REGIONAL ECONOMICS & MARKET STRATEGY MONTHLY

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

Regional recovery on track in Q3-2016

REGIONAL MACROECONOMIC DEVELOPMENTS & OUTLOOK

- **Q3-2016 flash GDP estimates** are expected to demonstrate that the economies of the region remained in good shape
- **Private consumption in the driver's seat** on improved sentiment, rising real wages, firmer labor markets and low inflation
- **Limited room** for further monetary and fiscal stimulus

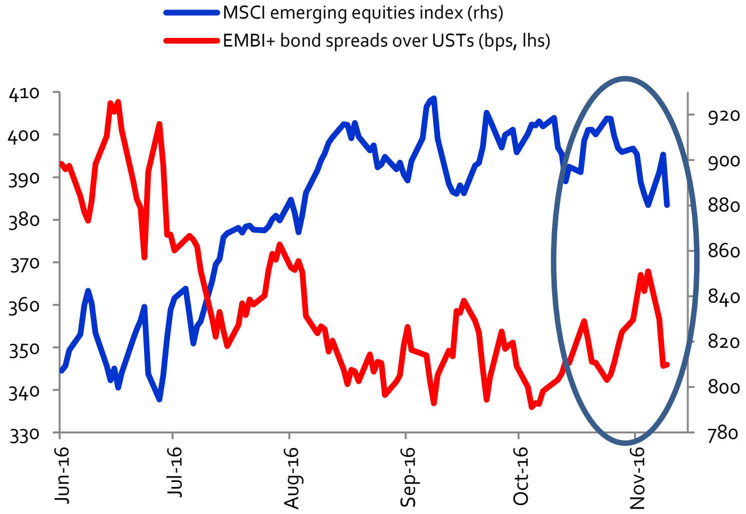
REGIONAL MARKET DEVELOPMENTS & OUTLOOK

- **Rally in regional financial markets** stalls following the US Presidential election
- **CESEE bourses outperformed other EM markets** on stronger economic fundamentals, closer links to the Euro area and lower USD funding needs
- **Regional currencies and rates markets** lost ground on rising risk aversion

COUNTRY FOCUS

- **Bulgaria:** Early Parliamentary elections ahead
- **Cyprus:** S&P and Fitch sovereign credit rating upgrades
- **Romania:** CHF loan conversion adopted
- **Serbia:** Economic recovery continued through to Q3 2016

Rally in EM assets stalls amid US elections



Source: Bloomberg, Eurobank Research

Contents

I. Regional Macroeconomic Developments & Outlook

Flash GDP growth estimates are expected to demonstrate that the region remained in good shape in Q3-2016

The flash GDP growth estimates of Q3-2016 about to be released are expected to confirm the good shape of the economies

A number of national statistics offices across the region are about to release later this week flash estimates of GDP growth for Q3-2016. Among them, the economies of our focus, Bulgaria, Romania, Cyprus are about to publish estimates that will most probably confirm that the economies are in relatively good shape and fully on track to meet, if not overshoot, the full year projections. Earlier this month, Serbia published such a flash estimate already. It has to be noted that both the IMF and more recently the European Commission upgraded their individual country forecasts for 2016-17 in their semi-annual forecasts update. As things stand at this moment, it would be fair to say that 2016 is braced to prove another very good year for the region, most probably the best since 2008.

Private consumption most probably has been in the driver's seat behind growth in Q3, while investments were constrained by lower EU funds absorption

On average, consumer sentiment, services and retail trade are on an improving trend as consumers continue to benefit from rising real wages, firmer labor markets and low inflation. In addition, the robust performance of agriculture and tourism makes us more optimistic on the forthcoming Q3 readings. Thus, private consumption has taken over as the principal driver behind growth, while investments are constrained by lower EU funds absorption. Finally, the performance of net exports has been mixed. In most cases, the private consumption acceleration has been accompanied by a concomitant imports recovery, trimming the contribution of net exports. On the other hand, we are concerned that the regional economies are about to or have already reached their cyclical peak. We have pointed out many times in our writings that the acceleration in regional GDP growth, at least in part, reflects lax monetary policies from both major and regional central banks plus the impact of lower energy prices on household-corporate and sovereign balance sheets. Given that energy prices are already on a normalization course and that interest rates in the region are already at historic lows, while a hike is looming on behalf of the US Fed, the room for further monetary easing is constrained. At the same time, room for further fiscal policy relaxation varies across the region and is contingent upon pre-crisis legacies and idiosyncratic factors. For example, that room is relatively limited In the economies of our focus as governments are either committed themselves to lower fiscal deficits (Bulgaria, Serbia) or have already stretched their budgets' capacity (Romania).

In Bulgaria, political risks have risen following the failure of the ruling party GERB nominee in the Presidential elections

At a country level, **Bulgaria** is entering a period of elevated political uncertainties. After the nominee of the ruling party GERB was defeated in the second round of Presidential elections, the incumbent Prime Minister vowed to resign leading the country to early parliamentary elections in spring. Meanwhile, the IMF revised GDP growth to 3.3% in 2016, up from 3% seen in mid-September and only 2.3% in the previous WEO report in spring. In **Cyprus**, two out of the three rating agencies -S&P and Fitch- have upgraded the sovereign rating by one notch in late September and mid-October respectively. Nevertheless, despite upgrading, Cypriot bonds are still below investment grade and thus do not qualify as collaterals for Euro system financing or QE. Meanwhile, the NPEs ratio stands at very high level -49% as of June2016- despite the restructurings taking place, mirroring the ongoing deleveraging and the EBA regulatory framework restrictions. In any case, following the clean exit from the adjustment program, the risk of complacency is looming as the reform momentum seems to have stalled ahead of the Presidential elections in 2018.

In late October, we traveled to Belgrade, Serbia to meet high-level officials and market participants so as to form an on the spot view on the latest economic developments and prospects going on forward

On the way to parliamentary elections on December 11th in **Romania**, political parties pledge to vote laws meeting their electorate's demands in order to enhance their popularity at the expense of stretching banking sector or budget capacities to absorb the cost. Strong growth is largely driven by private consumption, financed by an overly expansionary fiscal policy, and leads to a revival of macroeconomic imbalances. The key take away from our trip to **Serbia** is that there is a substantial unrealized upside potential in the economy provided that the momentum in the areas of reforming business environment, prudent budget execution and thorough restructuring of state-owned enterprises is sustained. In contrast to its regional peers, growth is driven by net exports and investments (mainly FDI inflows) so that now the investment ratio has reversed its declining trend, which makes us optimistic on the medium-term growth prospects of the economy.

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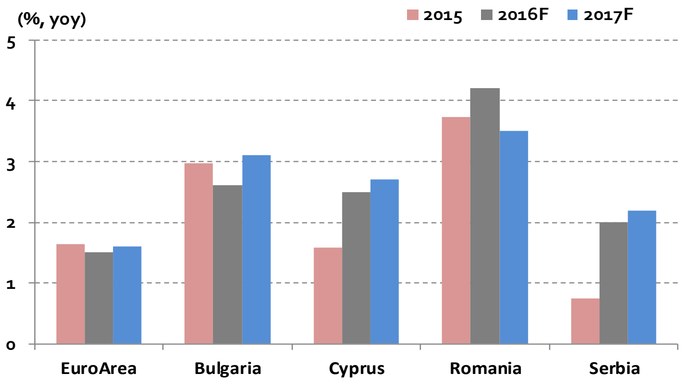
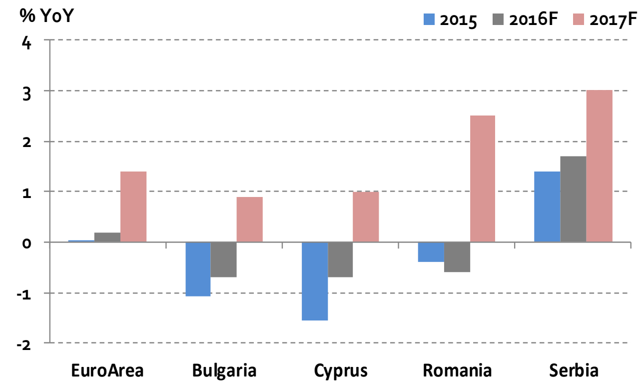
FIGURE 1: **GDP Growth performance 2015-2017**



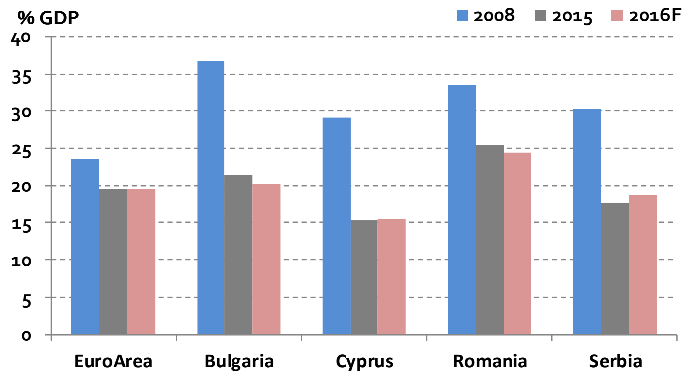
Source: Eurostat, National Authorities, Eurobank Research

FIGURE 2: **Annual average HICP inflation 2015- 2017**



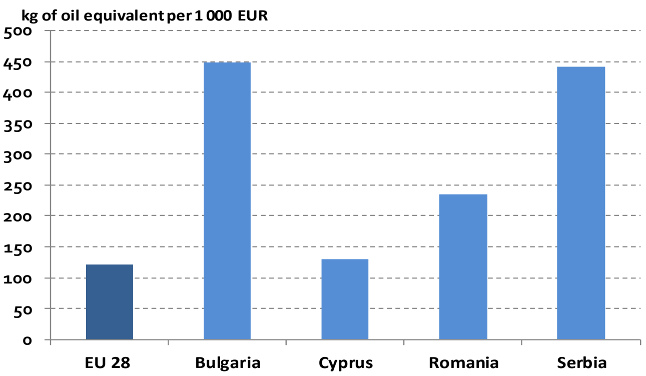
Source: Eurostat, EU Spring Forecasts, Eurobank Research

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



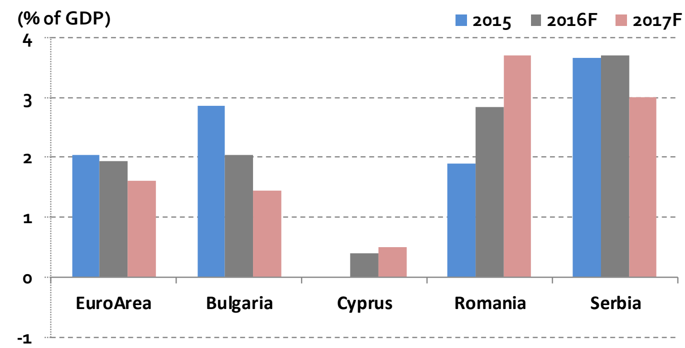
Source: IMF WEO, Eurobank Research

FIGURE 4: **Energy intensity of the individual countries, 2014**



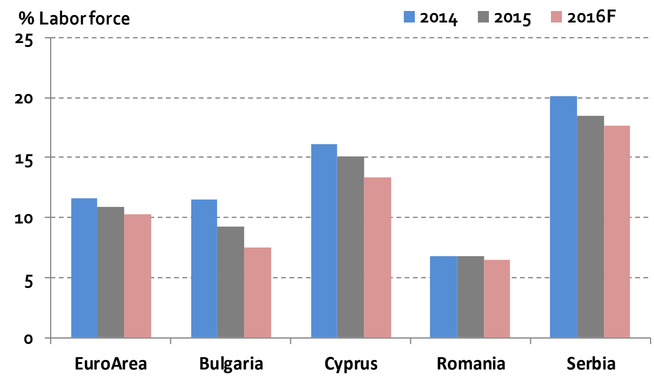
Source: Eurostat, National Authorities, Eurobank Research

FIGURE 5: **Fiscal Balance (% of GDP, Cash basis) 2015- 2017**



Source: Eurostat, National Authorities, Eurobank Research

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



Source: Eurostat, National Authorities Eurobank Research

II. Regional Market Developments & Outlook

Rally in regional financial markets stalls following the US Presidential election

Emerging market assets staged a lukewarm performance since the end of September on investor caution in view of the Nov.8 US election

Emerging market assets staged a lukewarm performance since the end of September as investor caution prevailed on the way to the US election held on November 8. Most opinion polls conducted ahead of the ballot placed candidate of the Democratic Party Hilary Clinton ahead of Republican Party nominee Donald Trump. However, a tightening of the race over the last few days before the election appeared to be taking the wind out of the previously witnessed rally in high-yield assets amid investor concerns over the impact of a Trump victory on global growth, foreign policy, monetary and fiscal policies, trade and immigration. Most importantly, Trump's victory and the Republicans' success in maintaining a majority in both chambers of Congress, the Senate as well as the House of Representatives, exerted hefty selling pressures US Treasuries that fed through to emerging market assets. A conciliatory tone adopted by the US President-elect in his victory speech somewhat mitigated earlier fears about the new government's policies. However, the prospect of fiscal loosening added to the view about rising inflation pressures, which in turn fanned expectations for a Fed rate hike in December and pushed global yields higher in a development that exerted selling pressures on EM assets anew.

CESEE assets fared better on strong economic fundamentals, closest links to Eurozone and lower USD funding needs

In this latest bout of risk aversion, CESEE assets fared better than their LATAM and Asian peers on strong economic fundamentals, closest links to the Eurozone than US and lower USD funding needs for the coverage of external financing requirements. Idiosyncratic factors also remain at play. Indicatively, Hungarian assets received additional support after Moody's upgraded by one notch in early November its sovereign credit rating to investment grade Baa3 on comparably strong domestic fundamentals, such as improving fiscal position and growth outlook as well as narrowing external imbalances. This is the latest of the three main rating agencies to proceed with such action this year. S&P raised Hungary's by one-notch to investment grade (BBB-/A3) in mid-September, following a similar move by Fitch in May. Elsewhere, Turkish assets have been under pressure on mounting concerns about the country's economic growth prospects and heightened domestic political risks, which overshadowed a revision of the country's credit outlook by S&P to stable from negative this month. Only recently, industrial production data showed that activity in the sector shrunk by 3.1%YoY in September, raising concerns that the domestic economy may have slid into contraction on a quarterly basis in Q3.

CESEE bourses outperformed EM peers

Against this backdrop, the MSCI Emerging Market index slid to a 4-month low a few days after the US election, having lost almost 9% from a 1-year peak of 929.99 points reached in early September and standing approximately 6% weaker compared to about a month earlier. In a visible outperformance of LATAM and Asian peers, losses in CESEE bourses have been largely contained. The Hungarian main BUX index stood 10% higher over that period having hit a record peak on November 10 and brought its year to date gains to ca 30%. In the region of our focus, a similar performance was witnessed in Serbia and Bulgaria, where main indices were ca 5% and 7% higher from the end of September, while Romania's main index BETI traded in a marginally negative territory.

CESEE currencies and rates markets lost ground on rising risk aversion

In FX markets, the Mexican peso was the currency most hit in the aftermath of the US election amid mounting concerns about the impact of new US government policies on LATAM's second biggest economy. The currency sank as much as13% the day following the elections and reached a lifetime trough of 21.4 versus the USD on November 11. The Turkish lira also hit a record low near 3.2985/$ in mid-November, weighed additionally down by idiosyncratic factors. Similarly, the Polish zloty and the Romanian leu hit 4-month lows each near 4.4480 and 4.5240 vs. the EUR, respectively. The Hungarian forint did lose some ground reaching 2-month lows close to 310.40, but remained not too far from a 1 ½ year peak of 303/€ as it continues to receive support from recent rating upgrades. In the local sovereign debt markets, regional bonds pared some of their earlier hefty gains, on growing risk aversion. The prevailing market perception that Central Bank monetary easing cycles have mostly bottomed out also took a toll on T-bonds.

Risks lie ahead

With the US elections out of the way, any comments by President-elect Donald Trump will be closely scrutinized by market participants for any hints on his government's policies. A looser fiscal policy will necessitate a more aggressive monetary tightening path by the Fed and will take a toll on emerging market assets. Elections in the Netherlands (General, March, 2017), Austria (Presidential, December 4, 2016), France (Presidential, April 23 & May 7, 2017) and Germany (general, September 2017) as well as the referendum in Italy (December 4, 2016) remain key risk events in the Eurozone ahead.

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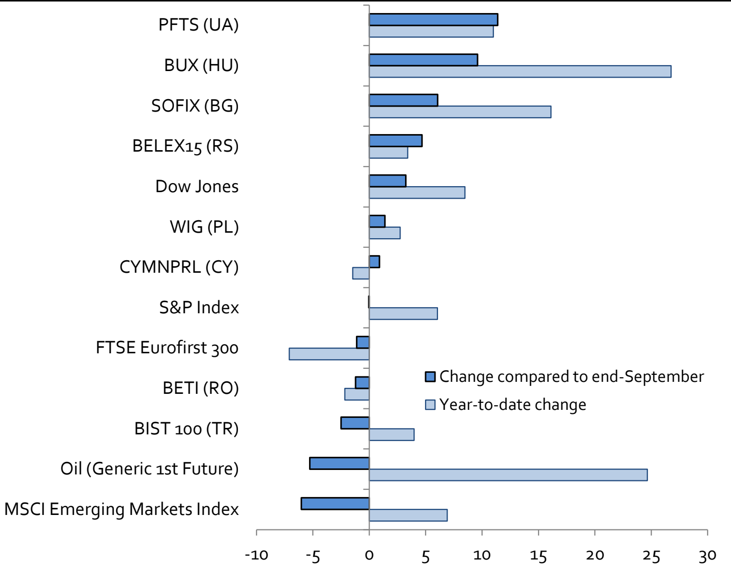
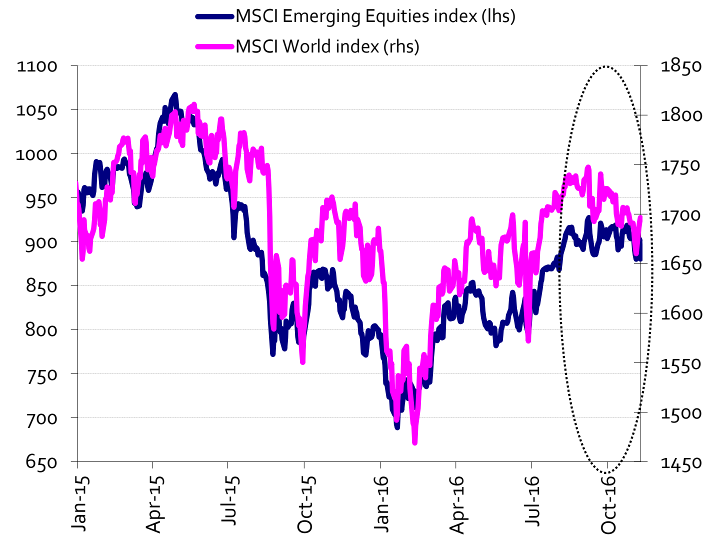
FIGURE 7: **Major world & CESEE stock markets performance (%)**



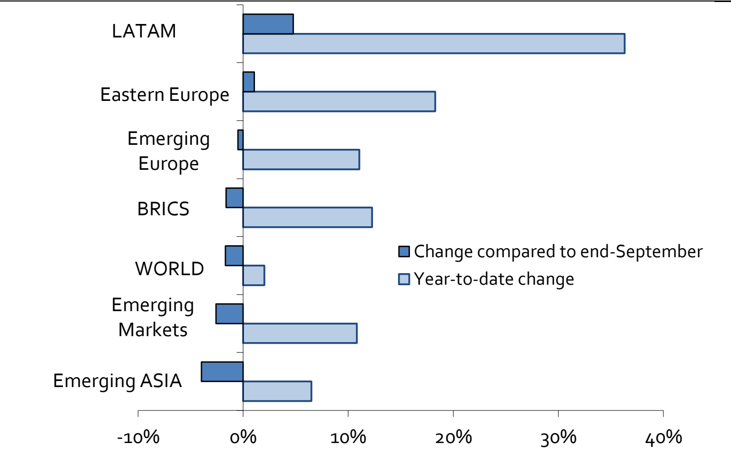
Source: Reuters, Bloomberg, Eurobank Research

FIGURE 8: **World & EM stock markets performance**



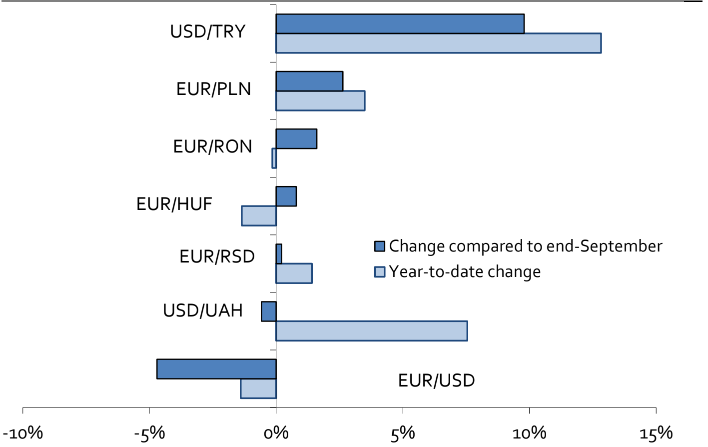
Source: Reuters, Bloomberg, Eurobank Research

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



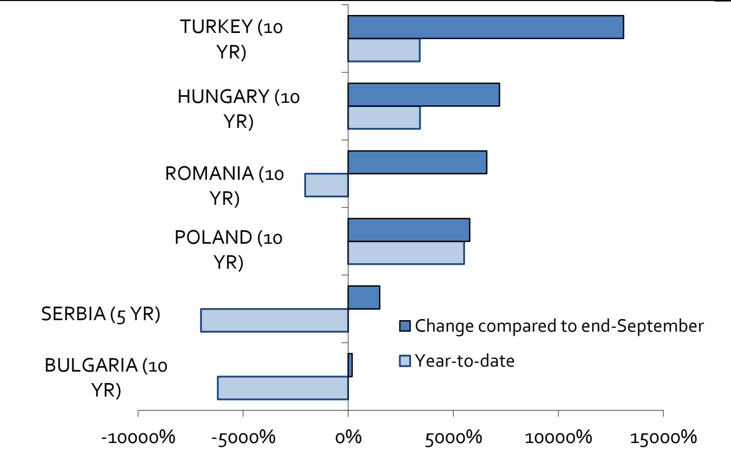
Source: Reuters, Bloomberg, Eurobank Research

FIGURE 10: **CESEE FX performance**



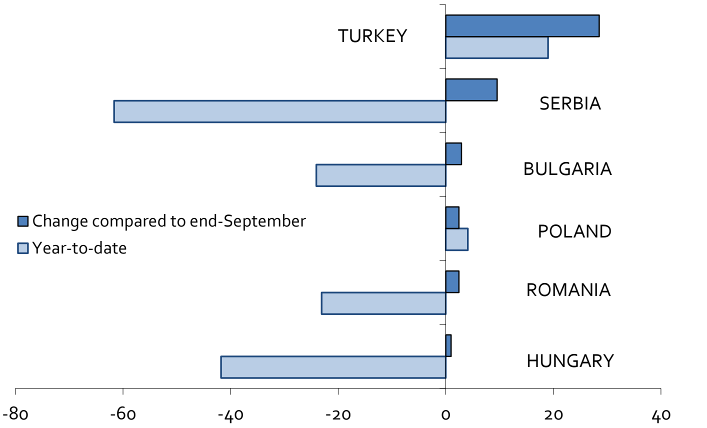
Source: Reuters, Bloomberg, Eurobank Research

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

FX

Neutral on the EUR/RSD

Although we are seeing increased dinar sales activity from corporates, the amount is barely enough to offset the inflows of hard currency (coming mostly from local EUR indexed loan disbursements). Therefore, our mid-term projection of weaker dinar ahead of Christmas is currently looking out of shape. The cross lies firmly around 123.00, remaining overwhelmingly supported by Central Bank (NBS) interventions. In this context, we withdraw our previous long EUR/RSD recommendation and back away from establishing any new positions. Looking ahead it may prove constructive to enter RSD carry trade positions in 2017. That said, undertaking such step would imply that domestic macroeconomic fundamentals are getting stronger.

Local rates

Bulgarian bonds lose ground on rising global benchmark yields, domestic political jitters

Bulgarian local currency bonds finally lost some ground over the last few weeks on the back of rising global benchmark yields and mounting domestic political jitters. The sector of medium maturity (5-8 years) underperformed with yields surging between 20 and 30 bps compared to end-September. Any further price decline would depend on the political developments in the country following the final round of the presidential elections scheduled for November 13. We expect the local yields to stay generally capped by the ample liquidity in the markets. According to recent speculation the auction calendar will likely remain empty until the end of the year in the light of a better-than-expected fiscal position. In fact, the Finance Ministry anticipates a surplus of 3.8% of GDP at end-October, which would be the first positive reading in eight years.

Neutral on Serbian local currency bonds as yields appear to have bottomed out

In its Memorandum of Inflation Targets until 2018, the National Bank of Serbia announced its decision to revise lower the inflation target from 4.0% to 3.0%, leaving the adjustment corridor in the same range of +-1.5%. The decision was backed up with improving macroeconomic fundamentals and encouraging projections of growth and investment. An anchored FX rate also attributed to this move. This development suggests that achieving the inflation target will be easier as of next year, which constrains NBS maneuverability in keeping monetary policy even more accommodative. This strongly supports our view that we reached bottom in KPR cuts. Hence, we would not opt to enter any trade positions on the local currency bonds market.

External debt markets

Bulgaria Eurobond 2023 T-Note could represent an attractive buying opportunity

Yields on Bulgarian Eurobonds have increased modestly since end-September, rising by 8 bps on average, to freeze in the first week of November ahead of elections. Further correction in the Eurobond market is possible amid political stability concerns after opposition candidate Radev won November's Presidential elections in a development expected to result to early elections. Our favorite paper, BGARIA 23, is trading 107 bps lower since issuance and in case of further pressure could represent an attractive buying opportunity.

Security	Position	Entry	Current level	Target	Stop loss
BGARIA 2023	Long	2.06%	1.51%	1.00%	2.20%

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We would also like to thank Costas Katsileros for his most valuable comments on the Regional Market Developments & Outlook

III. Country Focus

Bulgaria (Baa2/BB+/BBB-)

Early Parliamentary elections ahead

Prime Minister handed in his government's resignation in parliament after presidential candidate losses the race

GERB leader and Prime Minister Boyko Borisov handed in his government's resignation in parliament, a day after the second round of Presidential elections, won by the candidate of the main opposition Socialist party and former air force commander, Rumen Radev. According to partial official results released from the Electorate Commission of Bulgaria, Radev scored nearly 60% of the ballot on November 13, outpacing by a significant margin Parliament speaker and ruling centre-right Citizens for European Development of Bulgaria (GERB) party nominee Tsetska Tsacheva who achieved 36% of the tally. Albeit the President's position is largely ceremonial, it carries important responsibilities, such as, among other, the ability to veto legislation. Prime Minister Borisov had earlier signaled that if his party's candidate lost the presidential elections then the country would head for early elections, in a development that is likely to lead to a prolonged period of increased domestic political uncertainty. The presidential poll took place at a time of growing public discontent amid a slow anti-corruption and improving living standards process. At the same time, a referendum on the electoral system and financing of political parties was also held on the first round of the election on November 6, with the majority of voters backing the changes.

The government unveiled the main parameters of next year's budget framework.

The budget of 2017 envisages a consolidated government deficit of -1.4% of GDP, down from a recently projected balanced position in 2016. The budget of 2016 was initially targeted a consolidated government deficit of -2.0%, down from a realized -2.9% in 2015. The growth assumptions upon which the budget is built are quite conservative. Real GDP growth is expected to slow down slightly to 2.5% in 2017, from a projected 2.6% in 2016, on weaker net exports, before accelerating to 2.7% in 2018-2019, with private consumption and investment seen as the main drivers. The consolidated budget surplus had reached 3.7% of GDP in Jan-Sep 2016, compared to a -0.3% deficit in the same period a year ago. In January-September total revenue expanded by 6.4% YoY, to BGN25.7bn, increasing significantly faster than the 2.5% growth projected in the 2016 budget. The revenues overperformance took place despite the slowdown in EU transfers as a result of the initiation of the new programming period 2014-2020. On the other hand, total expenditure declined by -5.2% YoY in the same period, to BGN22.3bn as EU funds related expenditure plummeted by 69.7% in the first eight months according to the latest available data.

Consumer prices declined by -0.5%MoM/-0.6% YoY in September down from 0% MoM/-0.3% YoY in August on renewed food prices drop

Inflation edged lower at -0.5% MoM/-0.6% YoY in September, down from 0% MoM/-0.3% YoY in August, compared to -0.7% MoM/-0.2% YoY in July. Food prices, both the largest as well as the most volatile component of CPI, dipped down on a monthly basis, driven by lower prices of unprocessed food, namely fruits (-2.2% MoM/-6.0% YoY), reversing the sharp rise of July and August. Food prices declined by 0.0% MoM /-0.3% YoY, down from -0.2% MoM/+1.2% YoY in August vs. +1.7% MoM/+2.0% YoY in July, making a relatively large negative contribution on an annual basis. World energy prices, despite their recent spike, are still lower on an annual basis, thereby driving transportation prices lower by -0.3% MoM/-3.7% YoY in September, up from +0.5% MoM/-7.9% YoY in August, compared to +1.8% MoM/-8.7% YoY in July. Overall, despite the uptick of September, deflation has slowed down in the recent months. Looking ahead, inflation is expected to continue its gradual recovery in the coming months reflecting the dissipating impact of weak global energy prices. There is little evidence to support that underlying consumption-driven inflationary pressures are building despite its improving dynamics. Finally, inflation dynamics are also going to receive some support from the recent regulatory prices' adjustment in the water supply and the forthcoming one in the state energy sector in Q4.

The IMF board concluded its annual report for Bulgaria on a follow-up from the mission back in mid-September

The IMF board report acknowledged the resilience of the Bulgarian economy to multiple shocks in recent years and described the latest macroeconomic developments as encouraging. From that point of view, the GDP growth forecast of 2016 was further revised to 3.3%, up from 3% previously seen in the mission conclusion and only 2.3% in the latest World Economic Outlook (WEO) report. However, the IMF stressed that acceleration in structural reforms is required in order to sustainably boost the growth potential of the economy and thus speed up income convergence with the EU-28 average. Finally, IMF praised the new BNB leadership for the progress it has achieved in restoring financial sector stability by addressing shortcomings in banking supervision and resolution. In that direction, the IMF urged authorities to continue strengthening the institutional framework of the financial system.

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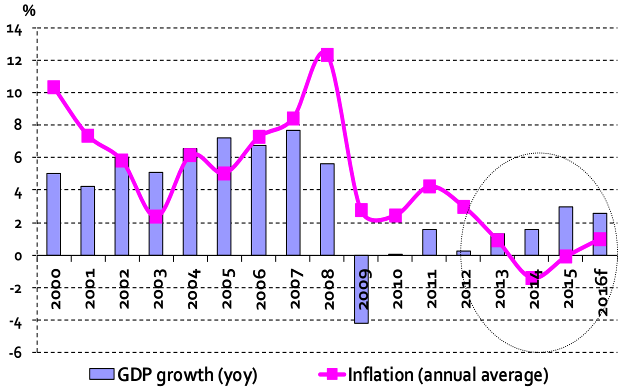
Bulgaria: Macro & Market Data	2014	2015	2016f	2017f
Real GDP (yoy%)	1.6	3.0	2.9	3.0
Inflation (yoy%)				
CPI (annual average)	-1.4	-0.1	-0.7	0.9
CPI (end of period)	-0.9	-0.4	0.3	1.2
Fiscal Accounts (%GDP)				
General Government Balance	-3.7	-2.9	-2.0	-1.4
Gross Public Debt	27.7	26.7	29.7	31.1
Primary Balance	-3.0	-2.1	-1.1	-0.4
Labor Statistics				
Unemployment Rate (LFS, %)	11.4	9.2	7.5	6.5
Wage Growth *(total economy)*	6.0	8.8	7.5	7.0
External Accounts				
Current Account (% GDP)	0.9	1.4	1.8	1.5
Net FDI (EUR bn)	1.3	1.6	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

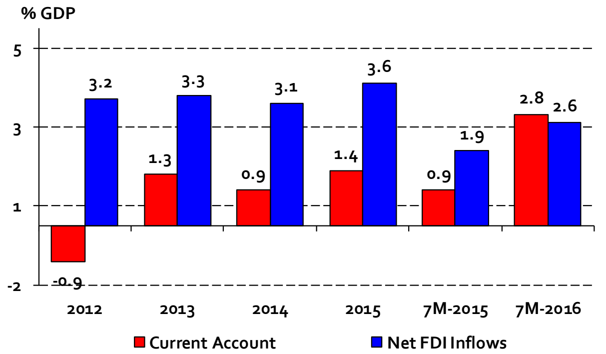
Source: National Sources, Eurostat, IMF, Eurobank Research

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



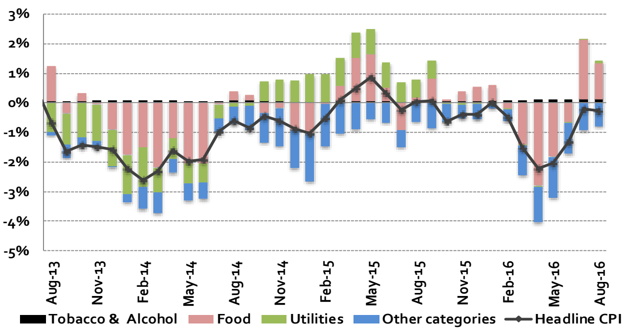
Source: National statistics, Ecowin Reuters, Eurobank Research

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



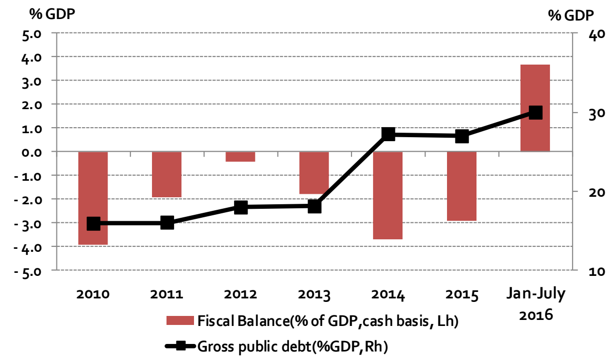
Source: National statistics, Ecowin Reuters, Eurobank Research

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



Source: National statistics, Ecowin Reuters, Eurobank Research

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



Source: Eurostat, Eurobank Research

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

S&P and Fitch sovereign credit rating upgrades

Despite S&P and Fitch recent upgrade, Cypriot government bonds are still ranked below investment grade

On October21st, Fitch upgraded the sovereign rating of Cyprus by one notch (from B+ to BB-) with a positive outlook. The decision comes on top the recent S&P upgrade in late September (from BB- to BB with a positive outlook). The upgrade reflects the strong progress in the aftermath of the 2013 banking crisis, the exit from the economic adjustment program last March in the context of outperformance of fiscal and economic program targets, the success at lifting capital controls, and steps taken to restructure the banking sector. Despite rating agencies' aggressive upgrading, government bonds have not reached investment grade status yet. After recent S&P and Fitch upgrading, two and three more notches are required in their respective grading systems, while four would be still required in Moody's ratings (currently at B1). As a result, ECB's waiver for government bonds eligibility for Euro system financing has been lifted as of April 1st and Cyprus no longer qualifies for QE. The waiver allowed these instruments to be used in Euro system monetary policy operations despite the fact that they did not fulfill minimum credit rating requirements.

The EU Commission autumn forecasts upgraded Cyprus growth outlook in 2017-2018, taking note of the fiscal relaxation envisaged in government policies

According to EU Commission autumn forecasts, GDP growth is expected to ease in the next two years from its current reading, yet to remain robust. The report envisages GDP growth at 2.8% in 2016, 2.5% in 2017 and 2.3% in 2018, up from 1.7% in 2017 and 2.0% in 2018 in the spring forecasts. Growth is seen driven by private consumption and investment, the latter benefitting from a stabilizing housing market. Tourism is expected to support growth but not to be as buoyant as in the preceding period. Accordingly, unemployment will further decline to 12.5% in 2016, 11.1% in 2017 and 10% in 2018. As far as fiscal performance is concerned, the general government primary surplus and headline deficit is expected to end in 2016 at +2.3% of GDP and -0.3 of GDP% respectively. The report took note of the fiscal relaxation in 2017 as a consequence of extra spending on professional soldiers, the abolishment of the property income tax, the expiration of the special payroll contribution levied in response to the crisis plus the unfreezing of public sector wage bill. Thus, even though the headline deficit is forecasted to inch up to -0.4% in 2017 and further decline to a balanced position in 2018, the structural balance is expected to switch from a surplus of +0.2% of GDP in 2016 to a deficit of -1.3% of GDP in 2017 and -1.8% of GDP in 2018. Public debt, after peaking at 107.5% in 2015, is projected at 107.1% in 2016 and further decline to 103.7% and 100.6% in 2017 -2018.

The NPEs ratio remains very high despite the restructurings taking place, mirroring the ongoing deleveraging and the regulatory framework restrictions

According to the Central Bank of Cyprus, the stock of non-performing exposures (NPEs) declined by only €145mn in July-August on top of the €1bn in Q2-2016, bringing the stock of NPEs down by 10.2% between December 2014-August 2016.The decline in NPEs reflects three main factors: increased repayments, the migration of successful restructurings to performing facilities after the completion of the observance period plus write-offs and settlements through immovable property exchange. Total loans decreased by €3.2 billion during the same period, resulting in the increase in the ratio of NPEs to total loans, from 47.8% in December 2014 to 48.4% in March 2016 and further up to 49.0% in June 2016 despite the significant decrease of NPEs stock. Based on the EBA conservative definition, a restructured loan is still classified as an NPE for a probation period of at least 12 months, even if it is serviced without incurring new arrears. As a result, a large fraction of the restructured loans are still classified in NPEs (€10.3bn out of €13.7bn in August 2016).In any case, the ratio remains extremely high, among the highest following any recent banking crisis. From that point of view, the Central Bank has noted that there is a long road towards the resolution of the NPEs problem.

The risk of complacency following the exit from the Adjustment Program is material for Cyprus

The incoming parliament, after the parliamentary elections in last May, is fragmented between more parties and appears less keen to back reform-friendly legislation. The approval of the bill setting a cap to the public sector wage bill, linking the expenditure expansion with GDP growth performance, is still pending. The Parliament has postponed the vote for this crucial piece of legislation, which would keep the wage bill on a sustainable level, minimizing the risk of fiscal derailment. The risk of complacency following the exit from the Adjustment Program is material for Cyprus. Firstly, a number of structural reforms of the economic adjustment program are still pending; these reforms are important in avoiding a backtracking of the economy. The incumbent government has a political window of one year to carry on with the remaining reforms as well as to conclude key privatization projects. Secondly, fiscal policy achievements may lead to more spending pressure, which is going to increase ahead of the Presidential Elections, scheduled for February 2018.

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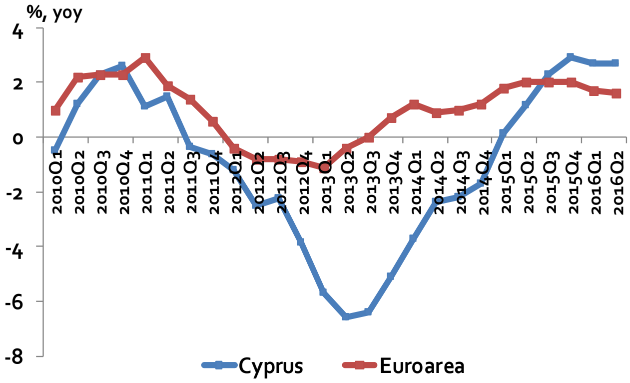
Cyprus: Macro & Market Data				
	2014	**2015**	**2016f**	**2017f**
Real GDP (yoy%)	-2.5	1.6	2.7	2.5
Inflation (yoy%)				
HICP (annual average)	-0.3	-1.5	-0.7	0.5
HICP (end of period)	-1.0	-1.4	-0.3	0.8
Fiscal Accounts (%GDP)				
General Government Balance	-0.2	0.0	-0.4	-0.5
Gross Public Debt	108.2	108.9	105.6	101.7
Primary Balance	2.7	1.8	2.2	1.9
Labor Statistics				
Unemployment Rate (LFS, %)	16.1	15.1	12.5	11.5
Compensation per employee (%)	-3.5	-1.0	1.1	1.4
External Accounts (% GDP)				
Current Account	-4.6	-3.6	-4.2	-4.6
Trade Balance (Goods)	-16.2	-18.4	-18.4	-18.6
Terms of Trade (of Goods)	7.1	2.6	2.2	-0.3
Domestic Credit	**2012**	**2013**	**2014**	**2015**
Total Credit (%GDP)	371.6	351.4	353.5	360.8
Credit to Enterprises (%GDP)	170.2	160.2	148.1	151.5
Credit to Households (%GDP)	138.2	140.0	142.7	136.4
Private Sector Credit (yoy)	6.2%	-12.2%	-2.3%	-3.4%
Loans to Deposits (%)	103.3%	135.3%	133.4%	136.6%

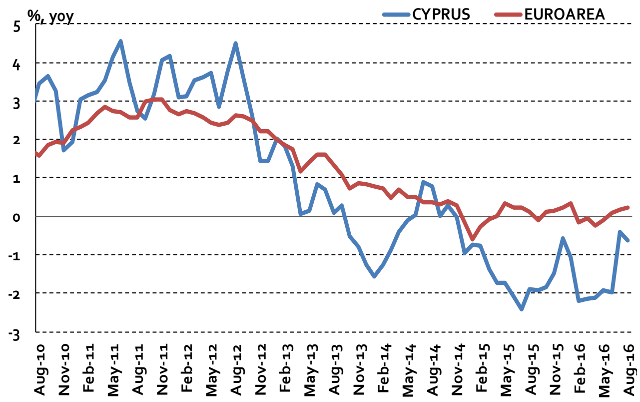
Source: National Sources, Eurostat, IMF, Eurobank Research

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



Source: Eurostat, Eurobank Research

FIGURE 18: **HICP Cyprus vs. Euroarea 2010-2016**

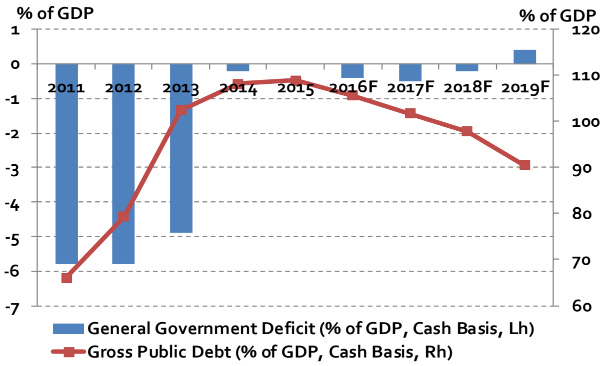


Source: Eurostat, Eurobank Research

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-)

CHF loan conversion law adopted

On top of the debt discharge law which enables borrowers to walk away from their contractual obligations, the parliament adopted unanimously the CHF loan conversion law

A new law allowing borrowers to convert their CHF denominated loans into RON at historical exchange rates was voted by the parliament unanimously on October 18th. The final draft law provides for no threshold for the outstanding amount balance, debt to income service ratio or the contract date of the loan and it includes those who had already benefited from a loan reconversion in other currency or from a restructuring of their loan. As of September, loans denominated in currency other than € or RON stood at RON 5.8bn or 5.1% of the retail portfolio. The NBR has recently assessed that the law, if implemented in its current version, will incur RON 2.4bn (0.3% of GDP) losses for the banking system. Even though the amount looks manageable, the risk is concentrated on three banks which are most likely to take 70% of the hit. The capital adequacy of two of them, which are non-systemic, is expected to decline below the regulatory minimum threshold. Meanwhile, the Constitutional Court ruling on the "Datio in Solutum" law, which reduced the scope of eligibility and potential impact of the debt discharge law, could pave the way for a similar ruling on the CHF loan conversion law. The Constitutional Court assessed that the law adopted in mid-April under which the borrowers can walk away from their contractual obligations by transferring the ownership of the collateral back to the banks, can only be applied under the condition of proving hardship within the loan contract. In that case, the borrowers must prove to the court their inability to repay the loan and that unforeseen events, outside the control of both parties, in conditions related to the loan took place.

Nominal wage growth remained robust in September while the parliament endorsed a new round of public sector wage hikes ahead of the parliamentary elections in December.

Net wages came at +0.9% MoM/+14.2% YoY in September, up from -0.1%MoM/+11.7% YoY in August, down from +10.2% MoM /+13.3% YoY in last December. Petroleum industry (+20.6% MoM) and Education (+8.0% MoM) were among the sectors with the highest monthly expansion, illustrating it concerns the private and public sectors alike. If the negative inflation stemming from the headline and VAT food stuff rate cuts is factored in, real wages growth are still expanding in double digit territory at 14.9% YoY in September, up from 14.4% YoY in August, compared to +14.2% YoY in December. The reading is still the highest in EU-28 and close to the recently recorded post-crisis high for Romania. Generous wage increases approved by the parliament for all other unions of the broad public sector- effective from last December except for the education and the health sectors which received 15% and 25% increases respectively is the main driver behind wage acceleration. Meanwhile, the parliament endorsed on November 8th a new round of an additional 15% wage increases for the education and health sectors. In response, the government is anticipated to challenge this decision in the Constitutional Court on the grounds of lack of additional available funding.

A soft landing scenario for Romania is most likely in 2017

The incoming government-after the parliamentary elections scheduled for December 11th, will most probably need to adopt a more conservative stance in order to bring the projected fiscal deficit below 3% (assuming no policy change the deficit is expected to surpass 3.7% of GDP in 2017), which will have a material decelerating impact on the economy next year. Robust real wage growth in private and public sectors, in tandem with improving sentiment and labor market tightening conditions, have been fueling a consumption spending boom throughout 2015-2016 at the expense of pushing government finances off consolidation track and exacerbating the external position. In an illustration of this, retail sales on seasonally and working adjusted basis have been expanding by +11.1% YoY in September, cooling off from +13.2% YoY in August vs. a multi month peak of 19.5% YoY in last March. On the downside, double digit wage formation entails negative implications for the price competitiveness of the tradables sector, which reflects on the net exports side and effectively will be RON negative.

Inflation surprised to the downside coming at -0.1% MoM/-0.6% YoY in September down from +0.1% MoM/-0.2% YoY in August driven by the sharp monthly decline of fruit and vegetables prices

Inflation remained in negative territory in September for a fifteen month in a row. Inflation declined by -0.1% MoM/-0.6% YoY in September compared to +0.1% MoM/-0.2% YoY in August, below market expectations this time (BBG survey: +0.3% MoM/-0.4% YoY). The annual dynamics of the CPI food component decelerated sharply in September driven by the sharp monthly decline of fruit and vegetables (-3.7% MoM). As a result, food prices came at -0.6% MoM/+0.5% YoY in September, down from -0.1% MoM/+2.0% YoY in August. Non-food items expanded by +0.2% MoM/-1.0% YoY in September, down from +0.3% MoM/-1.4% YoY in August. Non-food items dynamics were driven by the monthly spike in fuel prices (+0.7%MoM). Services remained almost flat at +0.0% MoM /-1.2% YoY down from -0.1% MoM/-1.0% YoY in August mirroring lower utility prices. Overall, the September inflation reading, despite the monthly uptick, suggests that pace of deflation has slowed down. The adjusted Core2 CPI (excluding administered and volatile prices, alcohol and tobacco) firmed to +0.6% YoY in September vs. +0.5% YoY in August, still depressed by the headline VAT rate cut effective from the beginning of the year (from 24% to 19%). The minutes from the NBR policy meeting in October-released for the first time-suggest that over the short term, and given the larger than expected positive output gap, underlying inflationary pressures are building. In the NBR's view, inflation will most probably end below the mid-point of the 2.5% target at the end of 2017, while it is now seen at the upper bound of the inflation target interval (2.5-3.5%) by the end of Q2-2018.

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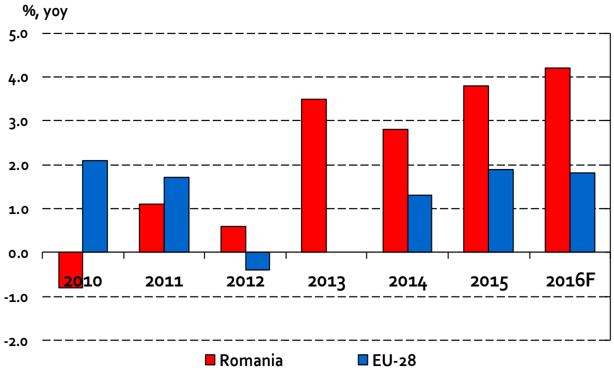
Romania: Macro & Market Data				
	2014	**2015**	**2016f**	**2017f**
Real GDP (yoy%)	2.9	3.8	5.0	3.0
Inflation (yoy%)				
CPI (annual average)	1.1	-0.6	-1.8	1.5
CPI (end of period)	0.8	-0.9	-0.4	2.0
Fiscal Accounts (%GDP, Cash Basis)				
General Government Balance	-1.9	-1.9	-2.8	-3.7
Gross Public Debt (including guarantees)	39.5	39.1	40.5	42.6
Labor Statistics (annual avg,%)				
Unemployment Rate (ILO, % of labor force)	6.8	6.7	6.5	6.3
Wage Growth (total economy)	7.6	8.4	12.5	5.0
External Accounts				
Current Account (%GDP, BPM5)	-0.4	-1.1	-3.0	-3.2
Net FDI (EUR bn)	2.5	2.7	3.0	3.5
FDI / Current Account (%)	385.0	157.1	58.8	60.8
FX Reserves (EUR bn)	32.2	32.2	33.5	32.0
***Domestic Credit** (end of period)*	**2012**	**2013**	**2014**	**2015**
Total Credit (%GDP)	52.0	47.0	44.4	43.9
Credit to Enterprises (%GDP)	20.3	18.0	15.7	15.5
Credit to Households (%GDP)	17.8	16.5	15.4	15.4
FX Credit/Total Credit (%, private)	62.5	60.9	56.2	49.3
Private Sector Credit (yoy)	1.3	-3.3	-3.1	3.0
Loans to Deposits (%)	133.9	118.4	106.3	106.6
Financial Markets	**Current**	**3M**	**6M**	**12M**
Policy Rate	1.75	1.75	1.75	2.00
EUR/RON	4.45	4.50	4.50	4.40

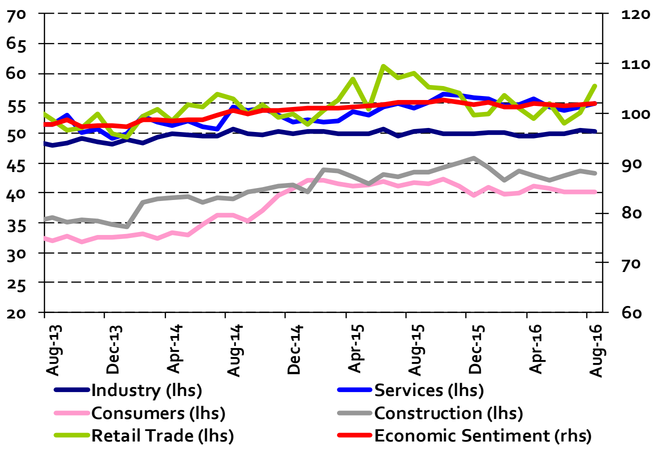
Source: National Authorities, EC, IMF, Eurobank Research

FIGURE 21: **Growth performance Romania vs. EU28 2010-2016**



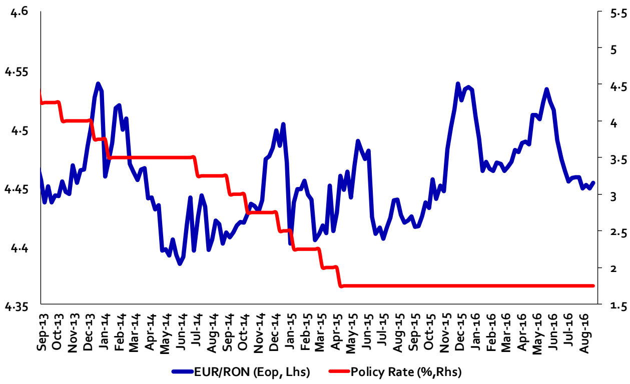
Source: Eurostat, Eurobank Research

FIGURE 22: **Sentiment indicators 2013-2016**



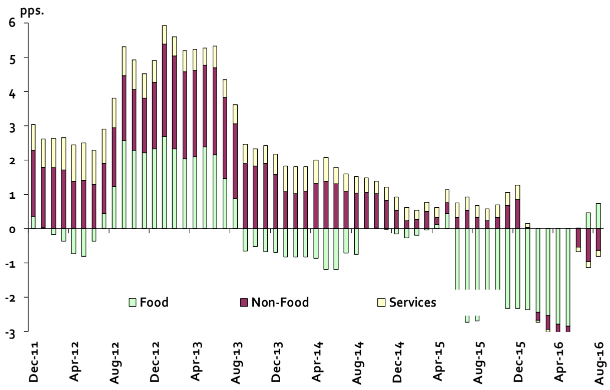
Source: Eurostat, Ecowin Reuters, Eurobank Research

FIGURE 23: **Monetary policy & FX rate 2013-2016**



Source: Bloomberg, Eurobank Research

FIGURE 24: **Inflation components 2011-2016**



Source: National statistics, Eurobank Research

Serbia (B1/BB-/B+)

Economic recovery continued through to Q3 2016

Real GDP growth picks up pace in Q3 2016

The domestic economic recovery continued through to Q3 this year, with the flash real GDP growth estimate exceeding a market consensus of 2.2%YoY and showing expansion of 2.5%YoY during the July-August period. The latter compares with readings of 3.8%YoY in Q1 and 2.0%YoY in Q2 and brings the annual rate of increase over the first nine months of the year to 2.7%. After bottoming out in Q3-2014, economic activity embarked on a recovery mode, with real GDP exhibiting six consecutive quarters of positive growth through to Q3-2016. Albeit not yet available, the breakdown of the data is likely to display that private investment and net exports were the main drivers of growth in Q3. According to the latest data available, investments expanded by 6.5% YoY in 1H-2016 (+4.9% YoY in Q2-2016 vs. +8.4% YoY in Q1-2016), broadly in line with the YoY performance experienced in the same period a year earlier. Separately, export growth accelerated to 10.8% YoY in 1H-2016, from 9.2% YoY in 1H-2015. At the same time, private consumption is expected to have provided a small, nevertheless still positive contribution in Q3, driven by higher real wages, further improvement in labor market conditions (unemployment rate stood at 15.2% in Q2-2016 compared to 17.3% in Q2-2015 and a peak of 25.5% reached in April 2012) plus recovering credit dynamics (+5.2% YoY in July 2016 in constant FX prices).

Further pick up anticipated next year in economic activity

In our recent Trip Notes (https://www.eurobank.gr/Uploads/Reports/EMERGING_MARKETS_SFR_201610.pdf), we have made an extensive analysis on the progress of the Serbian economy. After several years of struggling with recession and stagnation, the Serbian economy has embarked on a virtuous cycle. Serbia ranks among those few economies in the region that have accomplished to reverse the declining trend in the investment expenditure to GDP ratio. This is an important development supporting optimism for the sustainability of Serbia's medium-term growth performance. The said ratio is projected to increase to 18.3% of GDP in 2016, from levels around 17.5% in the prior two years and a pre-crisis high of 30.3% reached in 2008. The main driver behind this improving performance is increased inward foreign direct investment (FDI). Net FDI inflows have been incentivized by recent improvements in the domestic business environment as well as generous subsidies scheme offered to foreign investors. Net FDI inflows accounted for over 5% of GDP in 2015-16, a high ratio by both regional and international standards, providing more than full coverage to the current account deficit (159.3% of CA in Jan-Aug 2016). More importantly, in contrast to the pre-crisis era, more than one third of these FDI inflows are channeled to tradable sectors e.g. manufacturing. Looking ahead, economic activity is expected to accelerate to around 2.7% for the whole of this year, beating earlier official estimates for growth slightly below 2.0%. Prospects for 2017 are even more encouraging. The IMF expects growth to pick up further pace towards 3.0%. On top of private investment and net exports, which are expected to repeat their current strong performance, private consumption is expected to recover further, after several years of being a drag on growth. It is expected to provide more meaningful support to overall economic activity next year, driven by real wage growth and the positive fiscal impulse emanating from the targeted rise in public wages and pensions. Risks to the next year's growth outlook stem from, inter alia, the potential unforeseen spillovers from Brexit.

Central Bank revised lower its inflation target

Inflation has fallen dramatically since mid-2013. Headline CPI has remained firmly below the 4.0±1.5% Central Bank (NBS) tolerance band since early 2014. Both internal and external factors have been at play behind the steep disinflation trend. From an external perspective, this has been a consequence of lower global oil and primary commodities prices which, despite some recovery this year, continue to stand at relatively low levels. Internally, a good harvest season, fiscal consolidation, well-anchored inflation expectations and a relatively stable dinar have also kept price pressures at bay. The most recent data available showed CPI at 1.5%YoY in September, below the lower bound of the Central Bank's target tolerance band for the 32nd month running, while the YTD reading stood at 1.8%. With inflation remaining below the target for nearly three years, macroeconomic indicators improving and risks to the domestic economy appearing to be mitigated, the NBS justifiably decided in early November to revise lower its target to a more realistic range of 3±1.5% for 2017 and 2018. It is worth noting that CPI is anticipated to move higher and remain around 2-3% over the next two years, assisted by increasing aggregate demand, the impact of past monetary easing and base effects. Administered price hikes also expected to lift CPI in the coming months. In this context, CPI will be contained within the new tolerance band, while the target revision may also facilitate a reduction in long-term dinar interest rates and further boost lending.

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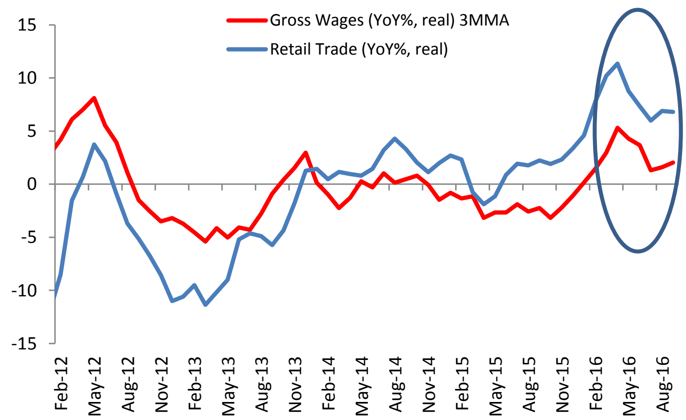
Serbia: Eurobank Forecasts				
	2014	**2015**	**2016**	**2017**
Real GDP (yoy%)	-1.8	0.7	2.5	2.8
Inflation (yoy%)				
HICP (annual average)	2.1	1.4	1.3	3.2
HICP (end of period)	1.8	1.6	2.0	3.9
Fiscal Accounts (%GDP)				
Consolidated Government Deficit	-6.6	-3.7	-2.5	-2.2
Gross Public Debt	72.0	77.4	76.8	75.1
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	-4.8	-4.2	-3.9
Net FDI (EUR bn)	1.2	1.8	1.6	1.5
FDI / Current Account (%)	60.0	112.5	114.3	107.1
FX Reserves (EUR bn)	9.9	10.4	10.1	10.3
Domestic Credit	**2012**	**2013**	**2014**	**2015**
Total Credit (%GDP)	62.8	57.0	61.5	63.6
Credit to Enterprises (%GDP)	31.2	26.1	25.0	25.0
Credit to Households (%GDP)	18.2	17.4	18.7	19.6
Private Sector Credit (yoy%)	9.5	-4.8	0.5	3.2
Loans to Deposits (%)	126.9	114.1	111.8	112.6
Financial Markets	**Current**	**3M**	**6M**	**12M**
Policy Rate	4.00	4.00	4.00	4.00
EUR/RSD	123.30	124.00	125.00	127.00

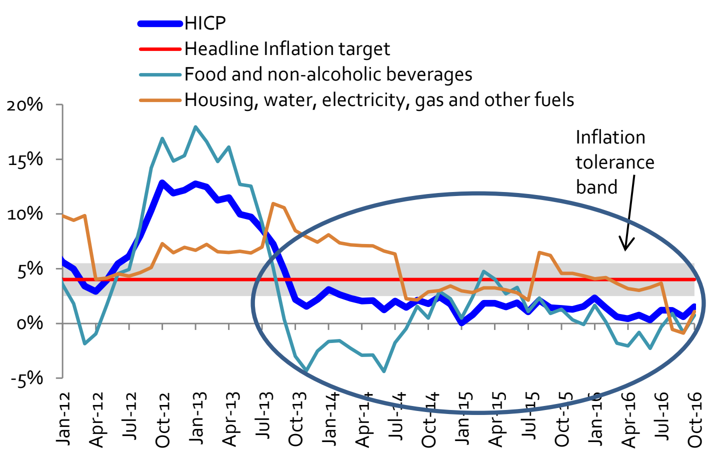
Source: National Authorities, EC, IMF, Eurobank Research

FIGURE 25: **Private consumption and wage growth remain robust (3MMA)**



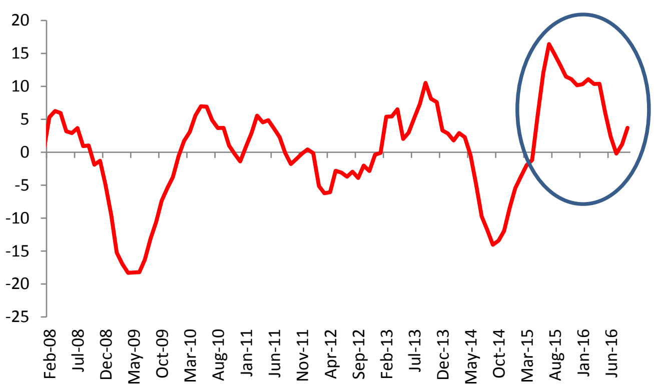
Source: National Authorities, EC, IMF, Eurobank Research

FIGURE 26: **Inflation remains below NBS target for more than two years**



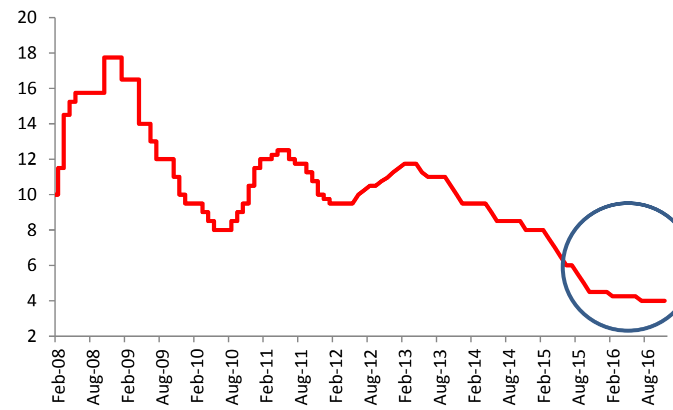
Source: National Authorities, Eurobank Research

FIGURE 27: **Growth in industrial production rebounds after seasonal factors' slowdown (3MMA YoY %)**



Source: National Authorities, EC, IMF, Eurobank Research

FIGURE 28: **NBS holds fire for 4th month running in November**



Source: National Authorities, EC, IMF, Eurobank Research

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