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www.eurobank.gr/research
research@eurobank.gr

REGIONAL ECONOMICS & MARKET STRATEGY MONTHLY

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Bulgaria | Cyprus | Romania | Serbia

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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Regional economies well positioned to withstand increased EM headwinds in 2016

REGIONAL MACROECONOMIC DEVELOPMENTS & OUTLOOK

- Region **well positioned** to withstand increased **headwinds in the EM space** this year
- **Sustained low world energy prices** provide a positive, albeit probably smaller than last year, boost on growth momentum in 2016
- **Downside risks** from higher US rates and Chinese slowdown relatively limited-**Political instability**, key risk as a result of the heavy election calendar

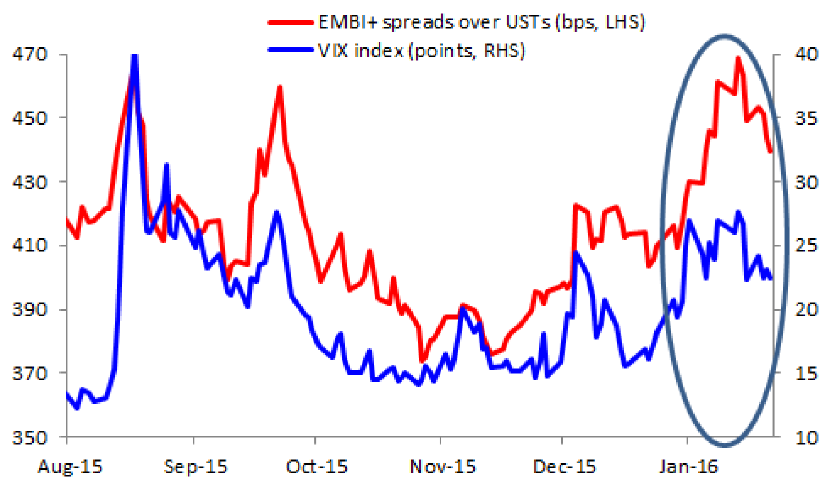
REGIONAL MARKET DEVELOPMENTS & OUTLOOK

- **Regional assets** broadly kick off the year on a negative footing amid heightened global risk aversion
- In line with deteriorating risk sentiment, **regional currencies** came under renewed pressure in January
- **Local-currency denominated government bonds** have retained a relatively firm tone on low oil prices, benign inflation pressures and accommodative Central Bank monetary policies

COUNTRY FOCUS

- **Bulgaria:** Support for multi-party government wanes in parliament
- **Cyprus:** Poised for a clean exit from the program
- **Romania:** Further easing through MRRs
- **Serbia:** Snap general elections ahead

Global risk sentiment deteriorates further in early 2016



Source: Bloomberg, Eurobank Research

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I. Regional Macroeconomic Developments & Outlook

Region well positioned to withstand increased headwinds in the EM space this year

The year has not started on the right foot for the world markets in 2016.

Renewed China related concerns compounded by the continued slide in oil prices sparked a new round of sharp sell-off across EM markets' assets in January. Oil prices hit a new twelve-year low during the outgoing month. While the oil prices plunge is positive for agricultural and manufacturing producers, it is negative for oil exporting nations. In addition, while the majority of analysts believe it is supply side-driven, it confuses signs on a prospective acceleration of the global economy. 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. The first US rates hike, delivered in last December, officially opened the cycle of interest rates normalization while the focus of the markets have turned to the pace of tightening in 2016. On the other hand, while ECB maintains an accommodative stance, no new measures are broadly anticipated until next March at the earliest. As a result, the renewed EM space turmoil has raised a lot of skepticism on the New Year's economic prospects. To that end, IMF only recently downgraded its growth forecasts for the world economy by 0.2 ppts to 3.4% and 3.6% in 2016 and 2017 respectively in the WEO update. Growth in emerging markets and developing economies is projected to increase, from 4% in 2015—the lowest since the 2008–09 financial crisis, to 4.3% and 4.7% in 2016 and 2017, respectively.

Despite increased EM space headwinds, we remain optimistic on the macroeconomic prospects of the region in 2016

Our optimism stems from two basic facts. Firstly, the economies of our focus are energy importers, thus among those few winners in the EM space. Secondly, concerned economies have either adopted the Euro, pegged their domestic currencies to the Euro or are highly correlated with it. Lax regional monetary policies, together with sustained low world energy prices, will most likely continue to provide a positive, albeit smaller than last year, boost on the growth momentum. This boost is destined to eventually fade away as energy prices normalize. For the time being, however, low energy costs keep inflation pressures subdued, supporting real disposable incomes and provide more flexibility to household, corporate, and sovereign balance sheets. Economic sentiment is at its highest or in some cases close to the highest level since 2008, as consumers benefit from rising real wages, firmer labor markets and low inflation. At the same time, external imbalances will most likely remain in check despite some uptick on the imports side. Overall, the region still benefits from the ongoing recovery of the Euroarea, its main trade partner and primary generator of capital flows, as well as from the relatively low direct exposure to the Chinese economy. Thus, we anticipate growth dynamics for the economies of our focus to accelerate in 2016. From that point of view, rating agencies are not negative either; even though not all those economies have seen upgrades in their sovereign ratings, at least none of them has been downgraded in recent months in terms of their outlook. On the other hand, there are a handful area-wide and individual country-specific downside risks. First of all, political instability could resurface in some cases, which would have a negative impact on this year's prospects. Cyprus and Romania have already scheduled parliamentary elections, Serbia has just announced snap elections in late April, while early elections could be also looming for Bulgaria. In addition, lower EU funds, as a result of the closing of the previous programing period, could also have a negative impact on public spending and investment that private initiative is called to compensate for. Last but not least, the region may be confronted with the direct and indirect implications of a number of pan-European issues, such as the refugee crisis and terrorism.

Cyprus will most probably be the third country after Ireland and Portugal to have made a clean exit from the economic adjustment program

On a country level, **Bulgaria**, having the highest energy consumption intensity in EU-28 and a very high exposure to Euro area via trade and capital flows, will most probably continue to benefit the most from low world energy prices and the ongoing Euro area recovery. However, political risks are lingering as the parliamentary support for the fragmented multi-party government led by GERB is very tight after one of the junior coalition partners dropped out of the majority in late December. **Cyprus** will most probably be the third country after Ireland and Portugal to have made a clean exit from the economic adjustment program, provided that the last review is endorsed by the official lenders. The clean exit 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.

Halfway through the current parliamentary term, Serbia is heading for snap elections in next April

Despite the political fall-out, **Romania** is expected to be a regional outperformer in 2016 as well. The side effects of the expansive fiscal policy have started to become more visible in the swelling current account deficit, which remains in check only as a result of the hefty services' surplus. The closing of the output gap, combined with external environment risks, have prompted NBR to end the easing cycle through rate cuts but turn to FX MRRs cuts –by 2%- in early January. Halfway through the current parliamentary term, **Serbia** is heading for snap elections in next April. The ruling government party which dominates the political scene -SNS- has decided to resort to the popular vote to get a new mandate that will allow for a stronger push on the structural reforms agenda.

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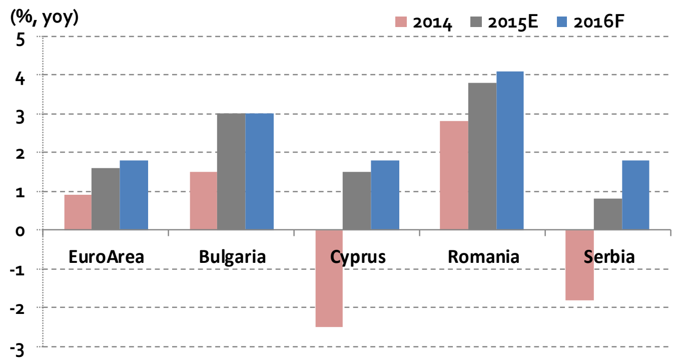
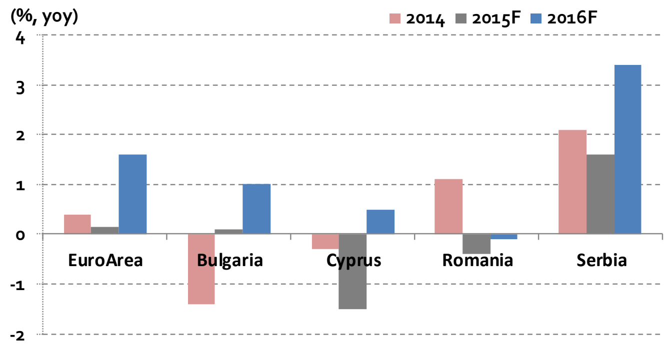
Ioannis Gkionis (igkionis@eurobank.gr)
(+30) 210 337 1225

FIGURE 1: **Growth performance 2014-2016**



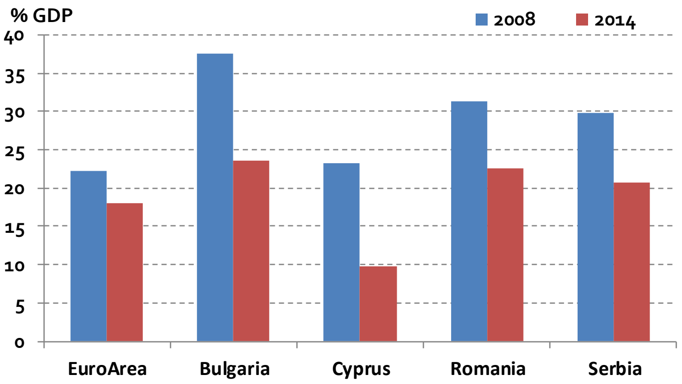
Source: Eurostat, National Authorities, Eurobank Research

FIGURE 2: **Annual average inflation 2014- 2016**



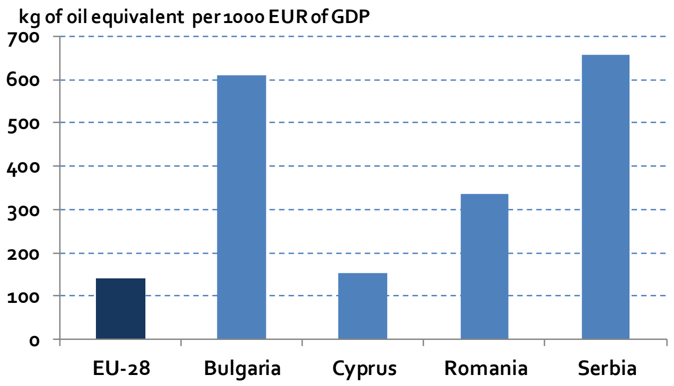
Source: Eurostat, National Authorities, Eurobank Research

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



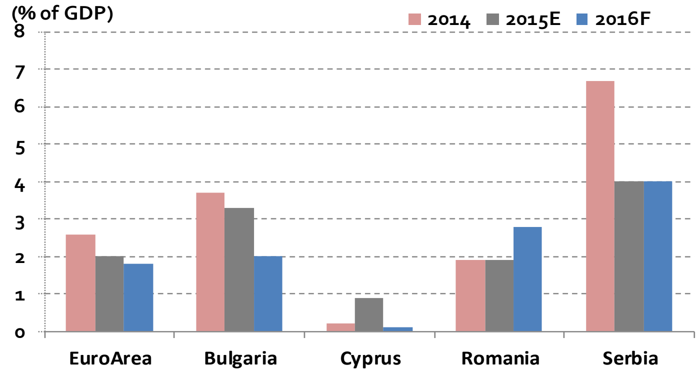
Source: IMF WEO, Eurobank Research

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



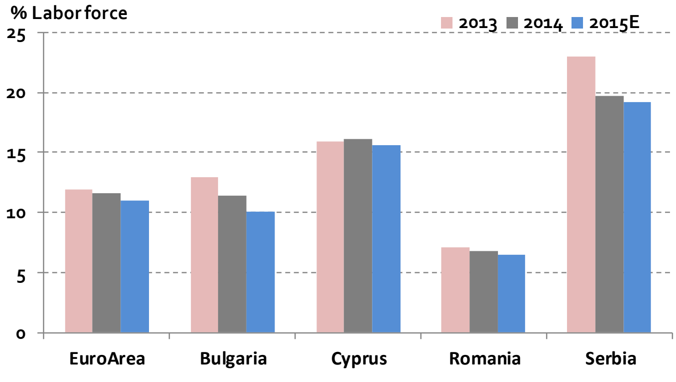
Source: Eurostat, National Authorities, Eurobank Research

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

II. Regional Market Developments & Outlook

Regional assets broadly kick off the year on a negative footing amid heightened global risk aversion

Emerging markets have broadly kicked off 2016 on a negative footing

Emerging markets have broadly kicked off 2016 on a negative footing, in an extension of last year's poor performance, amid deteriorating investor sentiment on the back of global risk aversion following the Fed lift off. The steep decline in oil prices, witnessed particularly in H2 2015 due to a supply glut, has been stretched into the beginning of 2016 as lingering oversupply concerns have been exacerbated by a recent streak of weaker-than-expected US data, mounting worries over China's economic growth prospects and news that Iranian sanctions were lifted earlier in the year allowing the country's return to the international oil market. Indicatively, the Brent crude oil price fell near 12-year lows of $27bbl in late January before retracing a significant part of its losses to stand around $35bbl at the end of that month, ca 5% lower year-to-date. The big question that lingers in the markets is whether this is purely a supply driven sell off or a demand related as well. Acknowledging deteriorating economic growth prospects, the IMF recently revised lower its global growth estimate by 0.2ppts for both 2016 and 2017 to 3.4% and 3.6%, respectively, from 3.1% in 2015. Reflecting increased volatility in global financial markets the Chicago Board Options Exchange Volatility Index (VIX) spiked to a 4-month peak just above 32 points on January 20th before pulling back slightly towards 20 points later in the month thanks to some respite provided in the wake of key Central Bank meetings across the globe. Notably, the ECB left the door open for further monetary stimulus in its upcoming meeting in March, while the FOMC adopted a rather cautious tone, leaving all options open for the upcoming meeting scheduled for March 15-16. The Bank of Japan's unexpected decision to introduce a negative interest rate of 0.1% in late January, also offered some comfort to global financial markets, as did the late month recovery in global oil prices from recent lows.

Regional bourses did not manage to escape the latest bout of increased risk aversion unscathed

Against this backdrop, the MSCI Emerging Markets index ended January 6.5% lower, having slid to 6 ½ years lows earlier in the month. CESEE bourses did not manage to escape the latest bout of increased risk aversion unscathed, though most fared better than their global EM peers on comparably better economic growth prospects, hopes for further ECB stimulus and broadly accommodative Central Bank monetary policies. Their oil-importer characteristic has also largely shielded CESEE stock markets against falling oil prices. On a regional basis, Romania's BETI index led the downtrend with losses of 10.5% in January, while Serbia's BELEX15 (-6.6%) and Bulgaria's SOFIX (-2.7%) trailed behind.

In line with deteriorating risk sentiment, regional currencies under renewed pressure in January

In line with deteriorating risk sentiment, emerging-market currencies came under renewed pressure in January. Idiosyncratic factors have also affected several countries. In the CESEE space, the Polish zloty largely underperformed regional peers having lost ca 4% of its value against the euro in January and hit a 4-year low near 4.51/EUR earlier in the month, weighed further down by concerns over the government's policies, such as planned increases in spending. Recently passed legislation in the ruling-PiS controlled parliament has sparked fears over an increase in the government's power over the Constitutional Court and media and led to an unprecedented inquiry by the European Commission over the country's state of democracy. Concerns over the new government's policies on the independence of Poland's key institutions were amongst the factors cited by S&P behind its unexpected decision late last week to cut Poland's sovereign credit rating by 1-notch to BBB+ with negative outlook. In the external debt space the S&P triggered sell off was seen as a buying opportunity for Polish risk. On a regional basis, the Romanian leu has withstood the latest spell of mounting risk aversion impressively well, having ended the month little changed at 4.55/EUR. Meanwhile, the Serbian dinar touched 1-year lows near 123.60/EUR in late January, though recovering some ground by the end of the month partly assisted by repeated Central Bank interventions in the FX markets to halt the currency's downside momentum. Elsewhere, CESEE local-currency denominated government bonds have retained a relatively firm tone as the recent decline in global commodity prices comes on the heels of an environment of already benign inflation pressures and supports accommodative Central Bank monetary policies. Bucking the broadly positive trend in the region, Serbian paper has come under some pressure, possibly on profit taking following last year's good performance and in view of supply side concerns ahead of large auctions due in the coming weeks.

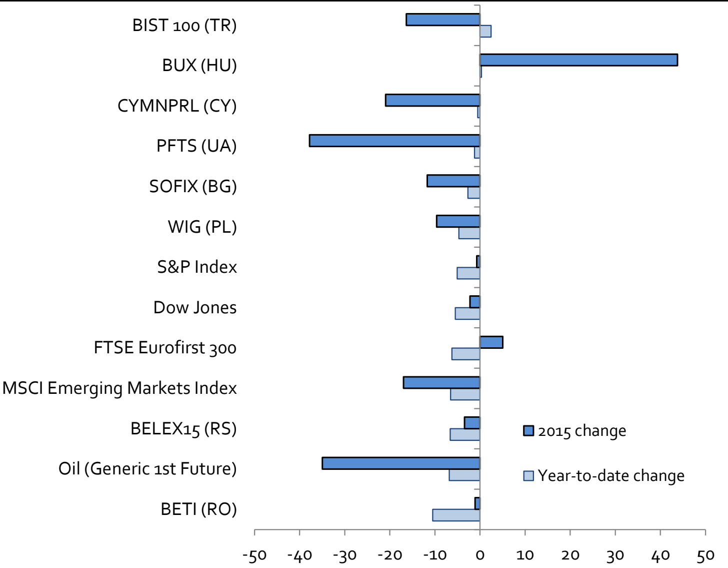
Local-currency denominated government bonds have retained a relatively firm tone

Despite a tentative recovery witnessed over the last few days of January, risks lie ahead

Despite a tentative recovery witnessed over the last few days of January in global risk sentiment, renewed strength in the USD accompanied by further declines in commodity prices and revived global growth concerns cannot be ruled out. The ECB's March meeting will also likely play a key role for the future financial market performance, especially on a regional basis. A heavy elections calendar in the region this year also suggests that potential risks, in the face of fiscal slippages and mounting political uncertainty, lie ahead.

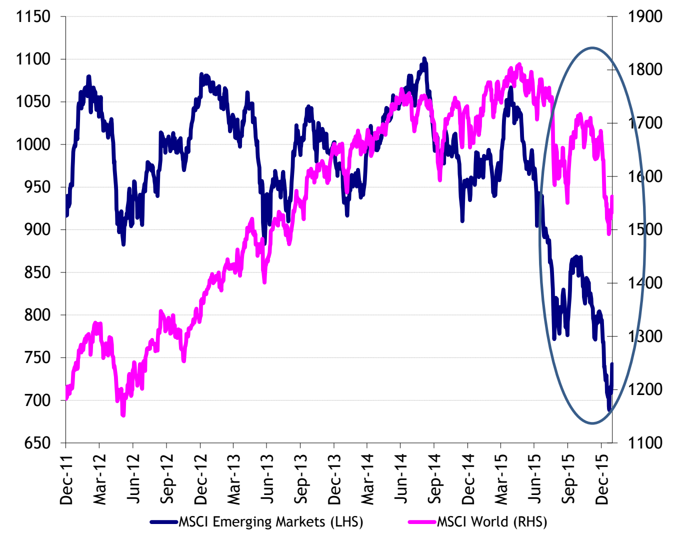
Galatia Phoka (gphoka@eurobank.gr)
(+30) 210 371 8922

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



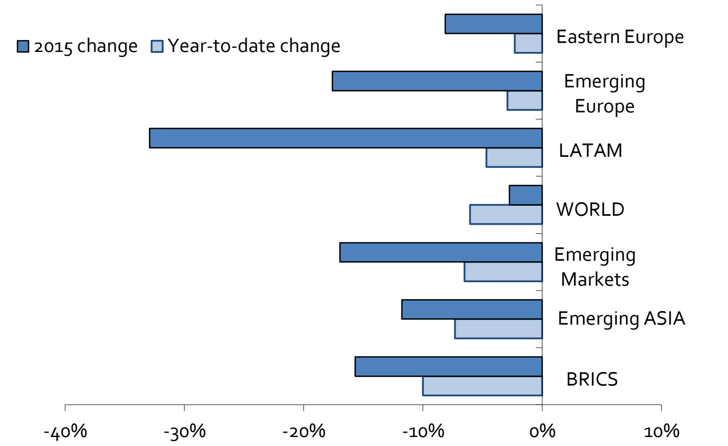
Source: Reuters, Bloomberg, Eurobank Research

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



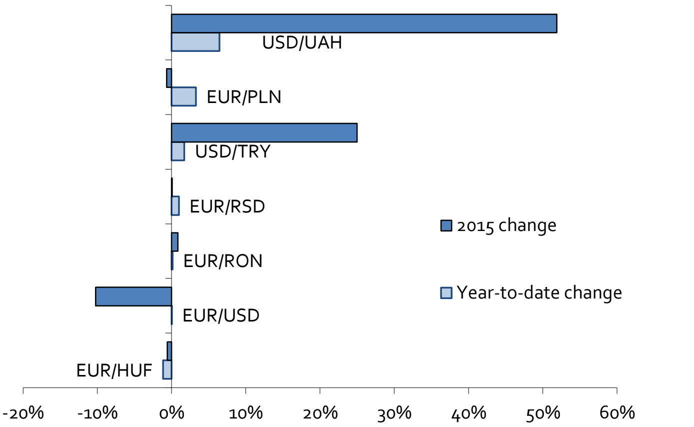
Source: Reuters, Bloomberg, Eurobank Research

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



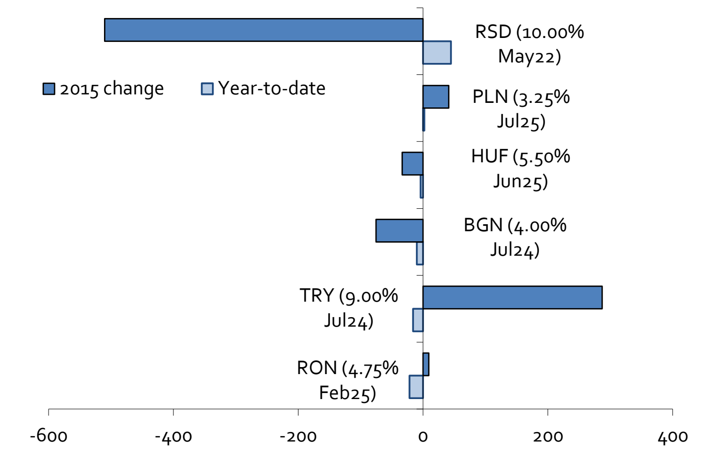
Source: Reuters, Bloomberg, Eurobank Research

FIGURE 10: **CESEE FX performance**



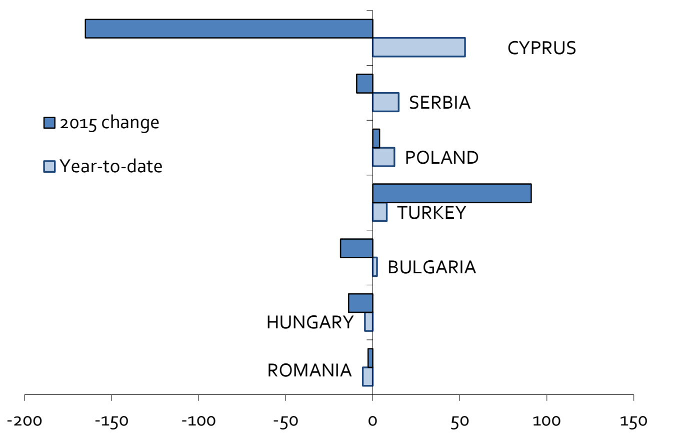
Source: Reuters, Bloomberg, Eurobank Research

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

Trader's view

The recent dinar weakening suggests pockets of opportunity in establishing short EUR/RSD positions

FX

In the past month and a half, the Serbian dinar has been under pressure from a combination of increased sessional demand for hard currency and global risk-off sentiment. In this context, the EUR/RSD has lost around 1% since the end of last year, though finally finding support around 123.00 levels as the Central Bank intensified its presence in FX markets selling ca EUR200mn from its reserves gradually in several sessions. Adding to the dinar's headwinds, the Prime Minister announced his decision to hold snap national elections, which could take place in April/May.

Although, a return to the polls half way through the coalition government's mandate may initially unnerve investors stirring concerns over a potential escalation of domestic political uncertainty, these worries are unlikely to last long as the most recent opinion surveys indicate that the political landscape is unlikely to change much in the wake of the ballot. Also arguing against further dinar depreciation in the coming weeks, the Central Bank appears ready to intervene anew in the FX markets in order to preserve FX stability. Moreover the recently failed privatization of Telekom Serbia might open the door for some additional T-bond sales locally in order to provide additional budget financing. The Public Debt Administration has already put on agenda the biggest dinar denominated auction, scheduled for February 18th in the amount of RSD 110bn. With fresh indications from ECB that they could expand measures further, Serbia could be in position to attract new capital and halt or even reverse recent dinar losses.

Along these lines we favour long RSD positions for the next couple of months, setting entry levels at 122.95, initial EUR/RSD target at 122.00 for half of the position, ahead of 121.50 for the rest, penciling in a positive carry of around 2.80% (equal to last 3M T-bill yield).

Security	Position	Entry	Current level	Carry	Target 1	Target 2	Stop loss	Comments
EUR/RSD	Short	122.95	122.85/ 123.05	2.80%	122.00	121.50	123.60	Central bank omittance to intervene would suggest a closure

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

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

Support for the multi-party government wanes in the parliament

Support for the multi-party government coalition wanes in the parliament

One of the key stakeholders of the government coalition, the Democrats for Strong Bulgaria (DSB), withdrew its support from the government in the parliament in mid-December. DSB, which controls ten seats in the parliament, had joined the loose multi -right wing- party electoral list of the Reformist Block (RB) in the last parliamentary elections in November 2014. After the ruling party of the Prime Minister Borisov Citizens for European Development of Bulgaria (GERB) failed to gain an absolute majority, the RB became one of the junior coalition partners together with Alternative for Bulgarian Revival (ABV) and Patriotic Front (PF) in the new cabinet. Tensions within the ruling coalition emerged last December after the failure of parliament to adopt all the amendments to the constitution with respect to the judiciary reform, which had been proposed by the outgoing Justice Minister, Mr. Ivanov, at that time. However, even after the withdrawal of support, the Minister of Health nominated by DSB retained his position. In addition, the RB leadership asked the rest of the party MPs confirm their support to the government but also negotiate an update of the coalition agreement as well as an evaluation of the government performance so far with the ruling party GERB. All in, the multi-party coalition now is in control of only 125 out of the 240 seat parliament. This is a tight majority given the relatively low popularity and the fragmentation within the ruling coalition. As a result, the possibility of early parliamentary elections cannot be ruled out, although it is still not a base case scenario.

The current account surplus was trimmed to 1.8% of GDP in the first eleven months of the year.

The current account deficit widened to €289.7mn in Nov2015, up from €68mn in Oct2015, compared to a deficit of €85.6mn in Nov2014. As a result, the current account surplus dropped to €789.5mn, or 1.8% of GDP in Jan-Nov2015, compared to €849mn or 2.0% of GDP in Jan–Nov2014. In terms of components, the current account dynamics were once again driven by the further compression of the trade deficit (from 5.5% to 3.7% of GDP) in the same period. Exports expanded by 6.1% yoy in the first eleven months of the year, helped by the ongoing recovery of the Euroarea, the main trade partner of Bulgaria. On the other hand, imports edged up by only 2.1% yoy, underpinned by lower energy imports mirroring lower world energy prices. Among other components, the primary income deficit widened to €1.6bn in Jan-Nov2015, or 3.5% of GDP, vs. a 2% deficit in the same period a year ago as a result of an increase in the profits' repatriation of foreign companies. In terms of financing, the capital and financial accounts recorded a hefty surplus which reflects improved EU funds absorption ahead of the closing of the programming period 2007-2013, increased FDI inflows and improved net external financing for the private sector. The capital account surplus widened to €1.2bn, an equivalent of 2.7% of GDP, up from €809.6 mn or 1.9% of GDP in Jan–Oct2014. Net FDI inflows increased by 83% yoy, reaching €1.4bn in Jan-Nov2015, compared to €786mn in the period a year ago.

The asset quality review (AQR) of the domestic banking sector will begin on February 15th

The BNB governor, Mr. Radev, announced in late January that the asset quality review (AQR) of the domestic banking sector will begin in February 15th. The AQR will culminate in a bottom-up stress test, the result of which will be made public by the end of August. In addition, he expressed his optimism that the AQR outcome will be positive and the stress test results will confirm the stability of the banking system. After the stress tests, the IMF and the World Bank will conduct an assessment of the banking sector again. The banking sector turmoil, following the collapse of the Corporate Commercial Bank in late June 2014, has raised attention on the issues of effectiveness of banking supervision and corporate governance. Although the collateral damage to the economy was minimized and the noise was short-lived, there has been a lot of media criticism on BNB which stirred the public debate on banking sector supervision reform.

Inflation remained unchanged at -0.4% YoY in December as a result of higher food prices offsetting partially the impact of lower world energy prices.

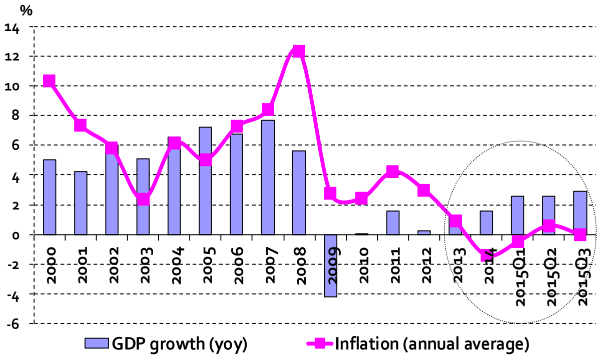
Inflation remained flat at 0.0% MoM/-0.4% YoY in December compared to -0.1% MoM/-0.4% YoY in November and +0.2% MoM/-0.6% YoY in October. On a monthly basis, the decline in the categories of food and non-food was enough to offset the spike in services and catering. Transportation recorded the largest decline on an annual basis (+1.1% MoM/-8.3% YoY) trimming -0.7ppts from the headline inflation, driven by lower world energy prices. The food component of the CPI, the one with the highest share in the consumer basket, spiked, adding +0.2ppts to the headline number in December. The spike was driven by seasonal effects (-0.5% MoM/+0.5% YoY in December up from -0.1% MoM/+0.4% YoY in November) stemming from higher prices for fruits, vegetables and oil & fats. Looking ahead, inflation is set to remain subdued throughout the rest of the year, as domestic demand dynamics become healthier, the spike in food prices continues, the deflationary pressures from the energy component subside, provided global prices normalize.

Ioannis Gkionis (igkionis@eurobank.gr)
(+30) 210 337 1225

Bulgaria: Macro & Market Data				
	2013	2014	2015e	2016f
Real GDP (yoy%)	1.3	1.6	2.9	3.0
Inflation (yoy%)				
CPI (annual average)	0.9	-1.4	-0.1	1.0
CPI (end of period)	-1.6	-0.9	-0.4	1.2
Fiscal Accounts (%GDP)				
General Government Balance	-1.8	-3.7	-3.3	-2.0
Gross Public Debt	18.6	27.7	31.8	31.2
Primary Balance	-1.0	-3.0	-2.0	-1.0
Labor Statistics				
Unemployment Rate (LFS, %)	12.9	11.4	10.1	9.4
Wage Growth *(total economy)*	6.0	6.8	7.5	7.0
External Accounts				
Current Account (% GDP)	1.0	0.9	1.5	1.0
Net FDI (EUR bn)	1.4	1.3	1.5	1.5
FDI / Current Account (%)	Na	Na	Na	Na
FX Reserves (EUR bn)	14.4	16.5	20.3	21.5
Domestic Credit	**2012**	**2013**	**2014**	**Q2-2015**
Total Credit (%GDP)	72.3	72.9	67.7	63.7
Credit to Enterprises (%GDP)	47.7	47.7	41.8	39.5
Credit to Households (%GDP)	23.0	23.0	22.3	21.6
FX Credit/Total Credit (%)	64.0	60.9	57.0	54.8
Private Sector Credit (yoy)	3.8	0.6	-6.7	-7.7
Loans to Deposits (%)	99.4	92.1	84.2	86.5
Financial Markets	**Current**	**3M**	**6M**	**12M**
Policy Rate		Currency Board		
EUR/BGN	1.96	1.96	1.96	1.96

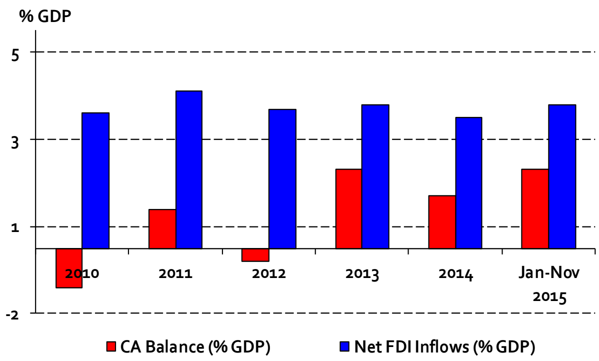
Source: National Sources, Eurostat, IMF, Eurobank Research

FIGURE 13: **GDP growth & Inflation 2000-2015**



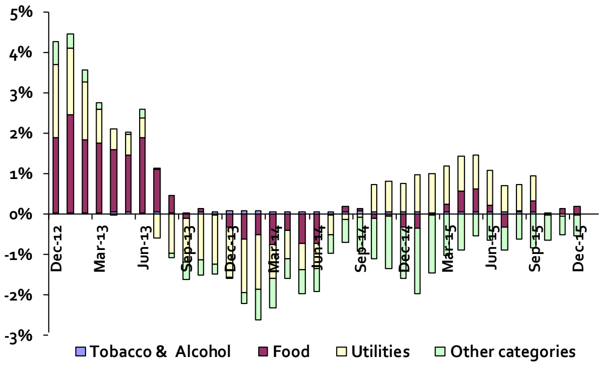
Source: National statistics, Ecowin Reuters, Eurobank Research

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



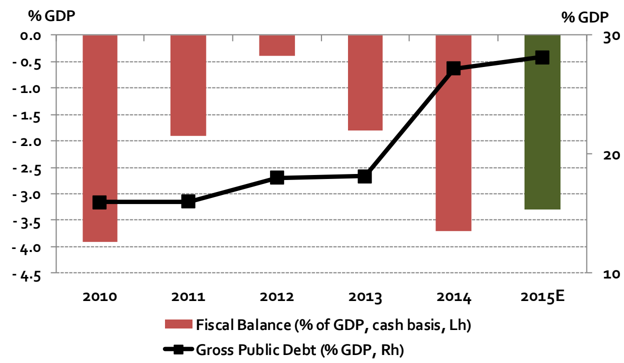
Source: National statistics, Ecowin Reuters, Eurobank Research

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

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

Poised for a clean exit from the program

The Eurogroup approval of the final review of the Cyprus program is contingent upon the fulfillment of all remaining prior actions

Cyprus was praised once more in the Eurogroup of January 14th for the high degree of ownership in the economic adjustment program implementation. Although Cyprus had made significant progress in implementing the program, it is now expected to fulfil two prior actions, so as to formally finalize the review. The pending review- the 8th and final according to ESM disbursement schedule-focused primarily on two out of the three state-owned public utilities widely known as semi government organizations: the Telecomm Utility (CYTA) and the Electricity Authority (EAC). As far as CYTA is concerned, the approval of legislation by the parliament which allows the transformation of the Telecomm Utility from a semi government organization to a limited liability private company is still pending. In addition, the new regulation for CYTA employees has been adopted by the Council of Ministers but needs also to be endorsed by the parliament. Regarding EAK, the decision on the ministerial level for the separation of production and supply activities (unbundling) of the power company in line with the EU energy market directive has been adopted. Finally, institutions have sent their remarks on the decrees of the Central Bank which is about to specify the implementation details of the recently adopted law which facilitates the securitization and sale of loans.

The privatization process has reached a decisive stage in which the political commitment of the government will be tested

The privatization program was an integral part of the structural reforms agenda within the economic adjustment program. According to the MoU, revenues of €1.4bn were initially anticipated to lower public debt (€1bn by the end of 2016 and another €400mn by the end of 2018 at the latest). However, the privatization process has been advancing very slowly given the complex preparation work for the organizations' corporatization but also because other targets of the program have been prioritized in the previous reviews. In addition, the outperformance of fiscal targets has rendered the privatization revenues less crucial for the achievement of the public debt reduction plan than initially envisaged in the first MoU. On the other hand, the benefits from the privatization process are not limited to sale revenues. More importantly, a successful process has the potential of fostering competition with multiple benefits for the domestic economy (attracting FDI inflows, creating jobs etc.) The process is politically highly sensitive, not only because multiple stakeholders (government, parliament, political parties, and unions) are involved, but also because of the scheduled parliamentary elections in next May.

Cyprus is poised for a clean economic adjustment program exit

In contrast to ESM, IMF approved the relevant review which enabled access to an additional amount of €126.3mn on January 29th. Up until then, Cyprus had already made use of a combined €7.2bn (€6.3bn by ESM and €882mn by IMF) out of the total €10bn available. Cyprus will most probably be the third country after Ireland and Portugal to have made a clean exit from the rescue program, provided that the last review is endorsed by the official lenders. Although the disbursement of the last ESM tranche is not absolutely necessary as market access has been restored, 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). While Cyprus is set to graduate successfully from the program in March2016, authorities will have to deal in the medium term with the high stock of NPLs, credit scarcity and elevated unemployment, while ensuring high primary surpluses.

The additional state aid of €175mn for the Co-operative Sector was approved by the EU Commission on the basis of an amended restructuring plan in line with the EU state aid rules

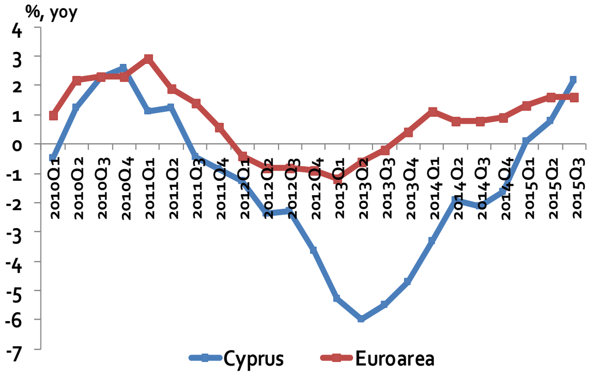
The EU Commission approved the additional state aid of €175mn for the Cypriot Co-operative sector. The Cooperative sector, which stands for ca 25% of the total domestic banking assets, was deemed viable, it was exempted from bail-in and, thus, it was decided that program funds would be used for its recapitalization. Thus, the government utilized €1.5bn from program funds in February 2014. As a result, the Cypriot State has become the 99% shareholder of the Cooperative Central Bank, which in turn obtained control over the previously independent cooperative credit institutions. In line with the centralization and rationalization foreseen under the original restructuring plan, the number of independent cooperative credit institutions was reduced from over 90 to 18 through mergers. The need for additional state support of Co-operatives emerged after the Transparency exercise carried out by the Single Supervisory Mechanism (SSM) of the ECB. The Cooperative Central Bank was compelled to raise the coverage ratio of NPLs to 50% (by €0.5bn approximately), resulting in a capital shortfall of €175mn.

Ioannis Gkionis (igkionis@eurobank.gr)
(+30) 210 337 1225

Cyprus: Macro & Market Data				
	2013	2014	2015f	2016f
Real GDP (yoy%)	-5.9	-2.5	1.5	1.8
Private Consumption	-5.9	0.4	1.4	1.6
Public Consumption	-4.1	-9.0	-2.1	-0.9
Gross Capital Formation *(Fixed)*	-15.2	-18.0	2.2	3.6
Exports	1.8	-0.5	1.2	1.3
Imports	-3.0	2.0	0.6	1.1
Inflation (yoy%)				
HICP (annual average)	0.4	-0.3	-1.5	0.5
HICP (end of period)	-1.3	-1.0	-1.4	0.9
Fiscal Accounts (%GDP)				
General Government Balance	-4.9	-0.2	-0.9	-0.1
Gross Public Debt	102.2	107.5	106.3	105.1
Primary Balance	-1.8	2.6	1.9	2.4
Labor Statistics				
Unemployment Rate (LFS, %)	15.9	16.1	15.6	14.6
Wage Growth *(total economy)*	-6.0	-4.7	-0.7	1.1
External Accounts				
Current Account (% GDP)	-3.0	-5.1	-5.5	-4.5
Net FDI (EUR bn)	0.2	1.1	2.0	1.5
FDI / Current Account (%)	55%	127%	208%	187%
Domestic Credit	**2012**	**2013**	**2014**	**Q2-2015**
Total Credit (%GDP)	373.5	351.4	356.0	359.5
Credit to Enterprises (%GDP)	171.1	160.2	150.1	153.1
Credit to Households (%GDP)	138.9	140.0	143.5	137.3
Private Sector Credit (yoy)	5.1%	-12.1%	-3.1%	2.0%
Loans to Deposits (%)	103.3%	135.3%	133.5%	136.6%

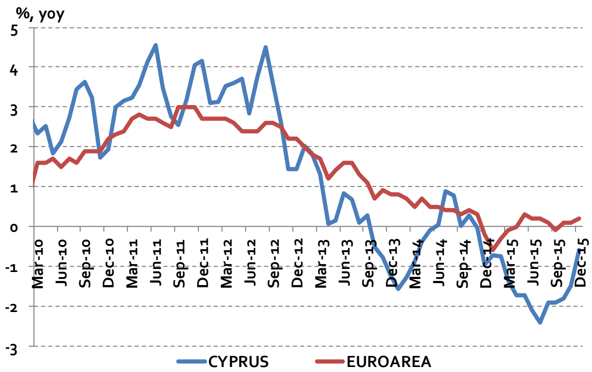
Source: National Sources, Eurostat, IMF, Eurobank Research

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



Source: Eurostat, Eurobank Research

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

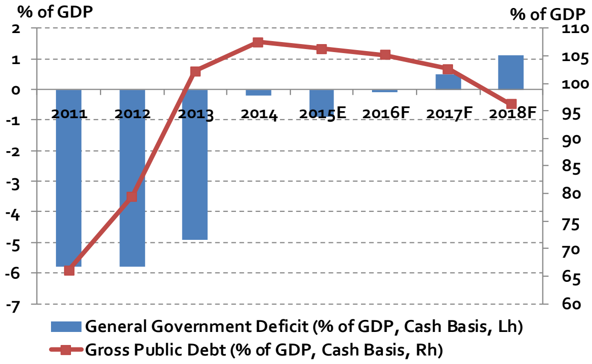


Source: Eurostat, Eurobank Research

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

Romania (Baa3/BBB-/BBB-)

Further easing through MRRs

The current account deficit has started swelling, but overall still remains in check.

The current account deficit doubled to €1.0bn in Jan-Nov 2015 compared to €440mn in the same period a year ago. As a percentage of GDP, it widened to 0.6% in Jan-Nov2015, up from 0.3% in Jan-Nov2014, yet very far from the pre-crisis peak of 13.4% in 2007. The current account deterioration was driven by a widening of the trade deficit and the primary income gap. The trade deficit widened from 3.7% to 4.2% of GDP due to imports dynamics being stronger than those of exports (+6.5% YoY and +5.2% YoY respectively). In addition, the primary income gap doubled from 1.3% to 2.1% of GDP, reflecting the increased outflows of profits' repatriation of foreign investments. On the other hand, the expansion of surpluses in services (by 15.1% YoY, from 3.6% to 4.0% of GDP) and in secondary income (by 50% YoY, from 1.1% to 1.6% of GDP) as a result of transportation services and improved EU funds absorption respectively, offset to a large extent the trade and primary income gap deterioration. The trade deficit deterioration is one of the warning signs that macroeconomic imbalances could reemerge as a result of the unwarranted fiscal stimulus ahead of the parliamentary elections in late 2016. From a financing point of view, net FDI inflows expanded by 17.2% YoY to €2.9bn, covering comfortably the current account deficit.

December inflation came just an inch higher than the year-end projection of the NBR

Inflation inched up to +0.1% MoM/-0.9% YoY in December, compared to +0.3% MoM/-1.1% YoY in November and +0.3% MoM/-1.6% YoY in October, a notch below market expectations (BBG survey: +0.3% MoM/-0.8% YoY). The implementation of the front-loaded food VAT rate cut-from 24% to 9% effective from June 1st, has pushed headline inflation into negative territory, given the high share of food products in the consumption basket (32%). The volatile food component of CPI remained edged up at +0.22% MoM/-6.20% YoY in December compared to +0.06% MoM/-6.20% YoY in November and +0.5% MoM/-6.51% in October. Non-food items increased further to -0.1% MoM/+1.95% YoY in December compared to +0.5% MoM/+1.54% YoY in November and +0.13% MoM/+0.75% YoY in October. Services continued even higher at +0.4% MoM/+2.4% YoY, compared to +0.3% MoM/+2.3% YoY in November and +0.3% MoM/+2.1% yoy in October in an illustration of demand side pressures building up in the non-tradables sector. Overall, the reading came just an inch higher than the latest year-end projection of NBR (-0.7% YoY in the November vs. -0.3% YoY in the August inflation report). Looking ahead, inflation is most likely to stay below the Central Bank target range (2.5%±1%) until at least the 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 December2015 vs. only +0.3%YoY in December 2014.

Nominal wage growth accelerated further in November both on a monthly and annual basis factoring in the granting of occasional and performance bonuses given at this point of the year.

Net wages stepped up further by +2.5% MoM/+10.0% YoY in November, up from +2.1% MoM/+9.7% YoY in October and +1.1% MoM/+8.0% YoY in September. Real wages expanded by +11.3%, a notch down from +11.5% YoY in October and +9.7% YoY in September. The wages in the sectors of computer informatics (+2.7% MoM/+16.9%YoY), manufacturing (+4.8% MoM/+9.8%YoY) and the financial sector (+6.2% MoM/+6.7%YoY) were among those recording the highest monthly increases. The reading is not only the highest in EU-28, but also a new post-crisis high for the standards of Romania. A generous wage increase approved by the parliament for all other unions of the broad public sector- effective from December except for the education and the health sectors which have already received 15% and 25% increases respectively -will continue to put further upward pressure to the average wage in the near term. Robust real wage growth in private and public sector in tandem with improving sentiment and labor market tightening conditions have been fueling a revival of consumption spending throughout 2015, a trend which most probably continue in 2016.

NBR stayed put on rates in January as expected, but reduced FX MRRs by 2ppts instead

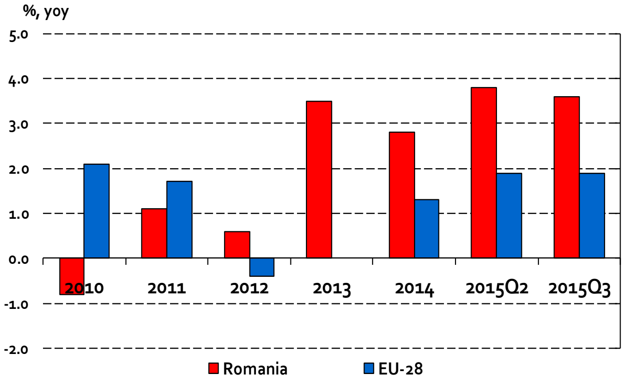
NBR maintained interest rates unchanged at 1.75% in early January in line with our expectations and the vast majority of analysts in Bloomberg's poll (14 out of 15). The MRRs for FX denominated liabilities were lowered to 12% from 14% previously, while those of the domestic currency were kept unchanged at 8%. NBR could stay put on rates until mid-2016, looking beyond the fiscally induced supply side shock and the weak inflation outlook, which are. First of all, the robust growth performance, implies a quicker than previously expected closing of the output gap. Despite the political fall-out, Romania stood out of the pack for a second consecutive year in 2015, and is expected to be a regional outperformer in 2016 as well. Growth is expected to accelerate further to 4.1% in 2016, up from a projected 3.8% in 2015. Growth dynamics are driven by a private consumption spending boom, fuelled by the unwarranted pro-cyclical fiscal stimulus ahead of the parliamentary elections scheduled in late 2016. Furthermore, external risks coming from the EM space weakness, the collapse of commodities prices and major Central Banks policy divergence have increased recently. That said, there is still enough space for NBR to lower the MRRs further should the need arise in 2016.

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

Romania: Macro & Market Data				
	2013	**2014**	**2015e**	**2016f**
Real GDP (yoy%)	3.4	2.9	3.8	4.1
Consumption	0.4	3.0	4.2	6.0
Investment	-7.9	-3.6	6.2	3.9
Exports	16.2	3.5	6.2	5.0
Imports	4.2	7.7	8.1	8.3
Inflation (yoy%)				
CPI (annual average)	4.0	1.1	-0.4	-0.1
CPI (end of period)	1.6	0.8	-0.9	1.3
Fiscal Accounts (%GDP, Cash Basis)				
General Government Balance	-2.2	-1.9	-1.9	-2.8
Gross Public Debt (including guarantees)	37.9	39.5	39.1	41.5
Labor Statistics (annual avg,%)				
Unemployment Rate (ILO, % of labor force)	7.1	6.8	6.7	6.6
Wage Growth (total economy)	4.8	5.3	7.0	6.5
External Accounts				
Current Account (%GDP, BPM5)	-0.8	-0.4	-1.0	-2.0
Net FDI (EUR bn)	2.9	2.5	3.0	3.5
FDI / Current Account (%)	250.1	385.0	264.9	105.1
FX Reserves (EUR bn)	35.4	35.5	32.2	33.5
Domestic Credit *(end of period)*	**2012**	**2013**	**2014**	**Q2-2015**
Total Credit (%GDP)	52.0	47.0	44.4	44.3
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	52.4
Private Sector Credit (yoy)	1.3	-3.3	-3.1	2.4
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	4.50	4.45	4.45	4.35

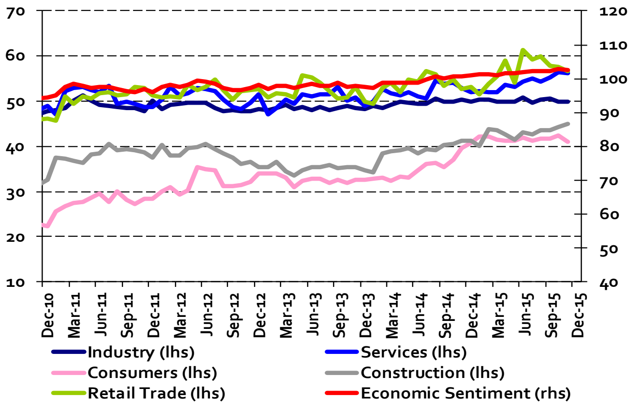
Source: National Authorities, EC, IMF, Eurobank Research

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



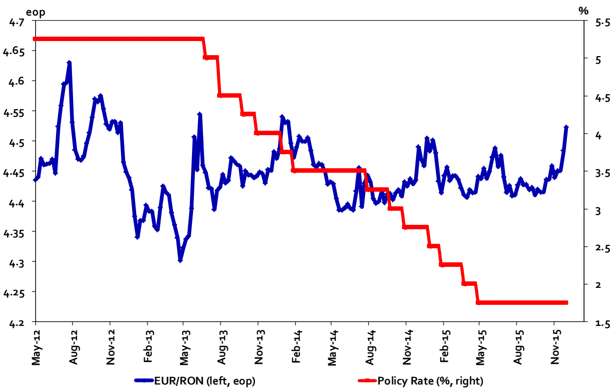
Source: Eurostat, Eurobank Research

FIGURE 22: **Sentiment indicators 2011-2015**



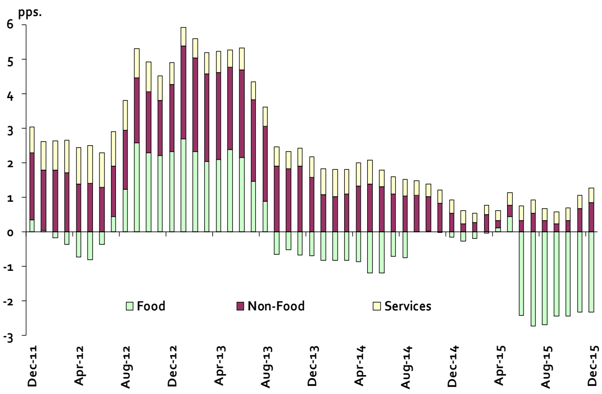
Source: Eurostat, Ecowin Reuters, Eurobank Research

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



Source: Bloomberg, Eurobank Research

FIGURE 24: **Inflation components 2011-2015**



Source: National statistics, Eurobank Research

Serbia (B1/BB-/B+)

Snap general elections ahead

Prime Minister announces decision to call early general elections

Midway through the government's 4-year term, Prime Minister Aleksandar Vucic announced earlier this year his decision to call early general elections. Although the current coalition enjoys an overwhelming majority in the National Assembly (ca 80%), the ruling Serbian Progressive Party (SNS) apparently seeks to strengthen its mandate and secure an extension of its tenure before embarking on a new round of economic austerity measures, including lay-offs in the public sector, shutting down of loss-making state-owned enterprises and other commitments agreed under the country's IMF programme. Most of the politically challenging pledges were left largely untouched in the first year of the said deal. Hence, it appears that the time is right to secure another 4 years in office. This holds especially as the most recent opinion surveys affirm strong public support – ca high 30% to low 40% - for the ruling SNS party and, primarily, for the PM.

Ballot most likely on April 24th, no major changes expected in political/macroeconomic landscapes

The upcoming general elections will most likely be held on April 24th, in order to coincide with the local and municipal polls. Barring any surprises in the run-up to the ballot, SNS is broadly anticipated to be close to securing an absolute majority in the 250-seat National Assembly, although not as overwhelming as that achieved in the 2014 elections. Current junior coalition partner, the Socialist Party of Serbia (SPS), polls around 10% of popular support and must make sure to differentiate from SNS, while not alienating it during the campaign, if they are to be invited once again to participate in a new coalition government. The opposition is feeble and fragmented, with each party primarily targeting to reach the 5% threshold to enter Parliament. Along these lines, we expect the new government to be formed quite quickly after the elections, with PM Vucic and the SNS continuing along the same pro-EU policies, while preserving a friendly relationship with Russia. On the macroeconomic front, we expect very little change; the new administration will likely retain the fiscally-disciplined IMF-agreed policies, at least for as long as the public debt growth trajectory remains on the upswing.

NBS likely to retain wait-and-see stance in the months ahead

Following 725bps of cumulative rate-easing since May 2013, out of which 350bps rendered in 2015, the National Bank of Serbia (NBS) stayed put on its latest Monetary Policy Committee in mid-January, maintaining the key policy rate at the current record low level of 4.50% for the 3rd consecutive meeting, as was broadly expected. The NBS Executive Board cited prevailing international uncertainties behind its latest decision, following the inception of the Fed's rate-hiking cycle late last year, ongoing geopolitical risks and the slowdown in China's economy. On the other hand, the NBS noted that these uncertainties will be cushioned by the ECB's December decision to render further monetary stimulus. The Central Bank also highlighted that the domestic economy is better shielded against risks stemming from the international environment in view of the country's improving fiscal position, business and investment environment and narrowing external imbalances. With regards to the inflation developments, it acknowledged that inflation pressures will remain subdued in the period ahead, with the annual HICP currently standing below target. Notably, HICP for December came in at 1.5%, vs. 1.3% in the prior month, remaining below the (4±1.5%) target tolerance band for the 22nd month running, as weak consumer spending, fiscal consolidation and low global oil prices are keeping price pressures at bay. The NBS reiterated that it envisions inflation returning within the tolerance band in H2 2016, partially thanks to past rate cuts. Looking ahead, we continue to anticipate that the NBS will likely retain its wait-and-see stance in the months ahead, as the impact of past monetary easing feeds through into the domestic economy, inflation is seen gradually returning towards the target, while fiscal and external risks linger and further rate cuts may weigh on the country's FX and debt markets. The dinar's recent depreciation to 1-year lows near 123.30/EUR and the NBS's repeated interventions to halt this trend, also argue in favour of stable interest rates, especially ahead of the looming snap general elections.

The IMF's SBA remains on track, but challenges lie ahead

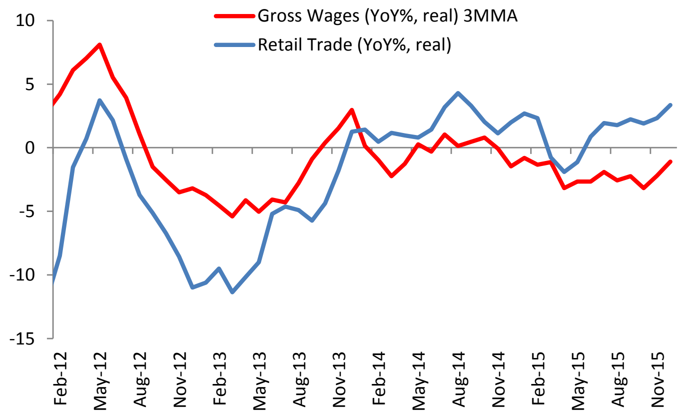
The IMF's Stand By Arrangement approved about a year ago remains on track. Upon completion of the 3rd review under the country's 36-month, €1.2bn precautionary deal in mid-December, the cumulative amount of SDR 491.085mn (about €627mn) has been made available, though Serbian authorities have indicated that they do not intend to withdraw any of these funds. The IMF has repeatedly acknowledged the fiscal consolidation progress made so far, having also highlighted risks stemming in the face of full implementation of the programme's commitments. In this context, any developments on reforms of state-owned enterprises (SOEs) and the reduction in the civil servants headcount are worth following, being considered amongst the programme's main thorny issues.

Galatia Phoka (gphoka@eurobank.gr)
+30 210 371 8922
Ivan Radovic (Ivan.Radovic@eurobank.rs)
+381 11 30 27 533

Serbia: Eurobank Forecasts				
	2014	2015	2016	2017
Real GDP (yoy%)	-1.8	0.8	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	-4.1	-4.0	-2.6
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	4.50	4.50	4.50	4.50
EUR/RSD	123.20	122.50	123.00	125.00

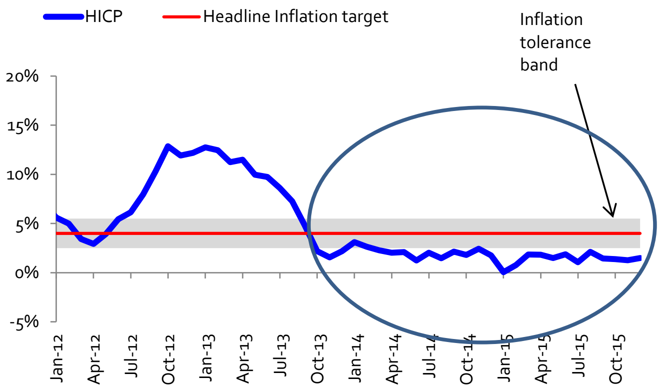
Source: National Authorities, EC, IMF, Eurobank Research

FIGURE 25: **Private consumption restrained by fiscal consolidation (3MMA)**



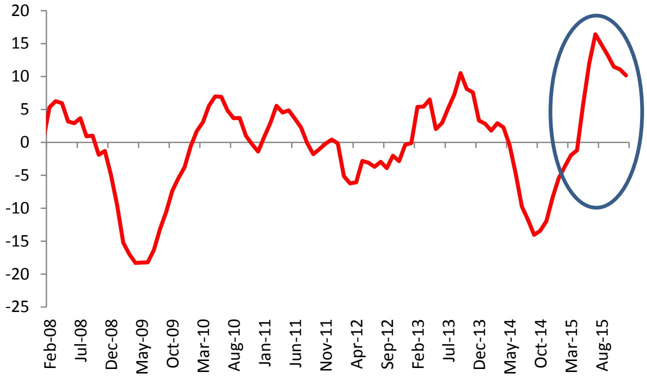
Source: National Authorities, EC, IMF, Eurobank Research

FIGURE 26: **Inflation remains below NBS target over recent months**



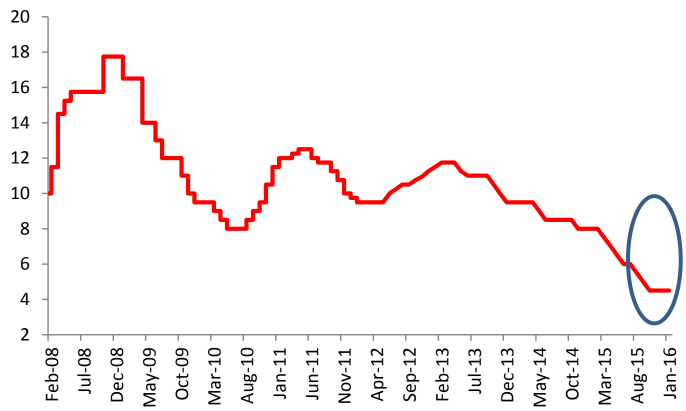
Source: National Authorities, Eurobank Research

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



Source: National Authorities, EC, IMF, Eurobank Research

FIGURE 28: **NBS retains wait & see stance on prevailing international uncertainties**



Source: National Authorities, EC, IMF, Eurobank Research

Eurobank Economic Analysis and Financial Markets Research

Dr. Platon Monokroussos: *Group Chief Economist*
pmonokrousos@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 3718 793

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

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

Theodoros Stamatiou: *Senior Economist*
tstamatiou@eurobank.gr, + 30 210 3371228

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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