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Intesa Sanpaolo
International Research
Network

Growth is forecast to weaken in 2019-20, after a stronger-than-expected 2018. A temporary drop in inflation and new ECB forward guidance support a softer monetary normalisation in most CEE/SEE. Rate cuts expected in CIS and Egypt.

From the 4Q18 release of GDP data, average growth for the **CEE/SEE region** in 2018 has been revised slightly upwards with respect to our December forecasts, to 4.5% yoy from 4.4% yoy, and to 3.9% from 3.8%, respectively, still showing, nevertheless, a weaker reading than in the previous quarters. The most recent high frequency indicators confirm that the business cycle in CEE/SEE economies is in fact softening, due to expectations of a declining contribution from external trade and a weaker (though still supportive) domestic demand. Growth is now forecast to decelerate in the region to 3.2% in 2019 and 2.8% in 2020. In the **CIS area**, economic growth is also forecast to slow, to 1.6% in 2019, after a better-than-expected dynamic in 2018 (+2.4%), mostly due to a significant revision of statistics in the construction sector in **Russia**, before rebounding in 2020 towards potential. In the **MENA region**, in **Egypt**, the GDP performance is expected to remain strong, at c.5.4% in FYs 2018/19 and 2019/20, and to move to an even higher 5.5% in FY 2020/21. In all the regions, risks for growth appear to have shifted to the downside.

Inflation forecasts have been revised downwards in the CEE/SEE region for 2019 (to a 2.2% avg from 2.5% projected in December), due to the temporary drop in oil prices, in addition to the weakening of GDP growth. Inflation is expected to recover in 2020, moving closer to targets. Outside the CEE/SEE region, inflation is forecast to accelerate in 2019 in **Russia** and **Egypt**, mainly due to planned changes in regulated prices, before easing again in 2020 towards CB targets.

Following the recent weaker readings of inflation and the shift in the ECB's *forward guidance*, **monetary policy** is forecast to remain broadly accommodative in CEE/SEE countries for a longer period than previously anticipated, with either a postponement of the reversal of policy rates or a softening/delay of further tightening where it had already started, as in case of Czech Republic and Romania. Market players are preparing for monetary tightening however in Hungary after the announced adjustment of past extraordinary measures and the raise of the O/N deposit rate in March. Outside the region, new easing monetary cycles are likely to start in **Ukraine** and **Russia** in late in 2019 or early in 2020. Lower policy rates are also foreseen in **Egypt** as inflationary pressures dissipate. **Long-term yields profiles**, still upwardly sloping, have shifted downwards in most CEE/SEE countries, due to lower inflation expectations and milder money market projections.

Forecasts for **lending growth** in the CEE/SEE region (around 6% average in 2019, after a strong 7.7% in 2018) are supported by economic backdrops and improving banking fundamentals. The dynamic of household loans is expected to remain stronger than that of corporates, but on a decreasing path, partly due to measures adopted by several CBs to avoid excess credit expansion, particularly in the CEE countries. NPLs continue to weigh on loan growth in a few SEE countries – especially in Ukraine. In the **CIS area**, lending growth has improved in nominal terms in both Russia (to 8.6% in 2019) and Ukraine (to 5.3%). In **Egypt**, it is forecast to remain in double digits, though still below nominal GDP growth. **Funding and liquidity conditions** should remain broadly supportive, with implicitly declining LTD ratios. **Banking interest rates** are forecast to increase, but very gradually, driven by easy money market rates. Their profiles have been revised slightly downwards in Albania, Croatia and Serbia, and slightly upwards in Czech Republic and Ukraine.

GDP % yoy CEE SEE (2019-21)



Sources: ISP Research Department Forecasts; note * weighted average

GDP % yoy CIS Egypt (2019-21)



Sources: ISP Research Department Forecasts; note * weighted average

Contents

Cross Country Analysis	3
Country-Specific Analysis	9
Czech Republic	9
Hungary	10
Poland	11
Slovakia	12
Slovenia	13
Albania	14
Bosnia and Herzegovina	15
Croatia	16
Romania	17
Serbia	18
Moldova	19
Russia	20
Ukraine	21
Egypt	22
Country Data: Economy, Markets and Banks - the economic cycle	23
Country Outlook	24



This note has been coordinated by Gianluca Salsecci. The names of the authors are reported in the single sections.

The note considers the countries with Intesa Sanpaolo Subsidiaries: Slovakia, Slovenia, Hungary, Czech Republic among the CEE countries, Albania, Bosnia, Croatia, Serbia and Romania among SEE countries; Russia, Moldova and Ukraine among CIS countries; Egypt among MENA countries. It also includes Poland, among the CEE countries, where ISP is present with a Branch.

The Economic and Banking Outlook is released on a quarterly basis in March, June, September and December.

Cross Country Analysis

Recent developments

In the **CEE region**, regarding **Q4 GDP**, the regional average growth was 4.4% yoy, below the previous quarter's trend (4.6%) and lower than the peak observed in 4Q17 (4.9%), but still strong. There are country-by-country differences underlying the 4Q18 regional average. Country-specific dynamics range from 2.9% in Czech Republic to 5.1% in Hungary. The breakdown of GDP data into components reveals that economic growth was still driven mostly by investments and household consumption which grew by about 8.8% yoy and 3.7% yoy, respectively, in Q4 (still strong, but below the previous quarter's trends (13% yoy and 4.1% yoy, respectively)). In the same period, government expenditures softened to 2.5% yoy from 3.1%, while the dynamic of exports (5.7% yoy) remained below that of imports (8.1%). Following the 4Q18 data, GDP growth for the entire year equals 4.5%. The current year started with the majority of high frequency economic indicators signalling a further weakening of the business cycle. The Economic Sentiment Indicator (ESI) decreased in Poland and Slovenia in February, and the same happened in the remaining CEE countries in January. In Hungary, PMI manufacturing, even if still above 50, fell in January, while in the same month, it remained below that level in Poland.

In the **SEE region**, **GDP growth** (excluding Albania and Bosnia, where Q4 GDP data have not been released yet) was on average 3.3% yoy in Q4, lower than the 3.8% recorded in Q3. Annual GDP growth is now estimated at 3.9%. At the country level, GDP growth ranged from 2.3% in Croatia to 4.0% in Romania. The breakdown of GDP data reveals that investments, after stagnating in Q2, returned to a positive trend in Q3 (+0.6%) and consolidated in Q4 (1.2% yoy). Although remaining fairly strong, export growth decelerated further in Q4 (to 1.6% yoy from 3.5% yoy), as did household and government expenditures (respectively to 0.9% from 3.3% and to 0.8% from 1.7%). The most recent data on the economic activity confirmed that SEE economies weakened significantly in the first month of 2019. Exports contracted in nominal terms by 7.1% yoy in Albania in January and by 10.8% in Bosnia, where industrial production decreased too (-6.5% yoy). Industrial production also decreased in Serbia in January (-4.5% yoy).

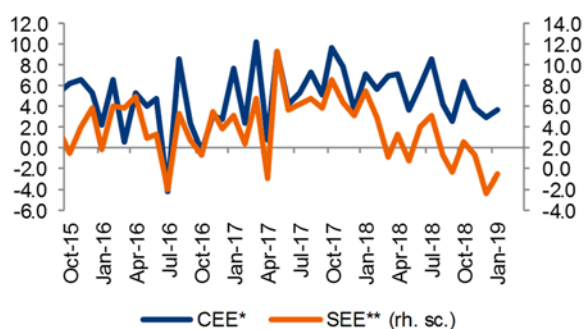
The most recent **inflation** figures, showed overall a decline in Q4 data (2.2% from 2.7% in CEE/SEE), due to lower imported inflation and due to the drop of oil prices (which have now partially rebounded however). From the beginning of the year, **monetary policy** rates have been still kept generally unchanged in CEE/SEE countries. The 3M policy rate has been also left on hold (at 0.90%) in Hungary but the O/N depo rate was raised by 10bps from -0.15% to -0.05% at the March NBH meeting when liquidity measures were also adjusted to support the start of monetary normalisation. In this first quarter of the year, long-term yields decreased slightly in almost all CEE and SEE countries. Thanks to still positive trends for exports, albeit softening, and softening financial market concerns about monetary tightening worldwide, exchange rates have appreciated slightly or remained roughly stable in the last three months.

Gianluca Salsecci, Giancarlo Frigoli, Antonio Pesce and Davidia Zucchelli

Economic growth continued to be robust in the CEE/SEE areas in 4Q18, albeit lower than in Q3

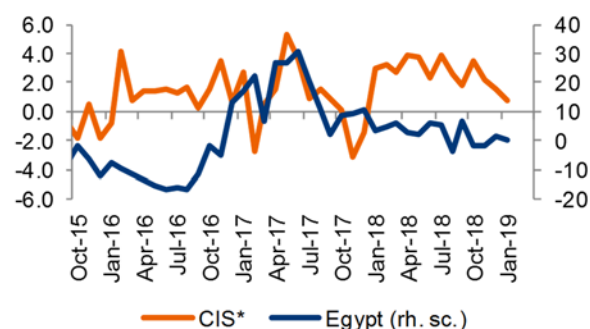
Lower inflationary pressure in the last months

Industrial production % yoy – CEE – SEE



Sources: National Statistics Offices; note * weighted average on Slovakia, Slovenia and Hungary data; ** weighted average on Bosnia, Croatia, Romania and Serbia data

Industrial production % yoy – CIS - Egypt



Sources: National Statistics Offices; note * weighted average on Russia Ukraine and Moldova data

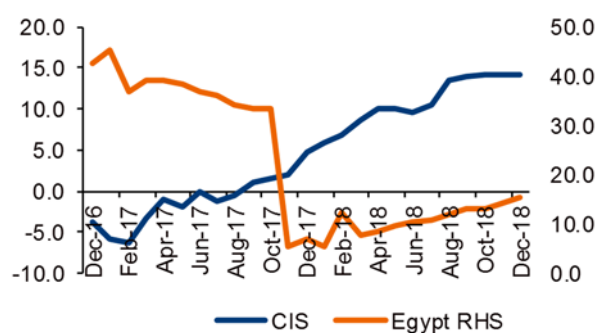
In the **CIS region**, the **Russian** economy grew by a stronger-than-expected 2.3% in 2018, reflecting a significant upward revision to construction activity data. The softer-than-expected Russian inflation figures for both January (5% yoy) and February (5.2% yoy) are now expected to bring interest rate cuts back on to the agenda sooner than anticipated. In **Ukraine**, real GDP in 4Q18 increased by 3.4% yoy, and in the whole year, growth accelerated to 3.3% from 2.5% in 2017. Annual inflation slowed, however, to 8.8% in February 2019. The Monetary Authority's target for inflation is 6.3% at the end of 2019. At its policy meeting in mid-March, the NBU left its policy rate unchanged at 18%, but it sees scope for easing with inflation falling into the target range. In **Moldova**, real GDP growth accelerated to 3.9% in 4Q18, and for the whole 2018, GDP growth was 4.0%, slowing from 4.5% in 2017. Annual inflation rose to 2.4% in February 2019 from 0.9% in December 2018. The central bank expects annual inflation to rise to the upper end of its 5%+/-1.5% target range in 2019.

In the **MENA region**, in **Egypt**, real GDP increased by 5.4% yoy in the first half of FY19, accelerating from 5.3% in FY18. Investments, tourism and gas extraction continued to be the key growth drivers. In February, the central bank cut its main reference rates by 100bps. After slowing from 17.7% in October to 12.2% in January 2019, inflation increased to 14.4% in February. Additional price pressures are expected to derive from another round of IMF-agreed subsidy cuts.

Banking aggregates, in the CEE/SEE area, strengthened further in 2018, with yoy changes in most cases higher than nominal GDP. The household lending dynamic remained strong. Corporate loans showed a significant recovery in Serbia, Romania and Hungary. The strongest performances in loans were realised in Hungary (+10.6%) and Serbia (+9.9%). The only decrease in loans in our sample occurred in Albania (-3.8%), due to the performance of corporates (-7.2%). Banks' annual profits were strong in Albania (ROA at 1.2%). Loans to corporates declined in 2018 because of restructuring in Slovenia (-1.4%) and Croatia (-1.1%, but +0.2% yoy in January). In Romania, banks are expected to be quite negatively affected in 2019 by the new tax on total assets (ROA was 1.6% in 2018). The **NPL level** remained over 10% of loans only in Albania. **Deposit** growth remained strong in 2018 in many countries, particularly Hungary (+14%) and Poland (+9.4%). In Serbia, the acceleration of corporate deposits (+25% yoy in December from +5% yoy in November) was due to temporary foreign currency funds provided to public companies.

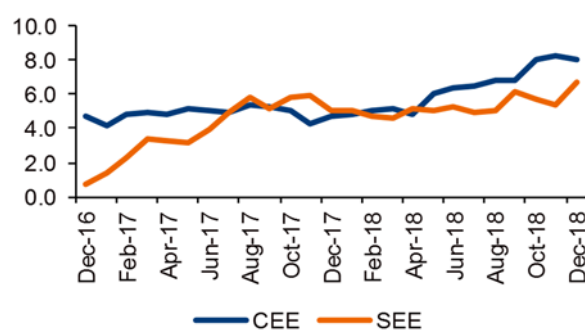
In 2018, in the CIS area, loan growth remained strong in Russia (+15%) and modest in Moldova (5.9%). In Ukraine, all sectors showed a deceleration in December. Total loans increased by 6.3% yoy (from +14.7% in November). Ukrainian banks generated high profits last year (ROA jumped to 1.6%). In Egypt, loans accelerated slightly (+15.3%) in both the corporate (+13.4% yoy) and households (+20.2% yoy) segments. **Falling interest rates** in all countries, apart from Romania, Czech Republic and Slovakia in CESEE countries, led to declining spreads.

Lending growth (% yoy changes, weighted averages)



Sources: ISP Research Department elaborations on central banks data.

Lending growth (% yoy changes, weighted averages)



Sources: ISP Research Department elaborations on central banks data.

The international outlook underlying the scenario

In the US, at its last meeting in mid-March, the FOMC communicated a more dovish stance on interest rates, and now the Fed is expected to stay put on rates this year and a rate hike next year is anything but certain. The Fed also revised downwards its projections for both GDP growth and inflation. Due to weaker consumption and investment, real GDP is now expected to rise by 2.1% this year (down from 2.3% forecast in December) and 1.9% in 2020 (vs 2% previously). Inflation is forecast at 1.8% this year (vs 1.9%) and 2% in 2020 (vs 2.1% previously). The bond market has already discounted this new scenario. The yield on 10Y T-notes is now hovering around 2.50%, down 70bps from the high last October.

At its March's meeting, the ECB also modified *forward guidance* on monetary policy, stating that rates will stay unchanged at least until the end of 2019, no longer only through the summer of this year. Moreover, the ECB announced funding measures that will extend the current easing conditions in the system well into 2021 and perhaps even beyond. A new series of TLTROs, each with a duration of two years, will be launched on a quarterly basis between September 2019 and March 2021. The macro projections for the Euro Area of the ECB's staff, which were released after the meeting, sharply cut GDP growth for this year (to 1.1% from 1.7% in December) and trimmed growth the forecast for 2020 (to 1.6% from 1.7%) while the number for 2021 was left unchanged (at 1.5%). On inflation, the ECB slashed its forecast for 2019 (to 1.2% from 1.6% in December) and trimmed its numbers for 2020 (to 1.5% from 1.7%) and 2021 (to 1.7% from 1.8%).

The economic cycle has also passed its peak in **emerging market economies** (EM). Most emerging countries have now released Q4 GDP data. For a sample that includes about 75% of the emerging world, real GDP growth slowed to 4.5% in the final quarter of 2018 from 4.8% in Q3. At a regional level, growth in Q4 weakened in Latin America as a result of a slower growth in Mexico and Brazil; in Emerging Europe, in Turkey, which following the financial turmoil seen in the summer of 2018, has just entered a recession; and in Asia, with growth weaker in both China and India. It accelerated instead among the CIS countries, following strong data in Russia, which was led by a one-off boost from construction activity (see text above), and in Africa, sustained by oil exporting economies like Nigeria.

There are good reasons to expect a slowdown across EM this year. Among **BRICS**, China, the largest of the group, is now in the midst of a slowdown partly linked to policymakers' focus on credit risk and, to a lesser extent, due to the effects of trade disputes with the US. The official forecasts set GDP growth at between 6% and 6.5% in 2019-20 (following a deceleration last year to 6.6% from 6.8% in 2017), but there are concerns that growth may weaken even further, depending on the outcome of the trade talks with the US. India's economy is slowing too, although it should remain an outperformer (real GDP growth is forecast at 7.1% in 2019 vs 7.3% in 2018). Russia is officially projected to grow by 1.5% this year vs the unexpected 2.3% seen in 2018. The countries where GDP growth is expected to strengthen this year are at early stages of cyclical recoveries (such as Brazil) or coming out of downturns (such as South Africa). Mexico's economy is also expected to be slightly stronger this year, even if this is mainly due to policy stimulus.

One consequence of the broad-based slowdown is that the **monetary policy** tightening across large parts of the emerging world are coming to an end. The bias over the next 12-24 months is likely to be towards looser monetary policy. Low inflation, with the annual rate for our sample decelerating to 3.5% at end 2018 from 3.9% at end 2017 and slowing further in January 2019 (to 3.3%), is another argument supporting lower policy rates. The more positive expectations about inflation and interest rates had a positive impact on EM financial markets, where in the first quarter of 2019, the **EMBI+ spread** narrowed by around 50bps (to 390bps) compared to its level at end-2018.

The Fed and the ECB are now more dovish due to a slowing growth and subsided inflation. The tightening cycle looks to be coming to an end in emerging countries as well.

The economic outlook

GDP growth and inflation

On the basis of the most recent quarterly GDP data, basically in line with our December's forecasts in the CEE area and just slightly below them in the SEE region, and after taking into account the readings of most recently released high frequency indicators, our forecasts for regional average GDP growth in 2019 have been revised downwards, but only slightly with respect to our December estimates. For the whole **CEE/SEE region**, GDP growth has been revised from 3.3% to 3.2%, due to a downward revision of growth by 0.5pp for the SEE area (from 3.4% to 2.9%). GDP growth is then confirmed to be on a decelerating path towards 2.6% in 2021, due to both a projected slowdown in domestic demand (even if still supportive) and net trade exerting a significant drag on growth.

Inflation forecasts have also been partially revised downwards in the CEE/SEE region to a 2.2% average in 2019 (from 2.5% in December), due to a weakening of demand and to temporary factors (mainly oil price drop) which drew inflation down in the final part of 2018. In most cases, inflation in 2019-20 is forecast to be within the targets set by the respective central banks, with the exception of Romania (3.5% in 2019) and Czech Republic (2.2% in both years), where nevertheless it is still forecast to be within the upper end of the target range. Over the forecast horizon, even if the output gaps are closing, due to pressures from tightening labour markets, inflation is expected to re-accelerate with respect to 2019, moving closer to CB target values.

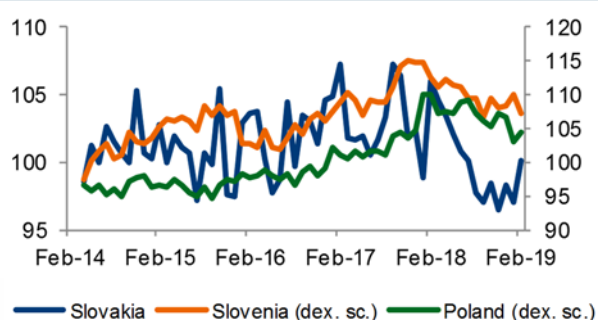
In the **CIS area**, after stronger-than-expected growth last year, in **Russia**, we forecast weaker growth in 2019, due to both external (including sanctions and cuts in oil output) and internal (VAT) factors. Growth is then expected to return to potential (around 2%) in 2020. In **Ukraine**, GDP growth is also forecast to decelerate in 2019, weighed on by still restrictive monetary policy to counter inflationary pressures and fiscal consolidation measures aimed at containing the public deficit adopted in agreement with the IMF, and it is then expected to re-accelerate towards 3.2% in the L/T. In **Moldova**, strong domestic demand is expected to keep the economy on a solid growth path (around 3.5%) also in the M/L term. In the **MENA region**, in **Egypt**, GDP growth is expected to increase further, to above 5.5%, in the L/T, boosted by the announced investment in hydrocarbons and infrastructure.

In the CIS area, in **Russia**, **inflation** is expected to accelerate significantly in 2019, mainly as a consequence of the rise in the VAT rate, to a range of between 4.7% and 5.2%, and then to slow down gradually and converge towards the 4% target. In **Ukraine**, the easing of inflationary pressures is expected to continue in 2019-20, although inflation is likely to remain above the central bank's official targets in both years. In **Moldova**, the inflation rate is expected to accelerate sharply in 2019, boosted by higher prices for food and regulated products. Pressure should ease starting from 2020, with inflation stabilising around 5%. In **Egypt**, we have raised our inflation expectations for this year following the jump in the annual rate seen recently, mainly related to food prices and the discounting of new subsidy cuts. Inflation is still forecast to slow significantly in the next few years.

Average GDP growth forecasts have been revised slightly downward in CEE/SEE area with respect to our December note

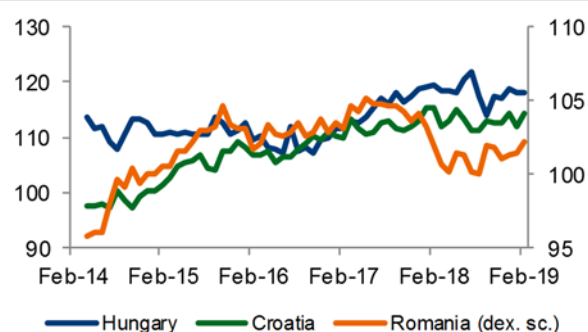
In CIS countries, GDP growth is likely to show a temporary slowdown this year. Growth in Egypt is likely to gain additional steam this year.

Economic sentiment indicator



Source: European Commission

Economic sentiment indicator



Source: European Commission

Monetary policy and financial markets

As domestic inflation is generally expected to remain inside target corridors and based on the dovish forward guidance announced by the ECB in the last meeting of the Governing Council, the **monetary conditions** in CEE/SEE countries are forecast to remain broadly accommodative for a longer period than previously expected, with either a postponement of the previously expected reversal of policy rates or a softening/delay of a further tightening where it has already started, as in case of Czech Republic and Romania. In the latter two countries, additional increases in policy rates are forecast to occur, but for these to be more modest than noted in our December forecasts, with only one (instead of two) 25bps rise now expected in 2019 in Czech Republic and one of the same amount more likely delayed to 2020 in Romania. Some concern due to inflationary pressures is rising in Hungary, with market players preparing for the normalisation of monetary policy after the announced adjustment of past extraordinary liquidity measures and the raise of the overnight deposit rate by 10 bps to -0.05% (base rate unchanged at 0.9%) in the last board meeting.

For the **CIS area**, central banks in both **Russia** and **Ukraine** are now expected to resume their easing cycle earlier than previously expected. In more detail, the Russian central bank might cut late this year or early next year, while rates in Ukraine should fall significantly starting from this year. In **Moldova**, we expect the central bank to stay put this year due to rising inflation and to err towards lower rates starting from 2020. In **Egypt**, we expect the CBE to cut policy rates again this year and over the forecasting period, not deterred by higher inflation, as we consider the recent price pressures to be temporary.

Following lower expected inflationary pressure and the decisions adopted by the ECB's Governing Council, **long-term bond yields** of EA benchmarks moved abruptly downwards, and, although to a lesser extent, in CEE/SEE region. The forecast profile of long-term interest rate, even if still upwardly moving, now incorporates implicit expectations of milder profiles for short-term rates in both the Euro Area and in most CEE/SEE countries. In **Russia**, long-term yields are expected to fall over the forecasting period, mirroring the drop in the risk premia on world financial markets.

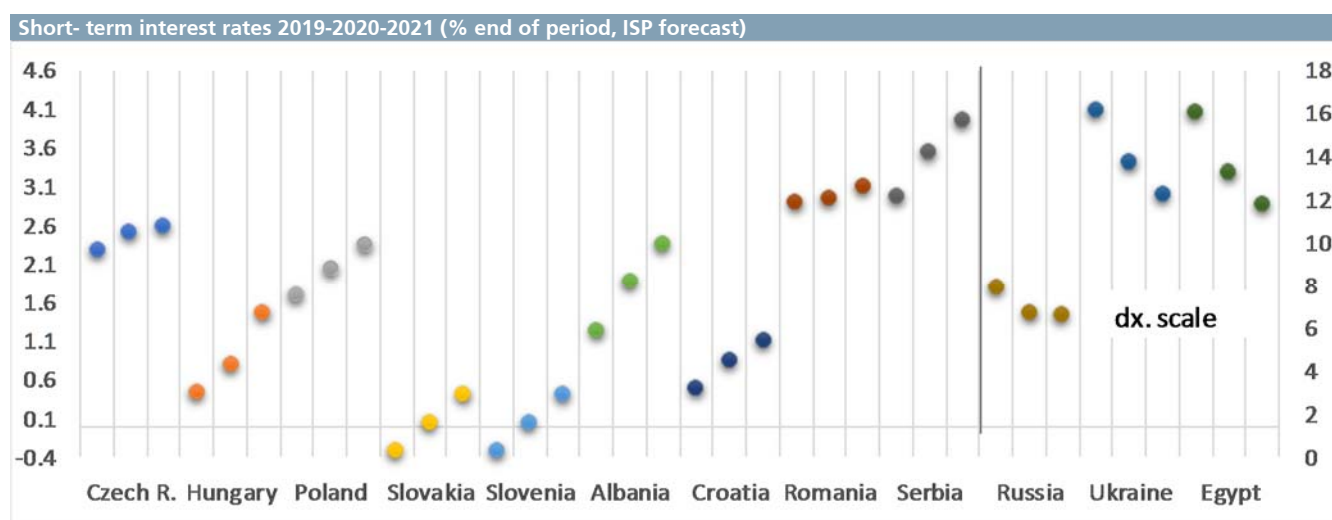
After the recent moves of the forint, we see forecasts regarding the Hungarian currency moving on a stronger path vs the December numbers. For the other countries in the **CEE/SEE region**, less affected by financial market volatility, we confirm a view of roughly **stable exchange rates** in 2019. In the **CIS area**, in **Russia**, higher crude oil prices should sustain the rouble, which is expected to follow a re-appreciation path in the M/L term. In **Ukraine**, higher inflation than in peer countries is expected to weigh on the hryvnia, with gradual depreciation seen over the forecasting horizon. In **Egypt**, the pound is expected to depreciate in order to defend the competitive position.

Monetary policy tightening is expected to be postponed with respect to projections in our previous forecasts.

In CIS, central banks expected to cut earlier than previously expected. In Egypt, easing mood of the CBE confirmed.

Downward revisions of long-term yield forecasts in CEE/SEE countries.

Higher oil price forecasts expected to sustain the rouble. Other CIS currencies expected to depreciate to defend competitive positions. Also, the Egyptian pound looks to be on a depreciating trajectory.



Source: ISP Research Department Forecasts

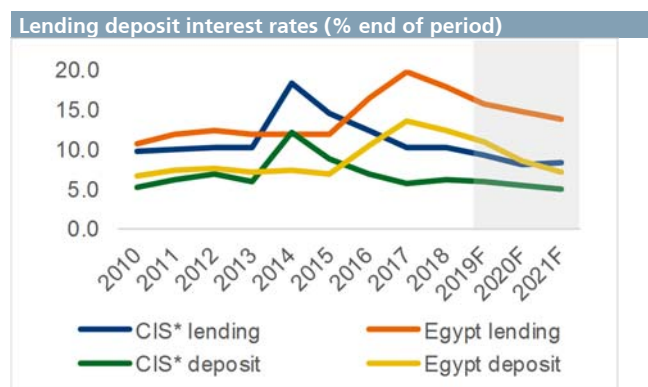
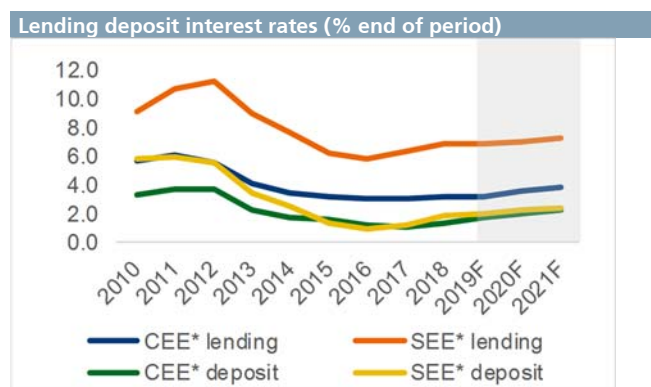
Bank aggregates and interest rates

After the strong performance in 2018, **loan dynamics** are expected to slow down slightly in **CEE/SEE countries** (from a 7.7% average in 2018 to 6.2% in 2019 and +4.7% in the following years) based on a softening of the business cycle, but holding back to nominal GDP growth in the medium term. The relatively lower level of private sector debt and improved fundamentals in the banking sector are expected to further support loan dynamics. The gradual increase in benchmark rates should have a modest impact on lending growth and the debt-servicing capacity of borrowers. In 2019, a mild loan deceleration is nevertheless expected in a few CEE countries where central banks have introduced a variety of tighter prudential measures (such as LTV and debt servicing ratios) to avoid a situation of excess credit to households, particularly in Czech Republic and Slovakia. A deceleration is also expected in some SEE countries, particularly where NPLs remain high. Total loans will continue to be driven mainly by households, both mortgages and consumer loans (with some concerns regarding higher risks), but encouraging signs are now also coming from the corporate sector. In **Romania**, loan forecasts have been revised downwards, due to potential effects of the heavy new bank taxation under discussion by national authorities.

In the **CIS area**, forecasts have been prudently confirmed (from a 14.2% average in 2018 to 8.3% in 2019), despite signs of recent acceleration in both the corporate and household sectors and stabilisation in NPL levels. In **Russia**, household loans are expected to maintain a very strong dynamic. The intervention of the state in failed banks could further support a bank sector recovery. In **Ukraine**, the high NPL levels continue to weigh on loan recovery. Some improvements in loan growth have been highlighted by the central bank, but the slowdown which occurred in December suggests prudence. In **Egypt**, lending dynamics are forecast to remain in double digits (+13.1% in 2019), but still below nominal GDP growth and decelerating, even with declining interest rates.

Funding and liquidity are expected to remain in good shape in the CEE/SEE regions. The gradual diffusion of further funding tools (such as covered bonds) is also expected. Thanks to higher wages and supportive labour markets, **deposits** are forecast to show positive trends, especially among CEE countries (from 9.3% in 2018 to 6.1% in 2019), although slowly decelerating because of potentially stronger competition from other savings products. The deposits/GDP ratios are forecast to decrease slightly in the forecast period. **Loan/deposit ratios** are generally projected to shrink further, to well below 100%, but to remain over 100% in Bosnia, Slovakia, Russia and Ukraine.

Banking interest rates are forecast to increase gradually, driven by higher money market rates. Taking into consideration the forecast paths of money market rates, however, their expected profiles have been revised slightly downwards in several cases, such as in Albania, Croatia and Serbia.



Country-Specific Analysis

Czech Republic

Real Economy

The Czech economy surprised on the upside in the final quarter of 2018, pushing full-year GDP growth to 3.0%, three-tenths of percentage point higher than we expected in our previous forecast. Despite the recent stronger-than-expected economic activity, we maintain our GDP forecasts for 2019 and beyond unchanged. The downward revisions of GDP growth forecasts for Germany, Czech Republic's main trading partner, likely erases any upside that recent data may have contributed to growth expectations for the Czech economy alone.

The forecast thus continues to assume gradual growth moderation of the Czech economy to around 2.4% in 2019, its potential or maybe slightly below it due to the external headwinds. Domestic demand should remain solid, thanks especially to robust household spending, which is supported by a tight labour market, featuring an EU-low unemployment rate of 2.2%, and wages advancing in real terms at a nearly 5% yoy pace. Strong domestic demand will meanwhile continue to exert pressure on core inflation and keep headline CPI inflation above the CNB target of 2% for the foreseeable future.

Financial Markets

With the economy booming and inflation stubbornly above target, the Czech National Bank (CNB) moved aggressively on rates in 2018, delivering in total five hikes. As the global growth outlook and sentiment deteriorated recently, the CNB has stayed its hand since December and indicated that no or at most one rate hike is the most likely scenario in 2019. We are partial to this view and now model one hike rather than the two envisaged for 2019 in our previous scenario. In addition, we also believe that projected increases in bond yields will be less steep than previously forecast, again driven primarily by external developments and lower yield profiles in core markets. On the exchange rate, however, we maintain our forecast, projecting appreciation of the koruna vs the euro, but at a lower rate than assumed by the CNB.

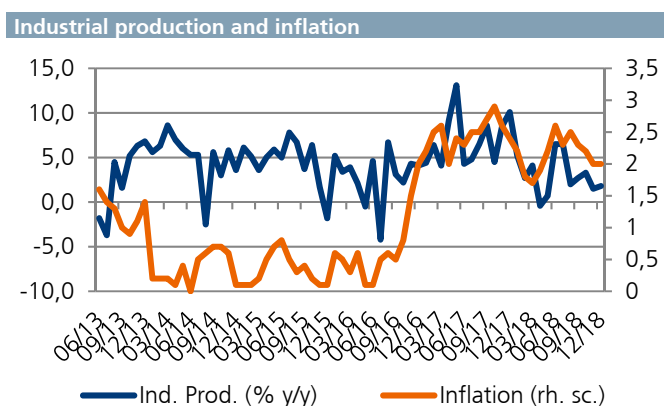
Banking Sector

The Czech banking sector is growing fast along with the booming economy. Growth of loans has been a bit slower in the latter part of 2018 than we envisaged earlier, as rising interest rates and tighter regulations in the mortgage market have started to have an effect. Going forward, though, we have penciled in some moderation and therefore maintain our previously projected growth rates for the foreseeable future unchanged. Deposits, on the contrary, finished 2018 on a stronger note than forecast, actually outperforming loans by a small margin, thereby increasing the already ample liquidity of the Czech market. For the future, we continue to expect the growth of both deposits and loans to be broadly even, gradually converging towards 4% yoy growth from around 7% currently, and with the loan/deposit ratio remaining at a comfortable 75%.

Zdenko Štefanides

Forecasts	2018	2019F	2020F
Real GDP yoy	3.0	2.4	2.3
CPI (avg)	2.1	2.2	2.2
Euro exchange rate (avg)	25.6	25.5	24.9
Euro exchange rate (end of period)	25.8	25.3	24.8
Short-term rate (avg)	1.3	2.1	2.4
Short-term rate (end of period)	2.0	2.3	2.5
L/T bond yields (avg)	2.0	2.1	2.3
Bank loans yoy (end of period)	6.8	5.2	4.5
Bank deposits yoy (end of period)	6.9	5.5	4.9

Source: Intesa Sanpaolo Research Department forecasts



Source: EC

Hungary

Real Economy

Hungary's forward-looking indicators including PMI essentially stagnated at the beginning of 2019 and failed to reflect fresh momentum compared to the end of last year. Similarly, industrial production and exports also showed relatively weak performances, with diminishing rates of expansion in the most recent period. Nevertheless, GDP growth was still supported by strong domestic demand and consumption. This was reflected in unexpectedly high Q4 growth of 5.1%, which resulted in the annual GDP growth rate reaching 4.9% in 2018. From the production side, market-based services remained the main driver of growth, similar to in the preceding quarters. Still, we believe that deceleration could start soon, as major drivers of growth (including investments fueled by EU funds, strong wage growth and real wage growth) are set to make lower contributions to GDP growth in the quarters ahead. Hence, we have left our GDP growth forecast unchanged from December, at 3.2% for 2019. Headline inflation figures have remained close to 3% recently, while core inflation surged from 2.4-2.6% to above 3%. In 2019, we expect a higher average CPI (3.3% vs 2.8% last year), though we may not see further rises over the course of the year.

Sandor Jobbagy

Financial Markets

The 3M policy rate of the NBH has been left on hold at 0.90% so far in 2019 (as in 2018) while the more functional O/N depo rate was raised by 10bps from -0.15% to -0.05% at the March NBH meeting. Liquidity measures were also adjusted to support the start of normalisation. This process is set to start despite the shift in ECB policy, with the elimination of unconventional measures after the latest swap and the phasing out of mortgage bond purchase programmes at the end of last year. The central bank has announced that a more cautious monetary approach is warranted, but intervention regarding liquidity will be put in place before the deposit rate is touched and eventually the 0.90% policy rate. The latter is forecast to occur only in 2020. BUBOR rates and longer yields showed downward corrections in 1Q19, but we see this as a temporary phenomenon and expect to see moderate rises in BUBOR rates in 2019. The forint partially corrected with a shift to 320-325 and to below 320 in 1Q19. Forint appreciation was supported by expectations of stricter monetary policy and to some extent by sovereign ratings upgrade to BBB by S&P and Fitch. We expect the EUR/HUF cross rate to stay at 310-320 this year.

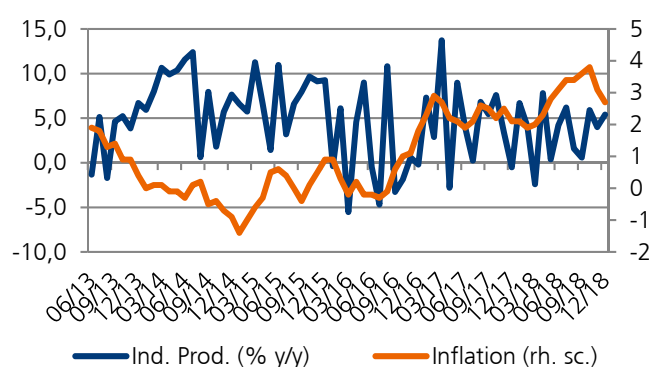
Banking Sector

In Q418 lending dynamics remained strong in Hungary's banking sector amid the ongoing rise of GDP growth and the strengthening of domestic consumer confidence and demand. Growth looks set to continue throughout this year and may even beat current expectations, even exceeding 2017's jump as the initial phase of the recovery. Housing loans are supported by state subsidies. Some loan segments (including mortgages and personal loans) are showing especially dynamic pick-ups. Asset quality continues to improve, even with NPLs already below 5%.

Forecasts	2018	2019F	2020F
Real GDP yoy	4.9	3.2	2.4
CPI (avg)	2.9	3.3	3.1
Euro exchange rate (avg)	318.8	316.5	315.1
Euro exchange rate (end of period)	322.9	314.0	315.5
Short-term rate (avg)	0.1	0.3	0.6
Short-term rate (end of period)	0.1	0.4	0.8
L/T bond yields (avg)	3.1	3.3	3.7
Bank loans yoy (end of period)	10.6	6.0	4.3
Bank deposits yoy (end of period)	14.1	7.0	5.5

Source: Intesa Sanpaolo Research Department forecasts

Industrial production and inflation



Source: CSO

Poland

Real Economy

Industrial and export performances in Poland remained strong at the beginning of 2019, but forward-looking sentiment indicators reflected potential for solid but diminishing economic growth rates. Economic growth remained above 5% in 4Q18, raising the full-year 2018 growth to 4.9% from 4.4% in the previous year. This is unlikely to be sustainable over the next few years: we project a significant slowdown in annual average GDP growth of 3.6% in 2019, which is an unchanged outlook compared to our December 2018 forecast. Nevertheless, growth has continued to be supported by relatively strong private consumption amid the revival of the industrial performance. Judicial reforms and conflicts with the EU have so far not had an adverse impact on overall GDP growth and the outlook. Fiscal policy remained in check, as shown by the annual deficit. Regarding inflation, domestic demand and rising wages have had limited impacts so far. While CPI had been rising till last September, the most recent figures were close to just 1%, with core inflation even lower. This year, we expect a similar inflation picture, with the annual average below 2% amid a gradual upward trend.

Sandor Jobbagy

Financial Markets

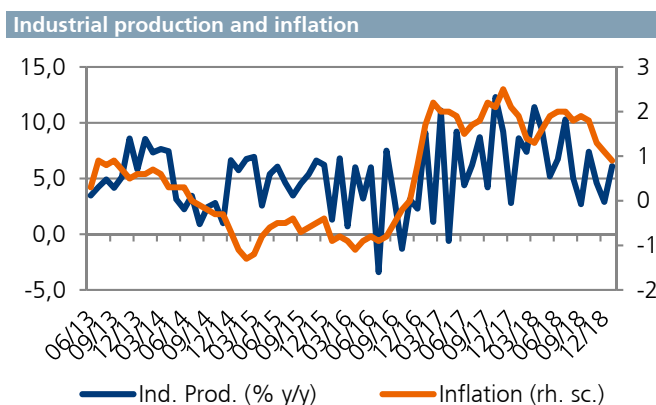
The NBP has left its policy rate unchanged (1.50%) so far in 2019, similar to the whole of last year. While earlier monetary decisions and central bank comments as well as market expectations had suggested an increasing probability of a tightening cycle starting in the near future, this outlook has shifted several times, with the latest move in ECB policy likely dropping expectations of Polish rate hikes not only for 2019 but also for 2020. This outlook is supported by the latest turn in domestic CPI as well. The central bank is concerned about food price growth, which has been on the rise since the end of last year, and also about accelerating wage growth. But, these risks are unlikely to exert strong upward pressure on the CPI in the year ahead. The EUR/PLN exchange rate has repeatedly risen above 4.30, and failed to hold below this level in a lasting manner so far, despite the most recent shift in March. We expect similar levels, close to EUR/PLN 4.31, to continue in 2019.

Banking Sector

Lending activity in the Polish banking sector is forecast to grow at close to 5% in 2019, following the multi-year record rate recorded last year, in tandem with the expectation of weaker GDP growth, but still supported by consumption. Loan stocks to the private sector showed persistent rises, and the overall annual growth rate of the loan stock came in above that recorded in 2016 and 2017. Deposit volumes have continued to increase, and these are likely to maintain momentum throughout 2019, despite the relatively low interest rates. The quality of the banking sector's entire loan portfolio remained solid, with low average NPL ratios. The banking sector is likely to experience further consolidation, as the sector's concentration is still viewed to be too low.

Forecasts	2018	2019F	2020F
Real GDP yoy	5.1	3.6	2.9
CPI (avg)	1.7	1.6	2.2
Euro exchange rate (avg)	4.3	4.3	4.3
Euro exchange rate (end of period)	4.3	4.3	4.3
Short-term rate (avg)	1.7	1.7	1.9
Short-term rate (end of period)	1.9	1.7	2.0
L/T bond yields (avg)	3.2	3.1	3.4
Bank loans yoy (end of period)	7.9	5.2	5.0
Bank deposits yoy (end of period)	9.4	6.2	5.8

Source: Intesa Sanpaolo Research Department forecasts



Source: NBR

Slovakia

Real Economy

The Slovak economy closed 2018 on a weaker-than-expected note. Until 3Q18, Slovakia has been defying the moderation in growth seen elsewhere in Europe. But, in 4Q, that ceased and GDP growth slowed to 3.6% yoy from 4.6% yoy in 3Q. The deceleration was due to the decrease of net exports. Domestic demand remained strong, thanks to both private consumption and overall investments. The overall story remained unchanged: the Slovak economy still shows solid fundamentals based on persisting strong growth in private consumption and public investments, with an extra boost expected to derive from car production, due to extraordinarily large investments in this sector in the previous year. After the contraction seen in the closing months of 2018, economic sentiment appears to have stabilised at the beginning of 2019 at a level consistent with above-potential GDP growth. Nevertheless, this could be insufficient to offset the deteriorated outlook of the key trading partners in recent months. This has led us to revise our previous GDP growth forecast to 3.5% yoy for 2019 from the previously forecast 3.9% yoy.

Andrej Arady

The labour market remains tight, but less so than previously. A declining trend in unemployment stopped in January, as the seasonally adjusted claimant unemployment rate edged higher. This is to what is occurring elsewhere in CEE, with capacity constrains production lower than in the recent past. On the price front, the level of inflation in January anticipated much of its full-year expected profile. The harmonised index of consumer prices started the year only slightly above 2%, ie, at 2.2% yoy in January and 2.3% yoy in February. The demand-driven aspect of inflation should continue to rise gradually, but a deceleration in food prices should compensate for this. Thus, inflation should not move much from current levels until the end of 2019.

Financial Markets

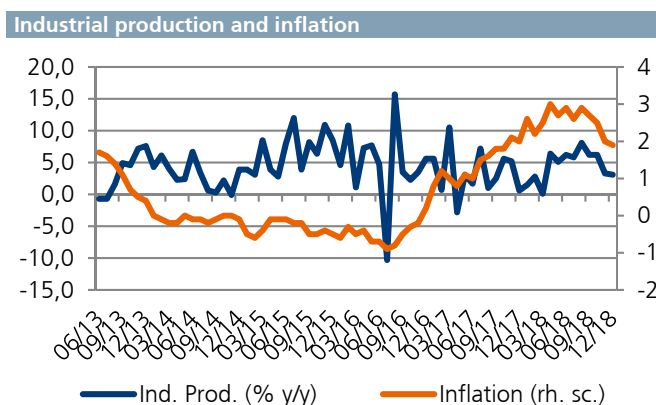
Regarding the bond market, spreads on 10-year government bonds vs German Bunds were relatively stable over the past quarter, remaining at around 60bps. We expect them to stay around this level for the rest of the current year. As yields in Germany have abruptly moved downwards after the disappointing data from the Eurozone, the forecast yield path for Slovak bonds moved downward somewhat as well.

Banking Sector

The story in the Slovak banking market has not changed. It is expected to grow fast in 2019, as it did in 2018. A recent rise in household indebtedness, an expected rise in interest rates, and tighter regulation of credit markets should, however, have a negative impact on future growth. Loan growth is expected to decelerate to 7% yoy in 2019. Growth of deposits, supported by rising household incomes, is expected to remain relatively unchanged, at well above 5% yoy.

Forecasts	2018	2019F	2020F
Real GDP yoy	4.1	3.5	3.4
CPI (avg)	2.5	2.2	2.2
Short-term rate (avg)	-0.3	-0.3	-0.1
Short-term rate (end of period)	-0.3	-0.3	0.0
L/T bond yields (avg)	0.9	0.9	1.3
Bank loans yoy (end of period)	9.4	7.0	6.6
Bank deposits yoy (end of period)	7.2	5.4	5.5

Source: Intesa Sanpaolo Research Department forecasts



Source: Statistical Office of Slovak Republic

Slovenia

Real Economy

Slovenia's GDP expanded by 4.1% yoy (0.8% qoq) in 4Q18 (vs 5% in 3Q), supported by both domestic and net external demand. Strong investments activity (+8.3% yoy) continued, albeit at a somewhat slower pace vs the previous four quarters, while private consumption growth accelerated to 2.1% yoy. Exports proved to be somewhat more resilient than expected (+6.8% yoy), outweighing imports (+6.6% yoy) and contributing a solid 0.7pp to headline growth. On a FY basis, GDP expanded by 4.5% yoy (vs 4.9% in 2017), in line with our expectations, based on the contribution of strong domestic demand (+4.2pp) and a somewhat less pronounced but still positive contribution from net external demand (+0.3pp).

Ivana Jovič

Looking forward, we see growth easing further, to 3.3% yoy in 2019, supported by domestic demand as positive labour market developments and favourable consumer sentiment support private consumption (January retail trade up by 11% yoy), while EU fund intake supports investments. In line with the expected slowdown in major trading partners, we see a net foreign contribution to headline growth turning more neutral: although January data indicate a 13.7% hike in exports, assessment of export order book levels in February declined to a two-year low. The inflation outlook reflects more demand-driven upside pressures than those attributable to the cost side; thus, we expect average annual inflation to stay below 2% this year, but to rise above that level next year.

Financial Markets

After the most recent ECB meeting, it is expected that loose monetary conditions will remain in place through the end of this year and possibly longer. Thus, we have left our 2019 average 3M Euribor forecast unchanged at -0.3%. In accordance with that and projected slower EA growth, the forecast of this year's average Slovenian government 10-year bond yield was lowered by 60bps yoy, to 1.0%, whereas the spread on benchmark Bunds was lifted by some 15bps to just shy of 80bps.

Ana Lokin

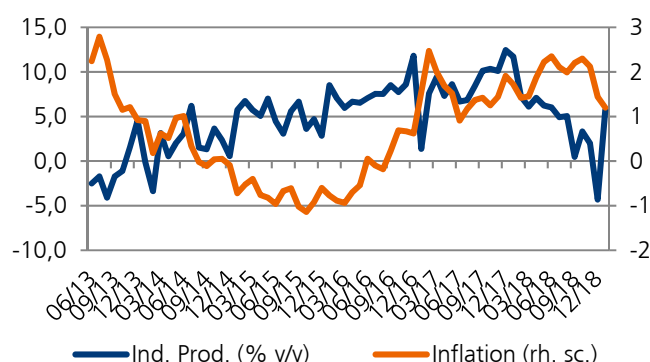
Banking Sector

The rising trajectory of private sector loans eased to 2.6% and 2.9% in December 2018 and January 2019. As was previously the case, this performance solely related to household lending (6.5% yoy both months), particularly consumer loans, while non-financial corporations continued to deleverage (-1.4% and -0.9% yoy, respectively). In 2019, loan trend so far remains under pressure from stricter credit standards for granting consumer loans to households and corporate reliance on non-bank sources of funding. All these factors, along with softer GDP growth projections, have prompted us to revise our 2019 loan forecast slightly downwards, to 3.2% yoy from 3.4% yoy. Our deposit forecast for 2019 is confirmed at 5.4% yoy. After a 6.7% yoy increase in December and 6.2% growth yoy in January, with household deposits increasing by 7% yoy and corporates exhibiting strong fluctuations, we expect the pace to decelerate in the months ahead as economic growth retreats from the peaks seen last year.

Forecasts	2018	2019F	2020F
Real GDP yoy	4.5	3.3	2.8
CPI (avg)	1.9	1.6	2.1
Short-term rate (avg)	-0.3	-0.3	-0.1
Short-term rate (end of period)	-0.3	-0.3	0.0
L/T bond yields (avg)	1.1	1.0	1.4
Bank loans yoy (end of period)	2.6	3.2	3.1
Bank deposits yoy (end of period)	6.7	5.4	4.8

Source: Intesa Sanpaolo Research Department forecasts

Industrial production and inflation



Source: Statistical Office of the Republic of Slovenia

Albania

Real Economy

GDP growth is estimated at 4.2% in 2018, fuelled by the expansion of private consumption, investments and exports, and of electricity production on the supply side. Over the medium term, the growth is projected to slow in 2019-2020 towards potential, partly related to a lower contribution from external demand due to an expected slowdown in major Euro Area economies. On the international side, a deceleration of trade was already recorded in February, with an increase of exports by 5.31% yoy and imports by 8.17% yoy, and a widening of the trade deficit by 22.6% yoy.

Inflation registered a slight decline in February 2019, at 1.7%. The fall reflected temporary supply-side shocks and fuller transmission of the effects of exchange rate appreciation. Those conditions are expected to persist over the first half of 2019.

Domestic inflationary pressures nevertheless look to be gaining strength in the medium term, due to the cyclical structure of the economy, as reflected in both the downward trend in the unemployment rate (now at 12.3%) and the improvement in the capacity utilisation rate. Growth in aggregate demand should contribute to reducing unemployment further, supporting wages, while disinflationary pressures arising from the exchange rate appreciation are expected to fade. Inflation is then expected to reaccelerate in towards target in 2020.

Financial Markets

As a result of the accommodative monetary policy stance, interest rates on deposits, credit and government securities remain at historically low levels. The exchange rate appeared to be stable in the first two months of 2019 (at around EUR 1/LEK 124.50), due to a better balancing of demand and supply of foreign currency.

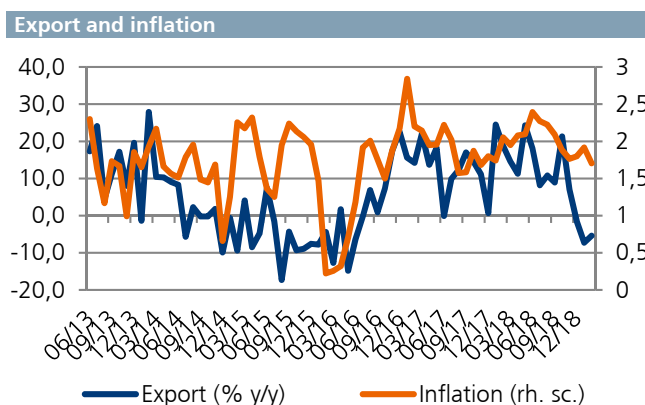
Monetary policy is expected to remain accommodative in 2019. The normalisation of monetary policy is then seen to proceed as data-dependent, with the aim of reaching the inflation target over the medium term.

Banking Sector

Credit to the private sector showed signs of recovery, although the reported downward stock continues to reflect the effects arising from the cleaning of balance sheets of both non-performing loans and the effect of the exchange rate. Excluding these two effects, credit to the private sector grew by 5.9% annually at the end of 2018. Credit growth continues to be faster for credit denominated in lek and in consumer loans. Meanwhile, regarding corporate loans, the banks still apply conservative policies. Total loans at the end of last year (ie, December) decreased by 3.83%: consumer loans increased by 3.46% while business loans shrank by 7.22% yoy. Total deposits in December 2018 decreased by 0.85% yoy and household deposits fell by 1.85%, but corporate deposits rose by 4.41%. The non-performing loan ratio has fallen to about 11%.

Forecasts	2018	2019F	2020F
Real GDP yoy	4.2	3.8	3.7
CPI (avg)	2.0	1.8	2.3
Euro exchange rate (avg)	127.6	124.5	125.3
Euro exchange rate (end of period)	123.4	124.5	126.0
Short-term rate (avg)	1.0	1.2	1.5
Short-term rate (end of period)	1.1	1.2	1.9
L/T bond yields (avg)	n.a.	n.a.	n.a.
Bank loans yoy (end of period)	-3.8	1.0	1.5
Bank deposits yoy (end of period)	-0.9	1.5	2.0

Source: Intesa Sanpaolo Research Department forecasts



Source: INSTAT

Bosnia and Herzegovina

Real Economy

GDP data for 4Q18 have not yet been published. So, we stick to our estimate that FY18 growth amounted to around 3.3%, assuming that 4Q18 growth softened to around 3.0% (from 3.2 in 3Q), in line with a slowdown in exports and investments (construction works stagnated over 2H18), while personal consumption remained supportive of growth (real retail trade up by 9.2% yoy in 4Q). A somewhat sluggish start to 2019, with January industrial production and exports declining by 2.2% and 10.7% yoy, respectively, accompanied by stagnating retail trade looks to be a bit misleading as it reflects the unusually strong performance recorded in January of 2017, with industrial production (+8%), exports (+25.6%) and retail trade (+15%) outperforming projections. Thus, going forward, we expect the economic performance to regain steam, although at a somewhat slower pace, reflecting uncertainty among major trading partners and a still non-functioning executive government post the October 2018 elections. Our 2019 outlook envisages 2.9% yoy growth, with risks broadly balanced, as a better-than-expected external environment could support the performance of exports; on the other hand, however, further political uncertainty could hamper infrastructure investments.

On 8 March, S&P Global Ratings revised its outlook on B&H to positive from stable, given the country's resilience to ongoing political tensions, solid growth and improving fiscal outcomes, at the same time affirming the 'B/B' long- and short-term foreign and local currency sovereign credit rating.

Banking Sector

Loans continued to slow in December and January, recording 5.5% and 5.6% yoy increases. The deceleration is a result of weaker growth in corporate lending (3.7% and 4.1% yoy); in contrast, household demand remained buoyant (7.3% and 7.1% yoy). The breakdown of loans to households by purpose reveals hefty rises in consumer loans continued (7.8% and 7.4% yoy), followed by recovering housing loans (7.7% and 8.4% yoy). Household loans continue to be supported by an improving labour market and still moderate levels of household indebtedness. Corporate loan demand looks likely to soften. As the loan trends remain in line with our expectations, we have trimmed this year's forecast slightly, to +5.4% yoy.

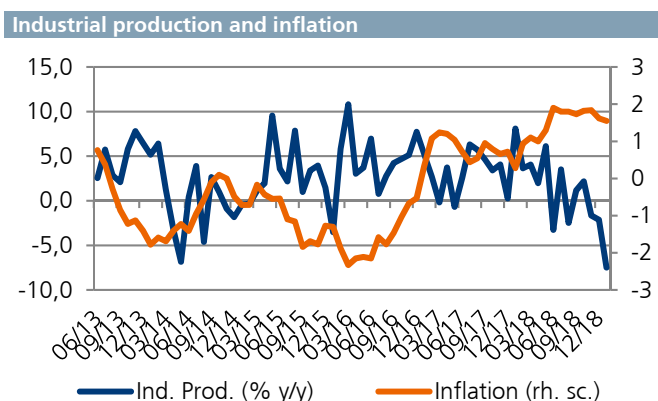
Deposit growth remained robust in December, at 8.5% yoy, moderating to 7.5% yoy in January, as growth of corporate deposits fell from 10.4% to 5.1% yoy while household deposit growth rose (7.8% yoy in December, 8.6% yoy in January). For households, we continue to see a sharp rise in transaction accounts and demand deposits while the rise in time deposits remains limited, suppressed by low savings interest rates. In 2019, we expect deposit growth to lose steam. Hence, we are leaving our year-end forecast at +6.5% yoy.

Ivana Jovič

Ana Lokin

Forecasts	2018	2019F	2020F
Real GDP yoy	3.3	2.9	2.9
CPI (avg)	1.4	1.7	1.9
Euro exchange rate (avg)	2.0	2.0	2.0
Euro exchange rate (end of period)	2.0	2.0	2.0
Short-term rate (avg)	n.a.	n.a.	n.a.
Short-term rate (end of period)	n.a.	n.a.	n.a.
L/T bond yields (avg)	n.a.	n.a.	n.a.
Bank loans yoy (end of period)	5.5	5.4	5.3
Bank deposits yoy (end of period)	8.5	6.5	5.7

Source: Intesa Sanpaolo Research Department forecasts



Source: BHAS

Croatia

Real Economy

Amid weakening external demand and underperforming exports (only +1.3% yoy), accompanied by strong 6.6% yoy growth in imports of goods and services, the net external demand contribution in 4Q18 was notably negative (-2.7pp). At the same time, domestic demand continued to support growth as private consumption and investments strengthened to +3.9% and +6.1% yoy, respectively. Thus, 4Q18 GDP expanded by 2.3% yoy (vs 2.8% in 3Q). Thus, FY18 growth was up 2.6% yoy, with the growth structure aligned with 4Q's negative external performance and supportive domestic demand.

Looking forward, we see growth slowing to 2.4% (0.2pp downward revision), mainly in response to headwinds from less favourable external demand, notably Italy and Germany as the main trading partners and tourist markets. Domestic demand is expected to remain supportive as private consumption reflects continued growth in wages and employment, accompanied by still favourable financing conditions and low inflation boosting households' disposable incomes. A recent upswing in investments is expected to strengthen, supported by stronger EU-funded activity. However, as strengthening domestic demand implies an increase in imports, and the exports outlook appears far more uncertain amid a slowdown in major trading partner as well as tourism easing from double-digit growth, we see net external demand as a key drag on headline growth.

Financial Markets

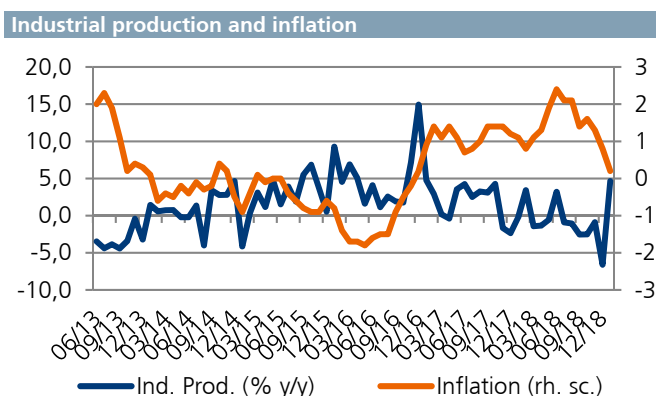
The forecast of the average EUR/HRK rate for 2019 was trimmed slightly, to 7.40. The kuna is stable in spite of elevated appreciation pressures, as the central bank has acted proactively regarding the market, purchasing excess foreign currency. We expect such conditions to persist in coming years as Croatia is hoping for ERM II entry in 2020. Loose monetary conditions are expected to remain in place. Thus, the 2019 3M average Zibor forecast was left at 0.5%. In 2019, average 10Y kuna government bond yields are forecast to be lower than in 2018, at 2.0%, whereas spreads on Bunds are expected to stay at the level seen in 2018. On March 22, S&P's raised its long- and short-term foreign and local sovereign ratings on Croatia to "BBB-/A-3" from "BB+/B", stable outlook, marking country's return to investment grade.

Banking Sector

December and January loan development surprised to the upside, at +2.3% and +3.4% yoy, owing to buoyant households and recovering corporates. Still, the 2019 growth forecast was prudently left at +1.7% yoy as elevated corporate NPL ratios point to further sales of problem loans, whereas a recent central bank recommendation, requesting alignment of credit standard for non-housing to housing loans, likely limits retail growth potential. The deposits projection was lifted to +3.1% yoy, primarily based on a better-than-expected household performance, followed by healthy corporate deposit growth.

Forecasts	2018	2019F	2020F
Real GDP yoy	2.6	2.4	2.5
CPI (avg)	1.5	0.6	1.7
Euro exchange rate (avg)	7.4	7.4	7.4
Euro exchange rate (end of period)	7.4	7.4	7.4
Short-term rate (avg)	0.5	0.5	0.6
Short-term rate (end of period)	0.5	0.5	0.8
L/T bond yields (avg)	2.2	2.0	2.2
Bank loans yoy (end of period)	2.3	1.7	1.8
Bank deposits yoy (end of period)	5.0	3.1	2.5

Source: Intesa Sanpaolo Research Department forecasts



Source: CBS

Romania

Real Economy

The second reading of GDP confirmed the slowdown in growth to 4.1% yoy in 2018 from 7% in 2017. The unusually large inventory contribution raises concerns about the sustainability of the growth rate going forward. However, household consumption is expected to remain one of the main growth drivers in 2019.

February headline inflation was 3.83%, surprising markets (3.45%, according to Bloomberg survey), and exited the central bank target interval (2.50% \pm 1pp) for the first time in the past four months. Industrial production barely managed to stay in positive territory in January 2019, at 0.86% yoy. The January budget surplus was the smallest in the past seven years, at only +0.07% of projected GDP, suggesting the strain expenses pose in an environment in which a growth deceleration reflects a mix of internal and external factors.

Financial Markets

The exchange rate of the local currency continues to trade near its all-time highs, above RON 4.75/EUR 1, with the RON maintaining losses incurred earlier this year as the fiscal uncertainty over taxes introduced (in banking, telecom, energy sectors) late in 2018 persists.

Money market liquidity conditions improved after a large bond redemption, worth RON 5.9Bn, and short-term rates moved from trading near the central bank credit facility rate of 3.50% to 1.50%, where the deposit facility rate sets a floor. The 3M rate also declined, but stopped just above 3%, reversing higher after the February inflation surprise. The yield curve steepened, with the longer end, the 10Y yield, moving above 5% and the short end, the 6M, staying just above 3% as the data deterioration is interpreted by the market as pushing the central bank to keep policy on hold, with domestic liquidity conditions remaining abundant in the wake of the additional liquidity measures announced by the ECB.

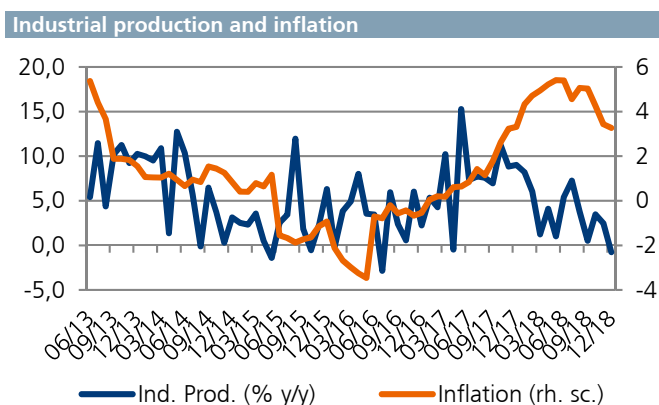
Banking Sector

In January 2019, banking sector data showed that local currency credit continued to perform well, at +12.86% yoy vs +0.87% for total private sector FX credit. Markets focused on household loans dynamic performance in the wake of a higher indebtedness level (40%) that started in January, and thus the acceleration to 9.39% yoy from 9.14% in December provided a positive market surprise. Total deposit growth accelerated to 9.72% yoy in January from 8.95% yoy the previous month, with growth in FX deposits almost triple, at 16.93% yoy, the 6.08% for local currency deposits' growth.

The tax on banks' financial assets is still a work in progress, with negotiations ongoing between Romanian officials and the private sector before the end-of-quarter deadline.

Forecasts	2018	2019F	2020F
Real GDP yoy	4.1	2.9	2.8
CPI (avg)	4.6	3.5	3.3
Euro exchange rate (avg)	4.7	4.7	4.7
Euro exchange rate (end of period)	4.7	4.8	4.7
Short-term rate (avg)	2.8	2.9	2.9
Short-term rate (end of period)	3.1	2.9	2.9
L/T bond yields (avg)	4.8	4.9	5.1
Bank loans yoy (end of period)	7.8	10.5	4.5
Bank deposits yoy (end of period)	8.9	14.2	5.6

Source: Intesa Sanpaolo Research Department forecasts



Source: NBR

Serbia

Real Economy

According to Statistical Office estimates, GDP in 2018 increased by 4.3% yoy, which is the highest growth rate since the global financial crisis. Favourable trends are expected to continue in 2019, with economic activity projected to expand by 3.3% yoy, at a slightly lower rate than in 2018, taking into account the high base from the previous year. GDP is expected to increase primarily due to new FDI, continued implementation of infrastructure projects, strong exports and higher consumption backed by rising employment, wages and pension hikes. Downside risks stem from potentially softer EU demand, uncertainties related to international primary commodity and financial markets, notably volatile oil prices, as well as the pace of structural reforms at home and potential domestic public capex under-execution.

CPI yoy is expected to remain low, and it should continue to move below the 3.0% midpoint in the next period. Average inflation is projected at 2.3% in 2019 and 2.5% in 2020. As usual, the projection will largely depend on inflation abroad and further changes in primary commodity prices, notably oil, and developments in international financial markets.

Financial Markets

The NBS kept the key policy rate unchanged at 3.0% at the beginning of 2019, in line with market expectations. The key policy rate is expected to remain at the same level over the course of the year, given current and expected inflation movements, well-anchored inflation expectations by corporates and the financial sector at around the inflation target, economic performance, and stable FX movements. Future rate movements are likely to be related to international developments and synchronised with the change in tone of central banks' monetary policies, primarily the ECB.

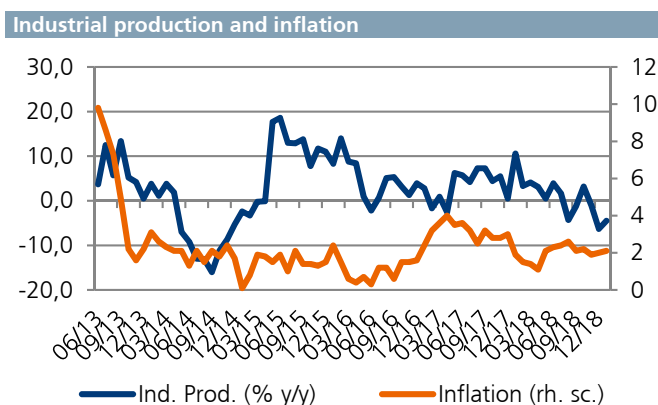
The dinar is expected to remain relatively stable, with the average value 118.3 in 2019, similar to in 2018. The local currency is expected to continue to be supported by strong macro and fiscal fundamentals, mainly rising exports, capital inflows and a fiscal surplus, while the NBS is expected to continue to intervene in the FX market in case of excessive FX rate volatility.

Banking Sector

After a strong increase in 2018 (+9.9%), lending activity in Serbia is likely to increase by 7.5% in 2019, driven by a good economic performance, past monetary easing, low interest rates in the euro area, and increased bank competition. Deposits are expected to increase at a similar rate as in the last three years, at around 2.6% and 2.7% on average, in 2019 and 2020, respectively.

Forecasts	2018	2019F	2020F
Real GDP yoy	4.3	3.3	3.0
CPI (avg)	2.0	2.3	2.5
Short-term rate (avg)	3.1	3.0	3.2
Short-term rate (end of period)	3.0	3.0	3.5
L/T bond yields (avg)	0.0	0.0	0.0
Bank loans yoy (end of period)	9.9	7.5	6.0
Bank deposits yoy (end of period)	14.9	6.0	5.8

Source: Intesa Sanpaolo Research Department forecasts



Source: Statistical Office, National Bank of Serbia

Moldova

Real Economy

Moldova's real GDP growth accelerated to 3.9% in 4Q18 from 3.4% in 3Q18. This was driven by a positive yoy change in household consumption (+4.7%) and net investment (3.6%) which counteracted the negative impact from the 5.7% decrease in net exports. Overall, GDP grew by 4% in 2018 compared to 2017, due to the positive contributions from almost all branches of the economy, with more positive contributions from trade (wholesale and retail; +1.2%), construction (+1.1%) and extractive industries (+0.7%). The manufacturing sector, however, continued its downward trend, declining by 5% in December 2018 compared to the same month last year. The notable positive change in extractive industries (+38.6%) and the production of electricity, gas, steam, hot water and air conditioning (+20.4%) ensured, eventually, a tempered 0.4% increase in industrial production yoy in December 2018. Nevertheless, it recorded a 3.7% increase yoy. For 2019 and 2020, we expect a slowdown in GDP growth to an average of around 3.5%. The annual inflation rate recorded as of February 2019 was 2.4%, a 0.4% increase compared to January 2019. The increase in average consumer prices by 0.4% was driven by the 0.8% increase in food prices, in non-food goods by 0.1%, and the increase in tariffs for the provision of services to the population by 0.2%. Although inflation has started to trend upward, as of February 2019, it was still below the lower limit of the inflation target range.

Natalia Mihalas

Financial Markets

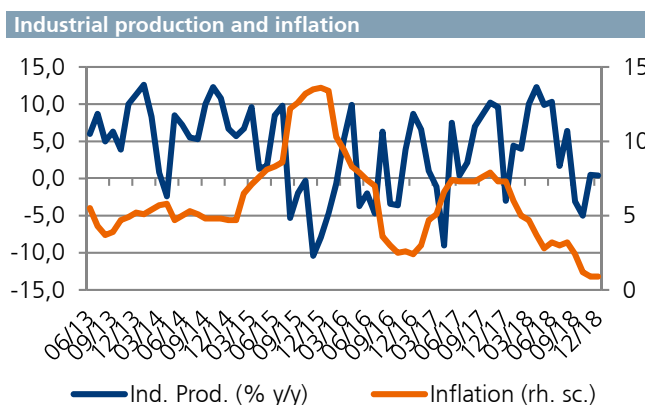
During 4Q18, interest rates on state securities for all maturities continued the positive (upward) trend started in the previous quarter. Treasury bills recorded a 0.4-1.2pp increase in interest rates, while government bonds with two-, three- and five-year maturities rose by 0.1-0.3pp. In 2018, with inflation slowing to a temporary all-time low (0.9% in December), the central bank left its main policy rate unchanged at 6.5%. This year, the monetary authority is likely to remain on the sidelines, as real interest rates remain positive. The easing cycle might resume over the forthcoming years.

Banking Sector

Total private sector deposits recorded a milder increase in December 2018 compared to the previous month, the yoy change as of December 2018 being 6%, down from 8.4% in November 2018. That is due to a reduced increase in deposits from corporates, 7.5% down from 14.1% recorded last month. The rate of increase of household deposits remains stable at approximately 5%. In the next few years, deposits are expected to accelerate slightly. The 5.9% yoy rise in the volume of loans in December 2018 was driven by the yoy 31% positive change in household loans which counteracted the 1.5% decrease in corporate loans. Total loans are expected to slow in 2019 and 2020. In 2018, the ratio of NPLs/total loans, though still high, continued to decline, reaching 12.5% in December. The LTD ratio remained stable at just above 50% by end-2018, and was 55.86% as of December 2018.

Forecasts	2018	2019F	2020F
Real GDP yoy	4.0	3.6	3.4
CPI (avg)	3.1	4.9	5.0
USD exchange rate (avg)	16.8	17.2	17.9
Euro exchange rate (avg)	17.1	17.4	18.1
Short-term rate (avg)	6.5	6.5	6.4
L/T bond yields (avg)	6.5	6.5	6.3
Bank lending	5.9	5.7	5.3
Bank deposits	6.0	6.2	6.4

Source: Intesa Sanpaolo Research Department forecasts



Source: National Bureau of Statistics of the Republic of Moldova

Russia

Real Economy

Considering the revised data regarding the construction dynamics, GDP growth in 2018 amounted to 2.3% yoy, which is explained by temporary factors. We forecast a slowdown in GDP growth in 2019, to 1.5% yoy. The economy is expected to grow at a pace below potential as the VAT increase has a deterrent effect on business activity. The most recent releases regarding industrial production, real wages and retail trade have showed a slowdown. Starting from 3Q19, economic growth should return to its potential level. In 2020, the GDP is expected to accelerate to 2.0%, which will be facilitated by the gradual accumulation of positive effects of the fiscal measures being adopted and the implementation of structural reforms. In February 2019, CPI amounted to 5.2%. The impact of the tax increase on consumer prices remained moderate, owing to the RUB strengthening, the stabilisation of prices for petroleum products, and the cut in prices for some food products. Inflation is expected to return to the target indicator of 4.0% in 1Q20.

Irina Lekareva

Financial Markets

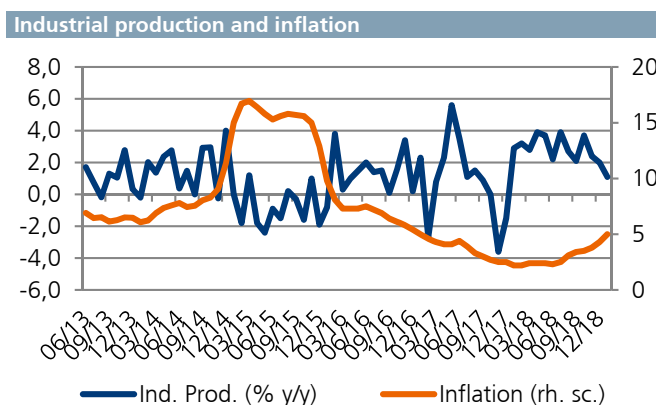
At its meeting on March 22, the Central Bank has left the policy rate unchanged in presence of a strengthening of the RUB and a moderate reaction of prices to the VAT increase. The Bank of Russia has also lowered its end-of-year annual inflation forecast in 2019 from 5.0-5.5% to 4.7-5.2% and expects inflation to return to 4% in the first half of 2020, while it has maintained its 2019 GDP growth forecast in the range of 1.2%-1.7%. Market participants expect as more likely a rate cut by 25bps, to 7.5%, in 4Q19 or 1Q20. With higher oil prices, the RUB is forecast to remain stable or slightly appreciate in the FX market. The Ministry of Economic Development lowered its forecast for the average RUB/USD exchange rate in 2019 to 65-66 vs 63-64, with appreciation likely in the future.

Banking Sector

From 3Q18, annual growth of corporate deposits steadily outpaced that for household deposits, and the gap between the two appears likely to grow. Household deposits continue to show volatile, but still increasing dynamics (+9.52% yoy in December, after +8.64% November). The growth rate of corporate deposits is on an upward trajectory, reaching 20.96% yoy in December (vs 19% yoy in November). Retail lending remains the main source of lending growth (+22.4% in December vs +12.3% for corporate loans). Given the favourable conditions for refinancing of previously issued loans, the level of NPLs reached 10.1% in December, after 10.4% in November. At the same time, the growth of the retail loan portfolio substantially exceeded the growth of nominal wages, creating the risk of loan portfolio deterioration in the future. In order to prevent overheating, the risk ratios for unsecured loans were increased, and restrictions were imposed on the maximum interest rate on loans by the CBR, which is likely to restrain the lending growth.

Forecasts	2018	2019F	2020F
Real GDP yoy	2.3	1.5	2.0
CPI (avg)	2.9	5.2	4.4
USD exchange rate (avg)	62.7	65.3	64.6
USD exchange rate (end of period)	67.3	65.0	64.0
Euro exchange rate (avg)	73.9	75.4	77.3
Euro exchange rate (end of period)	76.7	75.8	78.7
Short-term rate (avg)	7.7	8.2	7.2
Short-term rate (end of period)	8.6	7.9	6.7
L/T bond yields (avg)	7.9	8.2	8.1
Bank loans yoy (end of period)	15.0	8.6	7.2
Bank deposits yoy (end of period)	14.2	7.0	6.1

Source: Intesa Sanpaolo Research Department forecasts



Source: State Statistics Federal Service

Ukraine

Real Economy

Ukraine's real GDP growth in 4Q18 accelerated to 3.4% yoy compared to 2.8% in the previous quarter, resulting in 3.3% (preliminary estimation) full-year economic growth in 2018, the highest performance for last seven years, given a background of sustained consumer demand and agricultural production with record harvests of cereals and oilseeds. The 2019 forecasts point to a decelerating pace of growth in light of uncertainty arising from global markets and double political elections in Ukraine, though positively revised from the previous 2.5% to 2.7%, thanks to recent lower inflation prints (8.8% yoy in February 2019, down from 9.8% in December 2018) and consequently to the expected start of softening monetary policy. In the next few years, economic growth is expected to speed up again, to 2.9% in 2020 and 3.2% in 2021, fueled by a gradual easing in monetary policy and a revival of investment activity, after a decline in uncertainty related to the political situation.

Artem Krasovsky

Financial Markets

Given falling energy prices and supportive FX rates, resulting in a favourable inflation forecast for 2019 (eop at 7.8%, down from 9.8% in 2018) we expect the NBU to start to gradually cut the discount rate, with an estimated year-end target of 16-16.5%, down from current 18%. Although the UAH has been appreciation slightly in recent months (to 26.5 from 27.5 USD/UAH), the potential softening of monetary policy may mean in a lack of fuel for the local currency, pushing it to depreciate if accompanied by less supportive external markets and strong internal consumer demand. We expect it to end 2019 at 28.80 USD/UAH, with further gradual downward movements seen in the medium/long run (29.80 in 2020 and 30.70 in 2021). Despite political uncertainty, the recently reached agreement with the IMF is not expected to be suspended, allowing the release of two additional tranches of the IMF's loan in the spring and autumn 2019, thus supporting positive sentiment in financial markets.

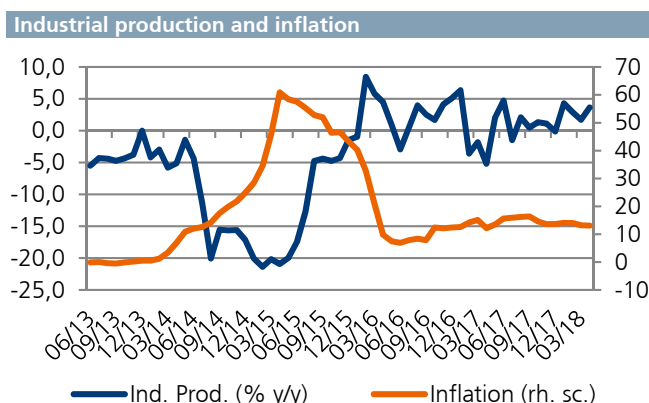
Banking Sector

In 2018, the banking sector recorded a record net profit of UAH 21.7bn (return on capital - 14.3%). During the current year, sector profits are likely to increase, due to low expected provision deductions.

After tangible growth of lending activity in 2018 (+6.3%), loans are expected to grow at a bit more moderate pace in nominal terms (by 5.3-5.5% yoy) in 2019-2020 and to further accelerate (just above 6%) in the following years. This will be supported by the expected decline in commercial interest rates, as the NBU is likely to move to a softer monetary policy in 2019. However, loan growth remains somewhat restrained because of still-high institutional risks and a significant share of NPLs (53% by the 2018 year-end).

Forecasts	2018	2019F	2020F
Real GDP yoy	3.3	2.7	2.9
CPI (avg)	11.0	8.7	6.9
USD exchange rate (avg)	27.3	27.9	29.3
Euro exchange rate (avg)	32.1	32.2	35.1
Short-term rate (avg)	18.4	17.3	14.5
L/T bond yields (avg)	0.0	0.0	0.0
Bank lending	6.3	5.3	5.5
Bank deposits	7.9	5.5	5.7

Source: Intesa Sanpaolo Research Department forecasts



Source: State Statistics Service of Ukraine

Egypt

Real Economy

The Egyptian economy is expected to grow by 5.5% in the 2018/19 fiscal year, supported by tourism (tourist visits increased by 16.5% last year, the country's best record since 2010 and a much faster dynamic comparing to the global average of 3.9%), natural gas discoveries (Egypt targets raising its natural gas production by 15% yoy by the end of 2019), and mega projects, such as the New Administrative Capital.

Samer Halim

Regarding inflation rates, annual headline CPI recorded an average of 13.5% in January and February 2019, mainly due to the rise in vegetable and fruit prices. Price volatility of different food items, in addition to the expected rise in fuel prices by mid-2019, according to the agreement with the IMF, is expected to keep the inflation rate relatively high during 2019, hovering around an average of 14.6%.

Financial Markets

In February 2019, the CBE cut the overnight deposit and lending rates by 100 bps, to 15.75% and 16.75%, respectively, supported by achieving the inflation target of 13% (+/-3%) in 4Q18 and the expected slowdown in interest rate hikes by the Federal Reserve, with no further cuts forecast in the year. Yields on 3M T-Bills have been declining since the beginning of 2019, reaching 17.5% in mid-March compared to 19.7% in January, supported by declining budget deficit (a primary budget surplus was recorded for the first time in almost a decade, amounting to 0.2% of GDP in 2017/18 and the government targets raising it to 2% during the current fiscal year) and less dependence on local borrowing after issuing USD 4bn of bonds in international markets. Hence, the money market rate is expected to decline to 16% by the end of 2019.

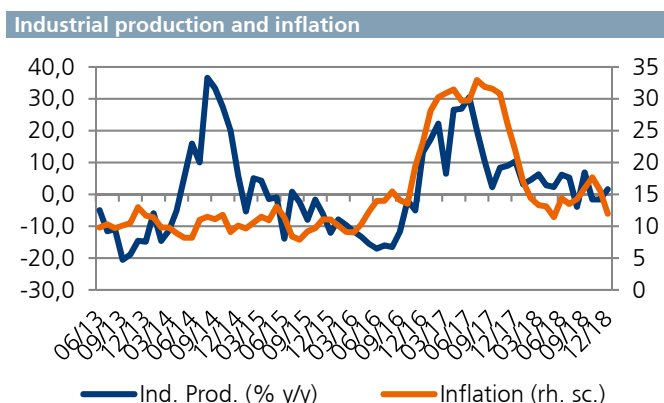
The Egyptian pound has appreciated by almost 3.5% in March compared to January 2019 in light of the recovery of foreign inflows to banks after the elimination of the Repatriation Mechanism, the stabilisation of major sources of foreign currency (as remittances, tourism revenues and Suez Canal revenues), and the disbursement of the fifth instalment of the IMF loan. However, we still expect a small depreciation of the EGP by the end of the year, to 17.90 per US dollar, given the high value of external obligations Egypt has to repay this year.

Banking Sector

Private loans are expected to grow at a slower pace in 2019, based on continuing pressure from government loans to fund mega projects. On the other hand, private deposit growth is expected to remain relatively stable in 2019, given the absence of alternative investment channels.

Forecasts	2018	2019F	2020F
Real GDP yoy	5.4	5.5	5.6
CPI (avg)	14.4	14.6	11.5
USD exchange rate (avg)	17.8	17.7	18.3
USD exchange rate (end of period)	17.9	17.9	18.5
Euro exchange rate (avg)	21.0	20.4	21.9
Euro exchange rate (end of period)	20.4	20.9	22.7
Short-term rate (avg)	18.8	16.7	14.3
Short-term rate (end of period)	19.7	16.0	13.2
L/T bond yields (avg)	n.a.	n.a.	n.a.
Bank loans yoy (end of period)	15.3	13.1	11.1
Bank deposits yoy (end of period)	13.8	13.6	13.5

Source: Intesa Sanpaolo Research Department forecasts



Source: Ministry of Planning, CAPMAS

Country Outlook

The economy												
	GDP (% yoy)	2016	2017	2018	2019F	2020F	Inflation (% avg)	2016	2017	2018	2019F	2020F
CEE	Czech Rep.	2.6	4.3	3.0	2.4	2.3	Czech Rep.	0.7	2.5	2.1	2.2	2.2
	Hungary	2.3	4.1	4.9	3.2	2.4	Hungary	0.4	2.4	2.9	3.3	3.1
	Poland	2.8	4.5	5.1	3.6	2.9	Poland	-0.6	2.0	1.7	1.6	2.2
	Slovakia	3.3	3.4	4.1	3.5	3.4	Slovakia	-0.5	1.4	2.5	2.2	2.2
	Slovenia	3.1	4.9	4.5	3.3	2.8	Slovenia	-0.2	1.6	1.9	1.6	2.1
SEE	Albania	3.5	3.7	4.2	3.8	3.7	Albania	1.3	2.0	2.0	1.8	2.3
	Bosnia Herzegovina	3.1	3.2	3.3	2.9	2.9	Bosnia Herzegovina	-1.6	0.8	1.4	1.7	1.9
	Croatia	3.5	2.9	2.6	2.4	2.5	Croatia	-1.1	1.1	1.5	0.6	1.7
	Romania	4.8	7.0	4.1	2.9	2.8	Romania	-1.5	1.3	4.6	3.5	3.3
	Serbia	3.3	2.0	4.3	3.3	3.0	Serbia	1.1	3.2	2.0	2.3	2.5
CIS	Moldova	4.5	4.5	4.0	3.6	3.4	Moldova	6.5	6.6	3.1	4.9	5.0
	Russia	-0.2	1.5	2.3	1.5	2.0	Russia	7.1	3.7	2.9	5.2	4.4
	Ukraine	2.4	2.5	3.3	2.7	2.9	Ukraine	14.9	14.5	11.0	8.7	6.9
MENA	Egypt	3.9	5.0	5.4	5.5	5.6	Egypt	13.7	29.6	14.4	14.6	11.5
Markets												
	Exch.rate (avg Euro)	2016	2017	2018	2019F	2020F	Interest rate (% avg)	2016	2017	2018	2019F	2020F
CEE	Czech Rep.	27.0	26.3	25.6	25.5	24.9	Czech Rep.	0.3	0.4	1.3	2.1	2.4
	Hungary	311.3	309.1	318.8	316.5	315.1	Hungary	1.0	0.1	0.1	0.3	0.6
	Poland	4.4	4.3	4.3	4.3	4.3	Poland	1.6	1.5	1.7	1.7	1.9
	Slovakia	-	-	-	-	-	Slovakia	-0.3	-0.3	-0.3	-0.3	-0.1
	Slovenia	-	-	-	-	-	Slovenia	-0.3	-0.3	-0.3	-0.3	-0.1
SEE	Albania	137.4	134.2	127.6	124.5	125.3	Albania	1.1	1.3	1.0	1.2	1.5
	Bosnia Herzegovina	1.96	1.96	1.96	1.96	1.96	Bosnia Herzegovina	-	-	-	-	-
	Croatia	7.5	7.5	7.4	7.4	7.4	Croatia	0.9	0.6	0.5	0.5	0.6
	Romania	4.5	4.6	4.7	4.7	4.7	Romania	0.8	1.2	2.8	2.9	2.9
	Serbia	123.1	121.4	118.3	118.3	118.5	Serbia	4.1	3.9	3.1	3.0	3.2
CIS	Moldova (USD)	19.9	18.5	16.8	17.2	17.9	Moldova	12.8	8.0	6.5	6.5	6.4
	Russia (USD)	67.1	58.3	62.7	65.3	64.6	Russia	11.2	9.4	7.7	8.2	7.2
	Ukraine (USD)	25.5	26.6	27.3	27.9	29.3	Ukraine	20.9	16.8	18.4	17.3	14.5
MENA	Egypt (USD)	10.1	17.8	17.8	17.7	18.3	Egypt	14.1	19.3	18.8	16.7	14.3
Banking aggregates (% change yoy)												
	Loans (pr. sector)	2016	2017	2018	2019F	2020F	Deposits (pr. sector)	2016	2017	2018	2019F	2020F
CEE	Czech Rep.	6.7	6.5	6.8	5.2	4.5	Czech Rep.	5.8	7.6	6.9	5.5	4.9
	Hungary	-1.9	6.0	10.6	6.0	4.3	Hungary	6.3	10.8	14.1	7.0	5.5
	Poland	5.3	3.2	7.9	5.2	5.0	Poland	9.2	3.7	9.4	6.2	5.8
	Slovakia	10.3	9.6	9.4	7.0	6.6	Slovakia	4.6	5.2	7.2	5.4	5.5
	Slovenia	-2.3	3.2	2.6	3.2	3.1	Slovenia	7.2	7.0	6.7	5.4	4.8
SEE	Albania	0.2	0.5	-3.8	1.0	1.5	Albania	2.3	-1.6	-0.9	1.5	2.0
	Bosnia Herzegovina	3.5	7.3	5.5	5.4	5.3	Bosnia Herzegovina	7.4	9.0	8.5	6.5	5.7
	Croatia	-4.3	-0.1	2.3	1.7	1.8	Croatia	2.8	2.4	5.0	3.1	2.5
	Romania	1.2	6.9	7.8	10.5	4.5	Romania	8.2	15.6	8.9	14.2	5.6
	Serbia	2.4	2.1	9.9	7.5	6.0	Serbia	11.5	3.1	14.9	6.0	5.8
CIS	Moldova	-9.0	-3.7	5.9	5.7	5.3	Moldova	9.2	9.2	6.0	6.2	6.4
	Russia	-4.2	5.2	15.0	8.6	7.2	Russia	-3.9	8.1	14.2	7.0	6.1
	Ukraine	2.0	0.9	6.3	5.3	5.5	Ukraine	9.1	12.1	7.9	5.5	5.7
MENA	Egypt	42.8	7.1	15.3	13.1	11.1	Egypt	41.4	23.8	13.8	13.6	13.5
Banking interest rates (%)												
	Lending (Corp. avg)	2016	2017	2018	2019F	2020F	Deposits (HH avg)	2016	2017	2018	2019F	2020F
CEE	Czech Rep.	1.9	2.0	2.7	3.3	3.4	Czech Rep.	1.1	0.7	0.9	1.6	1.8
	Hungary	3.8	2.5	2.3	2.5	2.9	Hungary	0.6	0.3	0.2	0.3	0.6
	Poland	3.5	3.7	3.5	3.5	3.7	Poland	1.8	1.6	1.7	1.6	1.8
	Slovakia	2.2	2.0	2.2	2.0	2.2	Slovakia	0.2	0.1	0.1	0.1	0.3
	Slovenia	3.1	2.5	2.2	2.2	2.4	Slovenia	0.2	0.1	0.2	0.2	0.3
SEE	Albania*	9.8	8.2	8.1	7.7	7.8	Albania*	0.8	0.8	0.7	0.4	0.6
	Bosnia Herzegovina	-	-	-	-	-	Bosnia Herzegovina	-	-	-	-	-
	Croatia*	7.3	7.0	6.4	6.0	6.3	Croatia*	1.2	0.8	0.6	0.5	0.7
	Romania*	5.5	5.7	7.0	7.1	7.1	Romania*	0.7	0.7	1.7	2.0	2.0
	Serbia*	9.1	8.9	8.6	7.9	8.0	Serbia*	2.7	2.8	2.7	2.6	2.7
CIS	Moldova	12.7	10.2	9.1	8.2	8.0	Moldova	12.6	6.2	4.5	4.2	4.2
	Russia	12.6	10.6	8.9	8.9	8.1	Russia	7.0	5.9	5.4	5.3	4.4
	Ukraine*	19.0	16.4	19.0	18.7	16.0	Ukraine*	11.5	9.1	12.0	11.7	9.3
MENA	Egypt	13.6	18.2	18.3	16.5	15.6	Egypt	7.9	12.1	12.3	11.1	10.3

Note: * private sector. Source: Intesa Sanpaolo Research Department forecasts

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