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REGIONAL ECONOMICS & MARKET STRATEGY MONTHLY

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Bulgaria | Cyprus | Romania | Serbia

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

Promising regional macroeconomic outlook in 2016

REGIONAL MACROECONOMIC DEVELOPMENTS & OUTLOOK

- Strong **GDP growth readings** in Q3 2015 confirmed
- Regional economies supported by accommodative monetary policies, **improved absorption of EU funds** and low world commodity prices
- Regional economies **winners** in the emerging market space in 2015; **promising** macroeconomic outlook in 2016

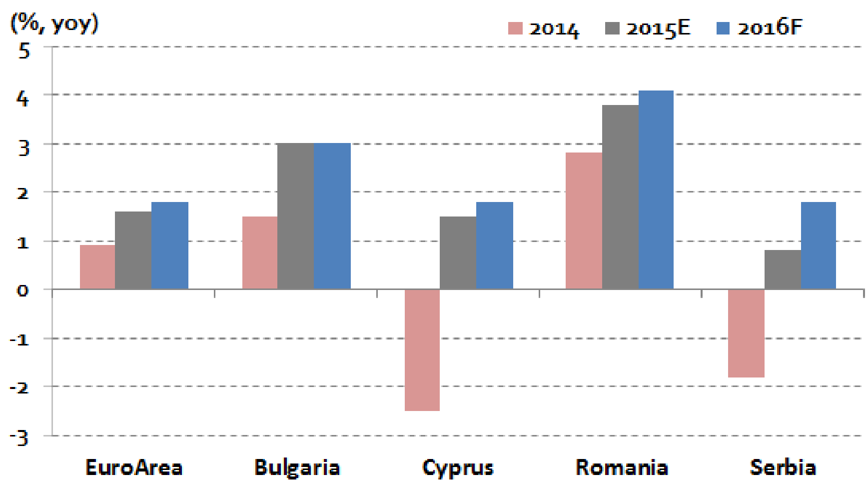
REGIONAL MARKET DEVELOPMENTS & OUTLOOK

- **Global emerging stock markets** poised to end 2015 deep in the red; **CESEE** and **regional** bourses fare better thanks to ECB's accommodative monetary policy
- **Regional currencies** under pressure so far this year on Central Bank monetary easing
- **Regional government bonds** favoured by globally subdued inflationary pressures and low interest rates

COUNTRY FOCUS

- **Bulgaria:** Strong growth performance expected to continue in 2016
- **Cyprus:** Growth to gain further momentum in 2016
- **Romania:** Fiscal stimulus supports the growth outlook of 2016
- **Serbia:** GDP growth to recover further in 2016

Regional GDP growth dynamics to accelerate in 2016



Source: Bloomberg, Reuters, National Authorities, European Commission, Eurobank Research

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I. Regional Macroeconomic Developments & Outlook

The macroeconomic outlook of the region for 2016 looks promising

From a growth point of view, it would be fair to say that 2015 has been a very good year for the region, most probably the best since 2008

The second estimates of the Q3 GDP growth released for the economies of our focus earlier in December confirmed the initial flash estimates. Growth readings, not only surprised to the upside, but were also among the strongest in the post Lehman period. Moreover, the last two sentiment surveys for October and November, albeit conducted after the terrorist attacks in Paris, suggest that the region has also started the final quarter of the year on a strong note. This assessment is corroborated by other recent high frequency indicators. From a growth point of view, it would be fair to say that 2015 has been a very good year for the region, most probably the best since 2008. Even though the emerging markets are being caught in the crossfire between world markets' fears of a Chinese economic slowdown, Fed's tightening and collapsing commodities prices since last summer, the region is looking like the safest port in the storm for the time being. Notwithstanding an increased degree of performance divergence within the broader region, the economies of our focus were among the winners.

The macroeconomic outlook of the region looks promising in 2016

The macroeconomic outlook of the region for 2016 looks promising. Lax regional monetary policies, together with sustained low world energy prices, will most likely continue providing a positive boost on the growth momentum. Economic sentiment is at its highest level since 2008, as consumers benefit from rising real wages, firmer labor markets and low inflation. Low energy costs continue to keep inflation pressures subdued, supporting real disposable incomes and provide more flexibility to household, corporate, and sovereign balance sheets. At the same time, external imbalances will most likely remain in check and the region will benefit from the ongoing recovery of the Euroarea, its main trade partner and primary generator of capital flows as well as from the relatively low direct exposure to the Chinese economy. Thus, we anticipate next year's growth dynamics for most of the economies of our focus to accelerate. On the other hand, there are a handful area-wide and individual country downside risks. First of all, political instability could resurface in some cases, having a negative impact on next year's prospects. Cyprus and Romania have already scheduled parliamentary elections in 2016, while the risk of early elections is looming for Bulgaria and Serbia. In addition, lower EU funds, as a result of the closing of the previous programing period, could also have a negative impact on public spending and investment that private initiative is called to compensate for. Last but not least, the region may be confronted with the direct and indirect implications for a number of pan-European issues such as the immigration refugees' crisis and terrorism.

The economy of Cyprus, a visible turn-around paradigm, has made strong progress with the economic adjustment programme in the past year. This has set the foundations for the economy to emerge from the three year recession in 2015

At a country level, the second reading confirmed that **Bulgaria** expanded by 2.9%YoY in Q3, the highest rate since 2011, up from a revised 2.6%YoY in the 1H-2015. Growth was once again primarily driven by net exports in Q3, complemented this time by the recovery of final consumption as a result of improved sentiment, rising real wages, modest employment gains and increased government spending related to the closing of the EU funds programming period 2007-2013. Given that Bulgaria has the highest energy consumption intensity in EU-28 and a very high exposure to Euro area via trade and capital flows, its economy will most probably continue to benefit the most from low world energy prices and the ongoing Euro area recovery. Thus, we anticipate next year's growth dynamics to remain at 3%, close to those recorded in 2015. The strong progress within the economic adjustment programme has set the foundations for the economy of **Cyprus** to accelerate to 1.8% in 2016, up from a projected 1.5% in 2015. Even though Cyprus is set to graduate successfully from the programme in March 2016, authorities will still have to demonstrate tangible results in two challenging areas in an election year in order to ensure sustainable growth in the medium-term: The high NPLs stock (NPEs at 47% in September 2015) and the politically sensitive issue of privatizing semi-government entities.

Romania is expected to be a regional outperformer in 2016 as well

Despite the political fall-out, **Romania** stood out of the pack for a second consecutive year in 2015, and is expected to be a regional outperformer in 2016 as well. Growth is expected to accelerate further to 4.1% in 2016, up from a projected 3.8% in 2015. However, growth dynamics are driven by a private consumption spending boom, fuelled by the unwarranted pro-cyclical fiscal stimulus ahead of the parliamentary elections scheduled in late 2016. Hence, the economy is driven close to, if not above, its potential growth rate at the expense of pushing government finances off consolidation track. The technocratic government solution provides some comfort against political uncertainty, but will most probably not be a game changer. Underpinned by higher investments and exports, **Serbia** is gradually trying to find its way onto a new growth path recovering from last year's catastrophic floods. Having expanded in Q3 on an annual basis for the second quarter in a row after five quarters in contraction, full year growth is projected at 0.8% in 2015 and further at 1.8% in 2016. Meanwhile, the prompt completion of the individual precautionary IMF agreement reviews allows for the implementation of structural reforms and further fiscal consolidation.

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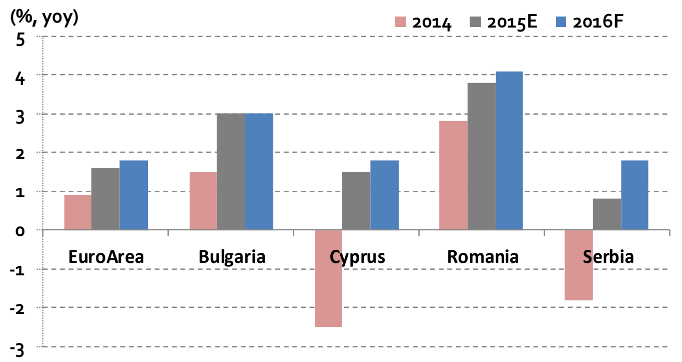
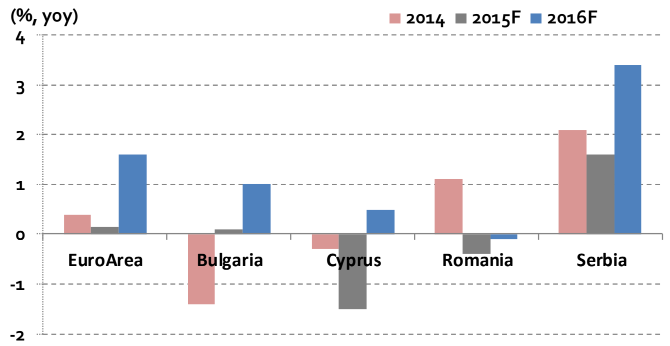
FIGURE 1: **Growth performance 2014-2016**



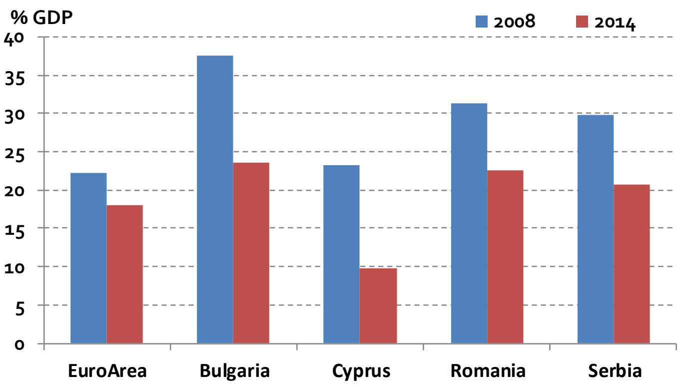
Source: Eurostat, National Authorities, Eurobank Research

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



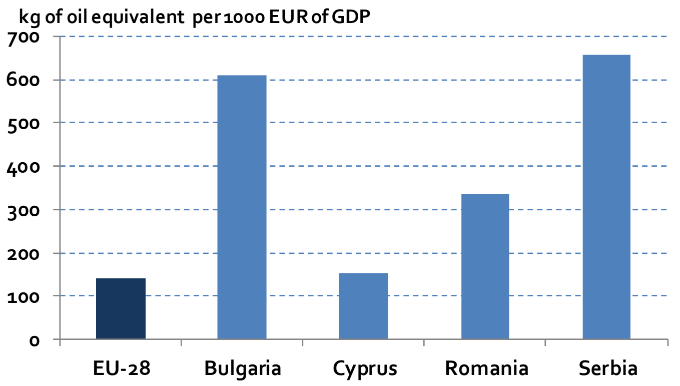
Source: Eurostat, National Authorities, Eurobank Research

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



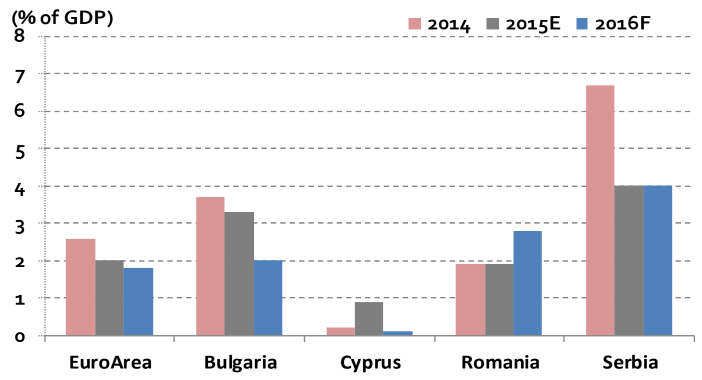
Source: IMF WEO, Eurobank Research

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



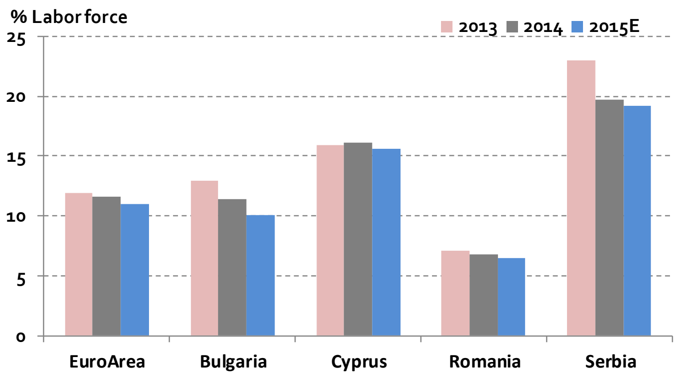
Source: Eurostat, National Authorities, Eurobank Research

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

2016 regional market outlook: Risks lie ahead

Global emerging stock markets poised to end 2015 deep in the red

With only a few days away from the New Year, global emerging stock markets appear poised to end 2015 deep in the red. Key culprits behind this downbeat performance have been expectations for the looming normalization of the Fed's monetary policy, concerns over China's slowing economic growth prospects and a slump in commodity prices that has exerted downward pressures on related shares. Idiosyncratic factors were also at play in several emerging countries. Brazil, Russia, Ukraine are amongst the most notable cases of economic recession, while (geo) political developments have taken centre stage in Poland, Romania and Turkey over recent months.

Sentiment towards risky assets soured further after the December ECB meeting, renewed drop in commodity prices

In the wake of the most recent developments that unfolded since the publication of our latest Regional Economics & Market Strategy Monthly market sentiment towards risky assets soured further. The ECB's decision in December for further monetary easing fell short of market expectations, oil prices hit new multi-year lows and the November US nonfarm payrolls report surprised to the upside adding to the prevailing market view that the Fed will deliver at its next policy meeting on December 15/16 its first rate hike since 2006. Against this backdrop, the broad MSCI Emerging Markets index hit a 4-month trough in mid-December, standing nearly 20% lower so far this year. In the CESEE region, Ukraine's PFTS leads the decline on a year-to-date basis (-38%), followed by Bulgaria's SOFIX (-16%). Hungary's BUX is the most notable outperformer this year, having rallied by ca 40%YTD, while Serbia's Belex15 (-5%YTD) and Romania's BETI (3%YTD) have also fared better compared to most EM peers, receiving some support from the ECB's accommodative monetary policy.

Regional currencies under pressure on accommodative Central Bank monetary policies; local rates markets favoured by globally subdued inflationary pressures and low interest rates

Against a backdrop of accommodative monetary policies pursued by major global as well as regional Central Banks, currencies of the countries of our interest have been largely under pressure so far this year. The Romanian leu remains close to its end-2014 levels having erased all gains recorded over the first four months of the year, following hefty NBR monetary easing, escalating domestic political noise and growing fiscal slippage risks next year. Meanwhile, the Serbian dinar has remained bound within the 119-124/EUR range amid ongoing Central Bank interventions on either side of the range. On the flipside, an environment of globally subdued inflationary pressures and low interest rates has favored local government bonds in the region. Serbian paper has led the gains with the yield of the 10.00% May 2022 government bond plunging more than 500bps to a record low near 6.7%, in late October, as the country's fiscal position is on the mend and the NBS has rendered 725bps of cuts in its key policy rate since May 2013, out of which 350bps took place this year.

Looking into 2016, significant risks lie ahead

Looking into 2016, significant risks lie ahead. From a global perspective, higher US interest rates are expected to weigh on risky assets' high yield allure and, thus, to take a toll on capital flows towards emerging markets. Additionally, concerns over the prospects of the Chinese - the world's second largest - economy are likely to remain in the forefront, while there is little to suggest an imminent and sustainable recovery in global commodity prices. From a regional point of view, fiscal slippage risks are a key concern. In the case of Romania, general elections towards the end of the year are likely to result in a hung parliament. Growing prospects of economic overheating and the potential for the Central Bank to fall behind the curve pose additional risks to the domestic economy and consequently on the country's assets.

Regional currencies likely to remain under pressure and local rate markets to retain a firm tone in the coming months

Regional currencies are likely to remain under pressure as Central Banks are likely to continue pursing accommodative monetary policies. That said, the room for further rate cuts appears limited, as inflation is anticipated to gradually return towards the official targets next year, with most regional Central Banks close to the bottom of their monetary easing cycles. In this context local government bonds are likely to retain a firm tone in the coming months, with the ECB's QE providing additional support.

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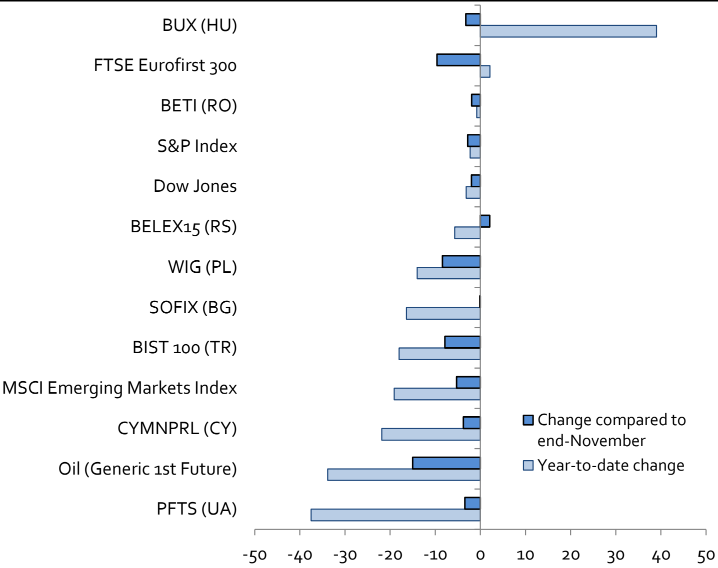
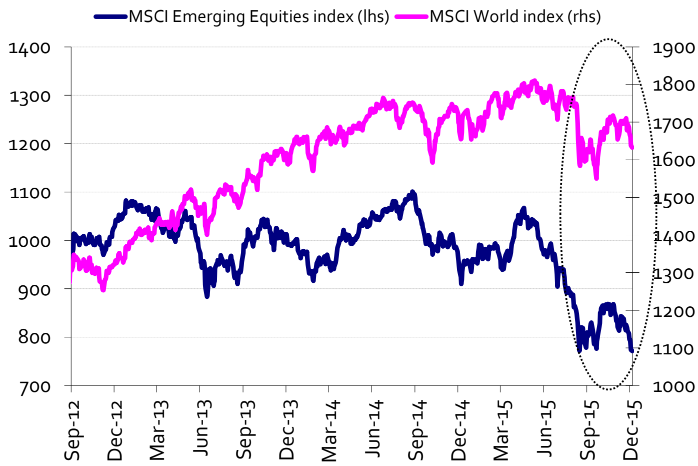
FIGURE 7: **Major world & CESEE stock markets performance (%)**



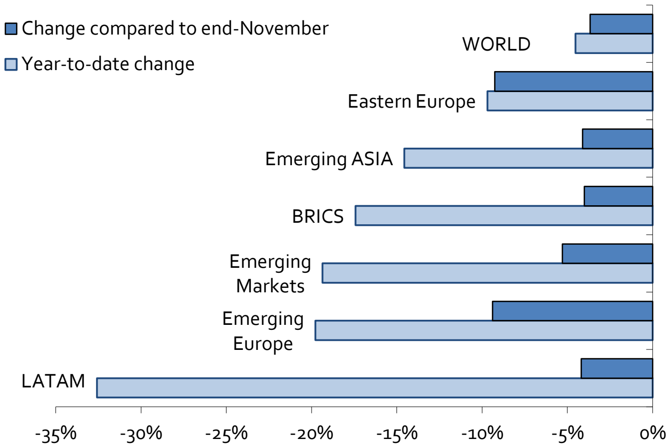
Source: Reuters, Bloomberg, Eurobank Research

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



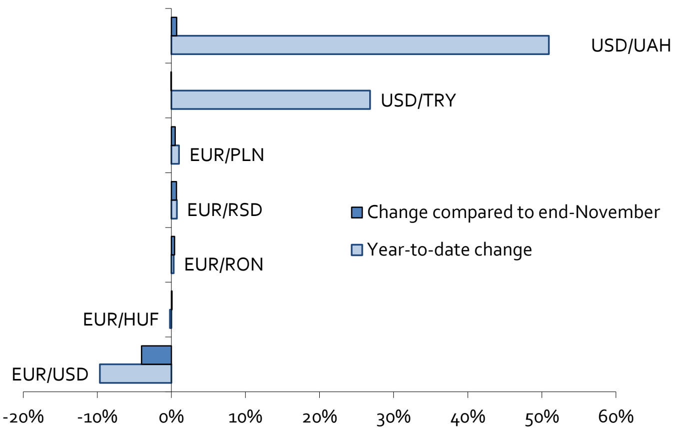
Source: Reuters, Bloomberg, Eurobank Research

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



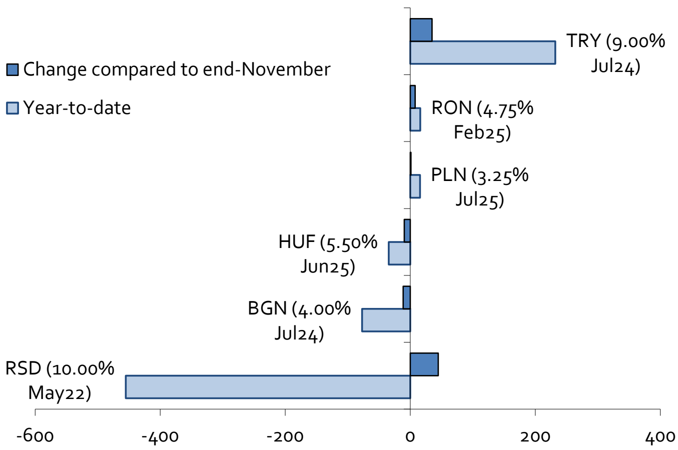
Source: Reuters, Bloomberg, Eurobank Research

FIGURE 10: **CESEE FX performance**



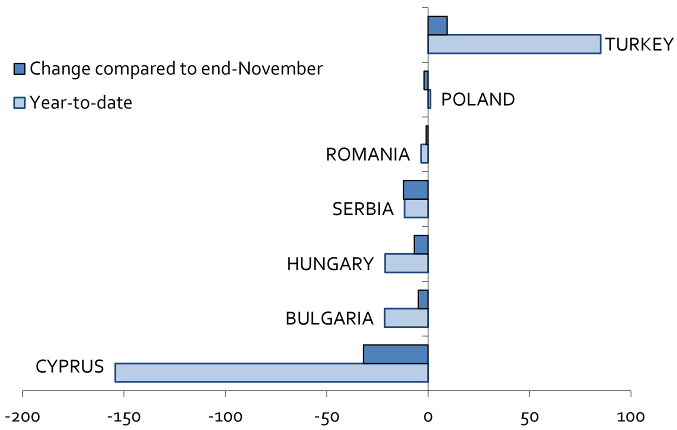
Source: Reuters, Bloomberg, Eurobank Research

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



Source: Reuters, Bloomberg, Eurobank Research

FIGURE 12: **Change in 5-Year CDS spreads (in bps)**



Source: Reuters, Bloomberg, Eurobank Research

III. Country Focus

Bulgaria (Baa2/BB+/BBB-)

Strong growth performance expected to continue in 2016

Second GDP growth estimate in Q3 confirmed at 2.9%, the strongest rate since Q2-2011.

The second estimate on the seasonally adjusted Q3 GDP reading confirmed the flash estimate of +0.7% QoQ/+2.9% YoY compared to an upwardly revised 0.6% QoQ/+2.6% YoY in Q2. As usual, the detailed national accounts data contained revisions and reallocations within the individual growth drivers' components. The largest revisions took place in the categories of inventories and net exports. In any case, final consumption appeared to have made a strong contribution to growth in Q3, switching to positive YoY rates in Q3 against negative readings recorded in 1H-2015. Final consumption expanded by +1.0%QoQ/+1.0%YoYin Q3-2015, up from +0.7%QoQ/-1.3%YoYin Q2-2015. As a result, the contribution of final consumption came at +0.8pps in Q3 up from a cumulative -3.9pps in 1H-2015. The spending recovery was mainly driven by the increase in government spending mirroring the increased EU funds absorption ahead of the closing of the programming period 2007-2013 by year end. In addition, rising real wages, improving sentiment, declining energy prices-Bulgaria has the highest energy consumption intensity in EU-28-and further modest gains in employment must have helped private spending gain more speed in Q3.

Net exports made still a hefty contribution to growth in Q3

On the negative side, investments remained in the red (-0.9%YoYin Q3 vs. -1.2%YoYin Q2) for yet another quarter, fourth in a row according to the revised data. Net exports, which were heavily revised, demonstrated a more positive picture than in the flash estimate. Exports advanced by +5.8% YoY in Q3 up from +5.2% YoY in Q2 outpacing imports by a wider margin than in the previous quarter (+3.3% YoY in Q3 down from +4.7% YoY in Q2). As a result, net exports made still a hefty contribution of +1.4 pps in Q3 compared to +4pps cumulatively in 1H-2015. In conclusion, given that there was no downward revision in the Q3 flash estimate and the government has already started implementing its decision to expand fiscally in Q4, full year real GDP growth is projected to jump to 3% in 2015 up from 1.6% in 2014.

Sentiment indicators have come out strong in the first two months of the last quarter

The Economic Sentiment Index (ESI) edged up to 105.7 in November compared to 105.6 in October driven by the improvement in the subsectors of industry and retail trade. The improvement of expectations year to November has been impressive (ESI stood at only 100.5 at the end of last year) and broad-based in all sub-categories. The readings of ESI in October and November support the idea of growth accelerating in Q4. On the other hand, high frequency indicators-such as retail sales (-1.3% YoY in October, the third consecutive negative monthly reading for the first time since Q1-2013) and industrial production (+1% YoY in October vs. +2.8% YoY in Q3 are still either in marginally positive or even red territory, disconnected from the upward economic activity trend.

The hefty consolidated government surplus of the first nine months vanished in October reflecting the increased EU-funds related spending

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According to the Ministry of Finance data, the government was still running a surplus in the first ten months of the year despite the hefty deficit recorded in October (BGN 557.6mn). As a result, the consolidated budget surplus came at BGN 63mn in Jan-Oct2015 (+0.1% of projected GDP) compared to a BGN1.8bn deficit (-2.1% of projected GDP) in the corresponding period of 2014.The increased EU funds related spending ahead of the closing of the 2007-2013 programming period was the main reason behind the fiscal performance in October. The official target for the consolidated government deficit in 2015 has been revised to 3.3% of GDP, up from an initial 3%. The updated fiscal framework 2016-2018 envisages and a more swift and ambitious fiscal consolidation for next year given that the consolidated government deficit target has been set at 2% in 2016. The FY consolidated government deficit in cash terms had widened to 3.8% of GDP in 2014, up from 1.8% in 2013, primarily reflecting spending slippages from the electoral cycle and the bail-out costs from the banking sector.

Deflation persists in the last quarter of 2015 as a result of lower world energy prices.

Inflation edged up to -0.1% mom/-0.4% yoy in November compared to +0.2% mom/-0.6% yoy in October down from -0.1% mom/+0.1% yoy in September. The category of transportation recorded the largest decline both on a monthly and an annual basis (-1.7% mom/-8.3% yoy) driven by lower world energy prices. The food component of the CPI, the one with the highest share in the consumer basket, spiked on annual basis due to seasonal effects (-0.1% mom/+0.4% yoy in November vs -0.4% mom/+0.1% yoy in October) stemming from higher prices for fruits, oil & fats and coffee. Looking ahead, inflation is set to enter and remain in a slightly positive territory for most of the months during next year, as domestic demand dynamics become healthier and the pressures from energy deflation decline as a result of some normalization of the global prices expected.

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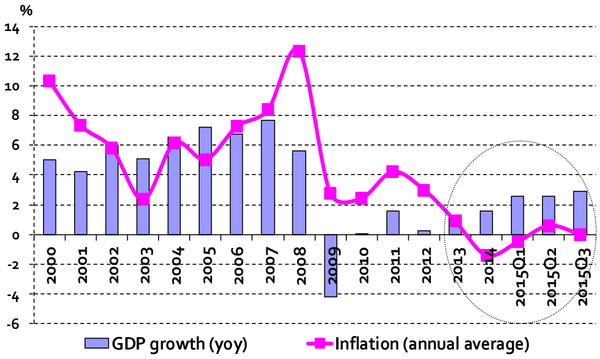
Bulgaria: Macro & Market Data				
	2013	2014	2015f	2016f
Real GDP (yoy%)	1.3	1.6	2.9	3.0
Inflation (yoy%)				
CPI (annual average)	0.9	-1.4	0.1	1.0
CPI (end of period)	-1.6	-0.9	0.0	1.2
Fiscal Accounts (%GDP)				
General Government Balance	-1.8	-3.7	-3.3	-2.0
Gross Public Debt	18.6	27.7	31.8	31.2
Primary Balance	-1.0	-3.0	-2.0	-1.0
Labor Statistics				
Unemployment Rate (LFS, %)	12.9	11.4	10.1	9.4
Wage Growth *(total economy)*	6.0	6.8	7.5	7.0
External Accounts				
Current Account (% GDP)	1.0	0.9	2.5	1.4
Net FDI (EUR bn)	1.4	1.3	1.5	1.5
FDI / Current Account (%)	Na	Na	Na	Na
FX Reserves (EUR bn)	14.4	16.5	20.0	21.5
Domestic Credit	**2012**	**2013**	**2014**	**Q1-2015**
Total Credit (%GDP)	72.3	72.9	67.7	65.9
Credit to Enterprises (%GDP)	47.7	47.7	41.8	41.1
Credit to Households (%GDP)	23.0	23.0	22.3	22.1
FX Credit/Total Credit (%)	64.0	60.9	57.0	55.9
Private Sector Credit (yoy)	3.8	0.6	-6.7	-7.5
Loans to Deposits (%)	99.4	92.1	84.2	86.4
Financial Markets	**Current**	**3M**	**6M**	**12M**
Policy Rate		Currency Board		
EUR/BGN	1.96	1.96	1.96	1.96

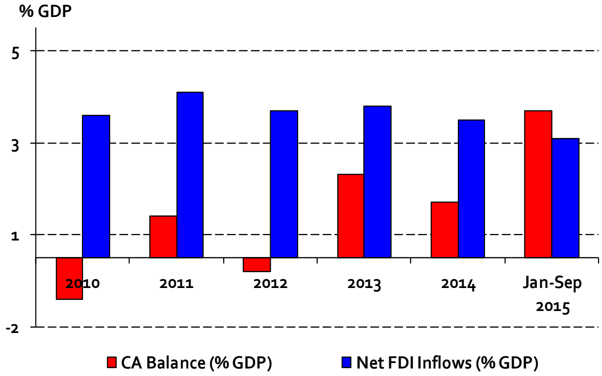
Source: National Sources, Eurostat, IMF, Eurobank Research

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



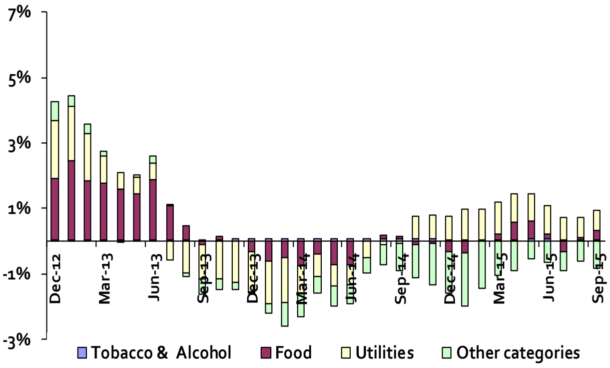
Source: National statistics, Ecowin Reuters, Eurobank Research

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



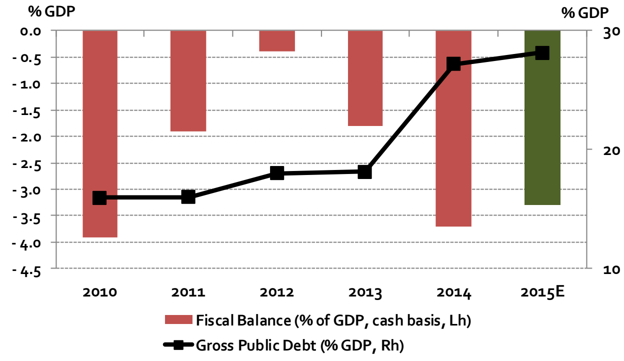
Source: National statistics, Ecowin Reuters, Eurobank Research

FIGURE 15: **Inflation dynamics 2012-2015**



Source: National statistics, Ecowin Reuters, Eurobank Research

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



Source: Eurostat, Eurobank Research

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

GDP growth to gain further momentum in 2016

Budget execution on track to meet the revised fiscal target of 2015

The general government budget surplus came at €65.3mn or 0.4% of GDP in Jan-Oct2015, down from €287.3mn or 1.7% of GDP in the same period a year ago. The general government primary surplus declined to +2.7% of GDP in Jan-Oct2015 compared to +3.8% in Jan-Oct2014.Total revenue declined by -3.8% yoy reflecting primarily the underperformance of non-tax revenue due to a lower Central Bank dividend, the loss of revenue linked to the financing of the national resolution fund for banking sector purposes, new taxation rules for e-commerce business and real estate property transactions. On the other hand, total expenditure edged up marginally by +0.2% yoy reflecting spending restraint on public consumption, wage bill and social transfers but also one-off expenses (e.g. the wind-up of Cyprus Airways). The budget execution so far creates optimism for overperformance of the revised program target of 1.3%; the latest projection of the Ministry of Finance stands close to -1%.

Cyprus has achieved impressive fiscal adjustment during the last two years.

A general government primary surplus of 2.6% of GDP in cash terms was already achieved in 2014, two years ahead of schedule vs. a primary deficit of -1.8% in 2013 and -2.9% in 2012. Accordingly, the general government deficit declined on a cash basis from -5.8% of GDP in 2012 and -4.9% of GDP in 2013 to only -0.2% of GDP in 2014, and is projected to widen modestly to -0.9% of GDP in 2015 mainly because of one-off factors. Accordingly, the public debt to GDP ratio peaked at 107.5% in 2014 and is expected to drop below 100% by 2018.

Deflationary pressures eased somehow in November, driven by higher food prices

Consumer prices, measured by HICP, edged further up to -1.5% yoy in November, up from -1.8% yoy in October, compared to +0.0% yoy in November2014. The largest declines were observed in the categories of transportation (-1.7% MoM/-4.6% YoY) and utilities (-0.4% MoM/-10.6% YoY), reflecting lower energy prices. On the other hand, the food component registered sharp increase -the highest among other categories- in November (+1% MoM/+1% YoY). Overall, deflation has continued for a third year in a row in 2015, albeit decelerated compared to last year. The average annual HICP came at -1.6% yoy in the first eleven months of the year, up from -2.1% yoy in FY2014 and -0.3% yoy in FY2013. Looking ahead, we anticipate deflation to recede further by the end of this year and finally enter a slightly positive territory in 2016 as the pressure from energy prices recedes and recovery gains further momentum.

Strong compliance with the program conditionalities allowed Cyprus to benefit from ECB's QE

The approval of the program reviews has allowed Cyprus to take advantage of the ECB's QE program. Even though the size of the expected ECB bond buy-backs seems not to exceed €500mn, it still represents a sizeable proportion of the outstanding stock (around 25%). According to the latest ECB data, the bond buy-backs had reached €385mn until the end of November. On top of the program implementation success, also acknowledged by the rating agencies, the QE has helped further to yields' compression, allowing Cyprus to make a faster return to international capital markets.

Second estimate confirmed that growth accelerated further in Q3, driven by net exports and the ongoing final consumption recovery

The flash estimate of Q3 GDP was confirmed at +0.5% QoQ/+2.2% YoY in Q3-2015, up from +0.5% QoQ/+0.6% YoY in Q2-2015 and -1.1% QoQ/-2.3% YoY in Q3-2014. The good news is that final consumption registered the second positive reading in Q3 since Q2-2012 (+0.3% yoy in Q2-2015), making a positive and meaningful contribution to growth (+1.2pps). The private consumption come-back (+2.0% yoy in Q3-2015 up from +1.6% yoy in Q2-2015, +1.35pps contribution) offset the milder contraction of public consumption (-0.9% yoy in Q3 up from-3.2% yoy in Q2-2015, -0.15pps). On the negative side, gross capital formation turned negative again in Q3 (-21.4% yoy in Q2-2015 vs. +42.7% yoy in Q1-2015, -4.6pps contribution), mirroring to a large extent the lack of inventories rebuilding in that period. In addition, net exports made a strong positive contribution, adding 5.6pps to growth. Exports accelerated further to +3.1% yoy in Q3-2015, up from +0.3% yoy in Q2-2015, while imports contracted by -5.5% yoy in Q3-2015, down from +7.0% yoy in Q2-2015. While the second quarter GDP reading confirmed the exit of the Cypriot economy from recession from a technical point of view, the third quarter predisposes that FY-2015 growth may even exceed the revised government projection for 1.5%. Looking ahead, we anticipate growth to gain further momentum in 2016 as lower energy prices, the lagged effect from Euro depreciation, the lack of additional fiscal austerity measures and a flourishing tourism sector are expected to provide more support to consumption's recovery and net exports. Even though Cyprus is set to graduate successfully from the programme in March 2016, authorities will have to deal with the challenge of a high NPLs stock (NPEs at 47% in September2015) in order to ensure sustainable growth in the medium-term.

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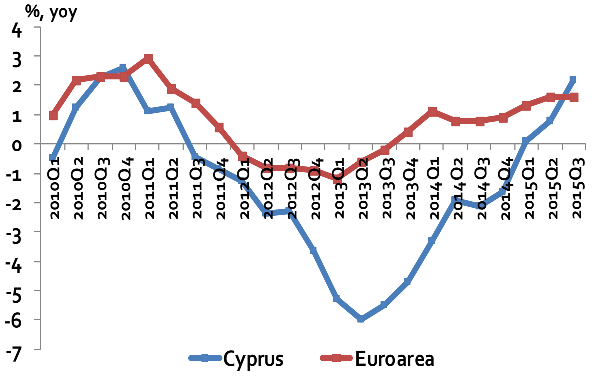
Cyprus: Macro & Market Data	2013	2014	2015f	2016f
Real GDP (yoy%)	-5.9	-2.5	1.5	1.8
Private Consumption	-5.9	0.4	1.4	1.6
Public Consumption	-4.1	-9.0	-2.1	-0.9
Gross Capital Formation *(Fixed)*	-15.2	-18.0	2.2	3.6
Exports	1.8	-0.5	1.2	1.3
Imports	-3.0	2.0	0.6	1.1
Inflation (yoy%)				
HICP (annual average)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

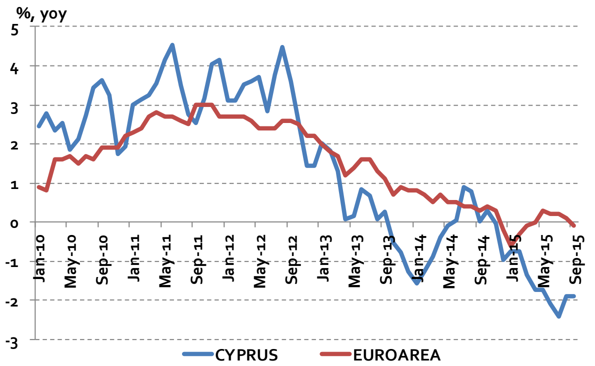
Source: National Sources, Eurostat, IMF, Eurobank Research

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



Source: Eurostat, Eurobank Research

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

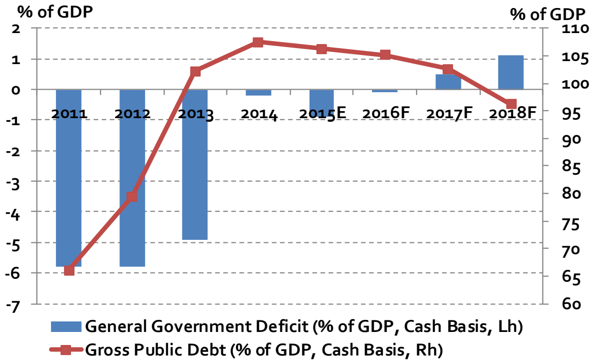


Source: Eurostat, Eurobank Research

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

Source: Bloomberg, Eurobank Research

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



Source: Ministry of Finance, Eurobank Research

Romania (Baa3/BBB-/BBB-)

Fiscal stimulus supports the growth outlook of 2016

The budget performance in the first ten months of the year implies that this year's target may be exceeded by a wider margin than previously thought

The consolidated government surplus came at RON9.0bn or 1.3% of projected GDP in the 10M-2015, up from a RON1.9bn surplus or 0.3% of GDP in the same period last year. Total revenues (27.2% of projected GDP) were still over performing the FY budget target of a 3.4% yoy increase, expanding by 7.9% yoy in the 10M-2015. Buoyant growth of VAT revenue (+11.8% yoy) and Income tax (+13.3% yoy) as a result of the consumption rally and improved tax compliance were the main drivers behind the stellar performance of revenues. These compensated partially for lower social contributions, as a result of the 5pps reduction legislated in autumn 2014, and lower property taxes. On the other hand, total expenditure (25.9% of GDP) was up by 4.0% yoy. Contained procurement related expenditure (+3.9% yoy) and lower debt servicing costs (-10.2% yoy) plus the rise in personnel expenditure (+5.4% yoy) were the main culprits on the expenditure side. Overall, the reading implies that the full year target, agreed with official lenders, a consolidated budget deficit of 1.9% of GDP in 2015, may be exceeded by a wider margin than previously thought. A large portion of public spending traditionally materializes in the last two months of the year; this in previous years translated in an enlargement of the deficit by 1.5-2% of GDP on average. Still, it is not enough to push the deficit even close to the target.

Next year's budget envisages a much higher deficit, incorporating generous wage hikes across the public sector and the amended Fiscal Code provisions

The Ministry of Finance announced the main parameters of the long-waited budget of 2016. The budget framework has been built upon the macroeconomic assumptions of a +4.1% rate of GDP growth, a Nominal GDP of RON 746.6bn and a fiscal deficit target of 2.8% of GDP in cash terms or 2.95% inESA2010 terms. The budget revenues are projected to increase by only 1.6%YoY, which is a relatively conservative forecast given the improved tax collection and the rich in consumption content of growth. In contrast, looming fiscal slippages and lower fiscal discipline ahead of the parliamentary elections in late 2016 may put budget execution at risk. The budget also incorporates the recent decisions of the parliament for generous wage hikes across the public sector employees. The public sector wage bill is expected to rise from 7.3% to 7.7% of GDP in 2016, while public investments are expected to expand from 4.7% to 5.1% of GDP, provided the public investments program is fully executed. In any case, the structural deficit is expected to reach 2.73% of GDP in 2016, off track from the 1% targeted previously in the medium-term program.

The second GDP estimate confirmed the stellar growth performance of Q3

The second estimate of the Statistical Service on the seasonally adjusted Q3 GDP reading confirmed the flash estimate of +1.4% QoQ/+ 3.6% YoY, compared to 0.0% QoQ/+3.8% YoY in Q2. Both private consumption and gross fixed capital formation posted very strong dynamics. Driven by higher disposable income, as a result of the generous VAT rate cut for food stuff and the rapid rise in real wages, private consumption jumped by +2% QoQ/+6.1% YoY in Q3, making a hefty contribution of 4pps to growth. Gross fixed capital formation expanded by -0.6% QoQ/+4.2% YoY, making a 1.1pps contribution, which was more or less offset by the negative contribution of inventories (-1.0pps). On the other hand, net exports made a negative contribution of -0.8pps, which is broadly expected as domestic demand recovery is accompanied by a recovery of imports. Had it not been for the negative contribution of the volatile agriculture sector (-1.4pps in Q3, -0.5pps in Q1-Q3), as a result of the unfavorable weather conditions, growth would have been even higher.

High frequency data point to an equally strong start in the last quarter of the year

The last quarter has started on a good foot, as shown by a strong ESI Index (sentiment and more high-frequency readings) in October and November. In addition, even though retail sales in October came out almost flat on a monthly basis (+0.7%,) they maintained the same impressive speed of +11.1% on an annual basis, expanding at the highest rate in seven years; Second, nominal wage growth accelerated further in October, factoring in the generous wage increase of 25% in the public health sector. As a result, net wages stepped up further by +2.1% MoM/+9.7% YoY in October, up from +1.1% MoM/+8.0% YoY in September.

Romania will most probably be a regional outperformer in terms of GDP dynamics next year too.

Looking ahead, we anticipate next year's GDP dynamics to remain above those of 2015. We foresee GDP growth to accelerate to 4.1% in 2016, up from a projected 3.8% in 2015, driven by improved domestic demand prospects. Sustained improvement in private consumption spending is expected, fuelled by the unwarranted pro-cyclical fiscal stimulus ahead of the parliamentary elections in late 2016, strong real wage growth dynamics, further labor market tightening, sentiment improvement, and ongoing recovery of RON credit dynamics. Net exports would most probably remain a drag on growth for a third year in a row, as domestic demand recovery boosts imports. Finally, there is room for investments to have a more positive contribution to growth thanks to improved EU funds absorption, public investments spending, plus the amended Fiscal Code tax incentives provided.

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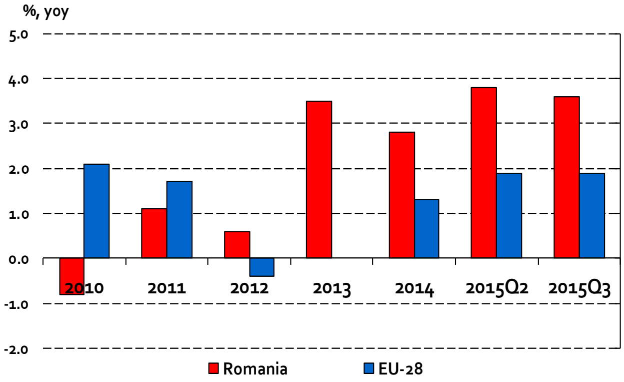
Romania: Macro & Market Data	2013	2014	2015f	2016f
Real GDP (yoy%)	3.4	2.9	3.8	4.1
Consumption	0.4	3.0	4.2	6.0
Investment	-7.9	-3.6	6.2	3.9
Exports	16.2	3.5	6.2	5.0
Imports	4.2	7.7	8.1	8.3
Inflation (yoy%)				
CPI (annual average)	4.0	1.1	-0.4	-0.1
CPI (end of period)	1.6	0.8	-1.2	1.3
Fiscal Accounts (%GDP, Cash Basis)				
General Government Balance	-2.2	-1.9	-1.9	-2.8
Gross Public Debt (including guarantees)	37.9	39.5	39.1	41.5
Labor Statistics (annual avg,%)				
Unemployment Rate (ILO, % of labor force)	7.1	6.8	6.7	6.6
Wage Growth (total economy)	4.8	5.3	7.0	6.5
External Accounts				
Current Account (%GDP, BPM5)	-0.8	-0.4	-0.7	-1.0
Net FDI (EUR bn)	2.9	2.5	3.0	3.5
FDI / Current Account (%)	250.1	385.0	272.0	211.8
FX Reserves (EUR bn)	35.4	35.5	31.0	33.0
***Domestic Credit** (end of period)*	**2012**	**2013**	**2014**	**Q2-2015**
Total Credit (%GDP)	52.0	47.0	44.4	44.3
Credit to Enterprises (%GDP)	20.3	18.0	15.7	15.5
Credit to Households (%GDP)	17.8	16.5	15.4	15.4
FX Credit/Total Credit (%, private)	62.5	60.9	56.2	52.4
Private Sector Credit (yoy)	1.3	-3.3	-3.1	2.4
Loans to Deposits (%)	133.9	118.4	106.3	106.6
Financial Markets	**Current**	**3M**	**6M**	**12M**
Policy Rate	1.75	1.75	1.75	2.00
EUR/RON	4.50	4.45	4.45	4.35

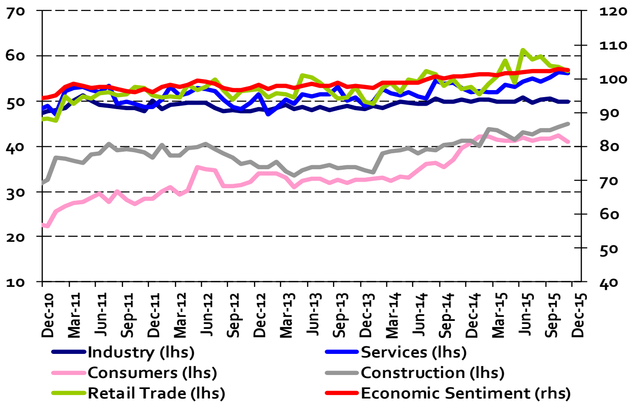
Source: National Authorities, EC, IMF, Eurobank Research

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



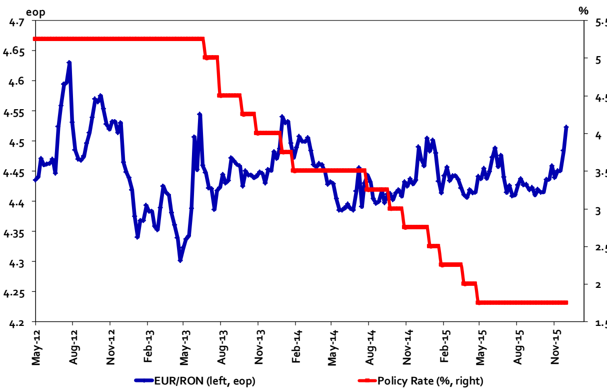
Source: Eurostat, Eurobank Research

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



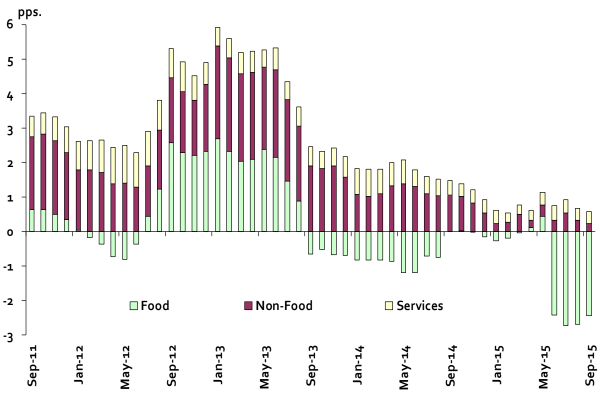
Source: Eurostat, Ecowin Reuters, Eurobank Research

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



Source: Bloomberg, Eurobank Research

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



Source: National statistics, Eurobank Research

Serbia (B1/BB-/B+)

GPD growth to recover further in 2016

Parliament adopts 2016 budget, envisioning a general government deficit of 4.0% of GDP

The Serbian Parliament adopted earlier in December the 2016 budget, envisioning a general government deficit of RSD 164bn, equivalent to €1.34bn. As a percentage of GDP, this corresponds to a deficit of 4.0%, which is well below this year's initial 5.9% deficit target and a 6.7% gap registered in 2014. Real GDP growth is assumed at 1.75%, average consumer inflation is penciled in at 2.8% and the dinar rate is seen at 122.5/EUR. The government plans to adopt further fiscal consolidation mTeasures over the next two years in accordance to the IMF programme. Among them is the reduction of subsidies in loss-making state companies and a 35k decrease in the public sector headcount in 2016, with another 5% of workforce layoffs penciled in for 2017. On the flipside, the government argues that the recent improvement in the country's fiscal position paves the way for increases in all pensions by 1.25% and 2 – 4%increases in the wages of teachers, doctors, the police and the military, in a partial reversal of the fiscal consolidation measures introduced in mid-2014, comprising of a 10% public sector wage cut and a progressive reduction of up to 25% in nominal pensions.

SBA remains on track

On the latter, the IMF appears to have given its approval on "modest pension increase in 2016, as well as some targeted wage increases", acknowledging that the good progress made so far under the country's 36-month, €1.2bn precautionary Stand-By Arrangement (SBA) provides the necessary fiscal space. With regards to the said programme it is worth noting that the two first reviews have been successfully completed, while a staff-level agreement has been reached on the third review and is pending final approval by the Fund's Executive Board tentatively scheduled for mid-December. Overall, we broadly anticipate the programme to continue as planned, though we note that challenges lie ahead. Delayed reforms of state-owned enterprises (SOEs) and the reduction in the civil servants headcount are considered as central for keeping the IMF programme on track. Regarding SOEs, preparations are underway for the sale of the country's second largest lender, Komercijalna Banka, insurance company Dunav Osiguranje and Belgrade airport along with hudreds of smaller state-owned companies. However, the government rejected only recently all the offers received for a majority stake in Telekom Srbija considering them to be too low. This was another blow to the SOEs' privatization process after the sale of the country's only steel producer, Zelezara Smederevo, collapsed earlier this year.

Central Bank holds fire ahead of December Fed meeting

With regards to the latest monetary policy developments, the National Bank of Serbia (NBS) remained on hold in December, the last MPC meeting for the year. In more detail, the Central Bank maintained the key policy rate unchanged at the current record low level of 4.5%. This marks the second consecutive MPC meeting of stable interest rates after three consecutive 50bps monthly cuts, and cumulative rate-easing of 725bps since May 2013, out of which 350bps were rendered in 2015. Serbia stands out as the second country globally so far this year, with regards to the largest size of cumulative rate cuts. Despite persistently below target inflation (CPI at 1.3%YoY in November) the market's consensus was for stable interest rates ahead of the December FOMC meeting, where the US Central Bank is anticipated to raise interest rates for the first time since 2006. In the accompanying statement, the NBS suggested that its decision was primarily based on the uncertainty surrounding the market's response over higher US interest rates, "notably capital flows towards emerging economies". The Serbian Central Bank also signaled that it preferred to retain a wait-and-see stance due to risks in the face of liquidity movements and fiscal expenditure execution in the coming months amid seasonal factors. With regards to inflation developments the Central Bank reiterated that it anticipates HICP to return within the target tolerance band (4±1.5%) in mid-2016. Albeit another 50bps rate reduction early next year cannot be ruled out, our baseline scenario is that the NBS will likely retain its wait-and-see stance in the months ahead. As the impact of past monetary easing feeds through into the domestic economy, inflation is seen gradually returning towards the target in H2 2016, while fiscal and external risks linger and further rate cuts may weigh on the country's FX and debt markets.

2016 real GPD growth to recover further

Following a 2.2%YoY real GDP growth reading in Q3 2015, the highest pace of increase since Q4 2013 as well as the 2nd consecutive quarter in the black after five quarters running in contraction, economic activity appears poised to return to an expansionary territory this year after a 1.8% contraction in 2014. The main drivers of this recovery have been favourable base effects, low international oil prices, economic reform implementation and improving foreign demand. Looking into 2016, we anticipate economic activity to further recover thanks to strengthening investments and improving demand from abroad. Although the negative impact from last year's austerity measures is likely to gradually wane in the months ahead, domestic consumption will probably remain weak in view of further planned fiscal consolidation.

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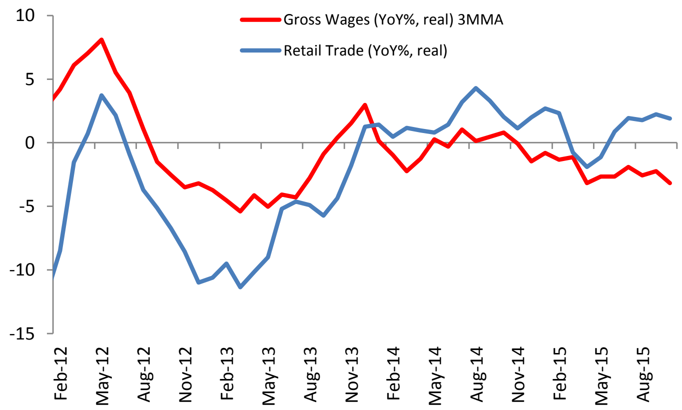
Serbia: Eurobank Forecasts				
	2013	2014	2015	2016
Real GDP (yoy%)	2.6	-1.8	0.8	1.8
Inflation (yoy%)				
HICP (annual average)	7.7	2.1	1.6	3.4
HICP (end of period)	2.2	1.8	2.5	4.1
Fiscal Accounts (%GDP)				
Consolidated Government Deficit	-5.6	-6.7	-4.0	-4.0
Gross Public Debt	61.4	72.4	76.7	78.4
Labor Statistics (%)				
Unemployment Rate (%of labor force)	23.0	19.7	19.2	19.0
Wage Growth *(total economy)*	5.7	2.0	0.0	0.0
External Accounts				
Current Account (% GDP)	-6.1	-6.0	-4.7	-4.6
Net FDI (EUR bn)	1.2	1.2	1.3	1.3
FDI / Current Account (%)	57.1	60.0	86.7	83.9
FX Reserves (EUR bn)	11.2	9.9	10.8	11.4
Domestic Credit	**2011**	**2012**	**2013**	**2014**
Total Credit (%GDP)	58.3	62.8	57.0	61.5
Credit to Enterprises (%GDP)	29.9	31.2	26.1	25.0
Credit to Households (%GDP)	17.7	18.2	17.4	18.7
Private Sector Credit (yoy%)	5.7	9.5	-4.8	0.5
Loans to Deposits (%)	137.6	141.3	132.6	130.6
Financial Markets	**Current**	**3M**	**6M**	**12M**
Policy Rate	4.50	4.50	4.50	4.50
EUR/RSD	122.00	122.50	123.00	124.00

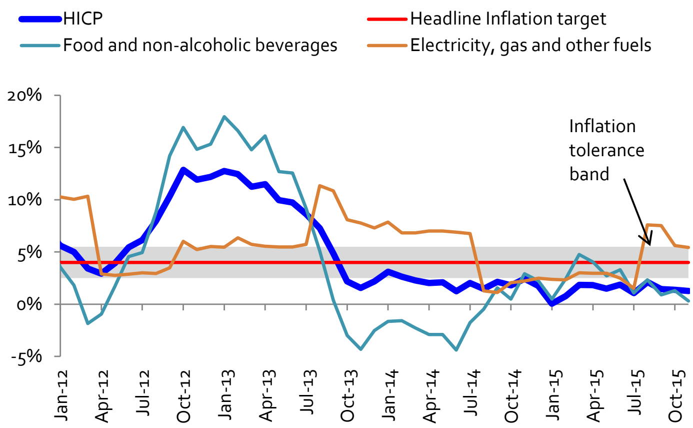
Source: National Authorities, EC, IMF, Eurobank Research

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



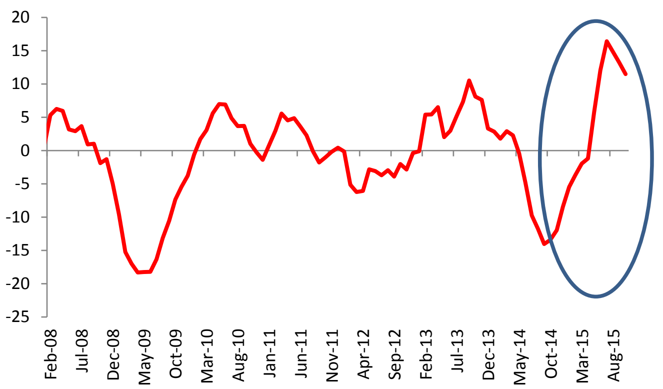
Source: National Authorities, EC, IMF, Eurobank Research

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



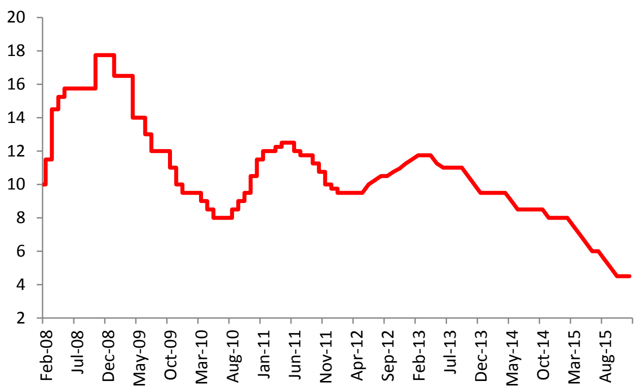
Source: National Authorities, Eurobank Research

FIGURE 27: **Industrial production recovery continues (3MMA YoY %)**



Source: National Authorities, EC, IMF, Eurobank Research

FIGURE 28: **NBS adopts a wait and see stance ahead of the FOMC**



Source: National Authorities, EC, IMF, Eurobank Research

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