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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

Regional markets outperform on expectations for further ECB easing

REGIONAL MACROECONOMIC DEVELOPMENTS & OUTLOOK

- Most regional economies record strong **GDP growth readings** in Q3 2015
- Regional economies supported by accommodative monetary policies, **improved absorption of EU funds** and low world commodity prices
- **Lower world energy prices** maintain inflationary pressures subdued, supporting real disposable incomes and providing more flexibility to corporate and household balance sheets in the short-term

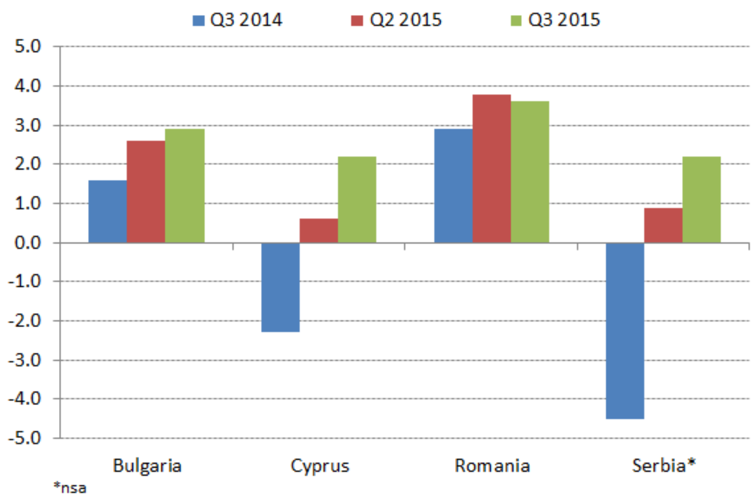
REGIONAL MARKET DEVELOPMENTS & OUTLOOK

- **Emerging stock markets** under pressure on increased expectations for a Fed rate hike in December; **regional markets outperform** on expectations for further ECB monetary stimulus
- CESEE FX markets affected by (geo) political developments in the broader region
- Regional **sovereign debt markets** supported by accommodative monetary policies
- ECB and Fed meetings in December **key** for regional markets performance ahead

COUNTRY FOCUS

- **Bulgaria:** Fiscal consolidation postponed for next year
- **Cyprus:** GDP growth strengthened in Q3 2015
- **Romania:** New technocratic government sworn in mid-November
- **Serbia:** Q3 2015 GDP data signal continuation of domestic economic recovery

Regional strong growth momentum sustained in Q3-2015



Source: Bloomberg, Reuters, National Authorities, Eurobank Research

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I. Regional Macroeconomic Developments & Outlook

Growth momentum maintained in the third quarter supported by ECB's QE program, low world energy prices

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 world focus in November was on the terrorist attacks in Paris. Subsequently, geopolitical tensions came at the forefront when Turkey downed a Russia aircraft over the borders with Syria. Those two events came on top of a list of concerns casting a shadow on the region outlook including the repercussions from the ongoing VW scandal, the surge of immigration refugees and the prospect of an imminent Fed hike in the next meeting in December. Yet, on the economic data front, flash estimates of third quarter GDP growth released for the economies of our focus earlier this month came out above consensus forecasts. In fact, these readings were also among the strongest in the post Lehman period. Moreover, judging by the last two sentiment surveys for October and November as well as other recent high frequency indicators, it seems the region has also started the final quarter of the year on a strong note. 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.

Lax monetary policies together with low world energy prices continue providing a positive boost on growth momentum

Lax monetary policies coupled with low world energy prices have helped the region sustain its growth momentum in the third quarter. Regarding monetary policy, the ECB's QE programme has a catalytic impact on financial market conditions creating more appetite for regional assets. In addition, the economies of our focus are well positioned to benefit from the improvement in economic conditions of the Euroarea, the main trade partner and capital flows generator for the region. In fact, the dependence on the Euroarea has shielded the region from the increased volatility of capital flows into and out of emerging markets induced by concerns for higher US interest rates. Finally, although each case is unique, monetary laxity was complemented by a growth supportive stance of fiscal policies together with improved EU funds absorption ahead of the programming period end. As far as energy prices are concerned, the region's deficit in energy resources together with the much higher than the EU average energy intensity exacerbate the energy consumption bill, thus making the regional economies highly sensitive to the volatility of prices. Lower-on an annual basis- energy costs continue to keep inflation pressures at bay, supporting real disposable incomes and providing more flexibility to household, corporate, and sovereign balance sheets. The positive boost on the growth momentum stemming from lower energy prices is expected to extend in the next year as well but inevitably will likely fade away.

Bulgaria benefits the most from declining world energy prices

At a country level, November was a month of hefty revisions for the national accounts statistics and economic policy targets in **Bulgaria**. The economy expanded at 2.9%YoYin Q3, the highest rate since 2011, up from a revised 2.6%YoY in the 1H-2015. Given that Bulgaria has the highest energy consumption intensity in EU-28, its economy benefits the most from declining world energy prices. Fiscal consolidation has been postponed for next year, as the Ministry of Finance revised its official target for the consolidated government deficit in 2015 to 3.3% of GDP up from a 3.0% target previously in order to accommodate increased EU funds absorption expenses ahead of the closing of the 2007-2013 programming period.

The flash growth estimate of Q3 is illustrative of the progress Cyprus has made within the program

The economy of **Cyprus** is a visible turnaround paradigm. Real GDP growth accelerated further in Q3, bringing the cumulative annual growth rate over the first nine months of the year at 1.2%. The flash estimate of Q3 is illustrative of the progress Cyprus has made within the last two and a half years, during which the country has been under an economic adjustment programme, as a result of the strong compliance with programme's conditionalities. Even though Cyprus is set to graduate successfully from the programme in March 2016, authorities will have to deal with the challenge of high NPLs stock (NPEs at 47% in September 2015) in order to ensure sustainable growth in the medium-term. The new technocratic government cabinet in **Romania** was sworn in mid-November, giving an end to political crisis. The technocratic solution provides some comfort against political uncertainty but will most probably not be a game changer. Meanwhile, the Q3 reading brought the cumulative annual growth rate over the January-September period to 3.7% driven by booming consumption.

Serbia posted the second annual pace of expansion in Q3 after five quarters in contraction

Economic activity in **Serbia** expanded in Q3 on an annual basis for a second quarter in a row after five quarters in contraction. Underpinned by higher investments and exports, the economy is gradually trying to find its way onto a new growth path after last year's catastrophic floods. In addition, the staff level agreement reached on the precautionary Stand-By Arrangement's third review has put the program fully on track. Finally, NBS stayed put on rates- citing external risks ahead of an imminent Fed hike in December-, thus signaling that monetary easing most probably has reached an end.

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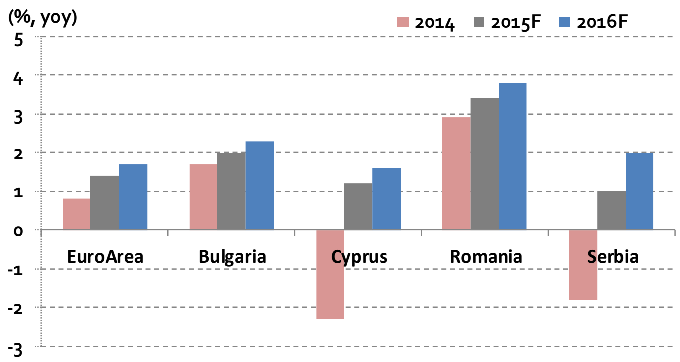
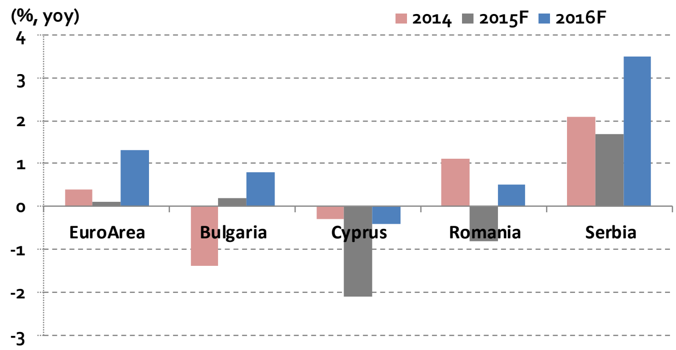
FIGURE 1: **Growth performance 2015-2016**



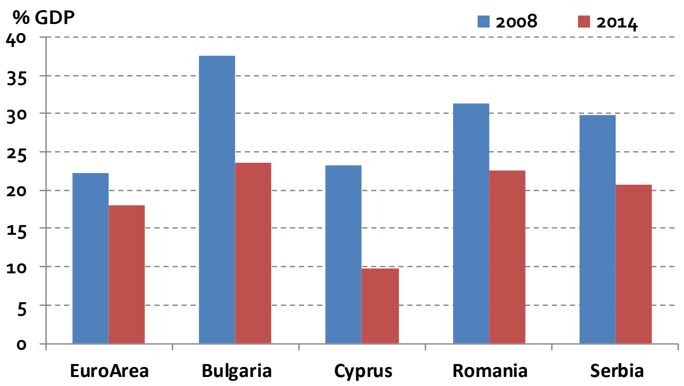
Source: Eurostat, National Authorities, Eurobank Research

FIGURE 2: **Annual average inflation 2015- 2016**



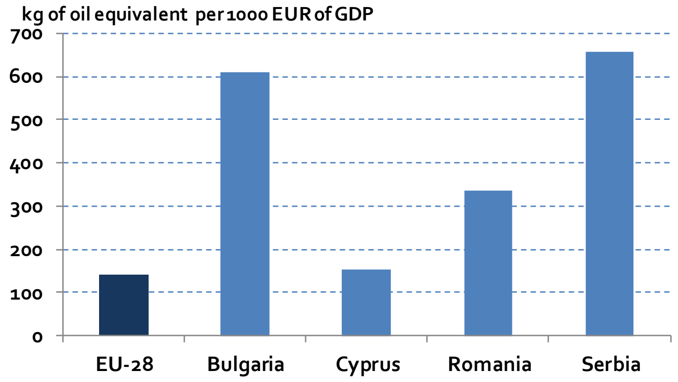
Source: Eurostat, National Authorities, Eurobank Research

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



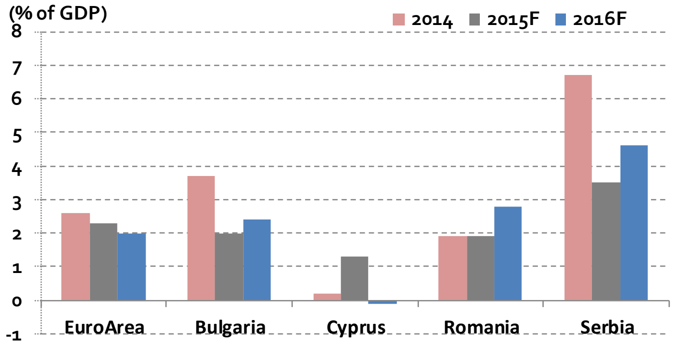
Source: IMF WEO, Eurobank Research

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



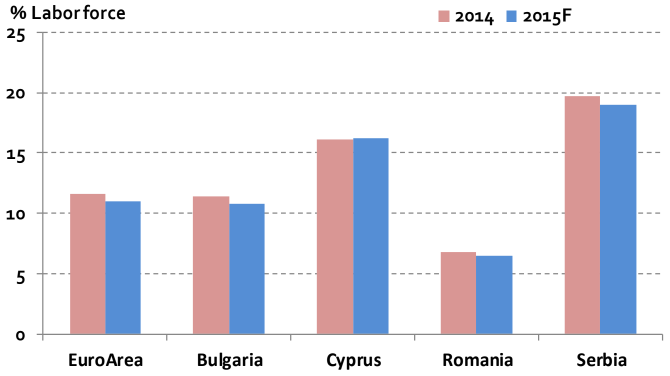
Source: Eurostat, National Authorities, Eurobank Research

FIGURE 5: **Fiscal Balance (% of GDP, Cash basis) 2015- 2016**



Source: Eurostat, National Authorities, Eurobank Research

FIGURE 6: **Annual average unemployment rates 2014-2015**



Source: Eurostat, National Authorities Eurobank Research

II. Regional Market Developments & Outlook

Risk sentiment sours on increased likelihood for a Fed rate hike in December, but regional assets outperform other EMs on expectations for further ECB easing

Emerging stock markets under pressure on increased expectations for a Fed rate hike in December; regional markets outperform on expectations for further ECB monetary stimulus

Emerging stock markets came under renewed pressure over the last month or so amid increased expectations for a Fed rate hike in December, the US Central Bank's first since 2006. This hawkish shift in market expectations was primarily instigated by the release of the US October non-farm payrolls report, which surprised to the upside revealing the largest rise in the headline since December 2014, an upward revision in the respective figure of the prior two months as well as a drop to a new 7 ½ year low of 5.0% in the unemployment rate. The FOMC October 27/28 meeting minutes did little to alter expectations for an FOMC rate hike at the next policy meeting on December 15-16, with the majority of policy members assessing that downside risks from the world economy and global financial markets "had abated". The prospect of higher US interest rates has been taking a toll on EMs this year as it is broadly anticipated to weaken capital inflows towards their assets. Also, China-related as well as global growth worries, Brazil's deteriorating economic and political situation and a slump in commodity prices have contributed further to negative EM sentiment. The recent flare up of geopolitical tensions - the November Paris attacks and the downing of a Russian military jet by Turkish forces near the Syrian border - also weighed on global risk sentiment of late. Despite receiving some comfort from Fed Chair Jannet Yellen's recent comments suggesting that, once incepted, the pace of tightening will likely be gradual, most EM indices recorded losses over the last month or so, as futures are now pricing in approximately an 75% probability that the FOMC will raise interest rates in December, up from 50% at the end of October. The MSCI EM index ended November nearly 4.0% weaker, in a partial reversal of October's 7.0% rally, bringing losses to around 15.0% so far in 2015. Developed markets have fared better with the MSCI World index marking concomitant declines of 0.7% and 0.9% in November and year-to-date respectively. Similarly, the majority of regional bourses have largely outperformed their global EM peers during the latest bout of increased risk aversion on further ECB stimulus hopes.

CESEE FX markets affected by (geo) political developments in the broader region

In view of deteriorating risk appetite, EM FX broadly lost ground in November. Regional currencies stood modestly weaker by the end of the month, as depreciating pressures from mounting expectations for a December Fed rate hike were somewhat counterbalanced by rising probability over further monetary stimulus measures by the ECB. In the broader CESEE region, recent (geo) political developments in several countries have played a key role in FX performance over the last few weeks. The Turkish lira rallied strongly in the immediate aftermath of the November 1st repeat general elections where the ruling AK Party scored an unexpectedly decisive victory. Confounding the outcome of the most recent opinion surveys conducted ahead of the poll as well as reversing previously weaker public support on the June 7 ballot, the ruling AKP managed to amass 49.5% of the vote and achieve parliamentary majority. The result significantly alleviated concerns about a prolongation of the recent escalation of domestic political uncertainty and a potential return to the polls for the third time in a year. In a knee-jerk reaction, the lira rallied approximately 6.0% vs. the USD in the wake of the said elections, hitting a 3-month peak at 2.7540. Despite the initial post-election rally, the currency erased all of its gains by the end of the month to stand more than 20% weaker year-to-date vs. the USD in view of the looming Fed rate-tightening and escalating geopolitical jitters between Turkey and Russia. With one of the highest current account deficits in the EM space, the lira is considered highly vulnerable to a potential slowdown in capital inflows. The outcome of the Polish general elections in late October was less welcomed by financial markets, where the main opposition Law and Justice (PiS) party won an outright parliamentary majority. During its pre-election campaign the party had pledged to impose higher taxation on banks, lower the retirement age and boost economic activity via the adoption of fiscal and monetary stimulus, fanning worries over a shift towards a more populist agenda and raising concerns about the country's m-t growth outlook.

Regional sovereign debt markets supported by accommodative monetary policies

In the local rate markets, regional government bonds largely retained this year's firm tone in November as the ECB as well as regional Central Banks continue to pursue accommodative monetary policies to support domestic economies. Serbian debt was an exception last month with the yield of the 10.00% May 2022 paper rising by 45bps, possibly on profit taking as this year's rally appeared to have been overstretched. That said, the aforementioned yield remains nearly 500bps lower from levels of 12.40% at the end of last year, thanks to hefty monetary easing and improving domestic fundamentals.

ECB and Fed meetings in December key factors for regional asset performance ahead

Looking ahead, the ECB and Fed monetary policy meetings in December are key factors to watch for future EM asset performance. Further ECB stimulus is likely to favour regional EUR-denominated assets the most. On the other hand, higher US interest rates are likely to weigh on EM assets, particularly of countries with relatively elevated external vulnerabilities.

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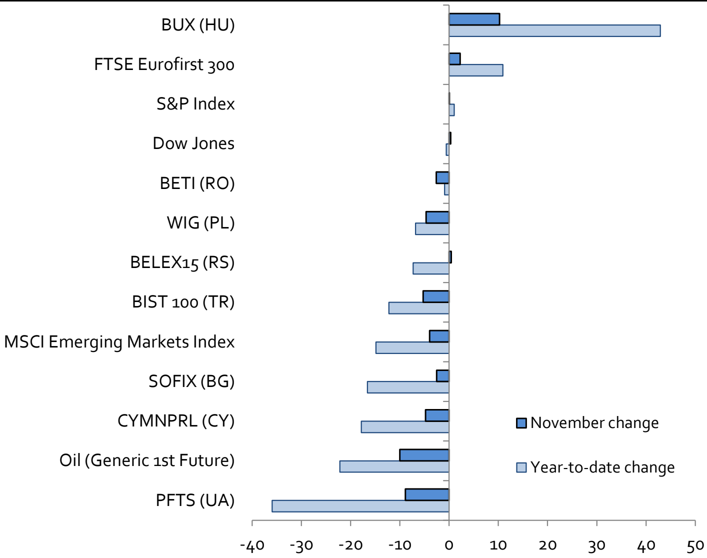
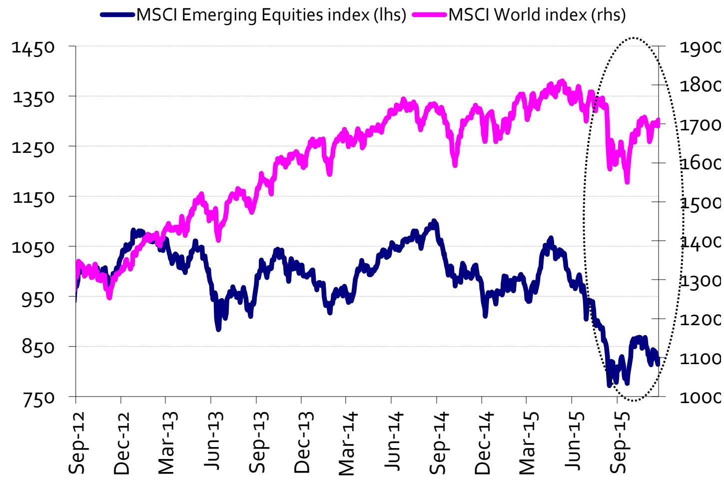
FIGURE 7: **Major world & CESEE stock markets performance (%)**



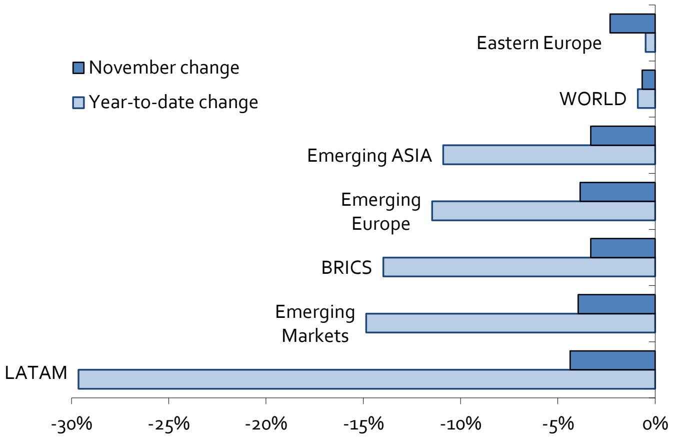
Source: Reuters, Bloomberg, Eurobank Research

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



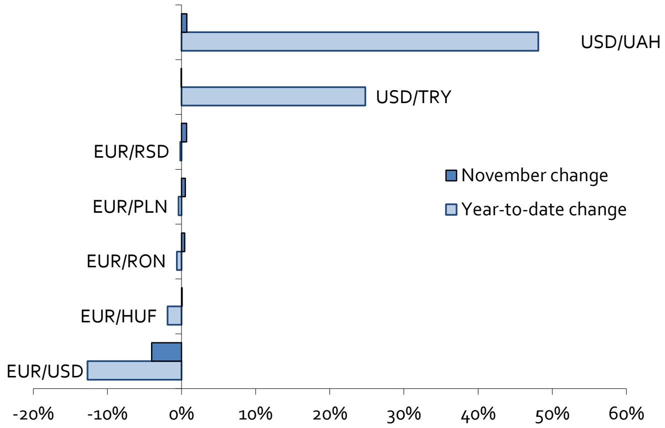
Source: Reuters, Bloomberg, Eurobank Research

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



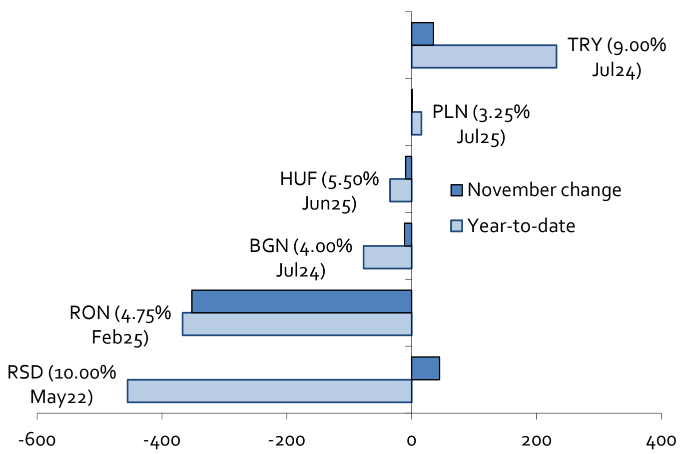
Source: Reuters, Bloomberg, Eurobank Research

FIGURE 10: **CESEE FX performance**



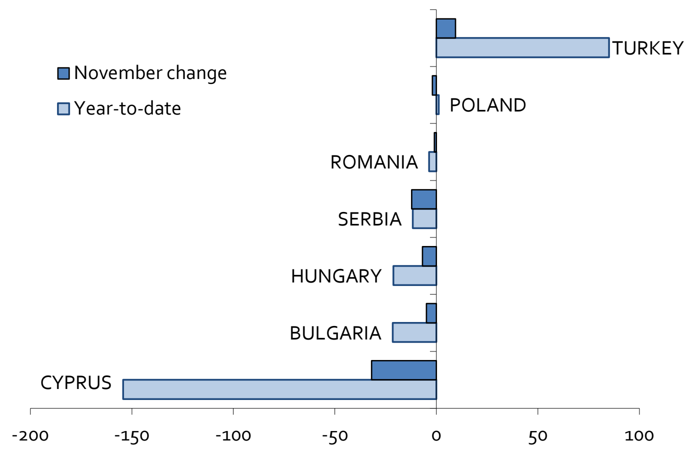
Source: Reuters, Bloomberg, Eurobank Research

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

Trader's view

Local Rates

BULGARIA

We favor the 5-7 year segment in Bulgarian Eurobond market as it seems underpriced compared to regional peers

Having broadly firmed over recent months on the back of good fiscal performance and easing Greek-related concerns, the rally witnessed in government bonds seems to be losing steam lately. The local BGN curve was little changed in November as investors remained on the sidelines in view of i) stronger Eurobond performance and ii) oversupply in the primary market. In fact, the Ministry of Finance held eight auctions for a total BGN 646.5mn over the last three months and thus institutional investors have already filled in their portfolios. Eurobonds, on the other hand, continued to recover, though at much slower pace than in previous months. Indicatively, yields decreased by 2-10bps in November against 30-40bps in the September-October period. We do not expect any notable re-pricing in the local yield curve in the imminent future but rather anticipate the market to enter a consolidation phase in the coming weeks. Identifying market opportunities, we favor the 5-7 year segment in the Bulgarian Eurobond market as it seems underpriced compared to regional peers.

ROMANIA

Took profit on our previous long ROMGB 5.6% Nov 2018 trade

We took profit on our previous long ROMGB 5.6% Nov 2018 trade as the yield target of 1.70% was recently reached. At present, we would prefer to stay sidelined in the local rates market and may consider establishing new positions after the Fed meeting in December.

SERBIA

Took profit on our previous trade recommendation, prefer to stay sidelined ahead of December's ECB meeting

We took profit of around 0.80% on our previous long RSMFRSD83827 recommendation as it recently hit the 4.00% target. For now, we prefer to abstain from establishing any new positions ahead of the ECB and Fed meetings in December. With the ECB's decision likely to have a more significant impact in regional assets, we assume that, although this year's rally in government bonds appears to be running out of steam lately, there seems to be some potential, especially in the long end of the yield curve. Depending on the ECB's outcome, we may consider on re-establishing new long positions on local RSD denominated bonds.

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

Fiscal consolidation postponed for next year

Economic activity gained further momentum in Q3 growing at the strongest rate since Q2-2011

The released flash estimate brought output performance at 2.9%YoYin Q3-2015, up from 2.6%YoYin Q1 & Q2-2015 (revised from 2.3% and 2.2% respectively). National accounts data were heavily revised again in late September in order to reflect that consumption and investment were a drag on growth in 1H-2015. The more detailed national accounts data will be published at a later stage and it is likely that large revisions and reallocations within the individual growth drivers' components will be observed once again. 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 +1.1%QoQ/+1.1%YoYin Q3-2015, up from +0.7%QoQ/-1.3%YoYin Q2-2015 compared to +0.1%QoQ/-3.6%YoYin Q1-2015. The spending recovery may have been driven by rising real wages; declining energy prices-Bulgaria has the highest energy consumption intensity in EU-28-and further modest gains in employment, despite the fiscal restraint. On the external sector, exports decelerated further in Q3 (+2.6%YoYin Q3 down from +5.2%YoYin Q2), yet imports' deceleration was faster (+1.2%YoYin Q3 vs. +4.7%YoYin Q2). 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. In any case, the Q3 reading is at odds with the picture of a more pronounced economic activity slowdown (industrial production, retail sales) implied by high frequency indicators. If the flash Q3 GDP data is to be taken at face value and the government actually implements its earlier announced decision to expand fiscally in Q4 full year real GDP growth is expected to jump to almost 3.0% in 2015, up from 1.7% in 2014.

The fiscal target of 2015 and the medium-term framework were heavily revised

In an unexpected move, the Ministry of Finance revised its official target for the consolidated government deficit in 2015 to 3.3% of GDP, up from an initial 3.0%. The revision was announced alongside the release of the 2016 budget draft, which is complemented with an updated medium term fiscal framework for the 2016-2018 period. The updated fiscal framework envisages that the consolidated government deficit will decline to 2.0% in 2016. According to the Ministry of Finance, "the increased EU funds absorption rate as a result of the closing of the 2007-2013 programming period, as well as other additional costs under autonomous budgets included in the consolidated budget are exerting the most significant additional pressure on budget spending". In our view, the revision implies a significant spending increase by the end of 2015, given that the budget execution was improved in the first nine months of the year and a more swift and ambitious consolidation in 2016. The consolidated budget surplus of 0.7% of GDP in Jan-Sep 2015 compared to a -1.8% deficit in the same period a year ago. The full-year 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. In ESA2010 terms, the 2014 deficit is equal to 5.8% of GDP, surpassing the Maastricht threshold for the first time since 2010. At this point it is most likely -but still not certain- that the deficit in ESA2010 terms will not overshoot the 3% threshold for a second consecutive year in 2015, which could result in the activation of the Excessive Deficit procedure by the European Commission.

The current account surplus widened to 3.2% of GDP in Jan-Sep2015

The current account recorded a surplus of €182.7mn in September 2015, up from €80.9mn in September 2014. As a result, the current account surplus widened to €1.36bn, or 3.2% of GDP in January-September 2015, up from €1.03bn or 2.4% of GDP in January – September 2014. In terms of components, the improvement in the current account was driven by the further compression of the trade deficit (from 4.7% to 2.8% of GDP). In terms of financing, net FDI inflows reached €1.1bn in Jan-Sep2015, up from €872mn in the period a year ago.

The Central Bank of Bulgaria amended the minimum reserve requirements in late November.

According to the press-release, BNB introduced the concept of "excess reserves" with the Central Bank and made it possible for the application of negative interest rates on excessive reserves when ECB's deposit facility rate is negative. In addition, BNB will no longer recognize as reserve assets banks' funds kept in accounts of Target2-BNB national system component. The amendments will be effective from January 4th 2016. In our view, the aforementioned measures aim to stimulate lending activity. The domestic banks' deposits held in the BNB were 2.5bn Leva or 31.6% of the total BNB liabilities in October.

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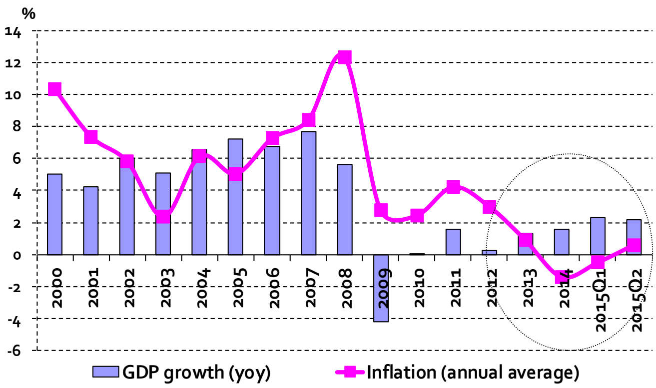
Bulgaria: Macro & Market Data				
	2013	**2014**	**2015f**	**2016f**
Real GDP (yoy%)	1.1	1.7	2.9	3.0
Inflation (yoy%)				
CPI (annual average)	0.9	-1.4	0.1	1.0
CPI (end of period)	-1.6	-0.9	0.3	1.2
Fiscal Accounts (%GDP) - *Cash Basis*				
General Government Balance	-1.8	-3.7	-3.3	-2.0
Gross Public Debt	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	10.8	10.2
Wage Growth *(total economy)*	6.0	6.8	7.0	6.0
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	19.0	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

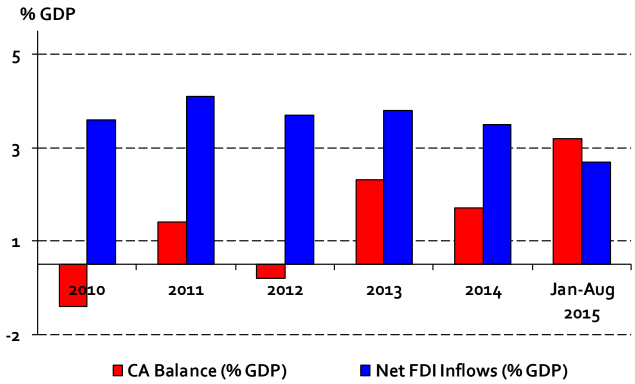
Source: National Sources, Eurostat, IMF, Eurobank Research

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



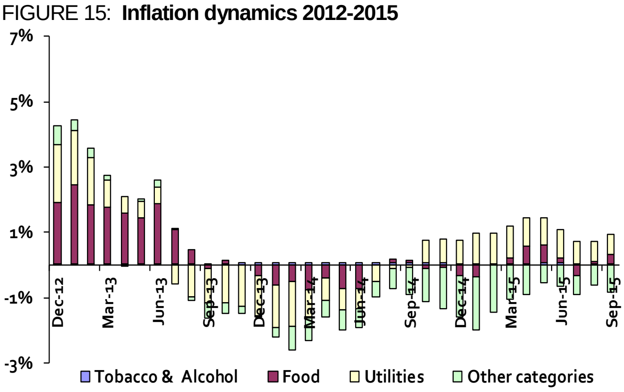
Source: National statistics, Ecowin Reuters, Eurobank Research

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



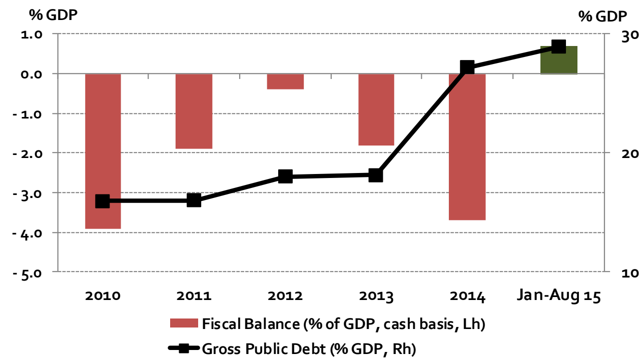
Source: National statistics, Ecowin Reuters, Eurobank Research

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 strengthened in Q3 2015

The conditionalities for the endorsement of the next review have been specified

On November 16th, the Cypriot government reached a staff-level agreement with the teams of international creditors on the areas of focus for the 9th review of the economic adjustment programme. The endorsement of the review is subject to four prior actions: 1) adoption of legislation by the parliament which allows the transformation of the Telecomm Utility (CYTA) from a semi government organization to a limited liability private company in order to be privatized 2) endorsement by the Council of Ministers of the new regulation for CYTA employees 3) decision on the ministerial level for the separation of activities of the EAC power company in line with the EU energy market directive 4) endorsement by the Troika of the recently adopted law which facilitates the securitization and sale of loans. According to the IMF press-release, a preliminary Troika assessment indicates that the law contains a number of favorable elements for borrowers. The final Troika assessment will be based on the consolidated official version and the implementation regulations that will be issued by authorities. So far, Cyprus has successfully completed eight reviews of the programme; the latest review was endorsed by the IMF Executive Board on September 23rd. Upon the €500mn ESM disbursement, Cyprus will have made use of a combined €7.2bn out of the total €10bn available in the programme (€6.3bn by ESM and €882mn by IMF).

Growth accelerated further in Q3, bringing the year to September performance at 1.2%

Growth accelerated to +0.5%QoQ/+2.2%YoYin Q3-2015, up from +0.5%QoQ/+0.6%YoYin Q2-2015 and -1.1%QoQ/-2.3%YoYin Q3-2014. Although the components of growth have not been known yet, it is highly likely that the consumption rebound has continued in Q3-2015, driven by improved confidence due to strong compliance with programme conditionalities, lower energy prices, lower unemployment. Consumption moved into positive territory in Q2-2015 for the first time since Q2-2012 (+0.3%YoYin Q2-2015 up from 0%YoYin Q1-2015), making a positive contribution to growth (+0.3pps). If 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 exceed the revised government projection for 1.5%, above our 1.2% forecast penciled in the last issue of *Regional Economics & Market Strategy Monthly*. The flash estimate of Q3 is illustrative of the progress Cyprus has made within the last two and a half years in the program. Only recently, in late October, the latest sovereign rating upgrades (by S&P and Fitch complemented also by the latest Moody's rating upgrade by two notches) paved the way for a new generic 10Y bond issuance at a historically low yield. Thus, Cyprus made the fastest come-back to international markets among all programme countries. Even though Cyprus is set to graduate successfully from the programme in March 2016, authorities will have to deal with the challenge of high NPLs stock (NPEs at 47% in September2015) in order to ensure sustainable growth in the medium-term.

Cyprus recorded the highest deflation in EU-28 in October.

Consumer prices, measured by HICP, edged up to -1.8%YoYin October, up from -1.9%YoYin September vs. +0.2%YoYin October 2014. The sharp deceleration of food prices deflation (-0.3%YoYin October vs. -1.3%YoYin September) was broadly offset by even lower energy prices (-18.4%YoYin October vs -16.6%YoYin September) which had a negative impact on the categories of transportation and utilities. Overall, deflation has continued for a third year in a row in 2015, albeit at a lower speed compared to last year. The average annual HICP came at -1.6%YoYin the first ten months of the year, down from -2.1%YoYin FY2014 and -0.3%YoYin FY2013. Headline deflation, measured by the national consumption basket, stood at -2.5%YoYin October, an unchanged rate of change compared to September. 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.

The SSM transparency exercise results call for additional capital injection to the Co-operative sector

The government announced its intention to provide new funds for the recapitalization of the Co-operative sector. The Co-operative sector, which stands for 25% of the total domestic banking assets, was deemed viable, it was exempted from bail-in and, thus, recapitalized with program funds in March 2013. So far, the government has utilized €1.5bn from programme funds. The need for additional state support of Co-operatives emerged after the Stress test carried out by the Single Supervisory Mechanism (SSM) of the ECB. The Cooperative Central Bank was compelled to raise the coverage ratio of NPLs to 50% (by €0.5bn approximately), resulting in the Core equity (CET1) to fall to 12.01%, slightly higher than the threshold of supervisory requirements. Including the new capital injection of €150-200mn, the Core equity is expected to increase by 2pps. The capital injection plan needs to be approved by the DG Competition before the end of the year, as the new rules for state-aid come in effect.

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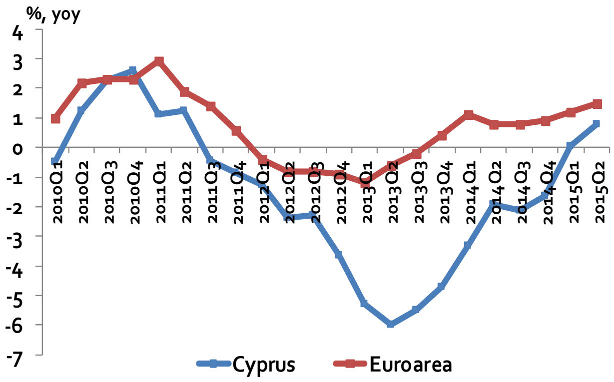
Cyprus: Macro & Market Data				
	2013	2014	2015f	2016f
Real GDP (yoy%)	-5.4	-2.3	1.2	1.6
Private Consumption	-6.0	0.4	1.1	1.3
Public Consumption	-4.9	-8.7	-2.5	-1.5
Gross Capital Formation *(Fixed)*	-17.1	-18.8	13.0	5.0
Exports	-5.0	5.7	0.5	2.5
Imports	-13.6	8.1	2.5	2.0
Inflation (yoy%)				
HICP (annual average)	0.4	-0.3	-2.1	-0.4
HICP (end of period)	-1.3	-1.0	-2.3	0.9
Fiscal Accounts (%GDP)				
General Government Balance	-4.4	-0.2	-1.3	0.1
Gross Public Debt	102.2	107.5	106.4	98.4
Primary Balance	-1.6	2.8	1.3	2.4
Labor Statistics				
Unemployment Rate (LFS, %)	15.9	16.1	15.5	15.0
Wage Growth *(total economy)*	-6.0	-4.7	-0.3	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%

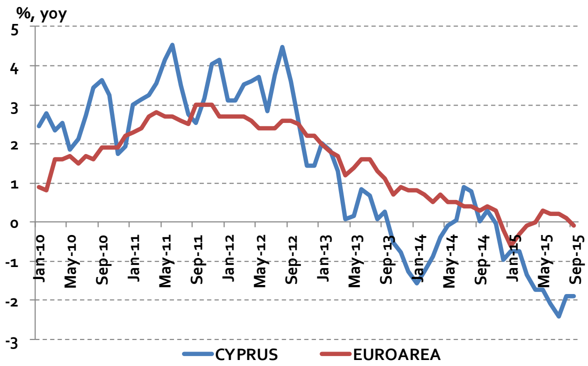
Source: National Sources, Eurostat, IMF, Eurobank Research

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



Source: Eurostat, Eurobank Research

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

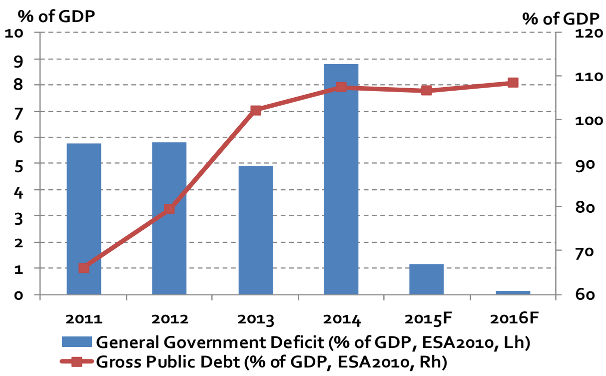


Source: Eurostat, Eurobank Research

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

Source: Bloomberg, Eurobank Research

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



Source: Eurostat, Eurobank Research

Romania (Baa3/BBB-/BBB-)

New technocratic government sworn in mid-November

A new technocratic government was sworn in mid-November, giving an end to political crisis.

After intense consultations with political parties, President Klaus Iohannis, nominated Mr. Dacian Ciolos, a former EU Commissioner for Agriculture, as the new prime minister. The new cabinet of the incoming Prime Minister Ciolos received a vote of confidence by 389 MPs, compared to 274 votes required, while 115 MPs voted against on November 17th. The new technocratic government, the fist in the post-communist history of Romania, received multi-party support. The largest parties of the parliament, the PSD (Social Democrat Party) and PNL (National Liberal Party) affirmed their support for the new government. The new government mandate is expected to last until regular parliamentary elections in late 2016.

The technocratic solution provides some comfort against political uncertainty but will most probably not be a game changer

The technocratic solution, one of the scenarios favored also by the Central Bank Governor, is on average good news for the market. The new technocratic government provides some comfort against political uncertainty given the ongoing public outcry. The new technocrat PM, backed also by the President Klaus Iohannis, will most probably provide some resistance against fiscally irresponsible and populist measures. On the other hand, the odds are against the cabinet change being a game changer as far as implemented economic policies and government efficiency in the lower levels of administration are concerned. In a pre-election year, the new cabinet will struggle to receive parliamentary support for politically sensitive structural reforms and measures.

Economic activity picked up in Q3, bringing the annual rate of expansion at 3.7% in the first nine months of the year

According to the flash estimate release, real GDP expanded in Q3 2015 by +1.4% on a quarterly basis, up from a revised flat pace in Q2. On a yearly basis, real GDP growth expanded by 3.6% in Q3 on both seasonally and not seasonally adjusted terms, slightly down from 3.8%YoYin Q2 and 2.9% in Q3-2014. The Q3 reading brings year-to-September growth performance at 3.7%. Although the components are yet to be known, we anticipate that growth has been primarily domestic demand-driven. In more detail, private consumption is booming in the first three quarters as a result of the real disposable income increase, which in turn is due to the VAT food stuff rate cut, wage increases in private and public sector, sentiment improvement and labor market tightening. On the negative side, the growth rally is concealing warning signs of an overheating scene in the making that could eventually result in a revival of macroeconomic imbalances, once inflation re-enters positive territory as a result of the phasing out of the VAT rate-cut.

The latest readings support the view that inflation is most likely to stay below the central bank target range (2.5%±1%) until at least the first half of 2016

Inflation picked up by +0.3% MoM/-1.6%YoYin October vs. +0.3% MoM/-1.7%YoYin September compared to -0.5% mom/-1.9%YoYin August in line with market expectations. The inflation print was underpinned by the higher than anticipated rise of food prices (+0.5% MoM, -6.5% YoY) on a monthly basis, which accounted for two thirds of the total monthly rise of consumer prices. Higher prices for fruits and vegetables was the main culprit behind the spike of food prices, as retailers took advantage of the lower supply in the summer months to push for higher mark-ups. Yet, the implementation of the front-loaded food VAT rate cut-from 24% to 9% -effective from June 1st- has pushed annual food prices dynamics and subsequently headline inflation into negative territory, given the high share of food products in the consumption basket (32%). On the other hand, non-food items advanced by +0.13% MoM/+0.75%YoYin October up from -0.15% MoM /+0.5%YoYin September as a result of the implementation of an excise hike on tobacco products. Accordingly, services inched up by +0.3% MoM/+2.1%YoYin October compared to +0.1% MoM/ +2.0%YoYin September in an illustration of demand side pressures building up in the non-tradables sector. Overall, the latest readings support the view that inflation is most likely to stay below the NBR target range (2.5%±1%) until at least the 1H-2016. Only recently, NBR downgraded its year-end inflation forecast in 2015 to -0.7%YoYvs. -0.3%YoYin the August inflation report but at the same time upgraded its year-end forecast in 2016 to +1%YoYcompared to +0.7%YoYpreviously.

Central Bank maintained interest rates unchanged at 1.75% in the November policy meeting

In early November, in the midst of the political turmoil, NBR stayed put on its monetary policy for a fourth consecutive time, in line with our and unanimous market expectations. In more detail, the key policy rate remained at the current record low of 1.75%, while the minimum reserve requirements for RON & FX denominated liabilities were left unchanged at 8% and 14% respectively. Despite the more cautious tone adopted in the aftermath of the political fallout, our view on the interest rates outlook has not changed. There are some good reasons why NBR could stay put on rates until mid-2016, looking beyond the fiscally induced supply side shock. Reasons include the robust growth performance, which implies the sooner than expected closing of the output gap, downside risks stemming from the unnecessary pro-cyclical fiscal stimulus which has raised deep concerns, also voiced by the EU and IMF, plus increasing worries over external risks- given that the probability of a Fed hike in December has increased- remain on the radar.

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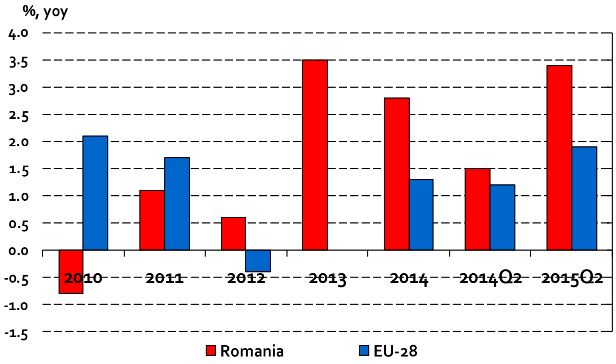
Romania: Macro & Market Data				
	2013	2014	2015f	2016f
Real GDP (yoy%)	3.4	2.9	3.5	4.1
Consumption	0.4	3.0	3.8	6.0
Investment	-7.9	-3.6	6.2	6.0
Exports	16.2	3.5	6.2	5.6
Imports	4.2	7.7	8.1	7.5
Inflation (yoy%)				
CPI (annual average)	4.0	1.1	-0.8	0.5
CPI (end of period)	1.6	0.8	-1.2	1.3
Fiscal Accounts (%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	6.5	6.4
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	2.50
EUR/RON	4.44	4.45	4.45	4.40

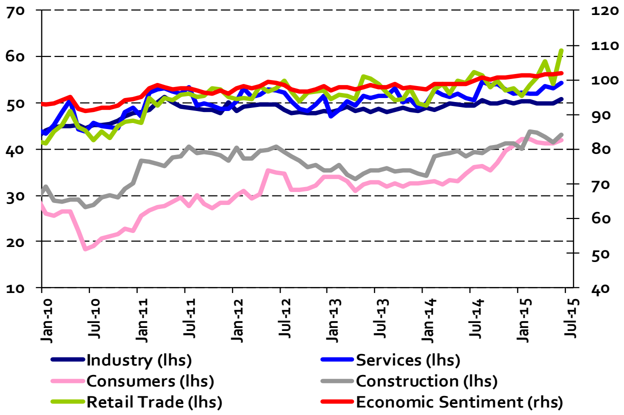
Source: National Authorities, EC, IMF, Eurobank Research

FIGURE 21: **Growth rates Romania vs. EU - 28 2005-2014**



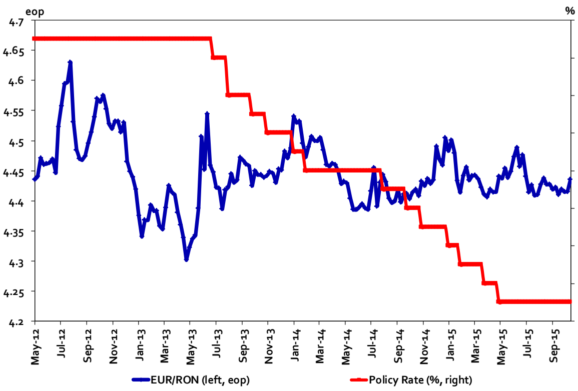
Source: Eurostat, Eurobank Research

FIGURE 22: **Sentiment indicators 2010-2015**



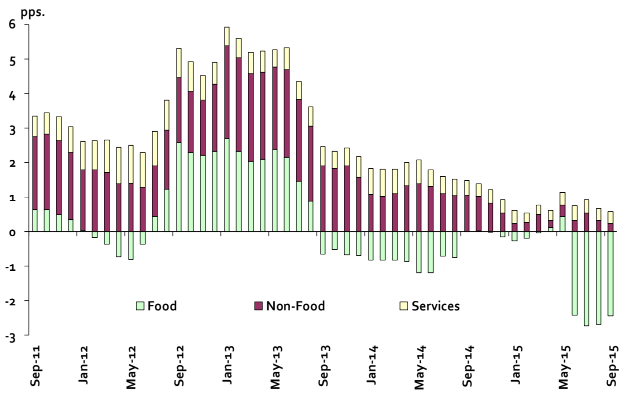
Source: Eurostat, Ecowin Reuters, Eurobank Research

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+)

Q3 2015 GDP data signal continuation of domestic economic recovery

Economic activity recorded positive growth for the 2nd consecutive quarter in Q315 after five quarters running in contraction

Economic activity slid back into contraction of 0.4%QoQ in Q3 2015 (sa), following a positive growth reading of 2.0%QoQ a quarter earlier. That said, the final YoY non-seasonally adjusted reading showed upwardly revised growth of 2.2% vs. a 2.0% flash estimate and follows growth of 0.9%YoY in Q2 2015. It marks the highest pace of increase since Q4 2013 as well as the 2nd consecutive quarter in the black after five quarters running in contraction. Favourable base effects amid a strong recuperation of the mining and energy sectors from the 2014 floods, low international oil prices, economic reform implementation and improving foreign demand have all boded well for a return to positive growth annual readings over the last two quarters. Vindicating our expectations, the breakdown of the data showed that the recent growth pattern, led by gross fixed capital formation and exports, continued in Q3 2015. Investment activity accelerated to 10.1%YoY in Q3 2015 from 8.7%YoY in Q2 2015, remaining in expansion for the 3rd quarter running and marking the highest rate of increase since Q3 2012. Meanwhile, exports' growth picked up pace to 8.8%YoY from 8.4%YoY in the prior quarter. Surprisingly, public expenditure rose mildly (+0.8%YoY) despite ongoing fiscal restraint, a development that is unlikely to be sustained in the coming quarters. Fiscal tightening kept growth in private spending in a negative territory of 0.6%YoY, though the pace of decline somewhat eased from the prior quarter's 1.3%YoY drop, possibly on the back of somewhat improving labour market conditions. Likewise, imports growth of 5.4%YoY in Q3 2015 came in above a timid 2.0%YoY rise in Q2 2015, but remained well subdued relative to the strong start witnessed in the beginning of the year. High frequency data released recently suggest that the rebound in domestic economic activity continued in Q4 2015. We retain our 1.0% GDP growth forecast for this year and 2.0% for the next amid accommodative monetary policy conditions, low commodity prices and economic recovery in the Euro Area. The waning fiscal consolidation impact is likely to provide further support next year.

Central Bank's monetary easing cycle has likely bottomed out

In its November MPC meeting, the National Bank of Serbia (NBS) decided to stay put on its monetary policy and keep the key policy rate unchanged at the current record low level of 4.5%. This follows three consecutive 50bps monthly cuts and cumulative rate-easing of 725bps since May 2013, out of which 350bps have been rendered so far this year. Despite persistently below target inflation (at 1.4% in October vs. 4±1.5% target tolerance band), falling inflation expectations and a relatively stable foreign exchange rate, the market's consensus was for stable interest rates ahead of December's key meetings by the ECB and the Fed. The two major Central Banks appear to be pursuing increasingly divergent monetary policies, with expectations having significantly increased lately over an expansion of the ECB's QE and a Fed rate hike in their upcoming meetings in December. With regards to the latter, the inception of the FOMC's rate-hiking cycle may weigh on foreign capital flows into emerging markets. The NBS has acknowledged this risk, though highlighted that the economy is shielded by the favourable effects of fiscal consolidation, improving growth prospects, reduced external imbalances and the IMF's policy anchor. Looking ahead, we believe that November's MPC decision flags the end of the Central Bank's current rate-cutting cycle. A wait-and-see stance is likely to be adopted in the months ahead, as the impact of hefty monetary easing and reduction in FX reserve requirements gradually feeds through into the domestic economy, while HICP is expected to sustainably return within the target band from mid-2016. Potential increases in public sector wages and pensions are likely to have a modest impact on inflation as they are likely to be of a limited scale.

Staff-level agreement reached in early November in the context of the 3rd review under the IMF programme

Domestic authorities reached a staff-level agreement with the IMF in November in the context of the 3rd review under the country's €1.2bn Stand-By Arrangement. The review's completion is subject to approval by IMF Management and Executive Board, tentatively scheduled for mid-December, and will make available ca. €89.6mn to Serbia, bringing the total amount of funds available so far under the current programme to €627mn, though Serbian authorities have indicated that they intend to treat the arrangement as precautionary. The IMF mission acknowledged that the economic recovery continues and revised by 0.25pps higher its real GDP growth projections for 2015 and 2016 to 0.75% and 1.75%, respectively, citing an earlier-than-expected recovery of the mining and energy sector and accelerating investments as well as job creation. On the fiscal front, the IMF acknowledged that the strong fiscal performance continued into Q3, with the 9-month budget realization outperforming the respective programme targets thanks to improved revenue collection and lower-than-planned public investment expenditure. Nonetheless, it underscored certain delays in fiscal and structural reforms, advising the government to put the public sector reform firmly on track and pursue more decisive reforms of state-owned enterprises, adding that public debt has to be placed on a downward path and noting lingering external risks.

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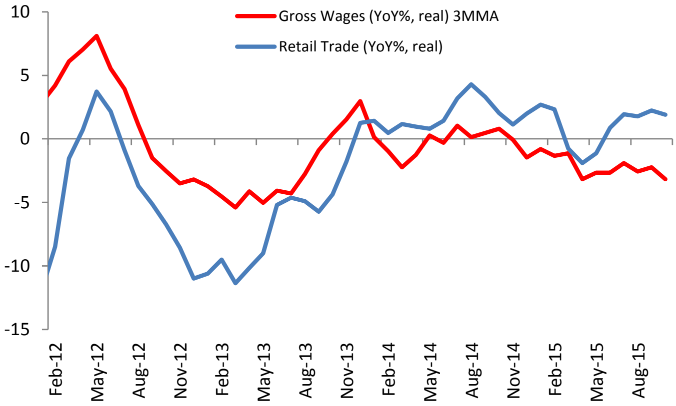
Serbia: Eurobank Forecasts				
	2013	2014	2015	2016
Real GDP (yoy%)	2.6	-1.8	1.0	2.0
Inflation (yoy%)				
HICP (annual average)	7.9	2.1	1.7	3.5
HICP (end of period)	2.2	1.7	2.3	4.0
Fiscal Accounts (%GDP)				
Consolidated Government Deficit	-5.6	-6.7	-3.5	-4.6
Gross Public Debt	61.4	72.4	77.3	78.8
Labor Statistics (%)				
Unemployment Rate (%of labor for	23.0	19.7	21.3	20.9
Wage Growth *(total economy)*	5.7	2.0	0.0	0.0
External Accounts				
Current Account (% GDP)	-6.1	-6.0	-4.3	-4.1
Net FDI (EUR bn)	1.2	1.2	1.3	1.3
FDI / Current Account (%)	57.1	60.0	92.9	92.9
FX Reserves (EUR bn)	11.2	9.9	10.6	11.5
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	120.00	122.00	123.00	124.00

Source: National Authorities, IMF, Eurobank Research

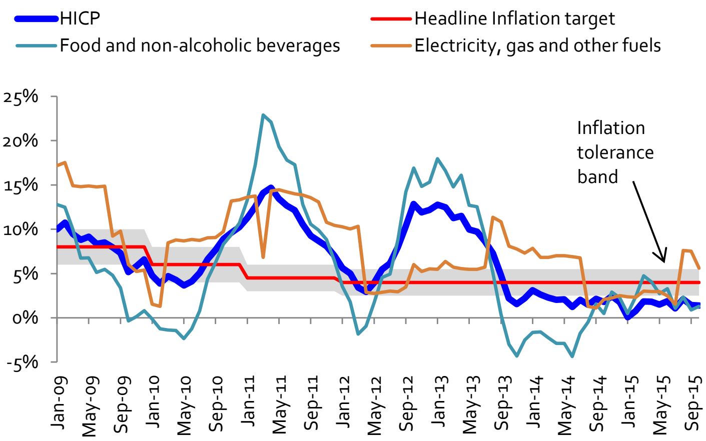
Source: National Authorities, EC, IMF, Eurobank Research

FIGURE 25: **Austerity measures weigh on private consumption (3MMA)**



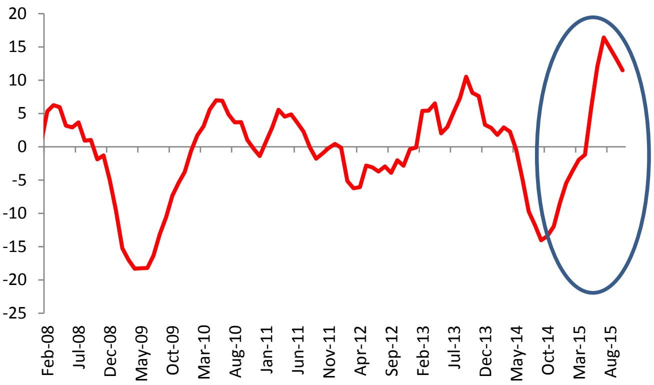
Source: National Authorities, EC, IMF, Eurobank Research

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



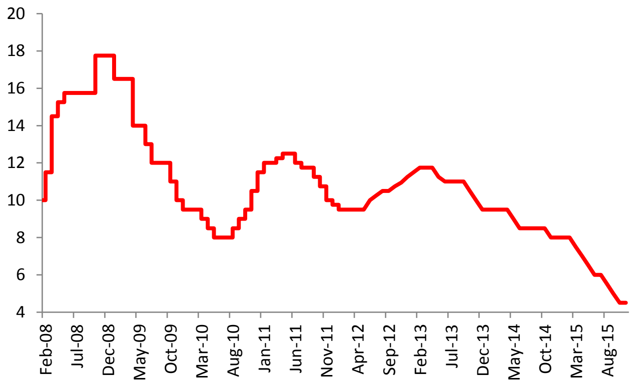
Source: National Authorities, Eurobank Research

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



Source: National Authorities, EC, IMF, Eurobank Research

FIGURE 28: **NBS cuts interest rates to new record low in October**



Source: National Authorities, EC, IMF, Eurobank Research

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