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REGIONAL ECONOMICS & MARKET STRATEGY MONTHLY

March 2016

Bulgaria | Cyprus | Romania | Serbia

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

Regional assets favored in March by ECB measures, scaled back expectations for Fed rate hikes

REGIONAL MACROECONOMIC DEVELOPMENTS & OUTLOOK

- **Regional prospects** in 2016 remain **on track** against a fragile global macro environment
- **Sustained low world energy prices** provide a positive, albeit probably smaller than last year, boost on **growth momentum** in 2016
- **Economic sentiment** and **high frequency releases** in the region so far point to lower **manufacturing** confidence yet **consumer** related data are still holding up well

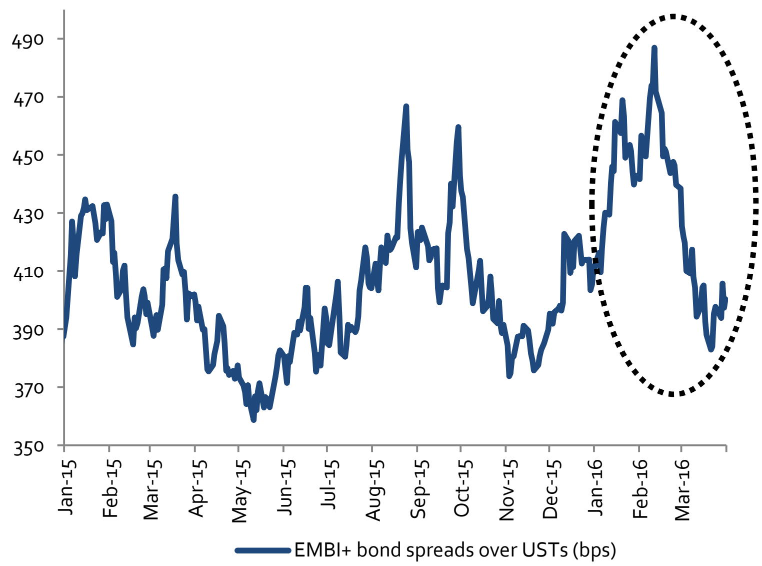
REGIONAL MARKET DEVELOPMENTS & OUTLOOK

- **Global risk sentiment improves in March** on ECB measures, scaled back expectations for Fed rate hikes
- **Regional bourses** trail the broader rally Emerging Markets rally
- **Regional currencies retain a firm tone** amid ECB stimulus and healthy growth prospects
- **Government bonds in the region extend gains** on ECB action, Central Bank accommodative monetary policies

COUNTRY FOCUS

- **Bulgaria:** Successful come-back to the international markets
- **Cyprus:** Exit from the economic adjustment program finalized
- **Romania:** Rising fiscal risks
- **Serbia:** Upcoming general elections on April 24th take centre stage

Spreads over USTs on the EMBI + index tighten sharply in March, reflecting improving global risk sentiment



Source: Bloomberg, Eurobank Research

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I. Regional Macroeconomic Developments & Outlook

Regional prospects of 2016 are still on track against a fragile global macro environment

Bold ECB stimulus package together with a flurry of macro data from US, China and some rebound in the oil price helped soothe concerns but the global picture remains fragile

The ECB's bold stimulus package, the main event of the past month, exceeded market expectations as far as the volume of QE is concerned, thus reducing, albeit not minimizing, downside risks to EA growth. Thus, a downgrade in the growth prospects of the Euroarea –the main trade partner and primary generator of capital flows for the region- has not been averted in March. The Chinese macro data releases have been mixed but more consistent with a gradual slowdown instead of a hard landing. Negative spillovers from the Chinese growth slowdown via the commodity markets continue to pose a serious problem for commodity producers in the EM space. Finally, some improvement in the US macro data has helped reduce recession fears while the US Fed is now seen at a wait and see mood until at least 2H. Despite the recent rally in the international markets, concerns about a higher than envisaged before slowdown in the global economic outlook remain and have put the growth forecasts for a number of economies in question. Against this unfavorable external backdrop, the region's prospects in 2016 have remained relatively unscathed.

The sentiment and high frequency data coming out for the region in Q1-2016 point to somehow lower manufacturing confidence and export orders, yet consumer related data and confidence are holding up relatively well

A number of national statistics offices across the region confirmed earlier this month their previous flash estimates of GDP growth for Q4-2015. Among them, Bulgaria, Romania, Cyprus and, earlier this month, Serbia published second estimates that confirm our earlier FY forecasts and serve as a reminder that there are few winners' economies in the EM space. Domestic demand has been the main driver behind growth in Q4 in most cases. Lax monetary policies together with low world energy prices continue to provide a positive boost on the growth momentum. Although this boost is destined to eventually fade away as energy prices normalize, it is poised to carry on in 2016 as well; low energy costs keep inflation pressures subdued, supporting real disposable incomes and providing more flexibility to household, corporate, and sovereign balance sheets. The economic sentiment data published in March were overall a bit better for the region compared to February. For Q1-2016 as a whole, the indicator has retrenched to lower levels compared to 2H-2015 in some countries, including Bulgaria and Romania, with the exception of Cyprus, where the indicator stands at its highest level since Q4-2008. While latest readings point to overall lower manufacturing confidence, consumer sentiment, services and retail trade are still relatively strong as consumers continue to benefit from rising real wages, firmer labor markets and low inflation.

Bulgaria made a successful come-back to the international markets in March meeting comfortably the government financing requirement for the full year and strengthening the fiscal reserve

On a country level, **Bulgaria** made a successful come-back to the international markets in March issuing approximately €2bn of Eurobonds in a dual tranche, meeting comfortably the government financing requirement for the full year and strengthening the fiscal reserve. The economy expanded by 3.0% in 2015, the highest rate in the post-Lehman period, driven by net exports and EU funds-related government spending. The external sector benefits the most from the world energy prices decline, the high exposure to the EA, the main trade partner of the country, increases the vulnerability of the country in the case of an incipient EA downturn. On the negative side, government spending after the closing of the previous EU funds programming period 2007-2013 is expected to have peaked in 2015. Having emerged from a three year recession in 2012-2014, **Cyprus** is expected to expand by 2.0% YoY in 2016 vs 1.6% YoY in 2015, driven by the ongoing consumption recovery. Even though the conditionality of the last program review with respect to the corporatization of CYTA was not finally met, Cyprus graduated successfully from the economic adjustment program at the end of March.

The expansionary fiscal policy followed in Romania ahead of the parliamentary elections in late 2016 is pushing government finances off consolidation track against repeated IMF and EU advice

Romania is anticipated to stand of the pack for yet another year growing at 4.1% in 2016, up from 3.7% in 2015. However, growth dynamics are largely driven by domestic demand and financed by the expansionary fiscal policy at the expense of pushing government finances off consolidation track against repeated IMF and EU advice. Despite the continuous energy prices slump and the negative base effects from fiscal easing, inflationary pressures in Romania are building faster than in its regional peers, which could also translate into earlier than expected action in the monetary policy front. Driven by improved investments and a timid recovery in consumption, **Serbia** will most probably step up to 1.8% in 2016 vs. 0.8% in 2015.The economy is gradually trying to find its way onto a new growth path while not having recovered fully from the catastrophic floods in spring 2014. In the run up to early parliamentary elections in late April, the precautionary IMF agreement is on track, allowing for further fiscal consolidation, but a stronger push for structural reform is still missing.

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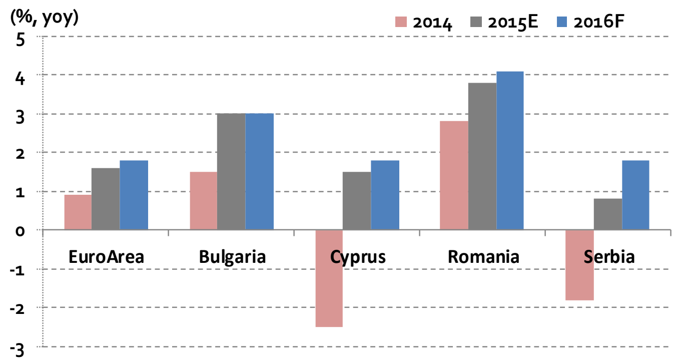
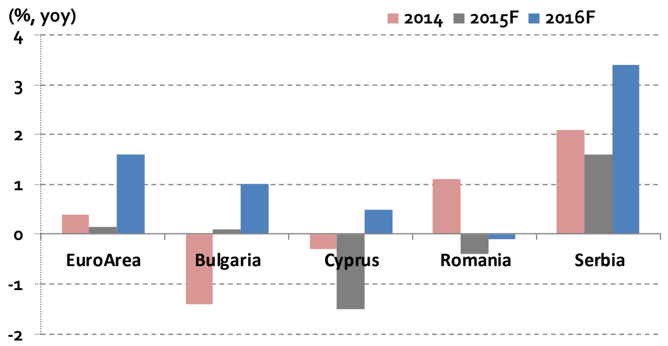
FIGURE 1: **Growth performance 2014-2016**



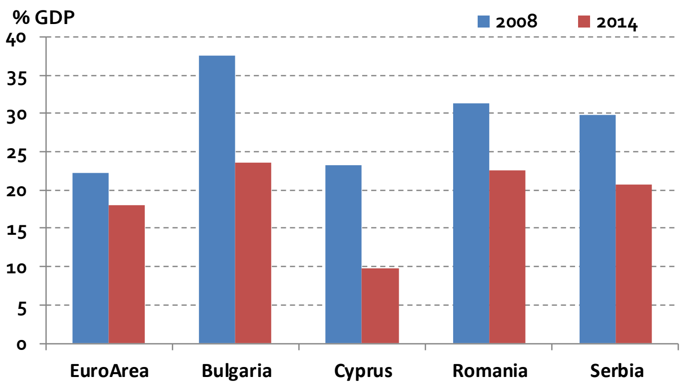
Source: Eurostat, National Authorities, Eurobank Research

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



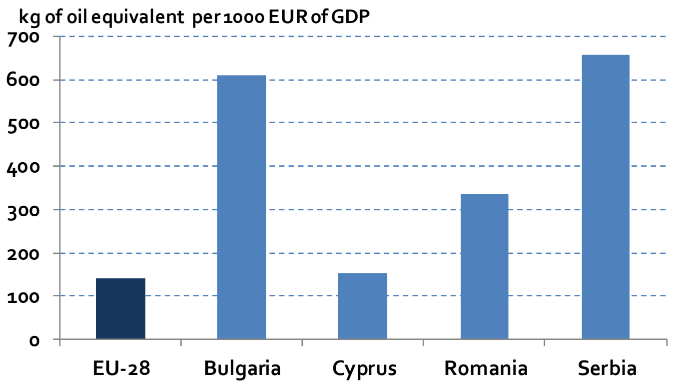
Source: Eurostat, National Authorities, Eurobank Research

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



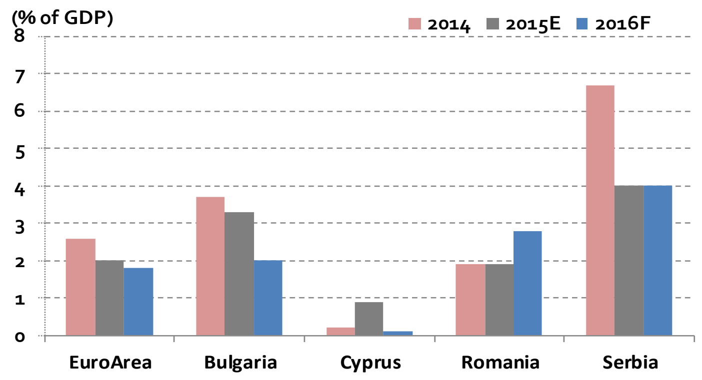
Source: IMF WEO, Eurobank Research

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



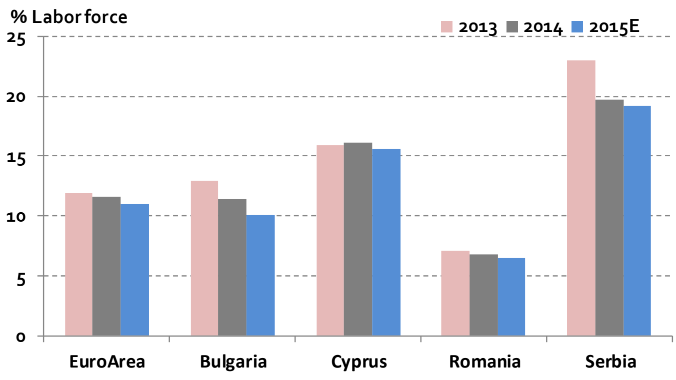
Source: Eurostat, National Authorities, Eurobank Research

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



Source: Eurostat, National Authorities, Eurobank Research

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



Source: Eurostat, National Authorities Eurobank Research

II. Regional Market Developments & Outlook

Global risk sentiment improves in March on ECB measures, scaled back expectations for Fed rate hikes

Emerging financial markets staged a strong recovery in March

Emerging financial markets staged a strong recovery in March, following a torrid start to the year. Exogenous factors were most at play. The ECB announced at its monetary policy meeting on March 10 a bold package of monetary easing measures aiming to boost domestic economic activity and counteract heightened risks on its price stability objective. Among them were a cut in all key interest rates, an increase in the amount as well as in the perimeter of eligibility of investment grade euro-denominated bonds issued by non-bank corporations in the monthly QE purchases and the launch of a new series of four targeted longer-term refinancing operations (LTRO II). A significant scale-back of expectations for the Fed's rate tightening path ahead also buoyed risky assets. Following the March FOMC meeting and Fed Chair Yellen's dovish comments, fed fund futures assigned a slightly higher than 50% probability for a rate hike by December 2016, well below nearly 80% priced in the middle of the month. A recovery in commodity prices since mid-February has also favored global risk sentiment.

MSCI EM index rallied in March, fully erasing its earlier year-to-date losses

Against this backdrop, the MSCI Emerging Markets index finished at 4-month highs in March. The index entered a so-called bull market having bounced by 22% from a 6 ½ year low, hit in late January. Snapping a 4-month falling streak and marking the highest monthly advance (+13%) since May 2009, it fully erased its earlier year-to-date losses and registered its best quarterly performance (+5.4%) since mid-2014 in Q1 2016. Key commodity producers benefited the most from recovering commodity prices. In this context, the LATAM sub-index led the gains with a 20% jump. Emerging Europe followed suit (+16%) favored by the improvement in global risk sentiment, comparably healthier economic growth prospects, ECB stimulus support and broadly accommodative Central Bank monetary policies.

Regional currencies retain a firm tone amid ECB stimulus and healthy growth prospects

Most EM currencies also firmed in March, partly mirroring the weakening of the US dollar. From a broader EM space perspective, the Russian rubble, the Brazilian real and the Colombian peso outperformed thanks to the stabilization in commodity prices and the significant rally in oil over the last month or so. On a CESEE as well as on a regional level, most currencies retained a firm tone on the back of ECB stimulus action and healthy growth prospects in the CESEE space. The Romanian leu was little changed on a monthly basis at the end of March, remaining near a multi-month peak hit a few weeks earlier. In more detail, the EUR/RON hovered around levels of 4.4670 on settlement of March 31, standing close to a 4-month trough near 4.4460 hit early in the month as the Central Bank adopted a hawkish tone. Notably, the National Bank of Romania is among the exceptions in the region as well as in the broader EM space where accommodative monetary policies prevail, as it appears to try to counterbalance the impact of fiscal slippage risks and a consumption boom in the domestic economy. Deflationary pressures remain primarily driven by temporary factors, such as VAT rate cuts, and barring their impact CPI has already entered the target band. The Serbian dinar firmed modestly in March, with repeated Central Bank interventions in the FX markets putting a lid on depreciation pressures on the RSD. Domestic seasonal factors, such as increased hard currency demand from energy importers as well as political risks ahead of April's general elections, and the global financial markets turbulence over the first couple of months of 2016 were mostly behind the dinar's weakening earlier this year. However, after hitting a record peak near 123.70 in late February depreciation pressures on the currency appear to have somewhat abated. The upward revision by Moody's to positive from stable on the country's sovereign credit rating outlook on March 18 also favored the dinar over the last couple of weeks.

Government bonds extend gains on ECB action, CB accommodative monetary policies

CESEE local-currency government bonds extended their recent gains in March. ECB monetary policy action, subdued inflationary pressures globally and accommodative Central Bank monetary policies all boded in favour of further upside in sovereign debt. Reflecting the improvement in global risk sentiment, external sovereign debt spreads over USTs, on the EMBI+ index, narrowed by ca 40bps to around 400bps, currently standing at their tightest level since November 2015.

Serbia's snap general elections take center stage in the region in April

Looking into April, Serbia's snap general elections take center stage in the region. On an international level, volatility in commodity prices, and especially oil, will likely continue to dominate the near term performance of emerging financial markets. In this context, the outcome of the OPEC April 17 meeting is worth watching. With no imminent policy action awaited from the ECB or the FOMC, focus now turns to upcoming data releases from both sides of the Atlantic. Additional risks continue to lie in the face of renewed global growth concerns, China-related jitters, Brexit as well as on a potential re-ignition of geopolitical tensions.

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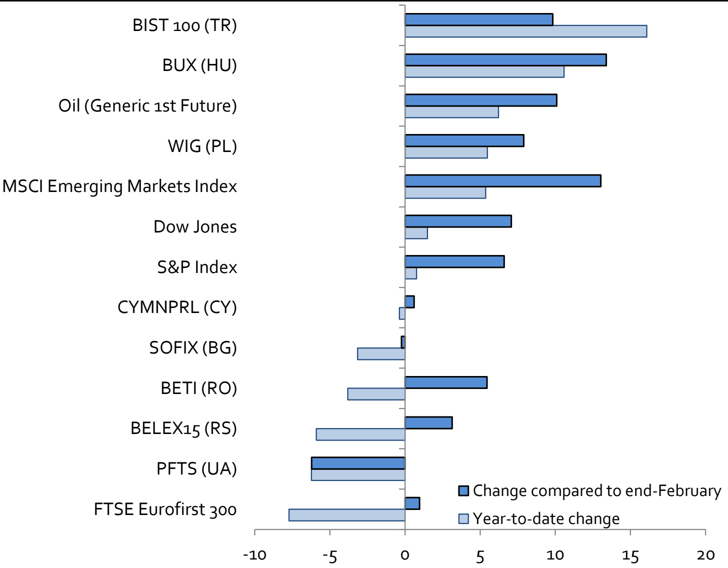
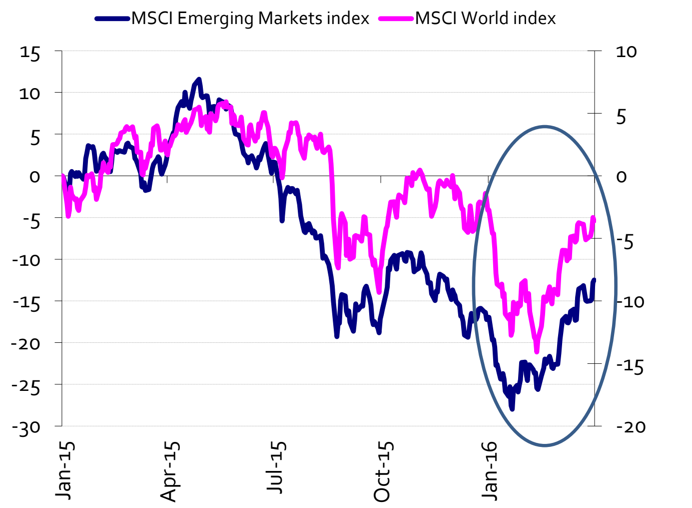
FIGURE 7: **Major world & CESEE stock markets performance (%)**



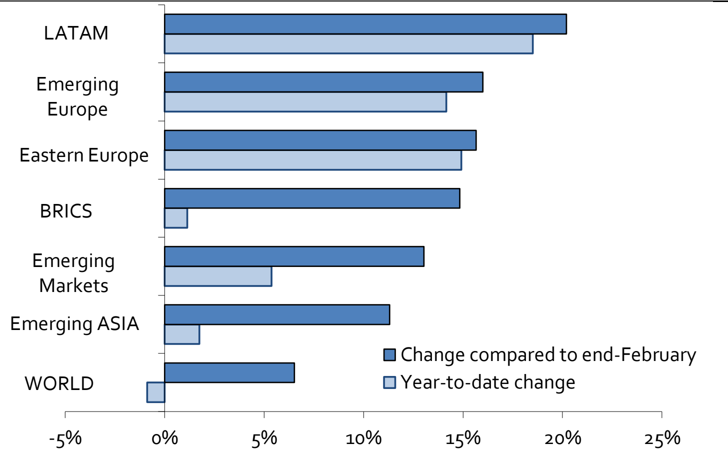
Source: Reuters, Bloomberg, Eurobank Research

FIGURE 8: **World & EM stock markets performance (Dec. 31, 2014=100)**



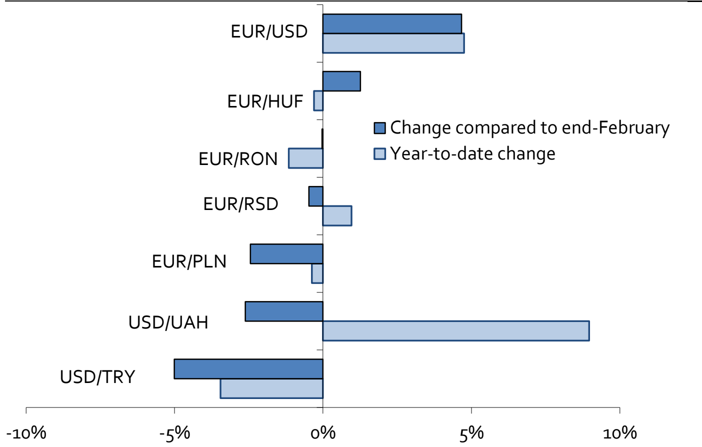
Source: Reuters, Bloomberg, Eurobank Research

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



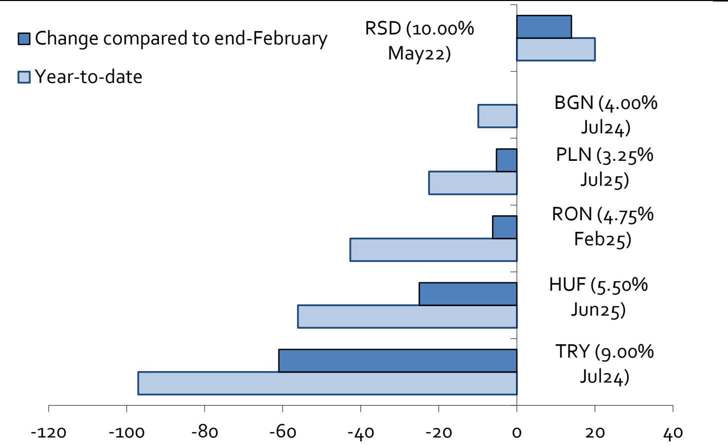
Source: Reuters, Bloomberg, Eurobank Research

FIGURE 10: **CESEE FX performance**



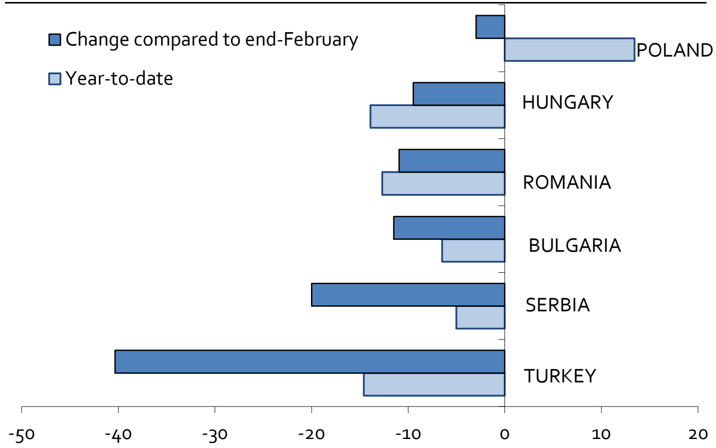
Source: Reuters, Bloomberg, Eurobank Research

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

We prefer to remain sidelined on the dinar

In our previous monthly *Regional Economics & Market Strategy Monthly* we had expressed belief that the dinar would remain bound within tight ranges in the coming weeks. In support of the aforementioned, we cited likelihood for renewed Central Bank interventions on either side of the EUR/RSD range in order to mitigate excessive daily fluctuations in the FX market. Our view was vindicated, with the pair remaining trapped mostly within 122.50-123.00 over the last month or so. Domestic factors, such as seasonally increased hard currency demand from energy importers as well as political and fiscal risks ahead of April's general elections, have weighed s on the dinar over recent weeks. However, NBS action put a lid on further depreciation pressures on the local currency. In March alone the Central Bank sold around €175mn in the local interbank market, bringing the total amount sold so far this year to €575mn. Looking ahead, several factors argue in favour of dinar strengthening in the coming weeks. Namely, enhanced global risk sentiment, seasonal influences and a renewed reform drive after the upcoming general elections. That said, significant EUR/RSD downside seems limited, as according to the recent past the Central Bank seems unlikely to allow the pair to slide below the 122.00 mark. In this environment we prefer to remain sidelined on constructing any new positions on the dinar, especially ahead of the April 24 ballot.

Local rates

We favor the long-end of the BGN curve (6-10Y), where bonds came under pressure earlier in February

Investors stayed on the sidelines on local secondary market over the last month or so. The auction calendar ahead is likely to remain empty in April given the prior month's Eurobond placement and the €300mn loan granted by World Bank to secure stability of the banking system. On the other hand, the redemption of €213.51mn of local paper on March 30 will likely continue to provide further liquidity and support to the market in the upcoming weeks. In this environment, we favor the long-end of the BGN curve (6-10Y), where bonds came under pressure earlier in February.

Long ROMGB positions remain favorable

The RON government bonds market was little changed in March. As a result, the yields of the long ROMGB 2025 previously recommended position currently stands close to entry levels.
However, the case for the position has become even more compelling on the basis of:

- support coming from dovish global (ECB and Fed) and regional (Hungary) central banks;
- the HUF yield curve moved markedly lower –the spread between the RON and HUF 2025 domestic bonds widened to +65 bps, way above its two year average of +5 bps;
- the RON government yield curve is extremely steep, with the 2-10Y spread at +215bps, providing fuel for gains from a potential bull flattening of the curve

Additionally, if funded from swaps at the current 1M implied level of 0.45% the position yields a very good carry at +300bps. Along these lines, we recommend continuing holding the position and move the target slightly lower to 3.00%.

Security	Position	Entry	Current level	Target	Stop loss	PNL to date (non-annualized)
ROMGB 2025	Long 	3.40%	3.33%	3.00% (new) 3.10% (past)	3.65%	+0.82% Out of which MtM profit: +0.56% Carry: +0.26%

External debt markets

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

March performance was dictated by the new, well-received, Bulgarian Eurobond placement that took place in mid-month. Taking advantage of the favorable market conditions following further ECB easing, the finance ministry placed € 1.994bn in a dual-tranche issuance of paper with 7-years (€1.144bn, 2.156%) and 12-years (€0.85bn, 3.179%) maturity. The yield curve continued to steepen on supply-side factors, with the 10-year sector suffering the most in the wake of the BG23s and BG28s auction. That said, BG23s and BG28s continued to rally on the secondary market, with corresponding yields easing ca 10bps and 20bps lower since issuance, and with room for further gains. Therefore, we see current levels as an attractive entry opportunity on the back of relevantly cheap prices in 7-year and 9-year government bond segment, ample financial system liquidity and the outperformance of state revenues and budget balance in the first months of 2016.

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-)

Successful come-back to the international markets

Bulgaria took advantage of the ECB latest stimulus measures to make a strong comeback to the international markets.

On March 15th, Bulgaria tapped international markets issuing a combined €1.994bn of Eurobonds in a dual tranche auction. The dual tranche consisted of €1,144mn in 7Y and €850mn in 12Y bonds. The 7Y tranche was priced at 98.192 with a 1.875% coupon at a spread of 185 bps over mid-swaps, an equivalent of 2.156% yield, while the 12Y tranche was priced at 98.237 with a 3.000% coupon at 235 basis points over mid-swaps or 3.179% yield. The bid-to-cover ratio came at 1.84 and 1.73 for the 7Y & 12Y respectively. The return to the international markets took place one year after the placement of €3.1bn bonds in three tranches (7Y-12-20Y) in March 2015 at a similar cost of funding. With this issuance, the Ministry of Finance covered the government financing requirements for the full year and strengthened further the fiscal reserve.

The economy expanded in 2015 at the highest rate since 2008

The second estimate on the seasonally adjusted Q4 GDP reading trimmed 0.1ppt off the initial flash estimate of +0.8% QoQ/+3.1% YoY. GDP growth now seen at +0.7% QoQ/+3.0% YoY in Q4-2015 is the highest pace since Q2-2011, up from +0.7% QoQ/+2.9%YoY in Q3-2015 vs. +0.6% QoQ/+1.8% YoY in Q4-2014. This minor revision in the last quarter's data does not change the big picture in the economy. From a demand side point of view, total consumption made a strong come-back, expanding by +0.9% QoQ/+2.7% YoY in Q4-2015, up from +1% QoQ/+1% YoY in Q3-2015 vs. -0.8% QoQ/+1.1% YoY in Q4-2014. In addition, investments entered into positive territory after four consecutive quarters in the red (+1.1% QoQ/+1.7% YoY in Q4, up from +0.6% QoQ/-0.4% YoY in Q3). The spending recovery was mainly driven by the increase in government spending mirroring the increased EU funds absorption ahead of the closing of the programming period 2007-2013 by year end. In addition, rising real wages, improving sentiment, declining energy prices-Bulgaria has the highest energy consumption intensity in EU-28-and further gains in employment have helped private spending gain more speed in Q4. Against an unfavorable external backdrop, net exports accomplished to make a further positive contribution to growth in Q4. Exports decelerated to +5.6% QoQ/+4.2% YoY in Q4, down from -1.9% QoQ/+5.8% YoY in Q3, yet still outpaced imports which edged to +3.9% QoQ/+3.4% YoY in Q4 vs. -0.8% QoQ/+3.3% YoY in Q3. Summing up, full year growth accelerated to +3.0% YoY in 2015, the highest growth rate since 2008, up from +1.6% in 2014. Looking ahead, our GDP forecast stands at 2.6% in 2016 as we see downside risks for growth stemming primarily from lower EU funds absorption mirroring the beginning of the new multi-annual EU budgeting program period, the need for fiscal consolidation and a lower than previously envisaged Euroarea growth in 2016, the main trade partner of Bulgaria.

The budget execution in the first two months 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 BGN961mn or 1.2% of projected GDP in the first two months of the year, compared to a budget deficit of BGN105.5 or 0.1% of GDP in the same period last year. Total revenues slowed down to +15.5% YoY in Jan-Feb, after soaring by +26.7% YoY in January only, reaching 16.7% of the annual target, driven primarily by higher reimbursements for EU funds projects related spending. On the other hand, total expenditure declined by -6.7% YoY in Jan-Feb, reaching 13% of the annual target in Jan-Feb, which is most probably explained by lower capital expenditures spending and given that government spending is skewed towards the end of the year. The consolidated government deficit target is set at 2% 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, concession revenues from the Sofia airport while additional buffers could emerge from higher than last year's budget- flexibility on the discretionary spending side.

Consumer prices re-entered a deflationary path in February again

Inflation came at -0.3% MoM/-0.5% YoY in February, down from +0.0% MoM/+0.0% YoY in January and 0.0% MoM/-0.4% YoY in December. As a result, the average annual inflation in the past twelve months came out flat again. The largest decline both on a monthly and an annual basis was recorded in the group of transportation. Driven by lower world energy prices, transportation prices plunged by -3.2% MoM/-5.5% YoY in February, down from -1.7% MoM/-2.7% YoY in January and +1.1% MoM/-7.6% YoY in December. The category of clothing and footwear recorded a hefty decline as well (+1.5% MoM/-2.8% YoY in February, down from +1.7% MoM/-2.1% YoY in January), most probably driven by seasonal retail store discounts. The food component of the CPI, the one with the highest share in the consumer basket, re-entered negative territory after six months, driven by lower prices for meat and vegetables on an annual basis, coming at +0.4% MoM/-0.2% YoY in February, down from +0.8% MoM/+0.5% YoY in January vs. -0.5% MoM/+0.5% YoY in December.

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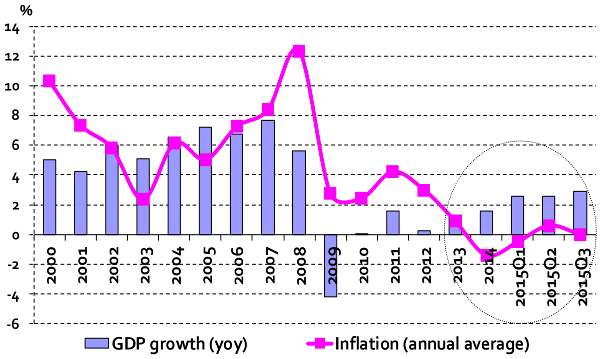
Bulgaria: Macro & Market Data				
	2014	2015	2016f	2017f
Real GDP (yoy%)	1.6	2.8	2.6	3.1
Inflation (yoy%)				
CPI (annual average)	-1.4	-0.1	1.0	1.5
CPI (end of period)	-0.9	-0.4	1.2	2.0
Fiscal Accounts (%GDP)				
General Government Balance	-3.7	-3.3	-2.0	-1.4
Gross Public Debt	27.7	26.7	29.7	31.1
Primary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

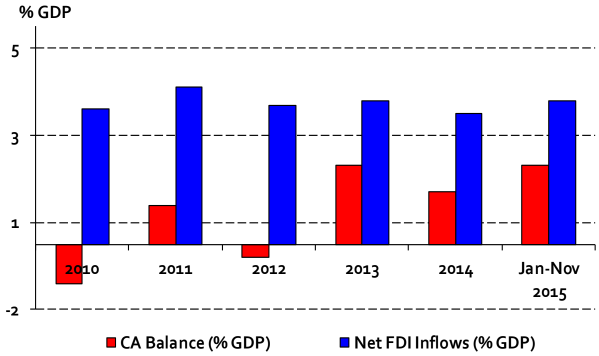
Source: National Sources, Eurostat, IMF, Eurobank Research

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



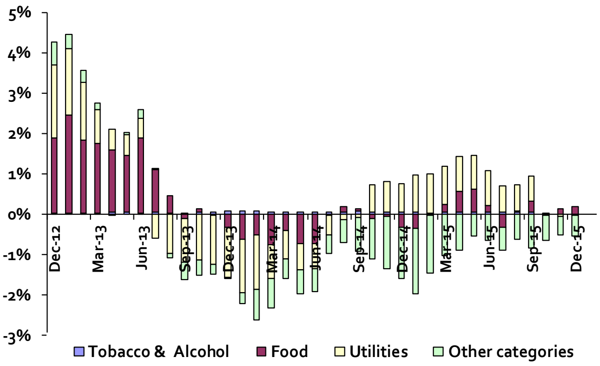
Source: National statistics, Ecowin Reuters, Eurobank Research

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



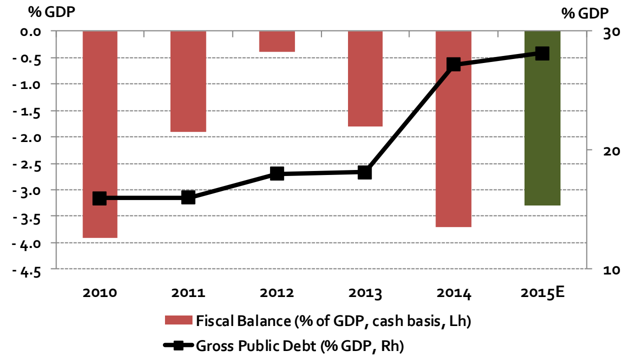
Source: National statistics, Ecowin Reuters, Eurobank Research

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



Source: National statistics, Ecowin Reuters, Eurobank Research

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



Source: Eurostat, Eurobank Research

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

Exit from the economic adjustment program finalized

After a three year recession in 2012-2014 the economy expanded by +1.6% YoY in 2015.

The second estimate of the Statistical Service on the seasonally adjusted fourth quarter GDP reading confirmed the flash estimate of +0.4% QoQ/+2.7% YoY in Q4-2015, up from +0.5% QoQ/+2.3% YoY in Q3-2015, compared to - 0.1% QoQ/- 1.6% YoY in Q4-2014. This is the fourth consecutive positive quarter on both a quarterly and an annual basis after a three year recession, an illustration that the economy is finally out of the woods. In the full year 2015, growth expanded by +1.6% YoY, compared to -2.5% in 2014, -5.9% in 2013 and -2.4% in 2012. From a sectoral point of view, construction and agriculture impressed in the last quarter of the year expanding at +8.9% YoY and +5.2% YoY respectively. In terms of demand components, the rebound of total consumption continued in Q4-2015 (-0.5% QoQ/+2.3% YoY in Q4 vs. +0.3% QoQ/+2.0% YoY in Q3), driven by sentiment improvement as a result of strong compliance with programme's conditionalities, lower energy prices, lower unemployment and increased public spending in the last quarter of the year. Consequently, consumption made the strongest positive contribution to growth since Q3-2010. Investments also made a positive contribution of 1.3ppt underpinned by the ongoing residential construction recovery. On the other hand, net exports had a negative contribution of 0.9ppts in Q4 mirroring the pick-up of imports (+6.2% YoY in Q4 vs.-3.3% YoY in Q3) against a slower increase of exports (+4.6% YoY in Q4 vs. +2.5% YoY in Q3).

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

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. 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 (€3.4bn in Feb 2016 or 19.1% of projected GDP down from €11.4bn in March2013) and maintaining high primary surpluses at the same time.

Cyprus' successful graduation from the economic adjustment program was finalized in the Eurogroup of 8th March

Cyprus exit from the program was finalized in the Eurogroup of March 7th. The Eurogroup praised authorities for the high degree of ownership and the important achievements and approved their decision to exit 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 of earlier macroeconomic imbalances. Overall, Cyprus made use of €7.3bn out of a total €10bn available under the program. Yet, the Eurogroup noted that the last prior action of the last program review with respect to the approval from the parliament of the corporatization of CYTA-the telecom public utility-has not been satisfied. Meanwhile, the Cypriot government asked to terminate the IMF portion of the program which was scheduled to expire in mid-May. As a result, Cyprus became the third country after Portugal and Ireland to have made a "clean" exit from its economic adjustment program. The disbursement of the last ESM tranche is not absolutely necessary as market access has been restored, albeit at a comparably higher cost than that of official lending. Cyprus has made the fastest come-back to international markets among other Euroarea program countries tapping the markets three times (June 2014, April 2015 and October 2015). The endorsement of the review would have sent a positive signal to the markets allowing for a further improvement in the cost of funding. On the other hand, Cyprus does not encounter significant repayment obligations until at least 2019. The amounts to be repaid in 2016-2017-2018 stand at €1.14bn, €453mn and €873mn respectively, most of which is held by domestic financial institutions. Finally, Cyprus will be subject to post program monitoring from official lenders twice a year until at least 75% of the financial aid has been repaid back.

Standard and Poor's and Moody's affirmed their respective long-term below investment grade sovereign ratings for Cyprus in late March

More importantly, ECB's waiver for government bonds eligibility for Euro system financing will be lifted as of April 1st. 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. As a result, the current exposure of the domestic banking system to the Eurosystem –at €866mn in February2016- will be replaced by ELA funding. Despite rating agencies' upgrading in the past autumn, the sovereign rating of Cyprus is still below investment grade. In fact, Standard and Poor's and Moody's' affirmed their respective long-term below investment grade sovereign ratings for Cyprus in late March. Currently, the sovereign rating stands at BB-& B1 by S&P and Moody's respectively. In turn, 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, while Fitch is expected to affirm their previous rating decision in late April.

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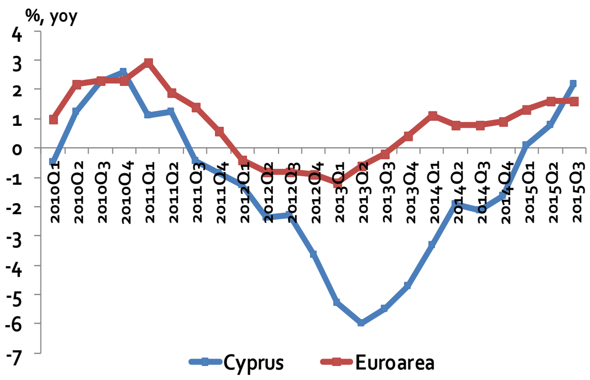
Cyprus: Macro & Market Data				
	2014	2015f	2016f	2017f
Real GDP (yoy%)	-2.5	1.6	2.0	2.5
Inflation (yoy%)				
HICP (annual average)	-0.3	-1.5	0.2	0.6
HICP (end of period)	-1.0	-1.4	0.6	1.3
Fiscal Accounts (%GDP)				
General Government Balance	-0.2	-1.5	0.0	0.8
Gross Public Debt	108.2	109.0	99.8	95.7
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%

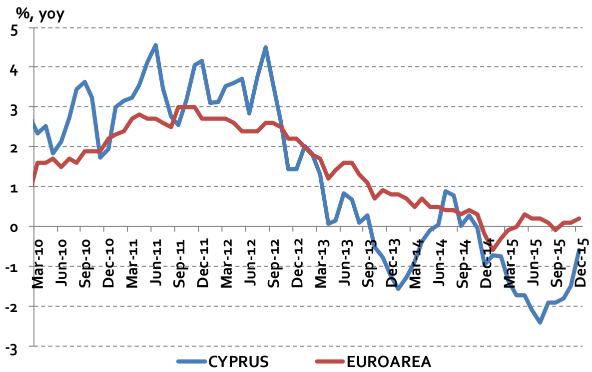
Source: National Sources, Eurostat, IMF, Eurobank Research

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



Source: Eurostat, Eurobank Research

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

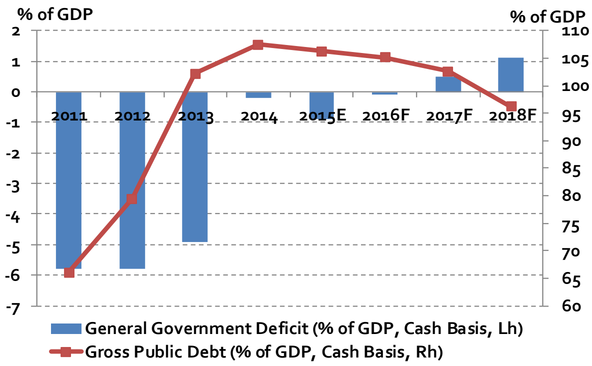


Source: Eurostat, Eurobank Research

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-)

Rising fiscal risks

Growth is expected to accelerate to 4.1% in 2016 up from 3.7% in 2015, driven primarily by the private consumption spending boom

The provisional estimate of the Statistical Service on the seasonally adjusted Q4 GDP reading confirmed the flash estimate of +1.1% QoQ/+3.8% YoY compared to +1.5% QoQ/+3.6% YoY in Q3. From a demand side point of view, both private consumption and gross fixed capital formation exhibited very strong dynamics. Driven by higher disposable income as a result of the tax cuts and the double digit rise in real wages-the highest in EU-28- private consumption expanded by +2% QoQ /+7% YoY in Q4, up from +2% QoQ/+6.1% YoY in Q3, making a hefty contribution of 4.5pps to growth. Gross fixed capital formation jumped by +3.1% QoQ/+11.0% YoY, up from -0.6% QoQ/+4.2% YoY, making a 2.6pps contribution to growth, which was partially offset by the negative contribution of inventories (-1.5pps). On the other hand, net exports made a negative contribution of -2.1pps, which was broadly expected as domestic demand recovery was accompanied by a recovery of imports. The Q4 reading brings FY growth at 3.7% in 2015, a notch below our 3.8% forecast, compared to 3% in 2014 and 3.5% in 2013. Had it not been for the negative contribution of the volatile agricultural sector (-0.2pps in Q4, -0.5pps in FY2015), growth would have been even higher.

The IMF mission's annual consultation advised authorities to postpone further fiscal relaxation scheduled in 2017

Growth is expected to accelerate further to 4.1% in 2016, driven primarily by the private consumption spending boom, fuelled by the expansionary fiscal policy. Hence, the economy may be driven close to, if not above, its potential growth rate at the expense of pushing government finances off consolidation track. The unwarranted pro-cyclical fiscal stimulus ahead of the parliamentary elections this year, induced by the amended Fiscal Code tax-cuts and the wide-spread public sector wage rises threaten to push the fiscal deficit in cash terms above the 2.8% of GDP target (2.95% in ESA2010) in 2016 and spill over in 2017-18. From that point of view, the IMF mission's annual consultation urged authorities to postpone the further tax reductions on VAT and excises scheduled to come into effect in 2017, a decision that would generate savings of 0.75% of GDP. Unless new measures are taken, the fiscal deficit is projected to overshoot the government target by 0.5% and 1% respectively in 2017 and 2018. Thus, the fiscal deficit is forecasted to reach 3.3% of GDP in cash terms, which implies an even higher deficit in ESA2010 terms. The mission emphasized the need for further structural reform in the areas of public administration and state-owned enterprises in the energy and transportation sectors so as to prop up potential growth. Finally, IMF advised that the pace of minimum wage hikes ought to be moderate, given the higher than its regional peers' ratio of minimum-to-average wage, in order not to undermine job creation and external competitiveness.

The poor fiscal performance pushed down the consolidated budget surplus in the first two months of the year

The consolidated government surplus narrowed down to RON0.8bn or 0.1% of projected GDP in January-February 2016 compared to RON2.3bn or 0.33% of GDP in the same period of 2015 against a hefty surplus of RON4.73bn or 0.63% of projected GDP recorded in January2016. The poor budget performance in February alone was the combined result of a contraction in total revenues (-3.0% YoY) coupled with an acceleration in total expenditure (+10.9% YoY). The slump in total revenues was driven by lower VAT revenues (-15% YoY in February) mirroring the impact of the headline VAT rate cut from January1st.Yet, the sustained robust performance of income tax (+39.3% YoY) in February and the solid VAT revenues collection in January maintained revenues expansion at positive territory (+4.6% YoY) in the first two months. On the other hand, total expenditure spiked by +9.9% YoY. Staff costs were up by +21.8% YoY reflecting a 10% wage hike, approved by the parliament for all public sector employees except for those in public health and education, who have already received a generous 25% and 15% wage increase respectively.

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

Inflation dipped to -0.2% MoM/-2.7% YoY in February-a historic low for the standards of Romania-down from -0.8% MoM/-2.1% YoY in January and compared to +0.1% MoM/-0.9%YoY in December. The print was below market expectations (BBG survey: +0.2% MoM/-2.3% 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- pushed has headline inflation further into negative territory. On a monthly basis, the volatile food component of CPI edged up to +0.34% MoM/-6.47% YoY in February vs. +0.47% MoM/-6.29% YoY in January. Both non-food items and services entered negative territory reflecting lower energy prices and the implementation of lower VAT on telecom services. Non-food items came at -0.27% MoM/-0.54% YoY in February vs. -1.56% MoM/+0.12% YoY in January. Services slowed down to -1.14% MoM/-0.31% YoY in February compared to -1.12% MoM/+1.23% YoY in January. Looking ahead, inflation is most likely to stay below the NBR target range (2.5%±1%) until the 1H-2016. However, notwithstanding the impact of taxes, inflation has already entered the target band. HICP at constant taxes came at +2.7%YoY in February compared to +3.4%YoY in January 2016 significantly higher than its regional peers (Poland: -1.4% YoY, Hungary: +0.5% YoY, Bulgaria:-1% YoY)

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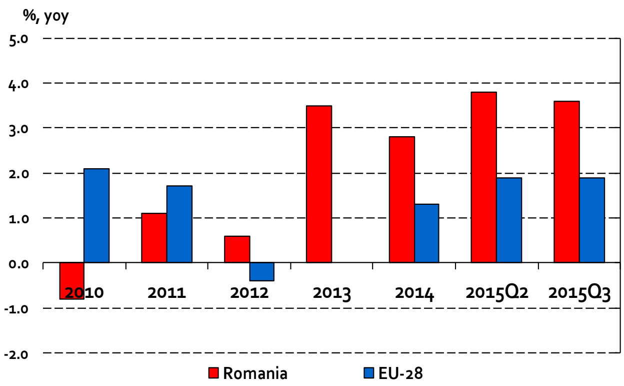
Romania: Macro & Market Data				
	2014	2015	2016f	2017f
Real GDP (yoy%)	2.9	3.8	4.1	3.5
Inflation (yoy%)				
CPI (annual average)	1.1	-0.6	-0.3	2.5
CPI (end of period)	0.8	-0.9	1.4	3.4
Fiscal Accounts (%GDP, Cash Basis)				
General Government Balance	-1.9	-1.9	-2.8	-3.7
Gross Public Debt (including guarantees)	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

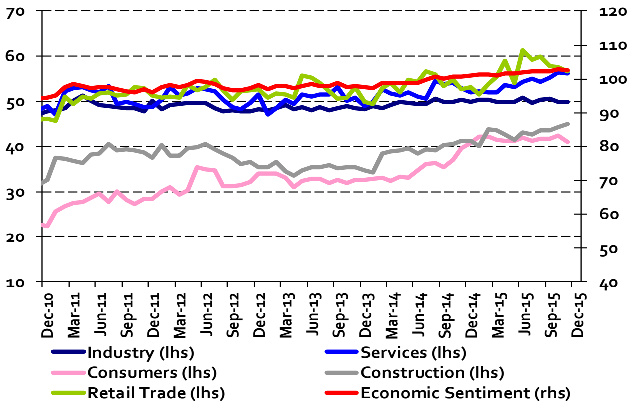
Source: National Authorities, EC, IMF, Eurobank Research

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



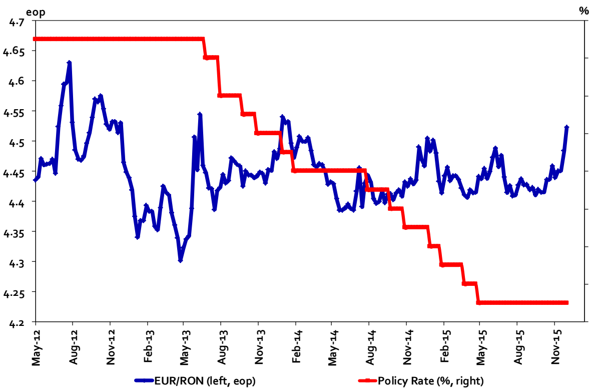
Source: Eurostat, Eurobank Research

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



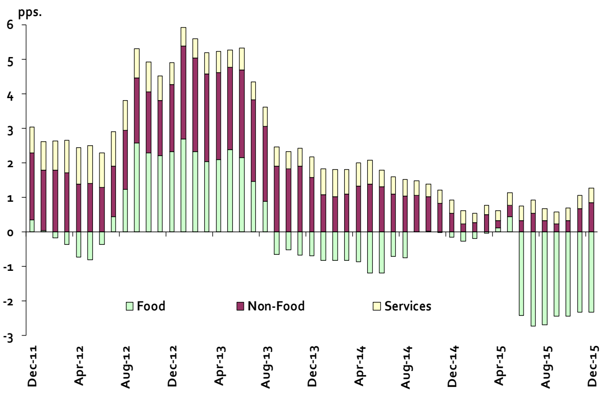
Source: Eurostat, Ecowin Reuters, Eurobank Research

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+)

Upcoming general elections on April 24th take centre stage

Real GDP growth returned to positive territory in 2015 after the 2014 contraction

Real GDP growth came in flat QoQ sa in Q4 2015, after a 0.2% decline a quarter earlier. On an annual basis, real GDP growth slowed to 1.2% from 2.3% in Q3 2015, in nsa terms, bringing the full-year reading to 0.7%. This marks a return to positive growth after a 1.8% contraction in 2014, despite sizeable fiscal consolidation and severe draught. Exports and investments were the primary forces behind last year's recovery. The former grew by 7.8%, mainly thanks to agricultural and manufacturing production. Growth of ca 8.3%YoY in investments was strongly supported by an enhanced business environment amid recently implemented reforms, favorable base effects and increased FDIs. Lower primary commodities prices also favored gross fixed capital formation as well as private spending. Cheaper debt servicing costs, subdued inflation pressures and higher remittances provided an additional lift to disposable income. Even so, private consumption remained a drag to real GDP growth due to the impact stemming from the government's strong fiscal consolidation efforts since late 2014. In the same context, public expenditure also provided a negative contribution.

Economic activity projected to pick up further pace in 2016 and 2017

As noted recently by the IMF, the positive macroeconomic trends witnessed last year are likely to continue in 2016. Real GDP growth will probably accelerate further this year and the next. Under the IMF's precautionary Stand-By Arrangement growth is projected to come in at 1.8% and 2.2% in 2016 and 2017 respectively. Investments are anticipated to continue leading the recovery in view of improving business climate and higher public capital expenditure. Public spending ahead of the general elections will also provide support to domestic economic activity this year. Growth in private consumption is expected to return to positive annual rates as the impact of fiscal consolidation gradually wanes and private sector employment recovers. The net exports' contribution will likely become more neutral as the recovery in domestic demand backs a concomitant growth in imports. Downside risks to growth prospects primarily lie on external factors; further normalization of the Fed's monetary policy, slowing economic activity in main trade partners and/or a less favourable global growth outlook and geopolitical tensions. Implementation of planned structural reforms is also of high significance.

Some modest rate easing after the looming elections cannot be ruled out entirely

The National Bank of Serbia (NBS) stayed put on its monetary policy at its meeting in March, maintaining the key benchmark rate at the record low level of 4.25%. The decision follows February's largely unexpected 25bps cut, the first since October 2015, which came on the heels of 750bps of monetary easing since May 2013. Inflation has remained below the 4.0±1.5 target for two years now in view of low global commodity prices, a restrictive fiscal policy and a negative output gap. In February, headline CPI stood at 1.5%YoY, while the core index came in at 1.6%YoY. Although these factors argued in favour of another rate cut in March, we – in line with the market's median forecast – anticipated the Central Bank to hold its horses ahead of the upcoming general elections. Fiscal slippage risks and potential delays in the implementation of IMF-backed reforms may exert depreciation pressures on the dinar, which has already lost ground this year. Ahead, some modest rate easing after the polls cannot be ruled out entirely as inflation pressures remain subdued and private consumption continues to be weak. That said, the NBS will likely retain a cautious stance as inflation is expected to gradually rise from mid-year and return within the target tolerance band late this or early next year thanks to the current monetary policy expansiveness. Any further decisions will likely be dependent on the aforementioned risks to the country's outlook and their implication on inflation dynamics as well as on the dinar's upcoming performance.

Ruling SNS Party poised for another landslide victory in the upcoming elections

The upcoming general elections, scheduled for April 24th, are lacking any uncertainty for the first time in many years. The ruling centre-right Serbian Progressive Party (SNS), led by PM Aleksandar Vucic got off to a big lead early in the campaign and are likely headed for another landslide victory. The latest opinion polls suggest support for the party ranges between 45-53%. Junior coalition partner Socialist Party of Serbia (SPS) is the only other group appearing braced to pass the 5% parliamentary threshold, with 11%-12% support. Opposition parties and other coalition partners are struggling for third spot, being on the verge of the 5% census. PM Vucic and the SNS are deriving their success thanks to the fight against corruption and pro-EU agenda. At the same time, their neutral stance towards Russia in their ongoing dispute with Europe has proved particularly popular with voters. Although the Progressives will command an absolute legislative majority – baring any major surprises - Mr. Vucic is likely to offer a minority role to a smaller party, in order to build a stronger mandate for what now seems a crucial 4-year tenure in the way to the EU accession and economic reforms.

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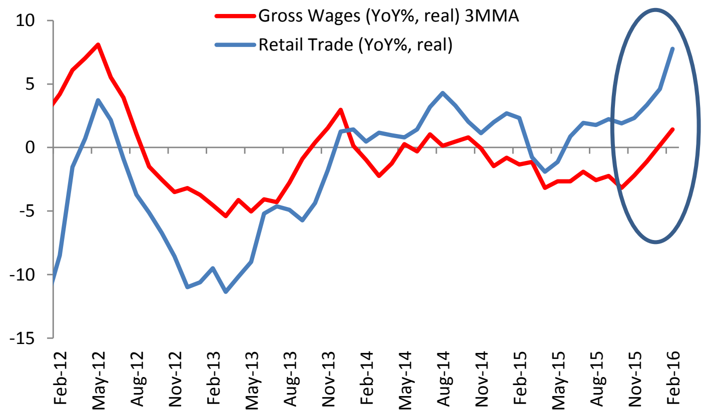
Serbia: Eurobank Forecasts				
	2014	2015	2016	2017
Real GDP (yoy%)	-1.8	0.7	1.8	2.2
Inflation (yoy%)				
HICP (annual average)	2.1	1.4	1.7	3.0
HICP (end of period)	1.7	1.5	2.5	3.5
Fiscal Accounts (%GDP)				
Consolidated Government Deficit	-6.7	-3.7	-3.7	-2.6
Gross Public Debt	72.2	75.9	78.1	76.3
Labor Statistics (%)				
Unemployment Rate (%of labor force)	19.4	17.7	17.7	17.0
Wage Growth *(total economy)*	2.0	0.0	0.0	0.0
External Accounts				
Current Account (% GDP)	-6.0	-4.7	-4.6	-4.3
Net FDI (EUR bn)	1.2	1.6	1.6	1.5
FDI / Current Account (%)	60.0	106.7	100.0	100.0
FX Reserves (EUR bn)	9.9	10.4	11.0	10.6
Domestic Credit	**2012**	**2013**	**2014**	**2015**
Total Credit (%GDP)	62.8	57.0	61.5	63.6
Credit to Enterprises (%GDP)	31.2	26.1	25.0	25.0
Credit to Households (%GDP)	18.2	17.4	18.7	19.6
Private Sector Credit (yoy%)	9.5	-4.8	0.5	3.2
Loans to Deposits (%)	126.9	114.1	111.8	112.6
Financial Markets	**Current**	**3M**	**6M**	**12M**
Policy Rate	4.25	4.00	4.00	4.00
EUR/RSD	123.00	122.50	123.00	125.00

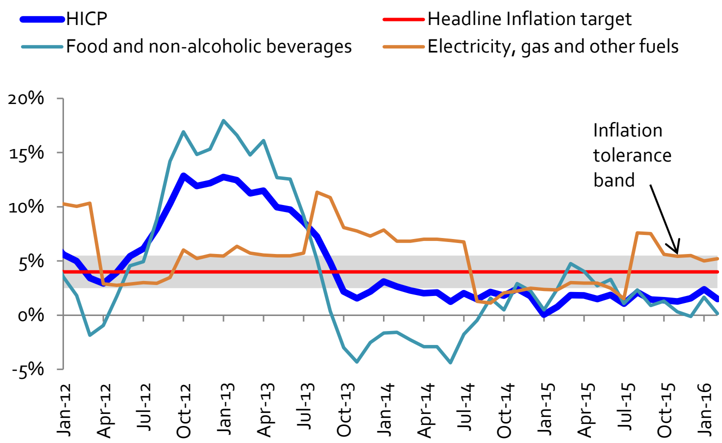
Source: National Authorities, EC, IMF, Eurobank Research

FIGURE 25: **Private consumption recovers further in February as wage growth dynamics improve further (3MMA)**



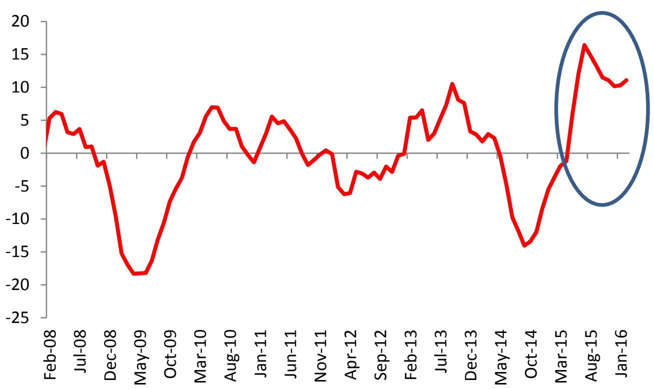
Source: National Authorities, EC, IMF, Eurobank Research

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



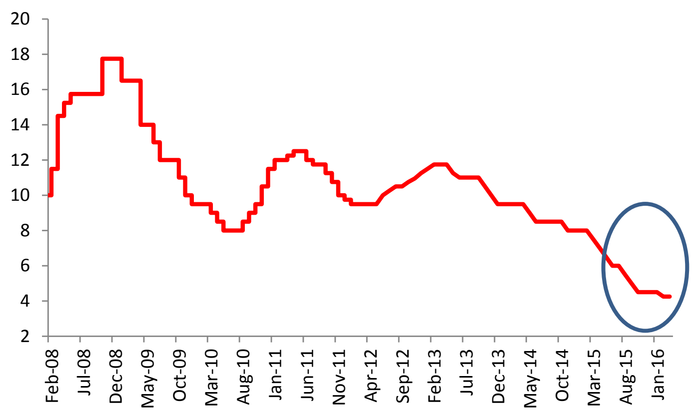
Source: National Authorities, Eurobank Research

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 ahead of the general elections**



Source: National Authorities, EC, IMF, Eurobank Research

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