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Regional Q1-2016 flash GDP estimates are set to confirm a good start in the year

REGIONAL MACROECONOMIC DEVELOPMENTS & OUTLOOK

- **Q1-2016 flash GDP estimates** are set to confirm a good start in the year
- **Lax monetary policies** together with sustained low world energy prices continue to provide a positive boost on **growth momentum** in 2016
- **Consumer sentiment**, services and retail trade confidence data **improvement** in the region

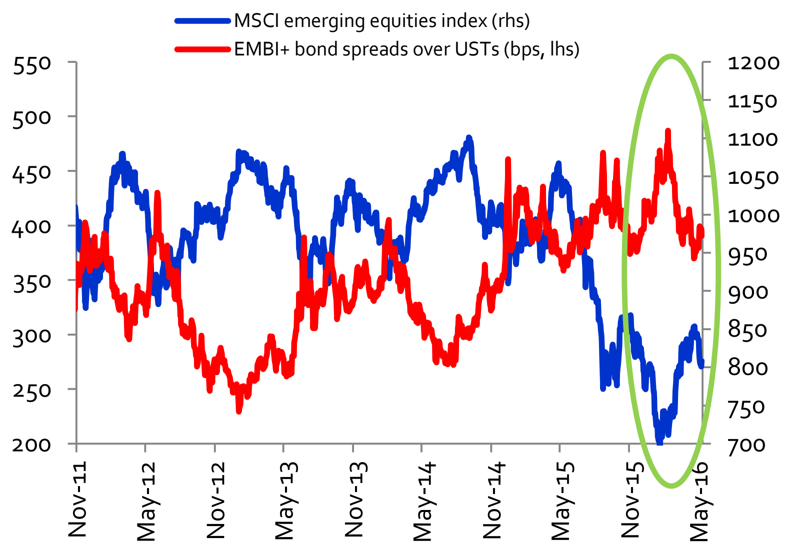
REGIONAL MARKET DEVELOPMENTS & OUTLOOK

- In line with the broader EM trend, the recent rally in **regional financial market**s rans out of steam
- CESEE currencies reversed earlier gains, **regional FX** broadly remains range-bound
- **Regional government bonds** under pressure on global growth worries

COUNTRY FOCUS

- **Bulgaria:** Further labor market conditions improvement
- **Cyprus:** Economic Sentiment Index reached a new post-Lehman high in April
- **Romania:** Debt discharge law adopted by the parliament
- **Serbia:** SNS-led alliance secures another landslide victory on April 24th snap general elections

Global growth jitters weigh on emerging financial markets



Source: Bloomberg, Eurobank Research

Contents

I. Regional Macroeconomic Developments & Outlook

Regional Q1-2016 flash GDP estimates are set to confirm a good start in the year

IMF downgraded its world GDP forecast once again in the latest WEO for this year in April

In the past month, the raft of data releases were on average positive, painting a more favorable global macro environment, that have helped risk-taking sentiment. This, together with the oil price rebound, fuelled a rally in both advanced and emerging markets. The EA flash Q1 GDP estimate (+0.6% QoQ/+1.6% YoY) surprised to the upside, the Chinese and Indian manufacturing data showed some recovery, while US growth & labor data came out relatively soft. In any case, concerns on sluggish global growth remain as the projected world's GDP growth rate this year is expected to be the slowest in the post-crisis era. To that end, IMF downgraded its forecast once again in the latest WEO to only 3.2% this year, 0.2 ppts down from its January forecast, 0.4 ppts lower than its estimate in October 2015, and 0.6 ppts down from its forecast in last July. Against this unfavorable external backdrop, the region's prospects in 2016 have remained relatively unscathed.

The flash GDP estimates to be released later this month are expected to confirm a good start in the year

A number of national statistics offices across the region are set to release later this month flash estimates of GDP growth for Q1-2016. Among them, Bulgaria, Romania and Cyprus. Serbia already published earlier this month its flash estimate, which was more bullish than expected. We anticipate other flash GDP estimates to confirm a good start in the year and serve as a reminder that there are few winners' economies in the EM space. Lax monetary policies together with lower-on an annual basis- world energy prices continue to provide a positive boost on the growth momentum. Although this boost is destined to eventually fade away as energy prices normalize, it is poised to carry throughout 2016 as well; low energy costs keep inflation pressures subdued, supporting real disposable incomes and providing more flexibility to household, corporate, and sovereign balance sheets. The economic sentiment data published in April were on average better for the region compared to March. Although the indicator has retrenched to lower levels compared to 2H-2015 in some cases, 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.

Improvement of labor market conditions in 2015 and further in Q1-2016 has set the foundations for consumption to have a bigger weight on this year's growth in Bulgaria

On a country level, in **Bulgaria**, unemployment has declined further to 7.3% in March, from 10.0% a year ago, as the economy adds more jobs in the labor-intensive areas of specialized services. The labor market conditions improvement in 2015, and further in Q1-2016, has set the foundations for consumption to have a bigger weight on this year's growth. On the negative side, government spending is expected to have peaked in 2015 along with the closing of the previous EU funds programming period 2007-2013. On balance, it would be harder for the economy under the circumstances to repeat last year's growth performance of 3.0%, the highest rate in the post-Lehman period. In **Cyprus**, the ESI sentiment index reached a new post-Lehman high in April. The cumulative ESI index improvement in the past twelve months, the second highest in the EU-28, is a reflection of the progress of the Cypriot economy in the past three years within the economic adjustment program and predisposes for growth to accelerate to 2% in 2016, up from 1.6% in 2015.

In Serbia, the ruling party together with its political allies achieved another landslide victory in the snap elections held in late April

In **Romania**, the recently adopted debt discharge law has raised a lot of concerns to market participants, regulators, banks, rating agencies and the EU Commission. The new law, if endorsed by the Constitutional Court and implemented in this version, is expected to have a negative impact on banking sector performance and financing conditions. Romania is anticipated to stand of the pack for yet another year growing at 4.2% in 2016, up from 3.8% in 2015. Yet, growth dynamics are largely driven by domestic demand and financed by the expansionary fiscal policy at the cost of pushing government finances off consolidation track against repeated IMF and EU advice. In **Serbia**, the ruling government party which dominates the political scene –SNS- achieved another landslide victory in the snap elections held in late April. Together with its political allies, the ruling party is expected to form a wider coalition that will allow for a stronger push on the painful, yet absolutely necessary, structural reforms agenda, including speeding up of the EU accession process and going ahead with the revamping of the economy. The dynamics of the macroeconomic data releases were positive in Q1-2016, which allows for optimism that the economy may accelerate above official projections in 2016.

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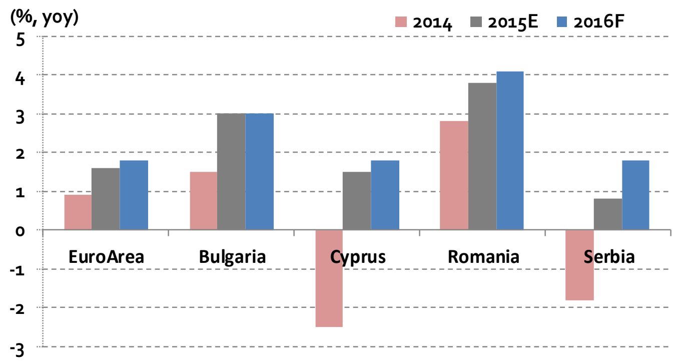
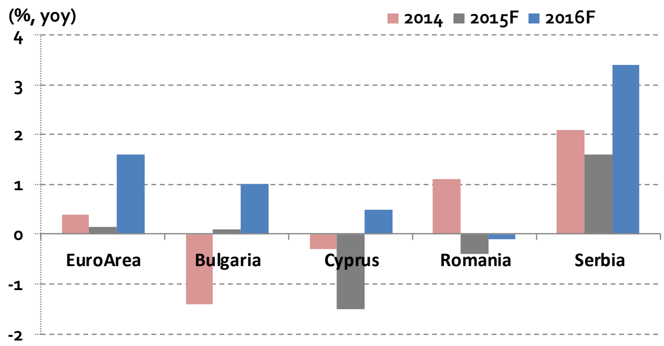
FIGURE 1: **Growth performance 2014-2016**



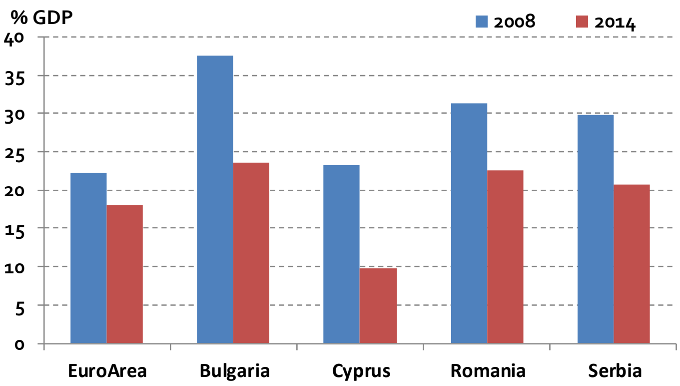
Source: Eurostat, National Authorities, Eurobank Research

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



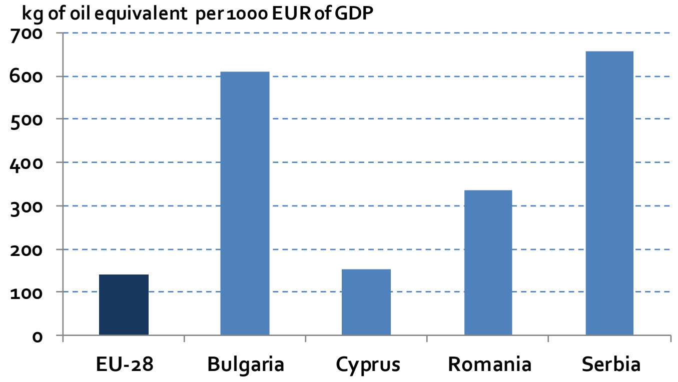
Source: Eurostat, National Authorities, Eurobank Research

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



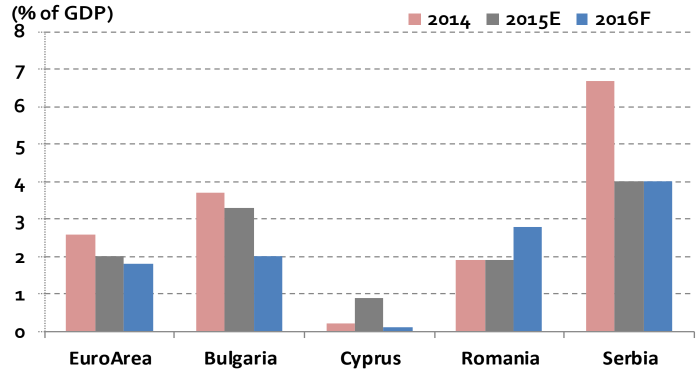
Source: IMF WEO, Eurobank Research

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



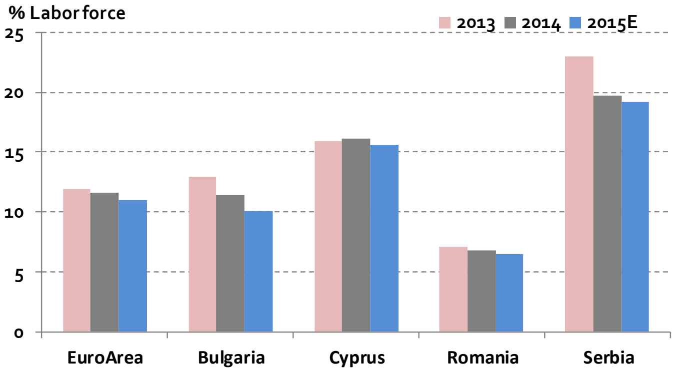
Source: Eurostat, National Authorities, Eurobank Research

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



Source: Eurostat, National Authorities, Eurobank Research

FIGURE 6: **Annual average unemployment rates 2013-2015**



Source: Eurostat, National Authorities Eurobank Research

II. Regional Market Developments & Outlook

In line with the broader EM trend, the recent rally in regional financial markets rans out of steam

Global growth jitters weigh on emerging financial markets

Following a strong rebound in March and most of April, the rally in emerging financial markets seems to have run out of steam. A resurgence of global growth jitters may be in part at play, while recently bullish positioning in EM assets proved to be overdone under a challenging fundamental backdrop. A mixed corporate earnings season has also weighed. In some cases, idiosyncratic factors have also played an important role in sentiment towards emerging markets. In this context, a recovery in commodity prices from decade lows in late January, additional signs of stabilization of the Chinese economy, the ECB's and BoJ's ultra-accommodative stance, the Fed's wait-and-see mode and a weaker US dollar, which supported the earlier rally, seem to have moved to the background.

MSCI EM gives back part of the gains registered over the last couple of months

Against this backdrop, the MSCI Emerging Markets index sold off by around 5% in early May, retracing part of the 13.4% cumulative gains registered over the prior two months. Nonetheless, the index remained near a 5-½-month peak hit in late April. In early May it stood in marginally positive territory on a year-to-date basis. In the CESEE space, domestic political jitters in Turkey and worries over the government's policies in Poland have added further downside pressure to domestic bourses, with key indices in both countries retreating to multi-week lows in early May. At the same time, Serbia's main index hit a 4-month high and Bulgaria's SOFIX rose to multi-week peaks.

CESEE currencies reversed earlier gains, regional FX broadly remains range-bound

Along similar lines, most CESEE currencies reversed earlier gains, with most recoiling from peaks hit in mid-April. Despite the recovery in global oil prices, inflation pressures in the region remain subdued, supporting the view for a continuation of ultra-accommodative monetary policies by Central Banks which does not bode well for regional currencies. Hungary's Central Bank resumed its rate-cutting cycle in March, having delivered two 15bps reductions which brought the base rate to a new historical low of 1.05% in April. Despite an upward surprise in April's consumer inflation data to 0.2%YoY and prospect for some further upside ahead, CPI is anticipated to remain below the 3% medium-term target in the months to come. Against this backdrop, the Hungarian forint hit a 4-month trough near 316/€ in early May. Meanwhile, the Turkish lira slid to a 2-month low of 2.9760/USD shortly after Prime Minister Ahmet Davutoglu announced in early May that he was stepping down from his post. The news stirred speculation over a potential snap general election this year and fanned worries over a slowing reform process, weighing on investor confidence towards the country's assets. Elsewhere, regional currencies have been little changed. The Serbian dinar has remained bound within a tight range of 122.00-123.00/€ over recent weeks as the Central Bank continues to repeatedly intervene in the FX markets on either side of the said range.

Regional government bonds under pressure on global growth worries

The majority of CESEE local-currency government bonds have rendered over the last month or so some of this year's gains on profit taking and deteriorating risk sentiment. Serbian paper has bucked the regional trend with the yield of the 10% May 2022 T-Note sliding by ca 60bps since the end of March to a new record low near 6.65% in early May. Bulgarian paper also outperformed regional peers. Both Hungarian and Polish paper lost some ground since the end of March. Despite this development, the Hungarian 10-year yield eased below the corresponding Polish for the first time in more than a decade in late April as the former received support from further monetary easing while mounting political risks weighed on the latter.

Risks lie ahead

Looking ahead, major Central Banks monetary policies and price action in commodities will likely remain a key factor in setting the tone for risk sentiment towards risky assets. Upcoming data releases from around the globe may also prove a key driver for emerging financial markets, especially in view of the recent escalation of global growth worries. In Europe, political noise lingers. The Brexit vote scheduled for June 23rd takes centre stage, while Spain is due to hold repeat general elections on June 26th after no party secured a majority in the 2015 ballot. Additionally, EU-wide bank stress tests (results to be published in early Q3) will also be closely scrutinized by market participants. On a regional level, the upcoming Q1 GDP flash estimates, general elections in Cyprus in late May and local elections in Romania in early June lure market attention in the coming days/weeks.

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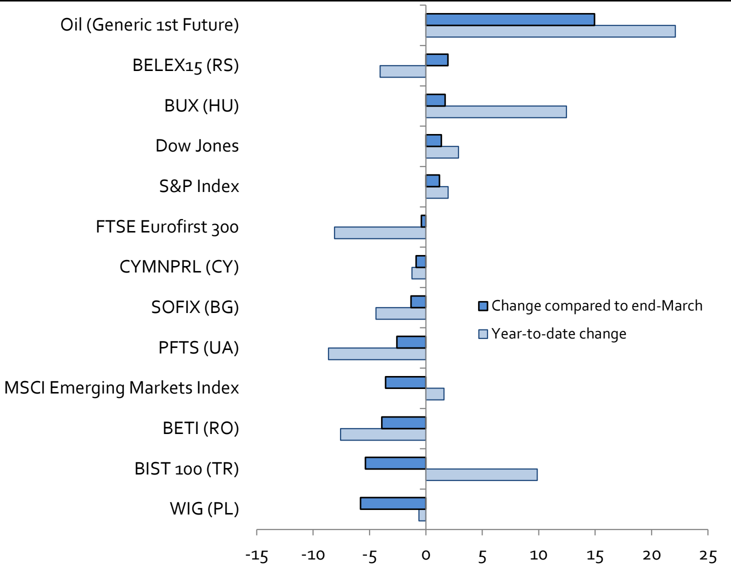
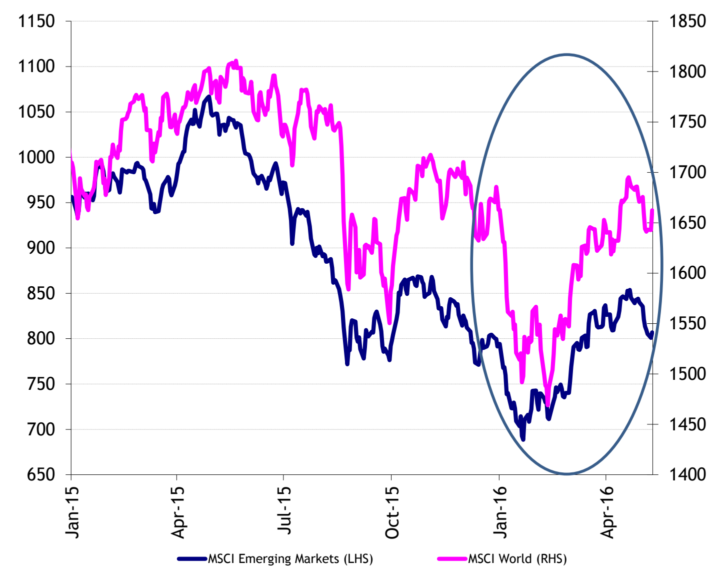
FIGURE 7: **Major world & CESEE stock markets performance (%)**



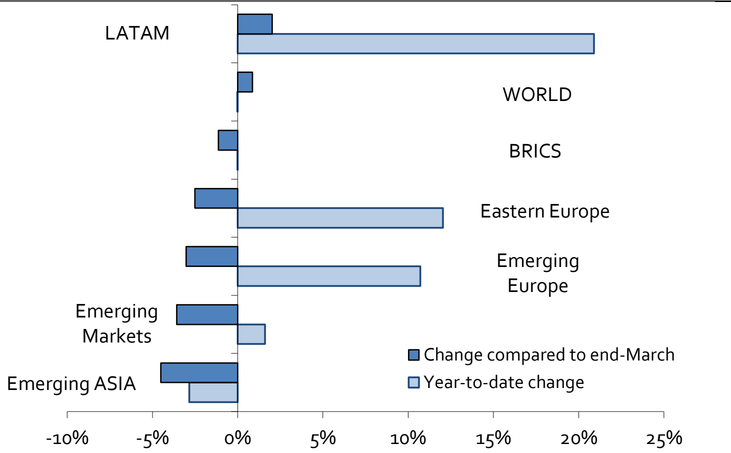
Source: Reuters, Bloomberg, Eurobank Research

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



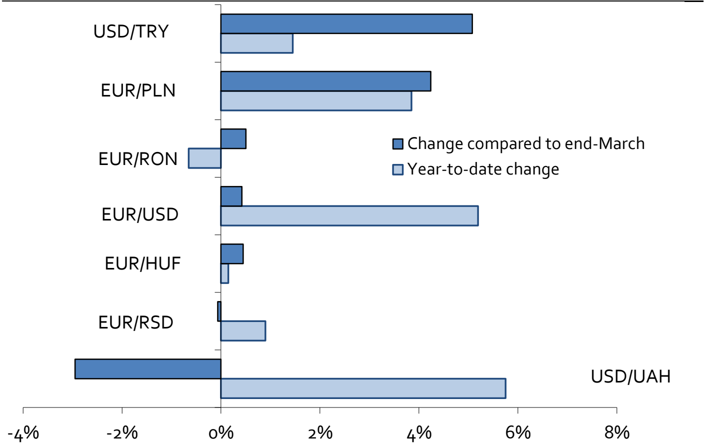
Source: Reuters, Bloomberg, Eurobank Research

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



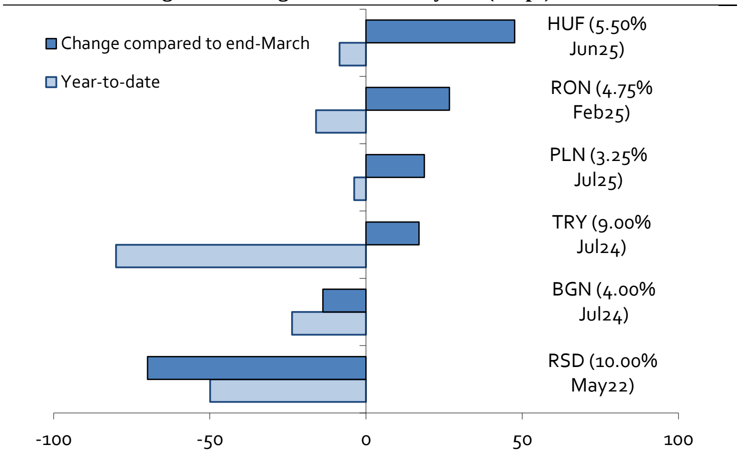
Source: Reuters, Bloomberg, Eurobank Research

FIGURE 10: **CESEE FX performance**



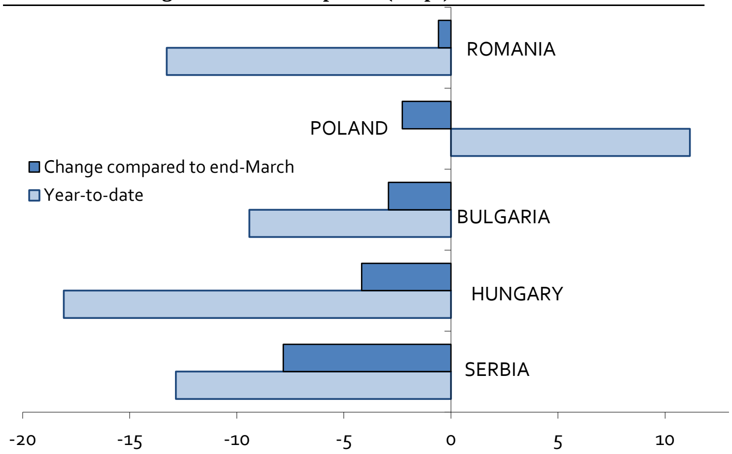
Source: Reuters, Bloomberg, Eurobank Research

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

Remain sidelined on the dinar

With April's election results confirming market expectations and supporting the view about a continuation of the policies endorsed by the prior administration, the EUR/RSD remained bound within a 122.00 -123.00 range over recent weeks. Range-trading has also been assisted by repeated Central Bank interventions. In the specter of a month, the Central bank acted several times in order to stop the dinar from depreciating further. If the pair moves in the opposite direction we reckon that the Central Bank will do the same from the other side of the range. Against this backdrop, short-term proprietary trading looks very difficult with not so grateful risk-reward ratio.

Local rates

Local currency Bulgarian paper in the 7-10 year segment to remain supported

Bulgarian local-currency government bonds in the 7-10 year segment remained well supported in April, with the 10-year benchmark yield closing more than 10bps lower on monthly basis. The auction calendar remained empty in April, while the Ministry of Finance recently announced a 10-year bond auction for BGN 100mn scheduled for May 16th. We expect strong investors interest as overall supply on the primary market for 2016 is expected lighter than in previous years.

We like entering long positions in 3Y RSD denominated T-bonds

In Serbia, we see some opportunity in fixed income, particularly for paper of 3Y tenor in RSD-denominated T-bonds. The reopened 3-year RSD government bond auction on April 28th showed undiminished demand for the said paper and pressured yields lower as a consequence. The average accepted yield eased by 58bps, settling the entire auction at 5.37%. Although significant, there is room for further declines in the yields ahead. Having said that, we aim to seal a deal at around 5.25% with the potential profit of around 75bsp. In support of the aforementioned, macroeconomic developments have provided positive surprises lately, with fiscal consolidation continuing to bear fruit and flash Q1 2016 GDP estimates showing impressive growth of 3.5%. With inflation pressures in Europe remaining well subdued, negative yields/or close to zero, are here to stay for long. Meanwhile, expectations for further Fed rate hikes this year have been scaled back.

Security	Position	Entry	Target	Stop loss	P&L (MtM+carry)
RSMFRSD	Long	5.25%	4.75%	5.50%	1.82% (MtM 0.90 + 0.92 Carry)

External debt markets

Long Eurobond 2023 T-Note recommendation is currently in the money

Bulgarian Eurobonds, outperformed in April as investors enthusiastically welcomed the new issues and rally spilled over to other maturities following a new placement with yields dropping by 15bps in the long-end of the curve. New 23's and 28's papers are currently trading 14 and 35bps lower since issuance, respectively. In terms of market opportunity, we favor the mid-segment (7 years) over long-term as we would expect further room for gains as well as lower exposure to the broad government bond sell-off taking place in Europe. High liquidity in the system and state budget surplus are expected to persist and support the market in the coming months. In this context we continue to favour our earlier long recommendation on the 2023 T-Note with remains in the money.

Security	Position	Entry	Current level	Target	Stop loss
BGARIA 2023	Long	2.06%	2.06%	1.90%	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-)

Further labor market conditions improvement

Consumer prices dipped even lower in March

Inflation printed at -0.7% MoM/-1.5% YoY in March, down from -0.3% MoM/-0.5% YoY in February, compared to +0.0% MoM/+0.0% YoY in January. As a result, average annual inflation in the past twelve months came at -0.2% YoY. Volatile food prices made the largest negative contribution both on a monthly and on an annual basis. The food component of the CPI, the one with the highest share in the consumer basket, dipped further in negative territory after recording the first negative reading in six months in February, driven by lower prices for vegetables and meat on an annual basis. Food prices came at -0.9% MoM/-1.3% YoY in March down from +0.4% MoM/-0.2% YoY in February. Driven by lower world energy prices on an annual basis, transportation prices plunged by -1.7% MoM/-10.7% YoY in March down from -3.2% MoM/-5.5% YoY in February. Looking ahead, consumer prices ought to recover in the 2H-2016, as we expect domestic demand dynamics to become healthier and deflationary pressures from the energy component to subside as a result of the normalization of global prices.

Labor market conditions improved further in the first months of 2016

Unemployment declined to 7.3% in March, down from 9.8% a year ago. The decline of unemployment in Bulgaria is the third highest in EU-28 after Cyprus and Spain. The labor market improvement has set the foundations for the recovery of consumption, more visible in the 2H-2015, that will most probably extend in 2016 as well. FY growth accelerated to +3.0% YoY in 2015, the highest growth rate since 2008, up from +1.6% in 2014. Labor intensive industries in the areas of specialized services (Information & Communication, Logistics, and Business Services) have taken the lead in job creation from traditional industries like manufacturing, retail and wholesale trade, construction. Employment expectations have remained relatively strong throughout Q4-2015 (especially in the area or retail trade), pointing to a further tightening in the labor market in the first months of 2016.

The budget execution in the first quarter of the year is heavily influenced by EU funds reimbursements of the past year
.

According to the preliminary data of the Ministry of Finance, the consolidated budget surplus came at BGN1,856mn or 2.1% of projected FY GDP in Q1-2016, compared to a budget surplus of BGN255.9mn or 0.3% of GDP in the same period last year. Total revenues expanded by +16.5% YoY in Q1-2016, after soaring by +26.7% YoY in January only, reaching 27.5% of the annual target, driven primarily by higher reimbursements for EU-funded projects' related spending. On the other hand, total expenditure declined by -4.2% YoY in Q1-2016, reaching 20.7% of the annual target, which is most probably explained by lower capital expenditures spending, given also that government spending is skewed towards the end of the year. The consolidated government deficit target in cash basis terms is set at 2.0% of GDP in 2016, down from a realized 2.9% in 2015. Although the headline number implies significant consolidation effort, the government anticipates improved revenues from EU reimbursements for spending in the past year and concession revenues from the Sofia airport, while additional buffers could emerge from higher than last year's budget- flexibility on the discretionary spending side.

Credit activity continued shrinking in Q1-2016.

Credit to the non-government sector contracted by -2.1% YoY in March 2016, down from -1.2% YoY in 2015 and -8.2% YoY in 2014. The data of 2014 reflect the dropping of assets of Corporate Commercial Bank (KTB) out of the official statistics in the aftermath of the bank run which eventually resulted in the bankruptcy of the fourth largest bank in terms of assets. Credit to the non-financial corporations declined by -2.7% YoY in March2016, down from -1.7% YoY in 2015 and -11.6% YoY in 2014. Credit to households declined by -1.5% YoY in March2016, broadly unchanged from -1.3% YoY in December 2015 and -1.6% YoY in 2014. On the other hand, non-government deposits expanded by +7.3% YoY in March, 2016 down from +10.6% YoY in 2015 but still up from +1.5% YoY in 2014. Deposits have fared strongly so far driven by increased precautionary households' savings, positive real interest rate differentials vis-à-vis the Euroarea and improved corporate sector deposits (+18.7% YoY in 2015, +10.9% YoY in March2016). Overall, credit expansion has been in negative territory for the past fourteen months constrained by both demand and supply factors. Demand for new credit has been weak but also the financial institutions have been reluctant to lend during heavy regulatory environment changes ahead of the conclusion of the ongoing asset quality review. The reform process will culminate a bottom-up stress test of banks, the results of which will be made public no later than end August 2016. The system's loans-to-deposits ratio stood at 77.7% in March, one of the lowest in the SE Europe region. This-together with the high liquid assets ratio (37.6% in February) illustrates the increased funding capacity and strong liquidity position of the banking system.

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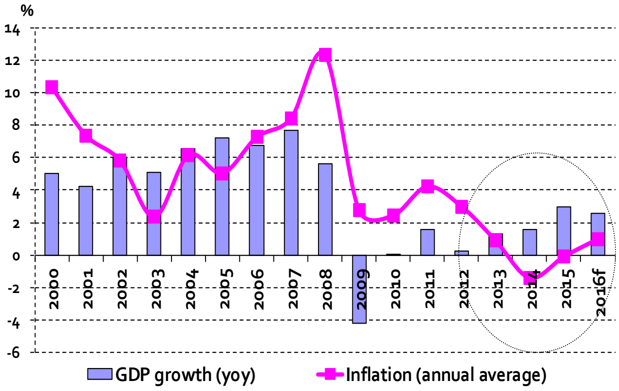
Bulgaria: Macro & Market Data				
	2014	2015	2016f	2017f
Real GDP (yoy%)	1.6	2.8	2.6	3.1
Inflation (yoy%)				
CPI (annual average)	-1.4	-0.1	1.0	1.5
CPI (end of period)	-0.9	-0.4	1.2	2.0
Fiscal Accounts (%GDP)				
General Government Balance	-3.7	-3.3	-2.0	-1.4
Gross Public Debt	27.7	26.7	29.7	31.1
Primary Balance	-3.0	-2.0	-1.1	-0.4
Labor Statistics				
Unemployment Rate (LFS, %)	11.4	9.9	9.1	8.5
Wage Growth *(total economy)*	6.8	7.5	7.0	
External Accounts				
Current Account (% GDP)	0.9	1.5	1.0	0.5
Net FDI (EUR bn)	1.3	1.5	1.5	1.5
FDI / Current Account (%)	Na	Na	Na	Na
FX Reserves (EUR bn)	16.5	20.3	21.0	22.5
Domestic Credit	**2012**	**2013**	**2014**	**2015**
Total Credit (%GDP)	72.3	72.9	67.7	57.1
Credit to Enterprises (%GDP)	44.1	43.9	38.1	34.9
Credit to Households (%GDP)	21.8	21.7	21.0	20.8
FX Credit/Total Credit (%)	63.1	59.8	54.3	50.6
Private Sector Credit (yoy)	3.0	0.2	-8.2	-1.2
Loans to Deposits (%)	99.4	92.1	84.2	78.2
Financial Markets	**Current**	**3M**	**6M**	**12M**
Policy Rate		Currency Board		
EUR/BGN	1.96	1.96	1.96	1.96

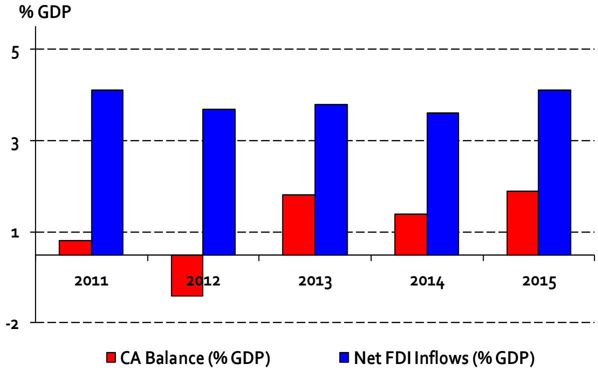
Source: National Sources, Eurostat, IMF, Eurobank Research

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



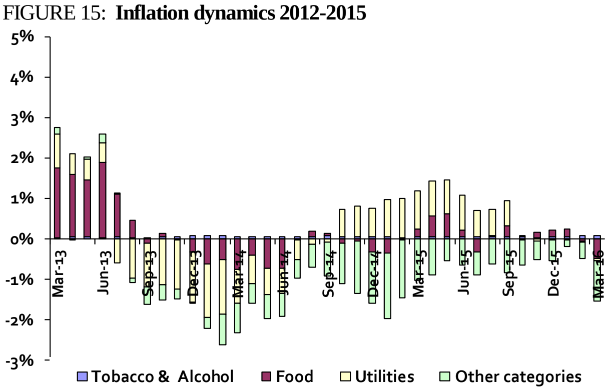
Source: National statistics, Ecowin Reuters, Eurobank Research

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



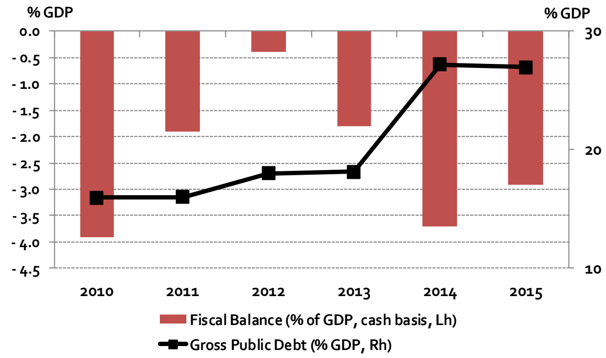
Source: National statistics, Ecowin Reuters, Eurobank Research

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+)

Economic Sentiment Index reached a new post-Lehman high in April

The ESI index in Cyprus has recorded the second highest improvement in EU-28 in the past twelve months

The Economic Sentiment Index (ESI) reached a new post-Lehman high in April. The ESI Index jumped up by 4.4 points to 113.3 in April compared to 108.9 in March. With the exception of services, which remained almost flat, all other sub-components of the index improved. The more pronounced improvement in expectations came from industry (by 6.5 points) and consumer sentiment (by 7.2 points). Overall, the ESI index has been on an improving trend in the past twelve months. In fact, the improvement recorded – a total of 10.5 points since May 2015- is the second highest in EU-28, after Luxemburg. Overall, the sentiment improvement is illustrative of the progress of the Cypriot economy in the past three years within the economic adjustment program. Cyprus has made significant adjustment progress within the program in a number of areas including, but not limited to, restoring the health of the banking sector, a complete lift of capital controls, the fixing of public finances and addressing earlier macroeconomic imbalances. Sentiment improvement is one of the key drivers of the consumption rebound taking place and feeds into output growth. In fact, consumption made the strongest contribution to growth in Q4 since Q3-2010 (+2.3ppts).

Growth is expected to gain further momentum to reach 2% in 2016

After a three year recession in 2012-2014, the economy expanded by +1.6% YoY in 2015. We anticipate growth to gain further momentum to reach 2% in 2016, above the most recent EU Commission Spring forecast of 1.7%, as lower energy prices, strong sentiment improvement, the lagged effect from Euro depreciation, the lack of additional fiscal austerity measures and a flourishing tourism sector are expected to provide more support to consumption's recovery and net exports. Still, after the prospective parliamentary elections of May, a handful of unfinished structural reforms need to progress in the areas of privatizations, public and health sectors, while addressing the challenges of a still high NPLs stock together with a still relatively high ELA exposure (€3.3bn in Feb 2016 or 18.7% of projected GDP, albeit down from €11.4bn in March2013) and maintaining high primary surpluses at the same time.

Fitch became the third sovereign rating agency to affirm its below investment grade sovereign rating for Cyprus

In April 22nd, Fitch became the third rating agency to affirm Cyprus' Republic long term rating at B+ with a positive outlook. The rating agency cited further banking sector stabilization, including a pick-up in loan restructurings, further track of economic recovery, reduction in private sector indebtness and continued fiscal adjustment among those factors that could lead to an upgrade. Despite rating agencies' aggressive upgrading in the past autumn, the sovereign rating of Cyprus is still below investment grade. Only recently, in late March, Standard and Poor's and Moody's' affirmed their respective long-term below investment grade sovereign ratings for Cyprus. Currently, the sovereign rating stands at BB-& B3 by S&P and Moody's respectively. An upgrade by 3 and 4 notches in their respective grading system would be required in order for Cypriot government bonds to get investment grade status. The next update on sovereign rating assessment of Cyprus from Moody's and S&P is scheduled for mid-July and mid-September respectively. 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 Eurosystem monetary policy operations despite the fact that they did not fulfil minimum credit rating requirements.

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

Addressing the high NPLs ratio remains a key challenge for the banking sector. The banking system-wide NPEs ratio- a more conservative asset quality EBA methodology, which inflates NPLs numbers by including restructured loans for a probation period of at least 12 months-edged up to 48.9% in February 2016, up from 45.8% in December 2015, compared to 47.8% in December 2014. The deterioration in the ratio at this point does not mirror a further rise in the non-performing facilities but rather the ongoing deleveraging which impacts the denominator. However, the ratio remains extremely high, among the highest following any recent banking crisis. On the other hand, the pace of loans' restructuring, an essential tool for the resolution of NPLs, has picked up. The amount of loans restructured has been on a continuous climbing trend, from €1bn in Q1-2015 to €1.2bn in Q2-2015, to €1.4bn in Q3-2015, further up to €2.3bn in Q4-2015 and close to €1bn in the two month period January-February 2016. As a result, a large fraction of the restructured loans falls into the 12-month probation period and are still classified in NPEs (41% in Feb2016, compared to 40% in Dec2015 vs.33% in Dec2014). On a more positive note, according to the Central Bank data, 76% of the fixed-term loans which were restructured between 1 January 2014 and 29 February 2016 abide by the new repayment schedule agreed as part of the restructuring process. The pace of restructuring is anticipated to accelerate in the coming months, now that more incentives are in place for borrowers and lenders, namely the foreclosures and insolvency framework are in full force.

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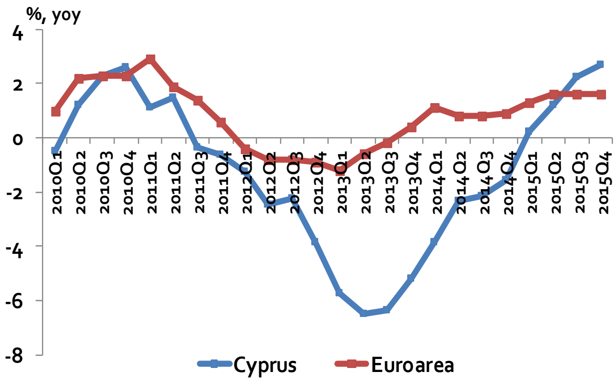
Cyprus: Macro & Market Data				
	2014	**2015f**	**2016f**	**2017f**
Real GDP (yoy%)	-2.5	1.6	2.0	2.5
Inflation (yoy%)				
HICP (annual average)	-0.3	-1.5	0.2	0.6
HICP (end of period)	-1.0	-1.4	0.6	1.3
Fiscal Accounts (%GDP)				
General Government Balance	-0.2	-1.5	0.0	0.8
Gross Public Debt	108.2	109.0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

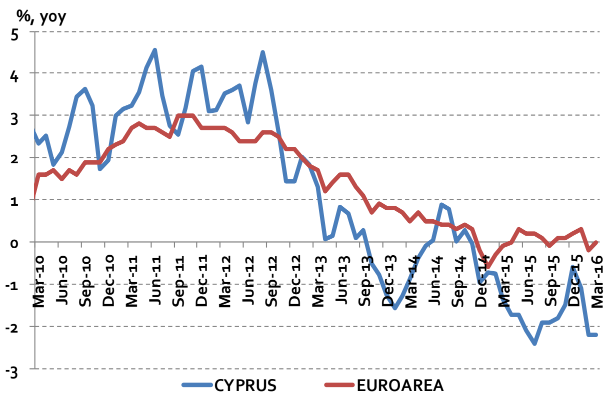
Source: National Sources, Eurostat, IMF, Eurobank Research

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



Source: Eurostat, Eurobank Research

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

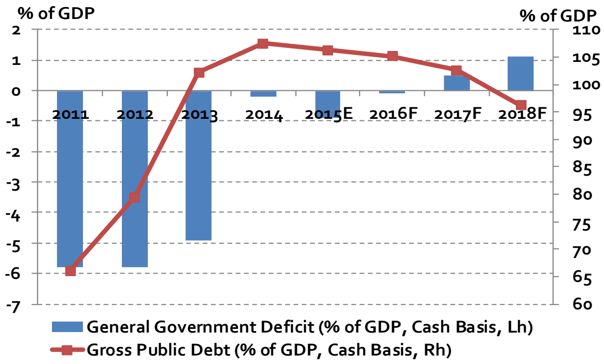


Source: Eurostat, Eurobank Research

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-)

Debt discharge law adopted by the parliament

The parliament of Romania adopted with an overwhelming majority the debt discharge law

On April 13th, the parliament of Romania adopted with an overwhelming majority (270 MPs in favor-1 MPs against) the debt discharge law ("datio in solutum"). The debt discharge law enables the borrower to walk away from the contractual agreement with the bank by transferring the ownership of the mortgage used as collateral in order to fully settle his liability. The law went through several amendments in different stages of the law making process. The final version of the law applies for both new and old consumer mortgage loans while a ceiling of €250,000 has been set at the initial size of loan value at the time of origination. The government subsidized program for the "Prima Casta" (First Home) was eventually excluded from the jurisdiction of the final version of the law. Finally, the approved law does not include a debt service-to-income threshold against Central Bank recommendations.

The new law-if implemented in this version- is expected to have a negative impact on the banking sector performance

The new law has raised a lot of concerns to market participants, regulators, banks, rating agencies and the European Commission. According to the latest NBR financial stability report, the law generates systemic risk, puts a drag on payment discipline and ultimately creates moral hazard. The NBR assessment estimates banking sector losses at RON2.8bn under the assumption of a lower loan cap at €150,000 envisaged in a previous draft of the law. More importantly, the bill threatens to derail the stabilization process of the real estate market as it will put more pressure on prices and increase the required by the banks down-payment for real estate assets. Last but not least, it will provide a disincentive for banks to extend new lending to the consumer mortgage segment thus holding back the ongoing local currency credit recovery. From a sovereign rating point of view, the adopted bill is also negative and comes on top of the accumulated fiscal and external outlook risks. Even though there is limited risk of an imminent downgrade, it will certainly weigh on the ratings agencies' decision making in next autumn. Both S&P and FITCH in their respective assessments (in March 23rd and April 8th) have already cited the retroactive implementation of the relevant legislation as a key risk to financing conditions and banking sector performance. In essence, the Constitutional Court is the only institution in a position to amend the aforementioned law now.

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

Inflation dipped to +0.1% MoM/-3.0%YoY in March compared to -0.2% MoM/-2.7% YoY in February-a new historic low. As a result, the average annual inflation eased to -1.4% YoY in March, down from -1.1% YoY in February. The print was below market expectations again (BBG survey: +0.2% MoM/-2.8% YoY). The implementation of a 4ppts headline VAT rate cut-from 24% to 20%-effective from January 1st, compounded by the food staff VAT rate cut-from 24% to 9% -effective from last June-has pushed headline inflation further into negative territory. On a monthly basis, the food component and services decreased marginally. The volatile food component of CPI declined to -0.01% MoM/-6.74% YoY in March vs. +0.34% MoM/-6.47% YoY in February. Services slowed down to -0.01% MoM/-0.47% YoY in March down from -1.14% MoM/-0.31% YoY in February. On the other hand, non-food items edged up at +0.23% MoM/-0.91% YoY in March down from -0.27% MoM/-0.54% YoY in February. The monthly spike in fuels (+1.3% MoM/-3.1% YoY) came as a result of oil prices rebound during March. Despite the energy prices slump and the negative base effects from fiscal easing, underlying inflationary pressures are rising in Romania. HICP at constant taxes came at +2.4% YoY in March vs +2.7%YoY in February, significantly higher than in its regional peers (Poland: -0.4% YoY, Hungary: +0.0% YoY, Bulgaria:-2% YoY).

NBR remained on hold on all its monetary policy instruments in early May

In May 5th, NBR maintained interest rates unchanged at 1.75% and MRRs for FX and RON denominated liabilities at 12% and 8% respectively. The decision was in line with our expectations and the almost unanimous view of analysts in Bloomberg's poll (14 out of 15). Inflation is most probably going to stay in negative territory until July and then gradually move up. According to the updated NBR report, the baseline scenario envisages the inflation rate gradually returning inside the variation target band (2.5% +/-1%) and standing in the upper half of the band at the end of the forecast horizon in Q4-2017. From a monetary policy point of view, NBR is not in a wait and see mode but ready to act on the right time. We recall that the first step in that direction would be to intervene through narrowing the interest rates' corridor by 25bps from currently ±150bps. In the previous press-conference the NBR governor, Mugur Isarescu, had called this step "monetary policy recalibration" instead of tightening. Finally, although there is no additional forward guidance with respect to the timing, our call is for such a move not to take place until the presentation of next inflation report in November when those aforementioned uncertainties would have most probably subsided.

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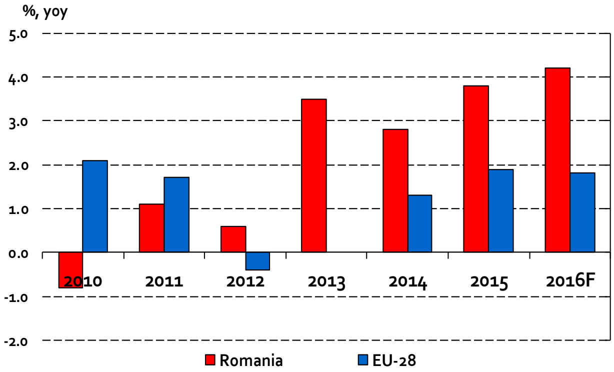
Romania: Macro & Market Data				
	2014	**2015**	**2016f**	**2017f**
Real GDP (yoy%)	2.9	3.8	4.1	3.5
Inflation (yoy%)				
CPI (annual average)	1.1	-0.6	-0.3	2.5
CPI (end of period)	0.8	-0.9	1.4	3.4
Fiscal Accounts (%GDP, Cash Basis)				
General Government Balance	-1.9	-1.9	-2.8	-3.7
Gross Public Debt (including guarantees)	39.5	39.1	40.5	42.6
Labor Statistics (annual avg,%)				
Unemployment Rate (ILO, % of labor force)	6.8	6.7	6.5	6.3
Wage Growth (total economy)	7.6	8.4	9.5	5.0
External Accounts				
Current Account (%GDP, BPM5)	-0.4	-1.1	-2.0	-2.5
Net FDI (EUR bn)	2.5	2.7	3.0	3.5
FDI / Current Account (%)	385.0	157.1	111.3	126.7
FX Reserves (EUR bn)	32.2	32.3	33.0	33.5
Domestic Credit (end of period)	**2012**	**2013**	**2014**	**2015**
Total Credit (%GDP)	52.0	47.0	44.4	43.9
Credit to Enterprises (%GDP)	20.3	18.0	15.7	15.5
Credit to Households (%GDP)	17.8	16.5	15.4	15.4
FX Credit/Total Credit (%, private)	62.5	60.9	56.2	49.3
Private Sector Credit (yoy)	1.3	-3.3	-3.1	3.0
Loans to Deposits (%)	133.9	118.4	106.3	106.6
Financial Markets	**Current**	**3M**	**6M**	**12M**
Policy Rate	1.75	1.75	1.75	2.00
EUR/RON	4.46	4.45	4.45	4.35

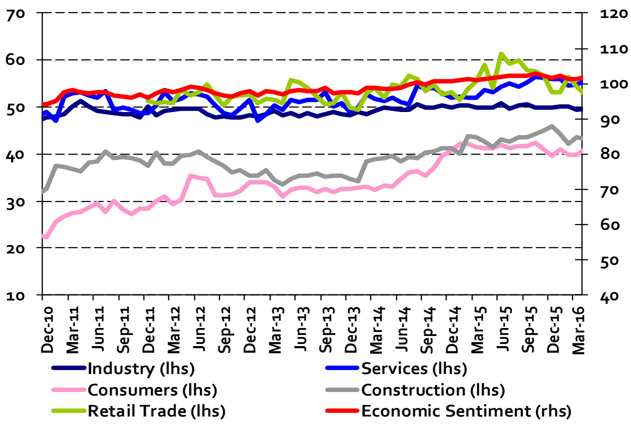
Source: National Authorities, EC, IMF, Eurobank Research

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



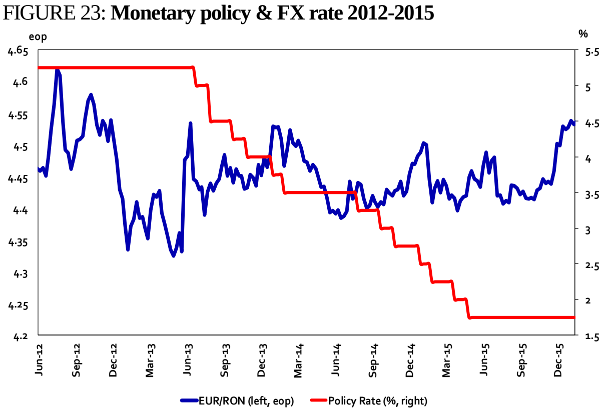
Source: Eurostat, Eurobank Research

FIGURE 22: **Sentiment indicators 2011-2016**



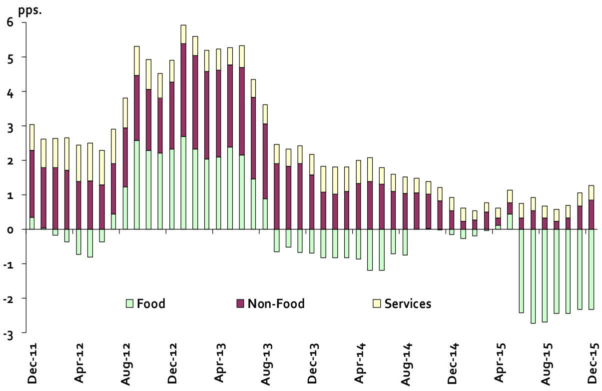
Source: Eurostat, Ecowin Reuters, Eurobank Research

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+)

SNS-led alliance secures another landslide victory on April 24th snap general elections

New government expected to be formed by early June

Serbian Prime Minister Aleksandar Vucic and the center-right conservative *Serbian Progressive Party* (SNS) won an overwhelming majority of votes, once again, in a snap general election held on April 24th, thereby securing another four years in office. In the very aftermath of the elections, Mr. Vucic pledged to form a new government by early June. According to final results announced by Republic Electoral Commission (RIK), the SNS-led alliance gained 48.3% of the ballot, almost matching the 2014 outcome. The *Socialist Party of Serbia* (SPS) - minority partner in the government - along with coalition partners (JS/ZS/KP) won nearly 11.0% of the vote and represents the most likely candidate for joining Vucic's new administration once again. The far right *Serbian Radical Party* made it back into Parliament with a strong showing of 8.1% on the resurging support for acquitted war crime suspect Vojislav Seselj. Four opposition groups also made it into the Assembly, namely, the liberal oriented newcomer *It's enough – Restart* (DJB) and *For a Just Serbia*, amassing ca. 6% each, as well as center-right *DSS/Dveri* coalition and center-left *Alliance for a Better Serbia* (SDS/LDP/LSV) led by former President Boris Tadic, with just above 5% each marginally passing the threshold of 5%.

Large number of parties that appears to have made it into Parliament suggests that the governing coalition will likely secure less seats compared to 2014 outcome

The fact that three additional parties made it into the Assembly compared to the 2014 outcome will however make Mr. Vucic's position much trickier. The larger number of parliamentary parties will drastically reduce the number of seats allocated to the Progressives. As a matter of fact, SNS ended up with just 131 MPs, falling short of the 158 seats allocated in the 2014 vote though achieving once again an absolute - albeit slight - majority in the 250-seat Parliament. In addition, out of the said 131 seats, only 97 formally belong to SNS, while the rest will be allocated to a dozen of small parties which were part of the wide *Serbia is Winning* coalition lead by the Prime Minister. This may pave the way for further additions in the new government, of at least one or maybe even two more junior partners. The SPS alliance, which secured 29 seats in Parliament, has already stated its readiness to join the new government and currently figure as the main candidate. A wider coalition is expected to strengthen the government's mandate and weaken potential disagreements from opposition parties in the way to adopting painful policies called for by the agreed 3Y Stand-By Arrangement with the IMF. In any case, the incumbent Prime Minister has already pledged to continue with the current key policies, including speeding up of the EU accession process and going ahead with the revamping of the economy, reducing the budget deficit and finally reversing the, currently upward, public debt trajectory. That said however, a larger coalition could induce certain execution risks on that agenda.

Latest macroeconomic data echo positive for domestic economic prospects

In terms of macroeconomic key data the first quarter has been quite positive. Fiscal execution came in better than expected, with an estimated consolidated shortfall of just €120m, less than a third of the forecast and a programme target of ca €300mn for Q116. The improvement is due to better than anticipated tax revenues in most major categories (VAT, excises, taxes and employment contributions), which may indicate a sustainable positive trend for the remainder of the year, and an indicator of a real economic recovery. On the expenditure side and unlike last year, the state capital spending runs on schedule. On the other hand, the lay-offs are being postponed for after the formation of the new government. As far as economic activity is concerned industrial production growth has proved robust over January-March this year, posting an average annual rate of increase of ca 10%YoY over the said period, which compares with a contraction of ca 2%YoY in Q1 2015. The improvement comes primarily on the back of improving investments, especially in the processing industry. In other news, Chinese HBIS group took over the troubled steel maker in Smederevo (the deal was sealed on April 16th) for €46mn. A giant conglomerate standing behind Smederevo warrantees long term support for the factory with 5 thousand employees and at least twice that many in related businesses. The company had been subsidized with over €100mn per year since 2012 and the sale will provide a significant relief to the state coffers.

Door open for some further, cautious, monetary easing ahead

With regards to the latest Inflation developments, CPI fell by 0.1%MoM in March, bringing the annual rate of increase to a 14-month low of 0.6%. Despite the recovery in oil prices, lower food prices brought CPI lower. Both the financial sector and businesses expect inflation to remain low and at the bottom of the NBS targeted range of (2.5%-5.5%) a year from today. In view of the renewed easing in consumer prices, it is becoming more likely that the Central Bank will slash the key policy rate by another quarter of a point in May after holding its fire since a 25bps cut in February.

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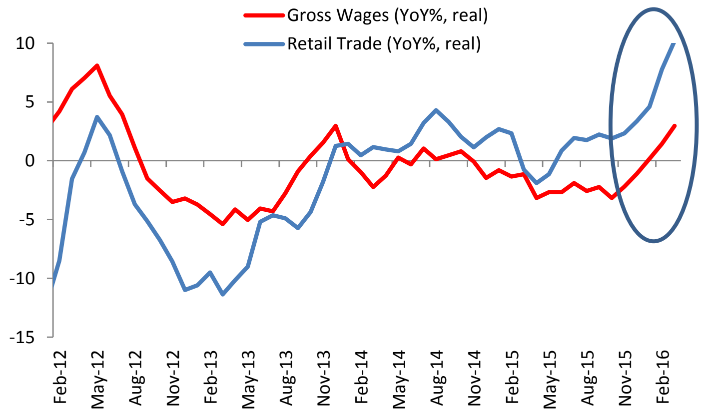
Serbia: Eurobank Forecasts				
	2014	2015	2016	2017
Real GDP (yoy%)	-1.8	0.7	1.8	2.2
Inflation (yoy%)				
HICP (annual average)	2.1	1.4	1.7	3.0
HICP (end of period)	1.7	1.5	2.5	3.5
Fiscal Accounts (%GDP)				
Consolidated Government Deficit	-6.7	-3.7	-3.7	-3.0
Gross Public Debt	72.2	75.9	78.1	78.0
Labor Statistics (%)				
Unemployment Rate (%of labor force)	19.4	17.7	17.7	17.0
Wage Growth (total economy)	2.0	0.0	0.0	0.0
External Accounts				
Current Account (% GDP)	-6.0	-4.7	-4.6	-4.3
Net FDI (EUR bn)	1.2	1.6	1.6	1.5
FDI / Current Account (%)	60.0	106.7	100.0	100.0
FX Reserves (EUR bn)	9.9	10.4	11.0	10.6
Domestic Credit	**2012**	**2013**	**2014**	**2015**
Total Credit (%GDP)	62.8	57.0	61.5	63.6
Credit to Enterprises (%GDP)	31.2	26.1	25.0	25.0
Credit to Households (%GDP)	18.2	17.4	18.7	19.6
Private Sector Credit (yoy%)	9.5	-4.8	0.5	3.2
Loans to Deposits (%)	126.9	114.1	111.8	112.6
Financial Markets	**Current**	**3M**	**6M**	**12M**
Policy Rate	4.25	4.00	4.00	4.00
EUR/RSD	123.00	122.50	123.00	125.00

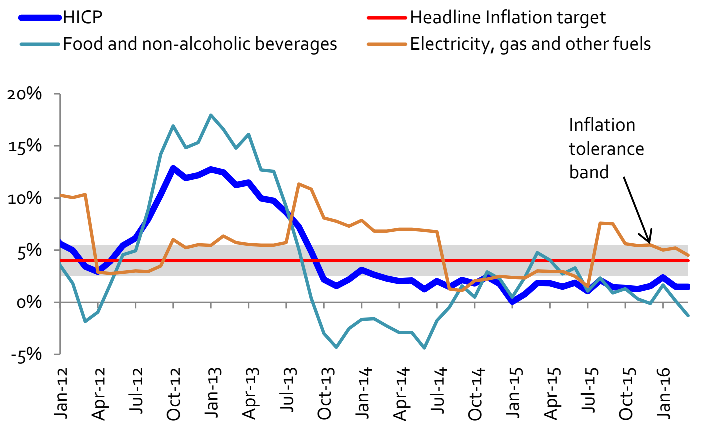
Source: National Authorities, EC, IMF, Eurobank Research

FIGURE 25: **Recovery in Private consumption and wage growth continues (3MMA)**



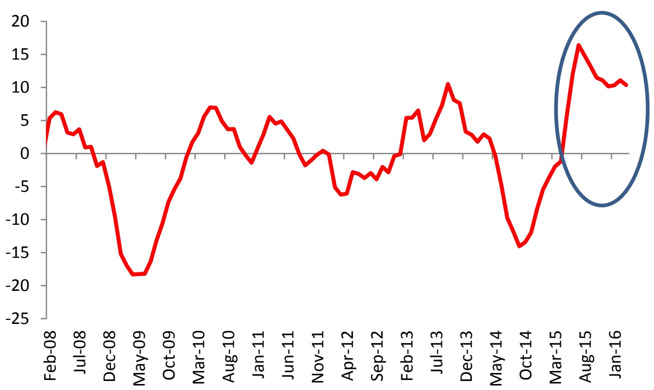
Source: National Authorities, EC, IMF, Eurobank Research

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



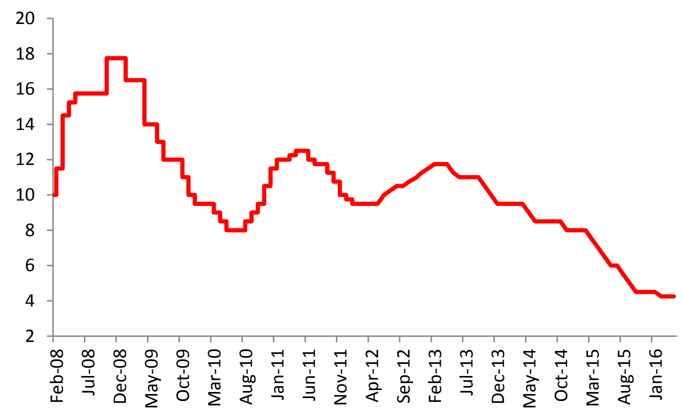
Source: National Authorities, Eurobank Research

FIGURE 27: **Growth in industrial production remains robust in Q1 2016 (3MMA YoY %)**



Source: National Authorities, EC, IMF, Eurobank Research

FIGURE 28: **NBS holds fire for second month running in view of general elections**



Source: National Authorities, EC, IMF, Eurobank Research

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