGURE 17: Growth performance Cyprus vs. Euroarea 2010-2015



Source: Eurostat, Eurobank Research

FIGURE 18: HICP Cyprus vs. Euroarea 2010-2015



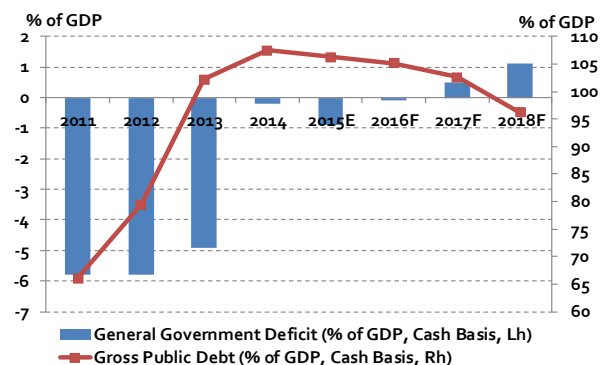
Source: Eurostat, Eurobank Research

FIGURE 19: 10Y Government Bond Yield



Source: Bloomberg, Eurobank Research

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



Source: Ministry of Finance, Eurobank Research

February 2016

Romania (Baa3/BBB-/BBB-)

Surprise inflation reading in January

Romania stood out of the pack for a second consecutive year in 2015. FY growth came at 3.7% in 2015 up from 3% in 2014

According to the flash estimate release, real GDP expanded by +1.1%QoQ/+3.8% YoY in Q4-2015 in seasonally adjusted terms, up from +1.5%QoQ/+3.7% YoY in Q3-2015 and +0.9%QoQ/+2.8%YoY in Q4-2014. The Q4 reading brings FY growth performance at 3.7% in 2015, a notch below our 3.8% forecast compared to 3% in 2014 and 3.5% in 2013. Although the components are yet to be known, we anticipate that growth has been primarily domestic demand-driven.

Romania is expected to be a regional outperformer in 2016 as well. Growth is expected to accelerate further to 4.1% in 2016, partly driven by a private consumption spending boom, fuelled by the unwarranted pro-cyclical fiscal stimulus ahead of the parliamentary elections scheduled in 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.

The trade deficit deterioration is one of the warning signs that macroeconomic imbalances could reemerge.

So far, the robust performance in services and current transfers as a result of the improved EU funds absorption maintain the current account deficit at relatively low levels (-1.1% of GDP in 2015.) According to the latest INSEE data, the trade of goods deficit widened to €1,174mn in December, up by 55.8% YoY bringing the cumulative deterioration at 38.0% in 2015. Double digit import growth (+12.4% YoY in December /+7.6% YoY in 2015) coupled with decelerating exports performance (+3.8% YoY in December/+4.1% YoY in 2015) as a result of the underperformance of exports to extra-EU28 destinations are the main drivers behind the trade of goods deficit dynamics (4.9% of GDP in 2015 vs. 4.2% in 2014)

Inflation surprised to the upside in the first month of the year despite the decline in energy prices and the headline VAT rate cut.

Inflation came at -0.8% MoM/-2.1% YoY in January, down from +0.1%MoM/-0.9%YoY in December. The print was significantly above market expectations (BBG survey:+0.3%MoM/-2.7%YoY). The 4ppts headline VAT rate cut-from 24% to 20%, effective from January 1st, compounded by the food staff VAT rate cut-from 24% to 9% effective from last June, pushed headline inflation further into negative territory. On a monthly basis, the volatile food component of CPI edged up at +0.47%MoM/-6.29%YoY in January compared to +0.22%MoM/-6.20%YoY in last December. Accordingly, non-food items decelerated sharply to -1.56%MoM/+0.12%YoY vs. -0.1%MoM/+1.95%YoY in last December. Finally, Services slowed down to -1.12%MoM/+1.23%YoY compared to +0.4%MoM/+2.4%YoY in December.

Despite the continuous energy prices slump and the negative base effects from fiscal easing, inflationary pressures are rising in Romania steeper than its peers.

In our view, there are two key takeaways from the January inflation reading. Firstly, the pass through effect of the headline VAT rate cut into inflation turned out effectively lower than in the case of the food VAT rate cut. To some extent, this is reflected in the less than expected slowdown of the services inflation component. This is not totally surprising, given that real wage growth- the highest in EU-28 at the moment-is rallying at double digit growth rates and subsequently feeds into retail sales and prices. Secondly, inflationary pressures are building fast, which may explain the hawkish NBR rhetoric in the February inflation report presentation, and could prompt earlier NBR action. The NBR governor, Mr. Isaescu, pointed out that given the two years' time lag of the monetary policy transmission mechanism, the time of taking some action may be approaching. However, he added that narrowing the interest rate corridor might be delayed in order to deter short-term speculative capital inflows. Having stayed put on rates and MRRs in February as expected, NBR upgraded its year end inflation forecast in 2016 to +1.4% YoY vs. +1.0% YoY in the November inflation report and presented for the first time its year-end forecast in 2017 at +3.4% YoY. Looking ahead, inflation is most likely to stay below the target range (2.5%±1%) until 1H-2016. However, notwithstanding the impact of taxes, inflation has already entered the target band. HICP at constant taxes climbed to +2.3% YoY in Dec2015 vs. only +0.3%YoY in Dec2014, at a comparably higher than its regional peers (Poland:-0.5%YoY, Hungary: +0.8%YoY, Bulgaria:-0.9%YoY).

Local currency credit dynamics accelerated to a new post-crisis high in December

Credit to the non-government sector continued recovering in December driven by the robust local currency credit dynamics. Non-government credit edged up to -0.4%MoM/+3.0%YoY in December vs. +1.9 MoM/+2.3%YoY in November. RON-credit accelerated to a new post-crisis high at -0.7% MoM/+19.7% YoY in December, up from +2.2% MoM/+18.7%YoY in November. Lending to households expanded briskly by +1.3%MoM/+31.1%YoY in December, while lending to the corporates somehow lagged behind at -2.5%MoM/+11.0%YoY. FX-lending continued shrinking by -0.1%MoM/-9.1%YoY in December, down from +1.6% MoM/-10.6%YoY in November. This reflects the lack of new FX-lending as a result of the macro-prudential regulations in place but also the disposal of NPLs at the end of last year. On the other hand, deposits of the non-government sector expanded by +6.8%MoM/+8.6%YoY in December, up from +1.6% MoM/+7.3% YoY in November driven by the seasonally increased consumer and government spending in the last month of the year.

Ioannis Gkionis (igkionis@eurobank.gr)
(+30) 210 333 71225

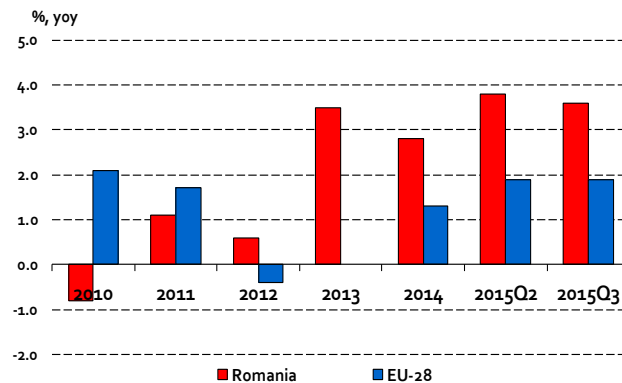
REGIONAL ECONOMICS & MARKET STRATEGY MONTHLY

February 2016

Romania: Macro & Market Data				
	2014	2015	2016f	2017f
Real GDP (yoy%)	2.9	3.8	4.1	3.5
Inflation (yoy%)				
CPI (annual average)	1.1	-0.6	-0.3	2.5
CPI (end of period)	0.8	-0.9	1.4	3.4
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	9.5	5.0
External Accounts				
Current Account (%GDP, BPM5)	-0.4	-1.1	-2.0	-2.5
Net FDI (EUR bn)	2.5	2.7	3.0	3.5
FDI / Current Account (%)	385.0	157.1	111.3	126.7
FX Reserves (EUR bn)	32.2	32.3	33.0	33.5
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	4.46	4.45	4.45	4.35

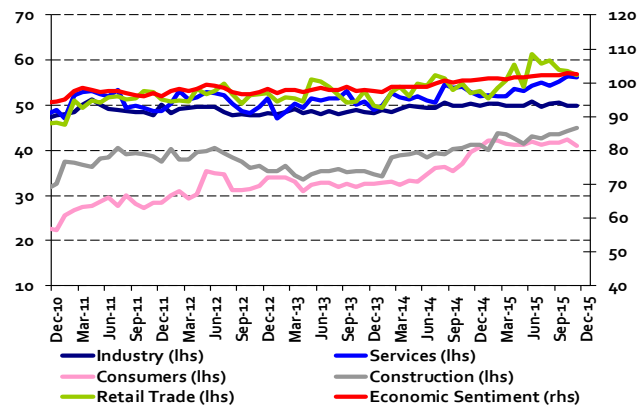
Source: National Authorities, EC, IMF, Eurobank Research

FIGURE 21: Growth rates Romania vs. EU - 28 2010-2015



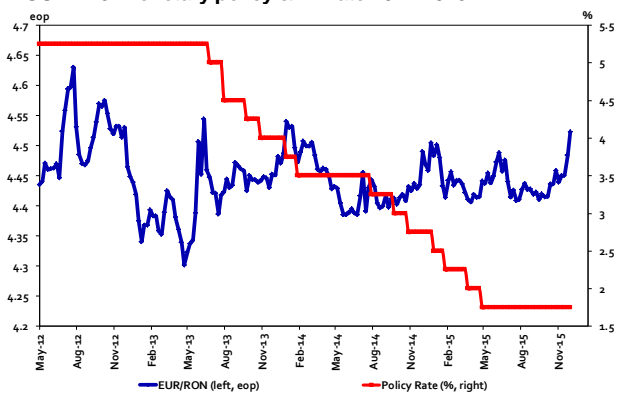
Source: Eurostat, Eurobank Research

FIGURE 22: Sentiment indicators 2011-2015



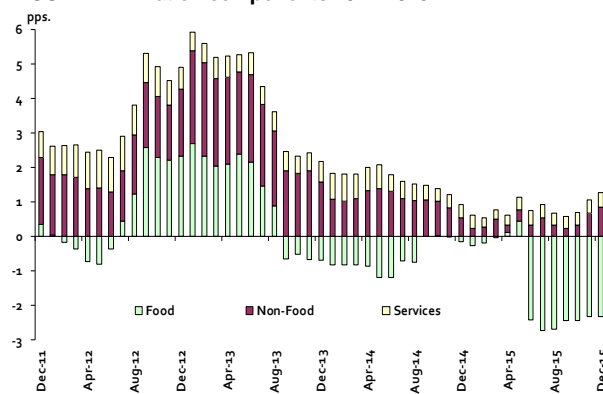
Source: Eurostat, Ecowin Reuters, Eurobank Research

FIGURE 23: Monetary policy & FX rate 2012-2015



Source: Bloomberg, Eurobank Research

FIGURE 24: Inflation components 2011-2015



Source: National statistics, Eurobank Research

February 2016

Serbia (B1/BB-/B+)

Delays in this year's fiscal consolidation measures likely ahead of the snap general elections

2015 budget deficit outperforms target and last year's shortfall

Serbia succeeded in almost halving its general government consolidated budget deficit in 2015 to ca. €1.2bn. As a GDP percentage the said shortfall corresponds to 3.7%, which marks a significant improvement from a 6.7% gap run a year earlier and the planned 4.1% deficit set with the IMF under the three year precautionary Stand-By Arrangement (SBA). Under the SBA, the IMF agreed the fiscal adjustment framework to lie on two main pillars: cuts in pensions and civil servants' salaries as well as the downsizing of the public sector. The bulk of the 2015 savings (for an estimated 2.4pps) were made through the first, while the latter has not been addressed yet. The remaining reductions in 2015 were realized through various ad-hoc measures and a moderately fruitful clampdown on grey economy, resulting in improved tax collections. In respect to the continuation of measures pursuing permanent savings, this year appears much more challenging. The lay-offs in the public sector, projected at ca. 10 thousand employees for the first quarter, have now been postponed. With the upcoming general elections expected in late April/early May, the government may come under additional pressure to loosen targets before the vote, thus further jeopardizing the fiscal adjustments for this year. Other measures projected in the 2016 budget rely on suboptimal measures from a macro standpoint (though politically easier to implement), such as the reduction of agricultural subsidies and an increase in petrol excise. Overall, the planned structural (permanent) deficit decrease goal of ¾ pps appears increasingly challenging, especially in an election year. The new government, which according to latest election polls is all but certain to be assembled by the same SNS coalition, led by current Prime Minister Aleksandar Vucic, would do best to use the fresh four-year mandate to tackle the most difficult issues and once and for all create a lean, yet productive public sector. A consolidated public deficit of 3.5% of GDP and above in the medium term spells an increase in public debt (currently at 75%) to dangerous levels.

CPI inches higher on base effects

The consumer price index rose by 0.6%MoM in January, bringing the annual rate of increase to 2.4% from 1.5% in December 2015. The rise in the annual reading is primarily explained by a very low base and regulated price hikes on electricity and tobacco products. The breakdown of the data showed that a 1.7%YoY rise in the prices of food & non-alcoholic beverages, namely vegetables (+5.7%YoY), oils & fats (+11.1%YoY) and non-alcoholic beverages (+5.6%YoY) posed amongst the main culprits of the resurgence in January's CPI. A 12.9%YoY jump in the prices of tobacco products – due to administered price increases - as well as a 12.2%YoY spike in electricity – in view of the regulated price hike that came into effect last August – also supported the uptick in the headline index, which is the highest YoY increase in more than a year. That said, January was 23rd consecutive month of inflation running below the 4%+/-1.5% Central Bank target tolerance band. Moreover, price pressures will likely ease anew in February and remain low through to the end of H1 2016 in view of the sustained decline in global oil prices as well as primary commodity prices, low aggregate demand and softer imported inflation. In line with the Central Bank's view, we anticipate a gradual return towards the target in H2 2016, with CPI likely to enter within the tolerance band late this year or early in the next year as domestic demand picks up further.

But scope for further NBS easing appears rather limited

With CPI remaining persistently below the target tolerance band, the National Bank of Serbia (NBS) slashed its key policy rate by 0.25ppts, to 4.25% at its MPC meeting in February, taking investors aback. Additionally, it narrowed the interest rate corridor relative to the key rate from 2.0% +/- to 1.75% +/- in order to further stabilize interest rates in the interbank money market that have declined sharply over the last year or so. The market's median forecast was for the Central Bank to stay put on its monetary policy in view of the recent global financial markets turmoil and mounting fiscal slippage risks in the run up to the upcoming parliamentary elections. The said decision is the first rate cut since October 2015, and follows 750bps of monetary easing since May 2013, out of which, 350bps were delivered last year. Behind its decision, the NBS cited subdued inflationary pressures primarily stemming from the international environment on the back of low global oil prices, risks on eurozone's economic growth outlook – Serbia's main trade partner –, the prospect of a slower than expected pace of Fed rate tightening, as well as the possibility for further ECB monetary accommodation in March. Albeit we anticipate the NBS to hold its fire in the coming months, another 25bps cut cannot be ruled out entirely in view of the Central Bank's scaled back inflation expectations and ongoing weakness in global oil and primary commodity prices.

Galatia Phoka (gphoka@eurobank.gr)

+30 210 371 8922

Ivan Radovic (Ivan.Radovic@eurobank.rs)

+381 11 30 27 533

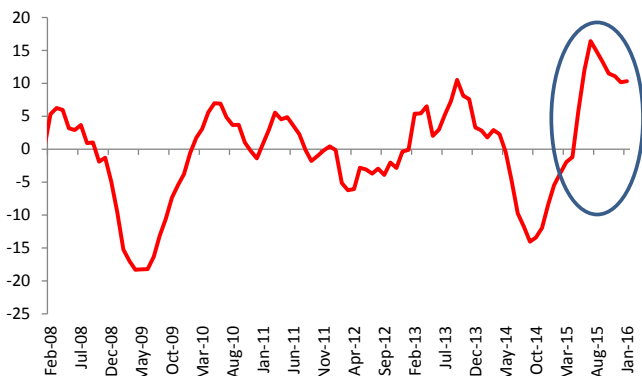
February 2016

Serbia: Eurobank Forecasts

	2014	2015	2016	2017
Real GDP (yoy%)	-1.8	0.7	1.8	2.2
Inflation (yoy%)				
HICP (annual average)	2.1	1.5	2.8	3.9
HICP (end of period)	1.7	1.5	3.5	3.8
Fiscal Accounts (%GDP)				
Consolidated Government Deficit	-6.7	-3.7	-3.7	-3.5
Gross Public Debt	72.2	75.9	78.1	76.3
Labor Statistics (%)				
Unemployment Rate (%of labor force)	19.4	17.7	17.7	17.0
Wage Growth (total economy)	2.0	0.0	0.0	0.0
External Accounts				
Current Account (% GDP)	-6.0	-4.7	-4.6	-4.3
Net FDI (EUR bn)	1.2	1.6	1.6	1.5
FDI / Current Account (%)	60.0	106.7	100.0	100.0
FX Reserves (EUR bn)	9.9	10.4	11.0	10.6
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	4.25	4.25	4.25	4.25
EUR/RSD	123.70	122.50	123.00	125.00

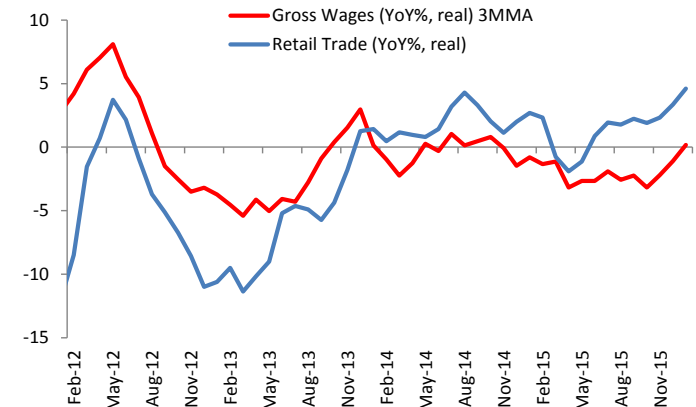
Source: National Authorities, EC, IMF, Eurobank Research

FIGURE 27: Growth in industrial production remains robust (3MMA YoY %)



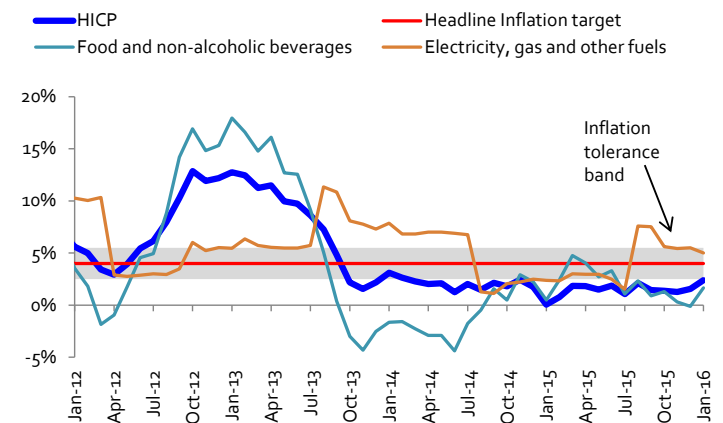
Source: National Authorities, EC, IMF, Eurobank Research

FIGURE 25: Private consumption modestly recovers as wage growth turns marginally positive (3MMA)



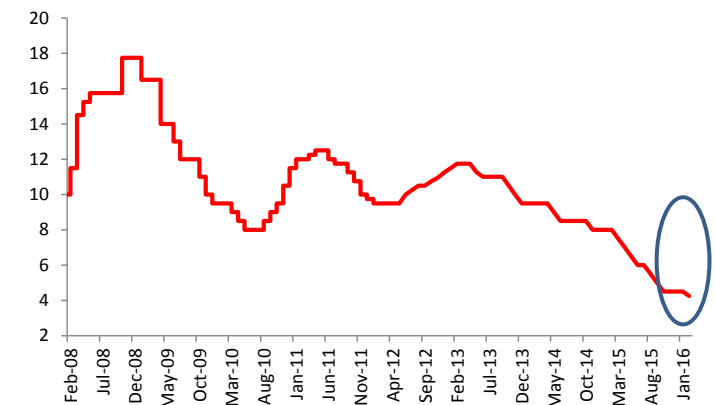
Source: National Authorities, EC, IMF, Eurobank Research

FIGURE 26: Inflation remains below NBS target for nearly two years



Source: National Authorities, Eurobank Research

FIGURE 28: NBS unexpectedly delivers a 25bps cut in the main policy rate in February



Source: National Authorities, EC, IMF, Eurobank Research

Eurobank Economic Analysis and Financial Markets Research

Dr. Platon Monokroussos: *Group Chief Economist*
pmonokroussos@eurobank.gr, + 30 210 37 18 903

Dr. Tassos Anastasatos: *Deputy Chief Economist*
tanastasatos@eurobank.gr, + 30 210 33 71 178

Research Team

Anna Dimitriadou: *Economic Analyst*
andimitriadou@eurobank.gr, + 30 210 37 18 793

Ioannis Gkionis: *Research Economist*
igkionis@eurobank.gr + 30 210 33 71 225

Dr. Stylianos Gogos: *Economic Analyst*
sgogos@eurobank.gr + 30 210 33 71 226

Olga Kosma: *Economic Analyst*
okosma@eurobank.gr + 30 210 33 71 227

Arkadia Konstantopoulou: *Research Assistant*
arkonstantopoulou@eurobank.gr + 30 210 33 71 224

Paraskevi Petropoulou: *G10 Markets Analyst*
ppetropoulou@eurobank.gr, + 30 210 37 18 991

Galatia Phoka: *Research Economist*
gphoka@eurobank.gr, + 30 210 37 18 922

Dr. Theodoros Stamatou: *Senior Economist*
tstamatou@eurobank.gr, + 30 210 33 71 228

Eurobank Ergasias S.A, 8 Othonos Str, 105 57 Athens, tel: +30 210 33 37 000, fax: +30 210 33 37 190, email: EurobankGlobalMarketsResearch@eurobank.gr

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