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Intesa Sanpaolo

International Research Network

**GDP growth seen to decelerate in CEE and accelerate in SEE countries where easy monetary stance is confirmed in 2016 and 2017. Limited impact seen from Brexit. Russia benefits from oil price recovery.**

In the CEE/SEE countries with ISP subsidiaries, given the GDP dynamics seen in 1Q16 and the business cycle indicators released since April, economic growth has been revised upwards, from 2.7% in March to 2.9% now, both in 2016 and 2017. In this context, some deceleration is expected among CEE (to 2.4% from 3.1% in 2015) and acceleration among SEE countries (to 3.2% from 2.8%). The British referendum's result – due to the areas' weak trade and limited financial links with the UK – is expected to have contained (mostly indirect) effects on growth.

Outside the CEE/SEE region, GDP growth has been also revised upwards in Russia, to -0.7% (from -1.5% seen in March) in 2016, thanks to anticipation of the oil price recovery, and left at 1% in 2017. In Egypt, growth has been broadly confirmed below potential, at 3.4%, in 2016, due to the negative impact from a decline in revenues from tourism and the Suez Canal, public investments delays and a more restrictive monetary policy to support the EGP.

The inflation profile has in general been revised downwards. In 2016, it is seen on year average below zero in Slovakia (-0.3%), Slovenia (-0.4%), Bosnia and Croatia (-1.2%), and Romania (-1.4%), just above zero in Hungary (+0.5%), and around 1% in Albania and Serbia. Together with an ultra-accommodative monetary policy for an extended period announced by the ECB, significantly below target inflation rates at local levels strongly support easy monetary stances in the CEE/SEE region. Interest rate cuts are foreseen in Russia and Ukraine following a sharper-than-previously-anticipated decline in inflation (to 6% and, respectively, 9% average in 2017).

Long-term rates are expected to remain low in 2016 in CEE/SEE countries, due to the low growth/low inflation environment, and to start to move upward only later in 2016 or in early 2017. The (so far limited) impact of the British referendum on spreads is any event expected to be reabsorbed on the assumptions of ECB interventions (if necessary) to stabilise the markets and of EU adequate action to address potential risks of a future break-up of the Union. In the CIS area, progress towards financial stabilisation is also supporting a drop in long-term premia.

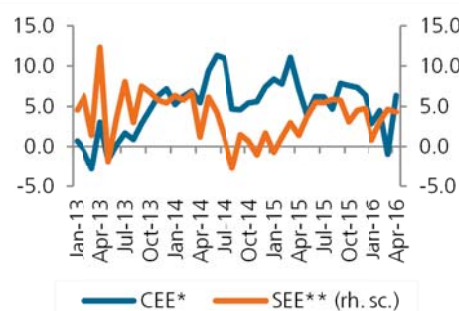
The loans dynamics is forecast to show signs of only weak recovery in the CEE/SEE regions. In Croatia and Hungary, credit growth rates are expected to remain in negative territory in 2016 due to the effect, in addition to the ongoing process of banks' portfolio restructuring (which is also still affecting Slovenia) of *ad hoc* measures to tackle the Swiss franc appreciation issue. Loans growth rates are finally expected to be in positive territory in all the countries in 2017. In the CIS area, the loans growth rate is forecast to stay below inflation both in Russia and (especially) in Ukraine. In all the countries with ISP Subsidiaries, deposits are still expected to remain on a positive trend, in nominal and real terms, and generally above the loans' dynamics. The loans/GDP and loans/deposits ratios are therefore likely to decline further together with a rebalancing between internal vs external funding.

Industrial production % y/y



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

Industrial production % y/y



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

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

The note considers the countries with Intesa Sanpaolo Subsidiaries and in particular: Slovakia, Slovenia and Hungary among CEE countries; Albania, Bosnia, Croatia, Serbia and Romania among SEE countries; Russia and Ukraine among CSI countries; and Egypt among MENA countries.

## Cross-country Forecast

### Recent developments

In 1Q16, the GDP dynamic, as we expected, slowed in the CEE area but strengthened in the SEE region, where the recovery cycle had comparatively started with some delay. Among the **CEE countries** with ISP subsidiaries, in Slovakia and Slovenia, GDP still grew at a significant rate (3.4% and 2.5% vs 4.3% and 3.3% in 4Q15), while Hungarian GDP rose by 0.9% y/y in 1Q16 (vs 3.2% in 4Q15), a lower-than-expected rate. In the area, in April, industrial production was above the rate seen in 1Q16, with annual rates from 5.3% y/y (Slovenia and Hungary) to 7.2% (Slovakia). Exports remained on a positive trend.

In the **SEE countries** with ISP subsidiaries, economic growth consolidated in 1Q16. It continued to accelerate in Croatia (2.7%), Romania (4.2%) and Serbia (3.5%); in the latter two cases, the recovery trend consolidated following (long, in the case of Croatia) recessions. Industrial production remained on a positive trend in April, ranging from 3.8% in Bosnia to 8.4% in Serbia.

The business cycle indicators confirm expectations of some economic deceleration in 2016 vs 2015 in CEE countries and of acceleration in SEE countries. In May, the ESI receded in Slovakia and Slovenia, although it remained close to the historical high. In the same month, in Hungary, the manufacturing PMI was below the value recorded in February (54.6, a record for the year), but was still above 50.

In May, **consumer price inflation** still experienced negative rates for the CEE countries (-0.2% in Hungary, -0.5% in Slovenia and -0.8% in Slovakia) and SEE countries (-1.6% in Bosnia, -1.8% in Croatia and -3.5% in Romania), with the exceptions of Albania and Serbia, at 0.7% and 1.5%, respectively. However, levels remained well below the target intervals set by the central banks. In general, low inflation is still supported by new lows for energy prices and weak pressure from domestic demand.

All the central banks of the CEE/SEE countries with ISP subsidiaries maintained or even strengthened easy **monetary conditions**. In Hungary, the MNB, which moved the benchmark rate to 0.9%, was also the first central bank in the non-EA CEE/SEE region to lower its overnight deposit rate to negative values (-0.05%). Exchange rates remained quite stable in the whole region as did the CDS, despite the turmoil in European financial markets following the British referendum, but they still declined with respect to the values seen three months ago.

In the CIS region, **Russia** started to benefit from the (partial) reversal of the oil price. In May, industrial production increased for a second month in row by 0.7% m/m (0.5% m/m in April), which compares with -0.7% recorded in 1Q16. In May, inflation remained unchanged at 7.3% y/y for the third consecutive month, and it looks like it is on course to edge up over the coming months. As the effects of last year's sharp drop in the currency wash out of the annual comparison, inflation should once again start to fall back once in the final months of 2016, however. On 10 June, the **Russian** central bank made its first rate cut in 10 months, lowering the key rate by 50pbs, to 10.5%. The bank showed more confidence regarding a steady decline in inflation, with the rate reaching the 4% target by end-2017. The accompanying statement noted that despite signs of recovery in the economy, there is little evidence of demand-side pressures on inflation.

In **Ukraine**, industrial production rose a modest 0.2% y/y in May. In January-May 2016 compared with January-May 2015, this increase amounted to 3.1%. Agricultural production volume in January-May 2016 was 2.3% lower than in the corresponding period of 2015. On 23 June, Ukraine's central bank cut its main policy rate for the third consecutive time to 16.5% from 18% previously, based on a persistent slowdown in inflation (the annual rate eased to 7.5% in May) and a stable currency market.

In **Egypt**, industrial production fell by 12.7% y/y in April, and in the first four months of 2016, it was 10.4% weaker than last year. Activity in the January-April period was dragged down by

Gianluca Salsecci, Giancarlo Frigoli, Antonio Pesce and Davidia Zucchelli

Economic growth continued in the CEE and consolidated in the SEE area in 1Q16

Inflation slowdown continued in May

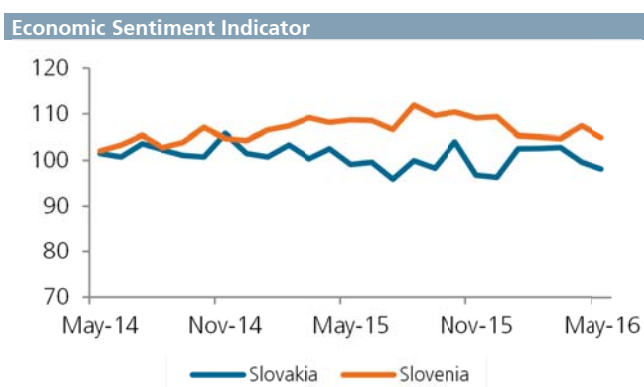
Easing process resumes in Russia and continues in Ukraine. New rate hikes in Egypt

much lower tourism, which tumbled by 60% compared to the same period in 2015, and, to a minor extent, by Suez Canal earnings (-1% y/y). All other industries reported gains, in particular retail (+10%) and refining (+9%). On 16 June, the Egyptian central bank raised its main policy rates by 100 bps (with the maximum rate set at 12.75%). It was the second rate increase this year, following the 150 bps hike delivered in March to support the exchange rate and control inflation.

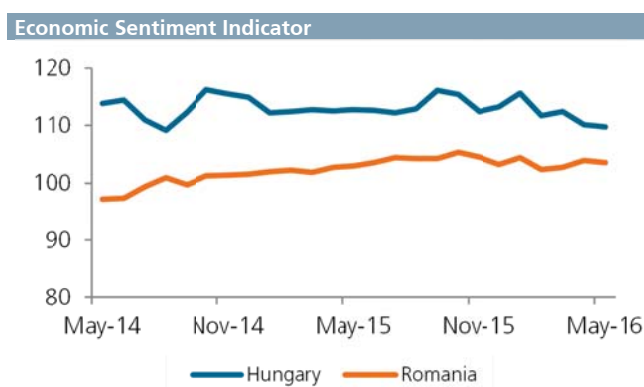
With reference to **banking aggregates**, loans dynamics remain weak. In April in Bosnia, Romania and Serbia, y/y changes were confirmed at over 2% y/y, as was the case in March. In Croatia, the conversion process of loans to households denominated in CHF into euros partly contributed to the further deep decline in loans stock (-6.2% y/y). In Slovenia (-7.4%), the banking sector is still experiencing asset quality issues, which have yet to be fully solved, and this is negatively affecting recovery. Deposits increased quite significantly in many countries in April – particularly in Romania (10.4% y/y), Slovakia (+8.6%) and Slovenia (+7.5%).

In the CIS area, positive changes in the main banking aggregates were simply due to the accounting effects of exchange rate depreciation. In Russia, loans rose nominally by 5.8% in March, but net of fx effects, they are estimated to have increased by only 1.3%. In Ukraine, where the banking sector is under particular stress, loans decreased by 10.4% in April, but net of the fx depreciation, they fell by 22%. Deposits increased by 2.2% y/y (but fell by 8% net of fx depreciation), due to a decrease in remittances and a lack of confidence among savers. Nonperforming loans rose to over 29.69% in March, putting further pressure on capital.

In April, **foreign liabilities** continued to decline significantly, both in some CEE countries (in Slovenia, -16.5%) and in some SEE countries (in Croatia, -34%, and in Albania, -15.5%). Among CEE countries, foreign liabilities grew, however, in Slovakia by 18.8%, but showed a further decrease in Hungary of 10.2% y/y. In Russia, they decreased nominally by 3% in March (but fell by 18.6% y/y net of fx depreciation). Similarly, in Ukraine, the trend in foreign liabilities was strongly negative in nominal terms (-22% y/y in March, but -40% net of the exchange rate effect). On the liability side, in several cases, the decrease in foreign funding was partly offset by the resilience of deposits.



Source: European Commission



Source: European Commission

## The International Outlook Underlying the Scenario

**GDP growth and monetary policy in the main countries.** Notwithstanding the support of very accommodative monetary policies and historically low commodity prices, the legacies of the global financial crisis continue to hamper a more robust pickup in activity in advanced economies. On the other hand, in emerging and developing economies (which as a group are still expected to outperform the advanced countries' growth rates), prospects across countries remain uneven and generally weaker than over the past two decades. In particular, a number of large countries, including Brazil and Russia, are still in recession. Growth prospects remain particularly good in Asia, where a slowdown is nevertheless expected in China, while the pace of the economy is forecast to accelerate in India.

**The financial crisis overhang continues to hound the global economy**

**Global financial market developments and the UK referendum.** Since March 2016, the easing of concerns about the China's economic developments and the perception that all the major central banks will do whatever they can to ensure global financial stability, have all contributed to improve the market sentiment. The US and EA Central Banks are still keeping, in this context, accommodative (albeit differentiated) monetary policies. The next tightening move by the Fed has been delayed to the fourth quarter of this year while the ECB has strengthened its Asset Purchasing Programme, to include corporate bonds.

**Financial Market Sentiment has improved since last March**

The financial market turbulences (mainly affecting equity markets and especially banking sector indexes) that has followed the immediate release of the UK referendum's result are thought to be gradually reabsorbed, on the assumptions of ECB interventions (if necessary) to stabilise the markets and of EU adequate action to address potential risks of a future break-up. They nevertheless signal concerns about the prospects of the European Union integrity and financial stability, adding to downside risks.

**The financial turbulences following the UK referendum are thought to be reabsorbed but add to downside risks**

**Euro zone forecasts.** Examining the developments seen over the last three months, the growth profile of the US economy has been confirmed (GDP slowing to 1.9% this year from 2.4% in 2015 and accelerating to 2.3% in 2017). As far as the Euro zone is concerned, the impact of the confidence shock that has followed the British referendum is seen to be modest, subtracting, according to most observers, only 0.1 pp from GDP growth this year and 0.2 pp in 2017. We nevertheless forecast a higher growth rate in the Euro area in 2016-2017 (1.7% on average vs 1.6% in 2015) on the back of positive data released in the first quarter of 2016 and of the additional (and extended) support announced by the ECB.

**Slightly higher growth rate of EA seen in 2016-2017 with respect to 2015**

## Economic Outlook

### GDP growth and inflation

For the whole **CEE/SEE area with ISP subsidiaries**, following the GDP dynamics observed in 1Q16 and the business cycle indicators released since April, the growth forecast has been slightly revised upwards for the full year 2016, from the 2.7% expected in March to the 2.9% forecast now. The same rate is also forecast for 2017. As remarked above, the British referendum – due to the weak direct links of CEE/SEE countries with UK – is seen to have only limited and mostly indirect effects on the economic growth of the region, less than that expected in the Euro area of -0.1-0.2 pp and not easily distinguishable from other business cycle drivers.

**GDP growth slightly revised upwards in the CEE/SEE region in 2016-2017**

The upward revision of the forecasts is the result of two different profiles expected for the CEE and SEE regions. Among the **CEE countries**, the GDP growth rate is expected to decelerate in 2016 to 2.4% (generally in line with the 2.5% expected in March) vs the 3.1% seen in 2015. The sharp deceleration – as anticipated in our March forecast note – is partly related to a lower contribution of EU funds related public investments (affecting domestic demand especially in Hungary) and to a weak recovery of the EA (affecting exports). Growth in the region is then expected to accelerate slightly in 2017 (to 2.6%) thanks to new investments announced in Slovakia (with some uncertainty, however, in the automotive sector after Brexit) and to some space left to be exploited in Hungary's public budget.

Among the **SEE countries**, GDP is expected to accelerate in 2016 to 3.2% (revised upward from the 2.9% seen in March) with respect to the 2.8% seen in 2015, mainly due to a higher than previously forecast GDP profile in 2016 in Romania (4% from 3.8% still expected in March), in Croatia (1.8% from 1%) and in Serbia (2.3% from 1.8%). The growth of the region is forecast to consolidate around 3% in 2017.

In the **CIS area**, thanks to a partial recovery of the oil price (now below USD 50/bbl, a forecast reached one year early vs previous expectations), growth has been revised upwards in 2016 for Russia at -0.7% (with respect to the -1.5% expected in March) and left at +1% in 2017. The growth rate may accelerate further in case of higher energy prices and of future (at least partial) removal of sanctions by Western countries.

**GDP growth in Russia should benefit from oil price partial recovery**

In the **MENA region**, the GDP growth forecast for Egypt is confirmed at much below potential in 2016 (at c.3.4%) due to the heavy impact of the previously noted fall in revenues from tourism and, to a lesser extent, from the Suez Canal (on the external side), and more restrictive monetary policy, which together with subsidy revisions are likely to affect demand (on the domestic side). Growth is expected to accelerate in 2017 to 4.2% on the assumptions that both external and domestic demand can recover and geopolitical tensions ease somewhat.

**GDP growth in Egypt, still below potential in 2016, seen to improve in 2017**

**Inflation forecasts** have generally been revised downwards in 2016 for the countries with ISP subsidiaries, given economic activity in the first five months of the year. The average inflation rate in 2016 is expected to be below zero in Slovakia (-0.3%) and Slovenia (-0.4%) among CEE countries, and in Bosnia and Croatia (-1.2%) and Romania (-1.4%) among SEE countries. It is forecast to be slightly above zero in Hungary (0.5%) and around 1% in Albania and Serbia. Inflation is expected to accelerate in the CEE/SEE regions in 2017, but stay below previous expectations, and *a fortiori* still remain for most countries much below the lower limits of the ranges set by the respective central banks. In the CIS area, inflation is forecast to further (and rapidly) decline in Russia and Ukraine (to 6% and 9% on average, respectively, in 2017). It is expected to show a *y/y* average of around 11% in 2016 and 11.5% in 2017 in Egypt, due to the ongoing effects of the currency depreciation that has occurred and the expected impact from the introduction of *ad hoc* measures, such as the Value Added Tax and a reduction of electricity subsidies.

#### Monetary policy and the financial markets

The expansionary stance of **monetary policy** anticipated in previous forecasts for 2016 and 2017 is confirmed for the **CEE and SEE regions**. The forecasts are supported (directly for Slovakia and Slovenia, members of the EA, but also indirectly for the other countries) by the decisions adopted by the ECB to strengthen the QE Programme and the possibility that some local central banks (as in the case of Hungary) would also introduce unconventional monetary measures to revive credit and growth. They are also supported by local trends in inflation rates, which are forecast to reverse course starting from lower than previously expected levels in both 2016 and 2017, while remaining well below the targets set by central banks.

**Monetary policies are forecast to be still accommodative in the CEE/SEE region**

In the **CIS area**, easing inflationary pressures and recovery of the currency should eventually lead to new rate cuts in the next months in Russia, with the MOSPRIME now expected to end this year below 10%. Lower monetary rates are also forecast in Ukraine. In the **MENA region**, in Egypt, money market rates are expected to remain around the higher level recently reached (rates on 3mo Treasury bills settled at 14.9% on the last auction) for the rest of the year, amid higher than previously expected inflation and in order to avoid further deep tensions in the currency market, before they can benefit of new cuts later in 2017.

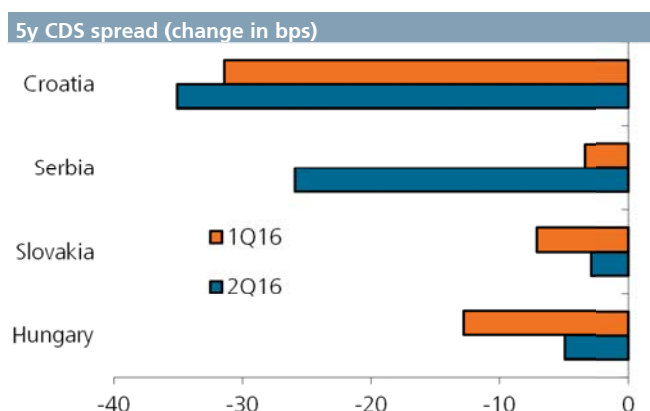
**Long-term rates** are still expected to remain generally low in 2016 in **CEE and SEE countries** – in line with March forecasts - and start to move upward only later in 2016 or early in 2017 based on reversals in inflationary trends. Turbulence that occurred in financial markets following the British referendum mainly affected equity markets (especially banking sector indexes) and government bonds only slightly (in particular 10yr German bunds whose yields have now fallen into negative territory). The impact on long-term spreads related to Brexit is expected to be gradually reabsorbed on the assumptions, as previously stated, of ECB interventions (if necessary) to stabilise the markets and of EU adequate action to address potential risks of a future break-up of the Union. In the **CIS region**, progress towards financial stabilisation has supported a drop in long-term premia both in Russia and Ukraine.

**Long rates are expected to remain low in 2016 on average, but start to move upward later in 2016 or early in 2017**

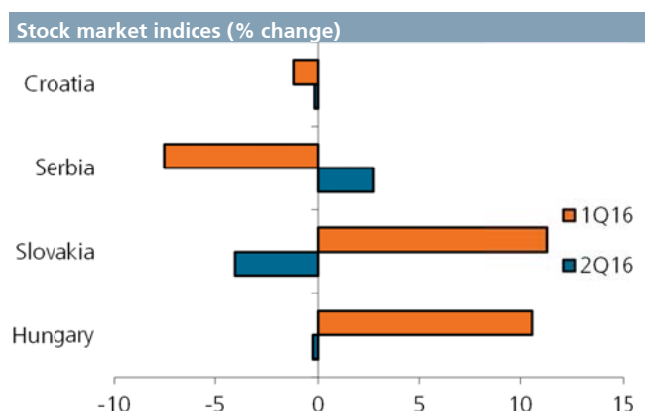
**Exchange rates** are forecast to remain around current levels in 2016 in the CEE/SEE areas. As in the case of government bonds, turbulence related to the Brexit result is only expected to have temporary effects. In the CIS area, the rouble is forecast to partially regain the value it lost in 2015, helped by the recovery in oil prices. The Ukrainian hryvnia is however forecast to follow a (gradual) depreciating path to counterbalance the ongoing appreciation of the real effective exchange rate. In Egypt, notwithstanding the recent large devaluation, the competitive pressures, the low levels of foreign exchange reserves, and the more flexible management of the exchange rate announced by the authorities point to further currency adjustments.

**Exchange rates generally stable in CEE and SEE countries. Tensions are easing in CIS area**





Source: Bloomberg.



Source: Thomson Reuters.

**Aggregates and bank rates**

**Private sector loan stock dynamics** in the CEE/SEE regions are expected to improve only slightly in 2016 vs 2015. The persistently slow recovery (as stated in previous forecast notes) is mainly seen to be the result of the long-lasting deleveraging processes occurring in the private sector (from the demand side) and NPL reductions in banks' portfolios (from the supply side). In Croatia and Hungary, loans growth rates are still expected to remain in negative territory in 2016 due to the impact, in addition to the ongoing process of banks' portfolio restructuring (which is also affecting Slovenia), of *ad hoc* measures to tackle the Swiss franc appreciation issue. Loans growth rates are finally expected to be in positive territory in all the countries in 2017.

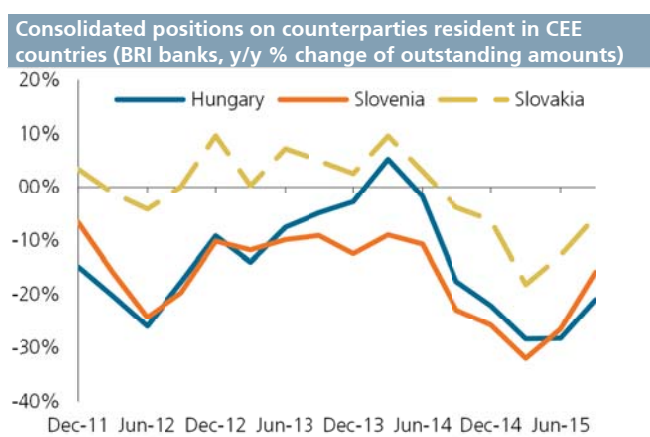
**Loan performance expected to recover slightly**

In the CIS area, the pace of the loan recovery is still forecast to be weak in 2016, at a rate still below inflation in Russia and in Ukraine as well. In Egypt, a still significant loans' increase (although at decelerating rate) is forecast in 2016 (+13.5%, after +18% in 2015). However, this is still below the nominal GDP dynamics.

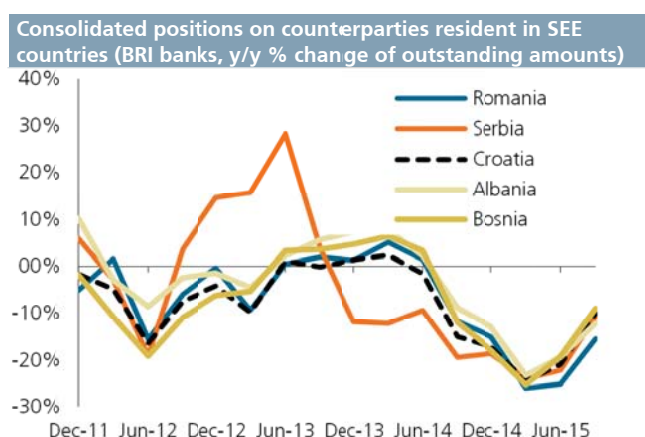
**Aggregates in the CIS area forecast to remain weak**

**Deposits growth rates** are forecast to be positive in 2016-2017 (even if lower than in 2015) and in general well above the loans' dynamics. The loans/GDP and loans/deposits ratios are expected to decline further together with further rebalancing between internal and external funding.

**Deposits growth profile above loans dynamics**



Source: Intesa Sanpaolo processing of Bank for International Settlements data



Source: Intesa Sanpaolo processing of Bank for International Settlements data

## Country-Specific Analysis

### Albania

#### Real Economy

Albania continues on a path of a gradual economic recovery despite difficult external conditions. GDP growth is projected to be near 3% in 2016-2017, supported by FDIs, (mild) credit recovery, and structural reforms being introduced. FDIs remain strong at around 9% of GDP on the back of large energy projects, such as the Trans-Adriatic Pipeline and the Statkraft/Devoll hydropower project. Although there is no contraction in consumption, inflation remains low, reflecting a combination of the negative output gap, weak import prices, and lower prices of agricultural products. The Central Bank has evaluated that this is a temporary outcome, which will run during the first half of 2016 and is expected to be corrected in the second half of this year.

Kledi Gjordeni

The outlook remains favourable. The Albanian economy is still running below potential, in our view. Official foreign reserves have been rising. With a Eurobond issuance in November 2015, gross FX reserves are at around five months of imports. Albania has made progress in terms of strengthening public finances and implementing structural reforms in the power sector. However, other reforms, critical for improving the business environment, including those related to property rights, non-performing loans, the judiciary, and governance, are still lagging.

#### Financial Markets

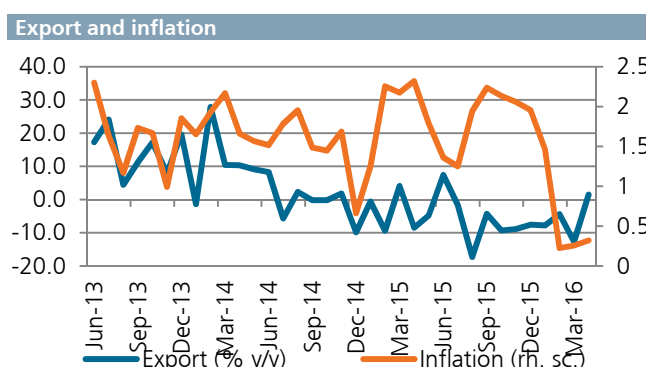
The monetary policy looks likely to remain on the accommodative side. There is still space for conventional monetary easing through lowering the policy rate, but at some stage the CB could consider the use of unconventional policy tools. The key interest rate is at a record low, at 1.25%. With increased reliance of public borrowing on external sources since late 2015, market liquidity has also increased significantly, creating further downward pressure on domestic T-bill yields. The monetary policy is functioning in reducing euro-isation in the banking system. The share of loans in domestic currency in relation to the total loan level today has increased to 45%. From the beginning of the year, the exchange rate against the euro has been stable, at a range between 138.00-138.50 Lek against the Euro.

#### Banking Sector

While deposit rates continue to decline steadily, lending rates are falling at a slower pace, reflecting continued risk aversion by banks still plagued by high NPLs at 20% in April. Credit growth remains weak, reflecting low demand from business and constrains on the supply side. In April 2016, loans to the private sector recorded a 1.3% annual growth yoy with a slowdown, however, in corporate loans by 2.6% yoy. On the liability side, in April 2016 Total Deposits increased by 0.2% yoy (+5.6% yoy in the business sector) while Foreign Liabilities recorded -14.7% yoy.

Forecasts	2015	2016F	2017F
Real GDP yoy	2.6	2.8	2.8
CPI avg	1.9	1.3	1.9
Euro Exchange rate avg	139.8	138.4	140.2
Euro Exchange rate (end of period)	137.7	139.2	141.2
Short term rate (avg.)	2.7	1.0	1.0
Short term rate (end of period)	2.2	1.0	1.0
L/T bond yields (avg.)	n.a.	n.a.	n.a.
Bank Loans yoy (end of period)	-2.6	1.5	2.5
Bank Deposits yoy (end of period)	1.0	1.5	2.0

Source: Intesa Sanpaolo Research Department forecasts



Source: INSTAT



## Bosnia and Herzegovina

### Real Economy

At the time of writing this analysis, the official Q1 2016 GDP outturn has not yet been published, and we have decided to keep our 2016 growth estimate at 2.6% y/y. Positive trends from the first quarter continued in the April/May period as industrial production increased by 2.9% and 3.9% y/y, mainly driven by a strong manufacturing. As foreign demand remained supportive, exports increased by 5.7% and 2.6% over the observed months, thus improving the overall trade balance. However, it seems that private consumption has eased slightly (compared to q1 +8.2%) since real retail trade in April increased by 4.6% y/y. We do not see any immediate impact of Brexit on the Bosnian economy, as the UK accounts for marginal 0.7% of the country's exports and 0.9% of imports. However, political turmoil in the European Union alongside political disagreements in Bosnia could jeopardise the country's candidate status perspective.

Ivana Jovic

Deflationary pressures remain strong, and the average 12-month CPI declined in May by 1.6% y/y, thus we estimate that the 2016 average inflation rate will be as low as -1.2%.

### Banking Sector

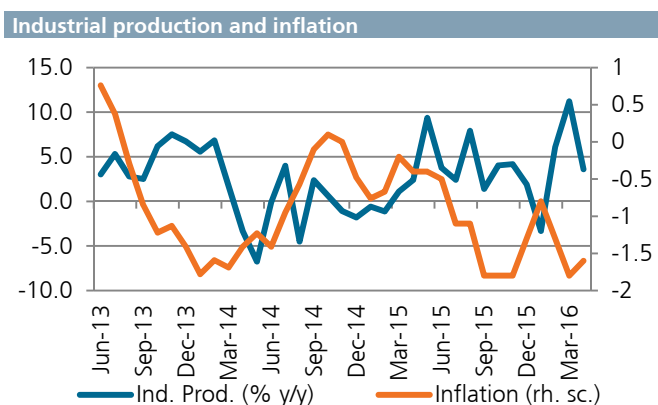
The growth of loans to the private sector edged down to +2.9% y/y in April owing to a somewhat slower rise in household (+4.0% y/y) and corporate borrowing (+1.8%). The most significant types of loans to households recorded an increase in April (consumer +5.8% y/y, housing loans +3.0%, and credit card +3.4%), but the dynamics has significantly changed in the past months. While consumer loans have speeded up notably, the growth rate of housing and credit card loans decelerated. Loans to non-financial corporations continued to grow on the back of an increase in the private sector borrowing (+2.5% y/y), while the loan portfolio of public companies continued to shrink (-10.8% y/y). For the following period, we expect that retail lending will maintain the pace of growth, with the strongest incentive coming from the prevailing consumer loans. In the corporate sector, recovery is expected to continue, supported by SME lending schemes. As such, we see the loan rise accelerating a little to 2.5% y/y this year.

Ana Lokin

The private sector deposit growth maintained momentum, recording a 7.2% y/y rise in April (corporate +7.0%, households +7.3%). On account of recovery of corporate deposits and steady rise in household savings, we expect the private sector deposit rise to remain robust in the rest of the year. However, due to a bit slower collection of deposits in the first months of the year, we have slightly corrected downwards our March estimate of the deposit growth rate to a still-high 7.2% y/y.

Forecasts	2015	2016F	2017F
Real GDP yoy	3.2	2.6	2.7
CPI avg	-1.0	-1.2	0.4
Euro Exchange rate avg	1.96	1.96	1.96
Euro Exchange rate (end of period)	1.96	1.96	1.96
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)	2.2	2.5	3.0
Bank Deposits yoy (end of period)	7.8	7.2	6.7

Source: Intesa Sanpaolo Research Department forecasts



Source: Labour and employment agency

## Croatia

## Real Economy

The stronger-than-expected q1 outturn (+2.7% y/y GDP growth) and continued positive trends in high frequency data (industrial production up 5.0% and real retail trade up 3.2% y/y in April), alongside the forthcoming tourist season and improved labour market conditions, have strengthened our view that the economy will perform at a solid +1.8% y/y growth rate in 2016. Even though the country's political turmoil (no-confidence vote in PM Oreskovic followed by a decision to dissolve Parliament on 15 July) leads to early elections in September, we do not expect it to jeopardise the 2016 growth outlook. However, another weak coalition Government could lead to another lost year in terms of structural reforms, thus jeopardising the mid and long-term growth outlook. Regarding Brexit, we do not anticipate any immediate negative impact as merchandise trade with the UK accounts for less than 2%. The receipts from UK tourists visiting Croatia are slightly more tangible, as they comprise around 4% of the total tourist intake, but we do not expect any radical or immediate changes in their spending behaviour. Deflationary pressures are prevailing, May CPI declined by 1.8% y/y and, as we expect that the second half of the year to gradually ease off, we forecast the annual average to end at around -1.2%.

Ivana Jovic

## Financial Markets

Both money market interest rates and EURHRK rate were mostly stable during May, but CNB intervened once to reign in sharper appreciation (7.49 avg.). Owing to high liquidity surpluses and the additional kuna supply by the central bank, for FY16 we forecast an average 3M mm rate at 0.9 % (-30 bps y/y), while BOP CA surplus is expected to support the kuna strengthening and push the average to 7.55 (-0.7% y/y).

Ana Lokin

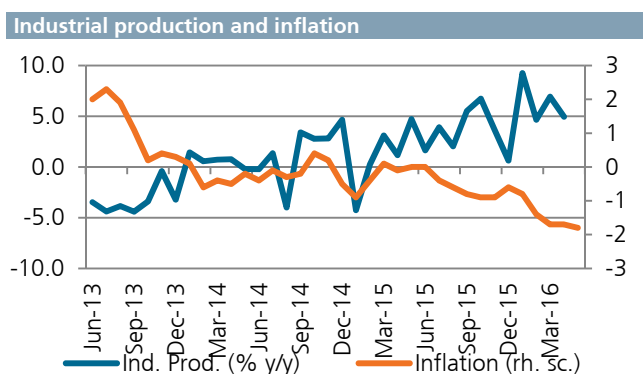
## Banking Sector

Loans continued to shrink in April (-6.2% y/y). As the CHF conversion is coming to an end, a decrease in the retail portfolio slowed to -4.0% y/y. The corporate loans dropped by 7.8% y/y. In 2016, we expect a decline in loans of 3.6% y/y. In spite of a revival in SME demand and a rise in transactions in q1, the corporate portfolio is under a strong influence from the portfolio sale and large corporate refinancing abroad. On the other hand, the retail portfolio trends are overshadowed by the conversion.

The deposit growth rate in April speeded up to 4.8 y/y owing to a 23.4% surge in corporate deposits (base effect, seasonal recovery) and 0.7% higher deposits of households. At the annual level, 2016 is expected to end with a modest 1.9% y/y deposit rise, as the 2015 one-off surge in corporate deposits will not be repeated, and low savings rates and transfer of savings to AUM are limiting the retail deposit volume rise.

Forecasts	2015	2016F	2017F
Real GDP yoy	1.6	1.8	1.9
CPI avg	-0.5	-1.2	0.7
Euro Exchange rate avg	7.61	7.55	7.58
Euro Exchange rate (end of period)	7.63	7.59	7.57
Short-term rate (avg.)	1.2	0.9	0.9
Short term rate (end of period)	1.2	0.9	0.9
L/T bond yields (avg.)	3.7	3.8	4.1
Bank Loans yoy (end of period)	-3.1	-3.6	1.3
Bank Deposits yoy (end of period)	6.4	1.9	2.5

Source: Intesa Sanpaolo Research Department forecasts



## Egypt

## Real Economy

Egypt's GDP growth rate registered 4% during Q4 2015, the same rate as the corresponding period in 2014, with final consumption and investment contributing positively to growth while net exports constrained growth with imports increasing by 4% and exports by 2.4%. The downturn in tourism proceeds and the foreign currency shortage still represent major challenges for the economy that urges the World Bank to lower its growth prospects for Egypt to be 3.3% in FY2015/2016 and 4.2% in FY2016/2017.

Emil Eskander

Annual headline inflation increased to a nearly six-year high in May, recording 12.30%. This notable hike in prices stemmed from the usual rise in demand ahead of the holy month of Ramadan, from the weakening of the EGP and from the increase in the prices of pharmaceutical products. Inflation is expected to continue rising in the coming months, as more devaluation of the Egyptian pound is expected and the shortage of foreign currency continues, setting the annual average rate of inflation at around 11%.

## Financial Markets

During its meeting on 16 June 2016, the Monetary Policy Committee of the Central Bank of Egypt raised the key interest rates by 100 basis points where, the overnight deposit and lending rates increased to 11.75 and 12.75%, respectively, and the discount rate increased to 12.25%, the second rate hike in 2016. The decision was aimed at curbing surging inflation and supporting the Egyptian Pound. A wave of increases in interest rates on savings instruments is expected, as public banks (National Bank of Egypt and Banque Misr) have begun raising interest rates on their saving accounts and time deposits by a rate ranging between 75-100bps, followed by some private banks. Also, the 91-day and 266-day T-bills yields reacted to the rate hikes, rising by almost 1% to 14.051% and 15.118%, respectively, in the auction held on 19 June, compared to a week earlier, reaching a three-year high.

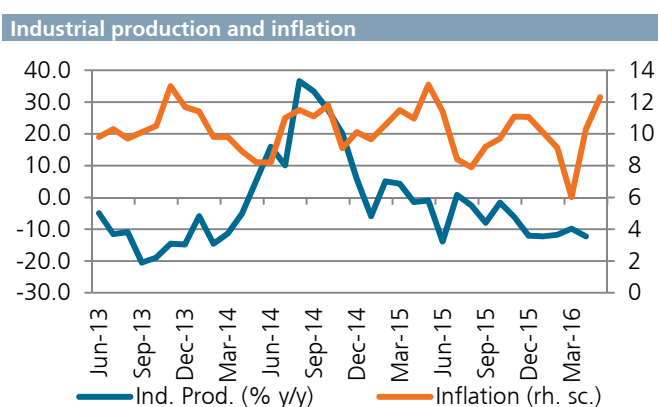
However, the USD continued appreciating in the black market against the EGP, with the Egyptian Pound exceeding EGP 11 per USD, where experts attributed the appreciation to the increased demand of foreign oil companies to obtain the dollar from the black market to meet their needs.

## Banking Sector

Total bank loans to customers reached EGP 847.6bn in March 2016, up 25.5% over March 2015. Private sector loans, which represented 74.9% of total loans at the end of March 2016, grew by 16.3% (yoy). Overall deposits increased by 20.6% yoy, to EGP 2.0tn in March 2016, where private sector deposits rose by 19.6%.

Forecasts	2015	2016F	2017F
Real GDP yoy	3.6	3.4	4.2
CPI avg	10.4	11.0	11.5
USD exchange rate (avg.)	7.7	8.7	9.3
USD exchange rate (end of period)	7.8	9.2	9.5
Euro Exchange rate avg	8.5	9.7	11.1
Euro Exchange rate (end of period)	8.5	10.4	11.4
Short-term rate (avg.)	11.3	13.5	14.5
Short term rate (end of period)	11.4	14.9	14.0
L/T bond yields (avg.)	n.a.	n.a.	n.a.
Bank Loans yoy (end of period)	18.0	13.5	12.0
Bank Deposits yoy (end of period)	20.4	13.3	13.2

Source: Intesa Sanpaolo Research Department forecasts



## Hungary

### Real Economy

Following the full-year 2015 economic growth rate came in at 2.9% (close to our original projection of 2.8%), Hungary's GDP is expected to moderate in pace. While the Q1 2016 dynamics were not only below expectations but even showed a drop on a q/q basis, below the market consensus, the outlook was improved by fiscal easing announcements. As such, we have kept our 2016 GDP forecast unchanged at 2.0%. Some one-off impacts (especially the drop due to the fallout of EU-funded state investments) should, in our view, start to evaporate, but private investments are slow to pick up. Also, the contribution of exports and industry (manufacturing) decreased. Still, we see room for faster growth rate in 2017 due to further fiscal stimulus (with a deficit planned to come in at 0.4 pps above this year's targeted gap) and due to rising wages in the private sector fueling domestic consumption. We expect GDP growth to reach 2.5% next year. However, the stronger pace is unlikely to become sustainable for the coming years, given poor investments and the lack of sufficient improvement in terms of potential GDP.

Headline inflation remained close to 0% in Q2 this year and the summer months may deliver further negative rates. The lack of an upwards shift is primarily driven by relatively low international oil prices and the lack of imported inflation. Annual average inflation is projected to stay below 1%, probably close to 0.5%, but still significantly dependent on oil prices. Core inflation has remained at 1.3-1.5% recently. Next year, annual average CPI is set to rise close to the current headline levels, at around 1.5%.

### Financial Markets

The NBH left the policy rate on hold at 0.9% in June, after having announced the end of the latest mini easing cycle. Further rate cuts are unlikely to come this year and even in H1 2017, in our view. Should any further room for easing emerge, the central bank is more likely to deliver unconventional monetary measures to lift inflation and to try to boost lending and the economy in general. The EUR/HUF exchange rate has remained fairly stable recently, only momentarily breaking the 320 level after the Brexit news. The forint is, in our view, likely to remain fluctuating in the 313-320 range against the euro in the rest of 2016 amid modestly rising government bond yields.

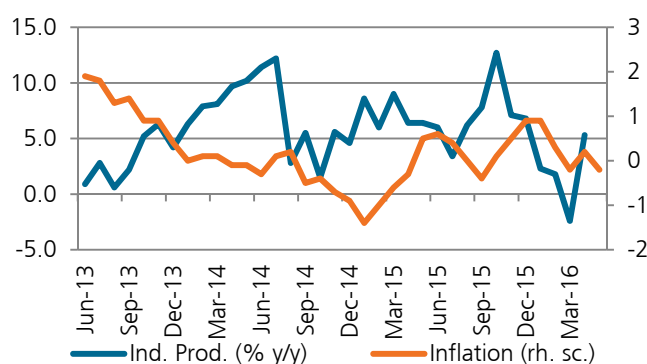
### Banking Sector

Real economic developments lent some support to the demand side of the loan market, but with the ongoing cautious approach of the private sector, we expect the overall corporate credit market activity to continue to have weak dynamics. Customer deposits are set to increase further this year. Corporate, retail clients and investment funds all contributed to the growing volume of deposits. The activity of MARK, the central bank's vehicle to buy low-quality debt from commercial banks, should receive momentum in H2 2016, in our view.

Forecasts	2015	2016F	2017F
Real GDP yoy	2.9	2.0	2.5
CPI avg	-0.1	0.5	1.5
Euro Exchange rate avg	310.0	313.5	314.5
Euro Exchange rate (end of period)	312.0	315.0	314.0
Short-term rate (avg.)	1.7	1.0	1.0
Short term rate (end of period)	1.4	0.9	1.0
L/T bond yields (avg.)	3.4	3.3	3.6
Bank Loans yoy (end of period)	-12.3	-2.5	0.5
Bank Deposits yoy (end of period)	7.5	2.3	2.5

Source: Intesa Sanpaolo Research Department forecasts

### Industrial production and inflation



Source: CSO

## Romania

### Real Economy

Growth gathered pace in the first quarter of 2016, with the flash estimate coming in at 4.3% y/y (up from 3.8% y/y the previous quarter). The main growth engine was household consumption, with a 9.2% y/y growth recorded. Investment was the other major driver. Given the data available so far, and the outlook for the rest of the year (general elections with an intense appetite for more fiscal stimulus on top of very low interest rates both in Romania and in the Eurozone), growth could achieve 4% this year. Going forward, the budget deficit (expected to be close to 3% of GDP this year) is going to be one of the main focus points, as it is widely considered the best gauge of Romania's profligacy.

Sebastian Maneran

### Financial Markets

Brexit was front and center in Romanian financial markets. Though relative to peers the Romanian markets underperformed, the direction was the same: expectations for a pro-EU vote before the results led EURRON FX spot lower and local currency bond yields higher, and the surprise results led EURRON FX spot more than 1% higher, local currency bonds went wide, interest rates on money markets and in the swap market went higher, although volatility underperformed by a wide margin.

A negative risk event in core markets leads to risk-averse behaviour, triggering a demand for safety in assets that are perceived less risky. The initial reaction was relatively short-lived in Romanian financial markets, and the authorities showed a good crisis management.

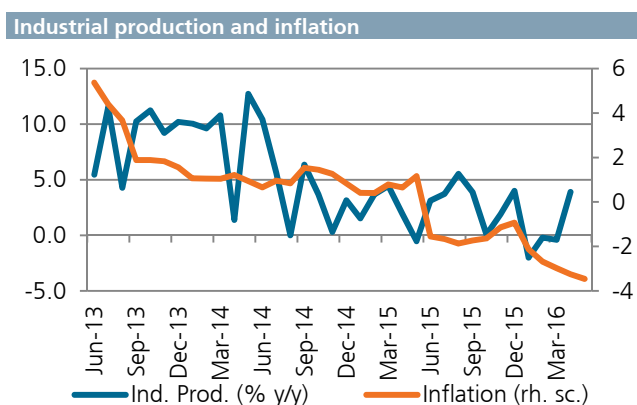
Notwithstanding, for the second-half of the year, increased volatility is to be expected in the FX market (the biggest market in Romania, and hence the most sensitive to moves in core markets) and also in the local currency bonds market, where foreign players are present.

### Banking Sector

There has been no major news in banking over the course of the past month. The law that allows debtors to walk away from their credit started to produce effects since it was enacted last month. Uncertainty still prevails, as the law is being fought by banks. So far, the two banks that are listed on the local stock exchange have not seen significant price action as a consequence of the law.

Forecasts	2015	2016F	2017F
Real GDP yoy	3.7	4.0	3.4
CPI avg	-0.6	-1.4	1.0
Euro Exchange rate avg	4.4	4.5	4.5
Euro Exchange rate (end of period)	4.4	4.5	4.5
Short-term rate (avg.)	1.1	0.7	0.7
Short term rate (end of period)	0.8	0.6	0.8
L/T bond yields (avg.)	3.5	3.5	3.8
Bank Loans yoy (end of period)	2.7	2.5	3.5
Bank Deposits yoy (end of period)	9.1	5.0	5.5

Source: Intesa Sanpaolo Research Department forecasts



Source: NBR

## Russia

## Real Economy

The Bank of Russia (CBR) revised its economic forecast for 2016-2018 mainly due to oil price increase. CBR considers that with average oil prices at 38\$/bbl in 2016, GDP will fall by around 0.7%, instead of 1.5% projected earlier. Quarterly growth rate will switch to positive territory in the second-half of this year, and annual growth rate in the fourth quarter of 2016. The forecast of the Ministry of Economic development (MED) is more optimistic – minus 0.2% in 2016.

In terms of inflation, the MED's forecast on the other hand is less positive than the CBR's forecast. MED expects a 6.5% annual inflation in 2016 with a gradual slowdown to 4% in 2019. CBR expects inflation slowdown to 5-6% in 2016 and 4% already in 2017. It should be noted that for three consecutive months (March-May) inflation stayed at the level of 7.3%. On 10 June, CBR decided to cut the key interest rate to 10.50% per annum. CBR noted positive developments in inflation stabilisation, reducing inflation expectations and inflation risks amid signs of the approaching recovery growth phase for the economy. CBR will consider the possibility of further key rate reduction once assessed inflation risks and compliance of inflation slowing dynamics with the target trajectory.

## Financial Markets

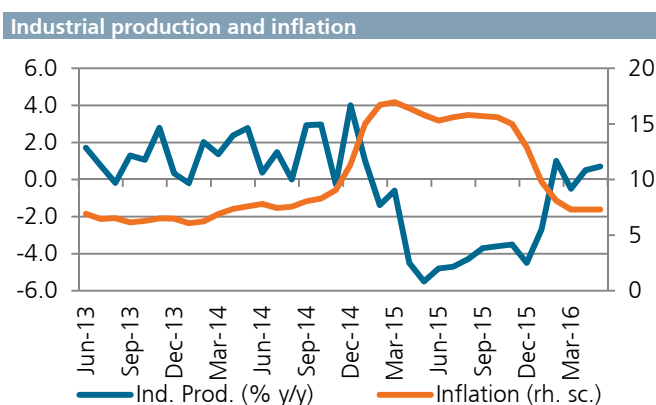
The results of Brexit referendum will not have direct impact on the Russian economy and Russian currency, in our view, but in the medium term due to possible reduction of oil prices the ruble may face a threat of its deterioration. Furthermore, high volatility and long-term uncertainty on the markets that will follow the decision of the UK might stimulate investors to leave risky assets and switch to a secure US dollar. The average exchange rate is expected at around 68 RUB/USD.

## Banking Sector

In 2016 low investment activity might lead to a slowdown of corporate loan portfolio growth rate. Contraction of retail loan portfolio will proceed in the second and third quarters of 2016. Loan rates reduction and increase in consumers' activity might provide retail portfolio growth in the fourth quarter, which will compensate the decrease in the first three quarters and lead to around zero retail lending dynamics. The ongoing economic slowdown and decreasing real incomes of the population will provoke further growth of NPLs in 2016. The volume of funds raised from clients will exceed lending portfolio growth, which will provide a better liquidity position in the banking sector. The rates will continue to fall in 2016, in our view. The potential cutback of the weighted average lending rate for corporate clients is estimated at up to 1.75 p.p. Inflation slowdown and comfortable liquidity position of the banks will stimulate further potential decline in retail deposit rates of up to 1.5 p.p.

Forecasts	2015	2016F	2017F
Real GDP yoy	-3.7	-0.7	1.0
CPI avg	15.5	7.5	6.0
USD exchange rate (avg.)	61.3	68.0	65.5
USD exchange rate (end of period)	72.9	66.0	65.0
Euro Exchange rate avg	68.0	75.5	77.9
Euro Exchange rate (end of period)	79.5	74.6	78.0
Short-term rate (avg.)	13.5	11.0	9.2
Short term rate (end of period)	11.8	9.5	9.0
L/T bond yields (avg.)	11.4	9.0	8.5
Bank Loans yoy (end of period)	8.2	3.0	5.0
Bank Deposits yoy (end of period)	18.8	5.5	6.0

Source: Intesa Sanpaolo Research Department forecasts



Source: State Statistics Federal Service



## Serbia

## Real Economy

Increases in investments and exports propped up growth in 1Q16 to 3.5% y/y, which is substantially higher than expected. Such a good result pushed the annual growth rate projection by the National Bank of Serbia up from the previous estimate of 1.8% to 2.25-2.5%, as it is expected that favorable trends regarding investments and exports will continue. On the production side, a better performance in manufacturing, construction and some service sectors should contribute to higher growth in 2016. The NBS view has recently been approved by the IMF, projecting GDP to expand by 2.5% in 2016.

Branka Babic

The inflationary pressures still remained low due to lower prices of primary commodities and low imported inflation. In April 2016, the y/y inflation reached only 0.4%, while in May it climbed slightly to 0.7%. According to the NBS estimation, the y/y inflation is projected to start rising moderately, returning within the target band ( $4\pm 1.5\%$ ) next year.

## Financial Markets

The National Bank of Serbia maintained a cautious approach to monetary policy, keeping the key policy rate on hold at 4.25% for the fourth consecutive month after a decrease of 0.25pp in February 2016. Despite the low inflationary pressures, the NBS assessed that current stance of monetary policy is sufficient to provide for a moderate rise of the inflation in the following period until reaching the desired target tolerance band ( $4\pm 1.5\%$ ).

Besides the uncertainties in the international financial market, the dinar's weakening since the beginning of the year has been caused by energy importers' demand for foreign currencies, servicing of foreign liabilities, and also foreign investors' reduction of the exposure to government securities issued in the domestic market. On the other hand, depreciation pressures were softened by stronger exports and the inflow of foreign direct investment.

## Banking Sector

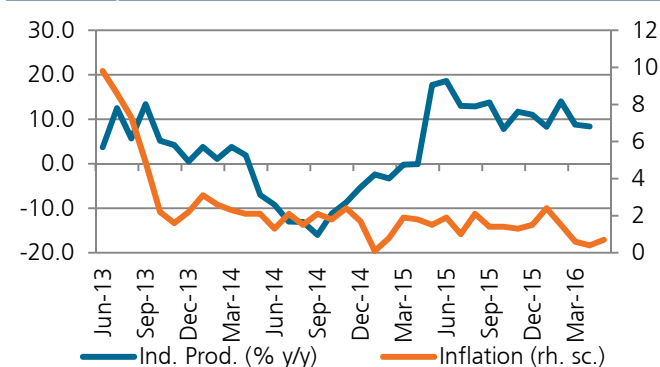
Lending interest rates continued to decline further as a consequence of past monetary easing, but also increased competition among banks. In such an environment, together with the accelerated economic growth, some recovery of domestic credit growth (forecast around 2% in 2016) is expected.

The banking sector is well capitalised. The NPL level is still high, but no longer increasing. In April 2016, it amounted to 20.4%. The share of NPLs in total loans represents the biggest challenge for the banking sector stability.

Forecasts	2015	2016F	2017F
Real GDP yoy	0.7	2.3	2.7
CPI avg	1.4	1.3	2.0
Short-term rate (avg.)	6.3	4.1	4.0
Short term rate (end of period)	4.5	4.0	4.0
LT bond yields (avg.)	0.0	0.0	0.0
Bank Loans yoy (end of period)	3.0	2.0	3.0
Bank Deposits yoy (end of period)	7.1	3.5	4.5

Source: Intesa Sanpaolo Research Department forecasts

## Industrial production and inflation



Source: Statistical Office, National Bank of Serbia

## Slovakia

## Real Economy

A second estimate of GDP showed the Slovak economy growing by 3.4% y/y in real terms and by 0.8% q/q in seasonally-adjusted terms, respectively, even a little higher than posted in the flash estimate a month ago. The economy in the opening quarter of the current year slowed from an extra high 4.3% y/y in 4Q15, but continued growing solidly, above our full-year forecast. Composition-wise, domestic demand downshifted on normalisation of investment activity, but still remained key to growth. Exports substantially decelerated, but as imports decelerated too, net exports contributed to the overall growth of economy positively.

Andrej Arady

1Q GDP data release was a slightly positive surprise, but meanwhile was offset by uncertainty caused by Great Britain voting to leave the European Union in a referendum. The so-called Brexit is clearly a negative factor for growth, but hard to quantify beyond the loss of trade considered by the National Bank of Slovakia to lower the path of Slovak GDP by about a tenth of a percentage point over the next three years. A bigger risk to growth from Brexit, however, stems from ensuing political uncertainty, which may not only impact investment decisions (including the massive investment of Jaguar Land Rover in Slovakia thought to lift Slovak GDP by nearly two percentage points by 2020), but could have unpredictable long term implications for further EU integration, with possible reverse processes that are currently impossible to foresee. We will closely monitor the development, but for now, we leave our previous forecast unchanged for the rest of current year, on the path to a full-year average of 3.3% y/y.

On price development, deflation in May notably deepened. CPI fell to a new all-time low of -0.8% y/y, from the previous -0.4%. The main culprits were decreasing prices of foodstuff. A weak inflation profile in the first five months of the year prompted us to revise full-year forecast from the previously expected +0.1% to -0.3% y/y.

## Financial Markets

With the UK referendum outcome triggering risk-off mode on the markets, assets started to fly to safe havens. This sent yields on German 10 years bunds to a new all-time low, but yields on Slovak government bonds did not follow them. Spreads thus widened by circa 16 points.

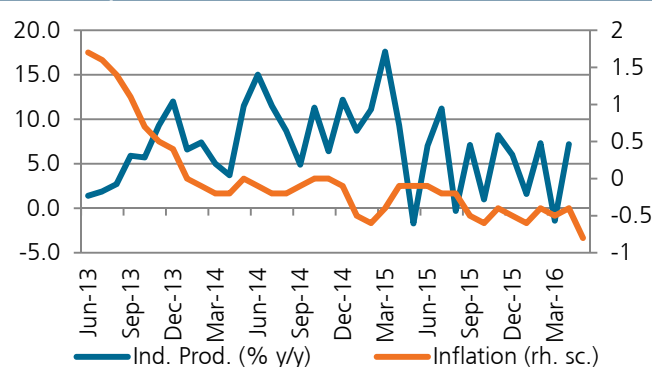
## Banking Sector

In the banking sector, trends of decently growing loans and deposits remained unchanged also thorough April, both growing above 8% y/y and even accelerating. A sharp drop of interest rates held up in particular housing loans, which grew at nearly 13% y/y in April. Mortgage rates continued to decline through April. In the key segment 1-5 year fix, Slovakia overtook Austria and is now ranked behind Germany with just one basis point.

Forecasts	2015	2016F	2017F
Real GDP yoy	3.6	3.3	3.5
CPI avg	-0.3	-0.3	0.6
Short term rate (avg.)	0.0	-0.3	-0.3
Short term rate (end of period)	-0.1	-0.3	-0.3
L/T bond yields (avg.)	0.9	1.0	1.3
Bank Loans yoy (end of period)	8.7	6.2	6.4
Bank Deposits yoy (end of period)	9.9	4.5	4.8

Source: Intesa Sanpaolo Research Department forecasts

## Industrial production and inflation



Source: Statistical Office of Slovak Republic

## Slovenia

## Real Economy

After two years of strong economic growth of around 3%, this year growth looks set to slow down due to lower government investments. Nevertheless, the recovery of the Slovenian economy is expected to continue (1q16: +2.5%, 2016 estimate: +2%), with exports and household consumption being the main drivers of economic growth. A growth slightly above 2% is expected for the following three years, and will be the result of further recovery of the household consumption, gradual improvement of private investment and still relatively strong exports.

In May, inflation remained negative (-0.5% y/y). The decline was still mainly due to lower oil prices and lower prices of durables. The price growth looks set to remain negative in 2016. However, prices are expected to start rising in 4q2016 and inflation should accelerate in 2017 as oil prices recover and wages increase.

Nastja Benčič

## Financial Markets

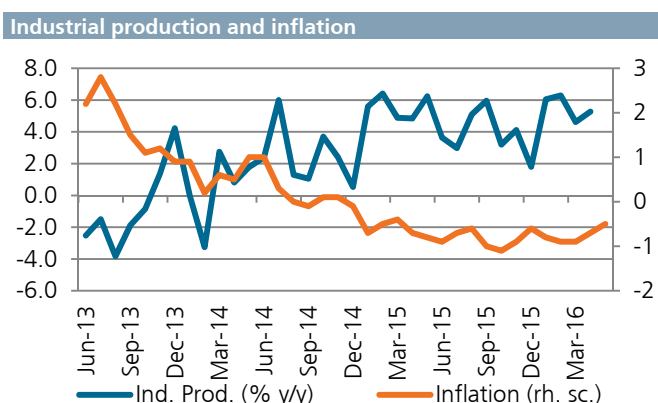
In the last quarter, the three-month Euribor continued to slowly decrease and moved even deeper in negative territory, where it has already stood since April 2015. Currently it is moving around -0.27% and considering the ECB's accommodative monetary policy it is expected to come close to -0.3% until the end of the year. Long-term interest rates are relatively stable. The 10-year Slovenian government bond yield is currently around 1.4%, staying nearly at the same level as three months ago. In 2016 it is expected to reach an annual average value of around 1.6%, turning up in the following years, mainly due to the expected gradual economic expansion and rising inflation. In May, Fitch Ratings agency affirmed Banka Koper's Long-Term rating at 'BBB'. The Outlook on the bank remains stable. In mid-June S&P Global Ratings raised its long-term sovereign rating on the Republic of Slovenia by one notch to 'A/A-1', keeping a stable outlook, mainly due to strengthening domestic demand and ongoing fiscal consolidation.

## Banking Sector

Mortgage and consumer loans volumes have been showing a positive trend in the last months, which can be attributable to lower indebtedness of the households, low lending interest rates and favourable real estate prices. On the other hand, corporate loans only slightly increased in April compared to the previous month, but remain significantly lower y/y. Banks remain reluctant to expand their lending activity either due to high indebtedness or weak equity of the companies. A negative loan growth is therefore expected for 2016. On the contrary, the growth in deposit volumes even strengthened in the last months, and the upward trend is expected to continue this year as well as in the following periods.

Forecasts	2015	2016F	2017F
Real GDP yoy	2.9	2.0	2.1
CPI avg	-0.8	-0.4	0.8
Short-term rate (avg.)	0.0	-0.3	-0.3
Short term rate (end of period)	-0.1	-0.3	-0.3
L/T bond yields (avg.)	1.7	1.6	1.9
Bank Loans yoy (end of period)	-5.2	-4.5	1.0
Bank Deposits yoy (end of period)	5.8	5.5	4.8

Source: Intesa Sanpaolo Research Department forecasts



Source: Statistical Office of the Republic of Slovenia

## Ukraine

## Real Economy

With the appointment of a new government under Prime Minister Volodymyr Groysman in April 2016, the political situation in Ukraine has stabilised and structural reform implementation regained momentum. This new commitment to reforms by Ukraine has led to a resumption of cooperation with the IMF. The IMF is now expected to unfreeze by the end of July a new tranche of the USD 17.5bn extended credit facility awarded in 2015 to Ukraine, and this has enhanced investor confidence. We also expect private consumption growth to recover as rapid disinflation supports real wages and disposable incomes. On account of improving domestic demand conditions, the economic recovery is likely to gain momentum over the coming quarters, with GDP growth accelerating significantly after the modest 0.1% annual increase recorded in 1Q16.

Giancarlo Frigoli

## Financial Markets

As a result of greater FX stability and falling inflation, the Ukrainian National Bank has adopted a more dovish stance by removing some of the existing capital controls and cutting its base rate again in June (from 18% to 16.5%). With annual inflation now in single-digit territory (7.5% the annual rate in May) and currency pressure subsiding, we believe that the central bank will continue to ease monetary policy in the coming quarters. Capital controls in place will continue to limit downside pressure on the currency although competitive concerns point to a weak currency in the medium to long-term.

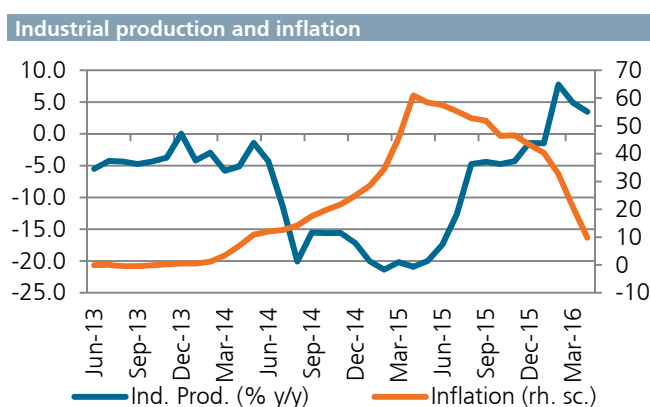
## Banking Sector

In Ukraine, banking aggregates remain weak. Nominal loans decreased by 10% y/y in April (from -14% in March) both in the corporate (-5.4% y/y) and in the households' sector (-27%); net of the exchange rate effect, loans showed a decline of 22%. Deposits also showed a nominal increase (2.2% y/y in April), but fell (approximately -8%) net of the exchange rate effect. According to the latest Lending survey conducted by the central bank, in Q1 2016, banks remained optimistic about expected changes in key indicators for the banking sector. In 2016, the corporate loan portfolio is expected to increase in volume and improve in quality, while the quality of the retail loan portfolio is also expected to improve. Most banks now expect growth of their corporate loan portfolio. Furthermore, in Q1, for the first time in the last years, corporate lending standards loosened, particularly for lending in domestic currency and for extending loans to SMEs, dragged down by banks' higher liquidity and competition for solvent borrowers.

Davidia Zucchelli

Forecasts	2015	2016F	2017F
Real GDP yoy	-9.9	1.5	2.5
CPI avg	48.0	14.0	9.0
USD exchange rate avg	22.0	25.6	26.8
Euro Exchange rate avg	24.4	28.5	31.8
Short term rate avg.	25.9	21.4	17.0
L/T bond yields avg.	n.a.	n.a.	n.a.
Bank lending	-3.8	2.0	3.0
Bank deposits	1.5	2.0	3.5

Source: Intesa Sanpaolo Research Department forecasts



Source: State Statistics Service of Ukraine

## Country Data: Economy, Markets and Banks - the economic cycle

Economy																		
	GDP chg yoy			Ind. Prod* . ch.yoy			Export nom** ch.yoy			Inflation ch.yoy				FX reserves chg***			CA bal ance***	
	1Q16	4Q15	2015	Last	mth	1Q16	Last	mth	1Q16	Last	mth	1Q16	2015	1Q16	4Q15	2015	1Q16	4Q15
<b>CEE</b>																		
Slovakia	3.4	4.3	3.6	7.2	Apr	2.5	6.4	Apr	0.8	-0.8	May	-0.5	-0.3	n.s.	n.s.	n.s.	n.a.	-227
Slovenia	2.5	3.3	2.9	5.3	Apr	5.7	6.3	Apr	3.6	-0.5	May	-0.9	-0.8	n.s.	n.s.	n.s.	703	673
Hungary	0.9	3.2	2.9	5.3	Apr	0.6	5.1	Apr	1.8	-0.2	May	0.3	-0.1	n.a.	-1804	-4256	n.a.	1010
<b>SEE</b>																		
Albania	n.a.	2.2	2.6	n.a.	n.a.	n.a.	1.6	Apr	-8.4	0.7	May	0.7	1.8	n.a.	169	n.a.	n.a.	-413
Bosnia H.	n.a.	2.1	3.2	3.8	Apr	4.5	2.6	May	-0.3	-1.6	Apr	-1.3	-1.0	-7	169	399	n.a.	-231
Croatia	2.7	1.9	1.6	5.0	Apr	7.0	2.4	Mar	3.9	-1.8	May	-1.3	-0.5	-508	270	1019	n.a.	-390
Romania	4.3	3.8	3.7	3.9	Apr	-0.9	6.9	Apr	4.0	-3.5	May	-2.6	-0.6		2456	-3990	n.a.	-826
Serbia	3.5	1.2	0.7	8.4	Apr	10.4	13.8	Apr	11.1	0.7	May	1.5	1.4	-698	-181	171	-249	-451
<b>CIS MENA</b>																		
Russia	-1.2	-3.8	-3.7	0.7	May	-0.7	-28.8	Apr	-33.4	7.3	May	8.4	15.8	9478	-2362	-18340	11700	14952
Ukraine	0.1	-1.4	-9.9	3.5	Apr	3.7	-13.5	Apr	-23.5	7.5	May	31.3	48.5	-729	581	5741	-1101	-283
Egypt	n.a.	4.0	3.5	-12.3	Apr	-11.3	-0.7	Mar	-5.9	12.3	May	9.4	10.4	116	110	1112	n.a.	-4940
<b>m.i. E. A.</b>	1.6	1.5	1.7	2.0	Apr	1.6	-0.9	Apr	-1.1	-0.1	May	0.0	0.0					

Source: Datastream, Reuters, Bloomberg; \*wda data for Slovakia, Slovenia; Bosnia, Croatia, \*\*USD for Russia, Egypt, Ukraine. \*\*\* USD Russia, Egypt, Ukraine, Romania (reserves)

Markets and Ratings														
	S/T rates*			L/T rates**			Foreign exchanges***			Stock markets		CDS spread		Rating
	24/06	chg bp	3M	24/06	chg bp	3M	24/06	3M chg%	1Y chg%	3M chg%	1Y chg%	24/06	24/03	
<b>CEE</b>														
<b>Vs Euro</b>														
Slovakia	-0.3	0.0		0.8	0.3		Euro	Euro	Euro	-3.4	29.9	38.0	41.7	A+
Slovenia	-0.3	0.0		1.3	-0.1		Euro	Euro	Euro	-5.4	-14.8	93.5	95.6	A
Hungary	1.0	-0.2		3.3	0.2		317.3	1.2	1.7	1.1	31.7	136.4	141.5	BB+
<b>SEE</b>														
Albania	0.9	-0.6		n.a.	n.a.		137.7	-0.5	-2.0	n.a.	n.a.	n.a.	n.a.	B+
Bosnia H.	n.a.	n.a.		n.a.	n.a.		1.96	Board	Board	n.a.	n.a.	n.a.	n.a.	B
Croatia	0.6	0.0		3.7	-0.1		7.5	-0.3	-0.6	-0.5	-3.8	240.2	275.5	BB
Romania	0.6	0.1		3.8	0.3		4.5	1.5	1.8	-7.0	-10.5	110.5	113.1	BBB-
Serbia	4.3	0.0		n.d.	n.d.		124.0	0.7	3.1	-1.0	-14.6	245.3	271.6	BB-
<b>CIS MENA</b>														
<b>Vs USD</b>														
Russia	11.0	-0.8		8.6	-0.6		64.3	-4.2	17.3	-0.3	8.1	222.6	256.7	BB+/N
Ukraine	20.8	-3.8		9.7	0.0		24.9	-4.8	18.5	-0.2	-30.1	n.a.	n.a.	B-
Egypt	14.9	+2.0		18.0	0.8		8.9	0.0	16.4	3.6	-16.2	488.2	506.5	B-/N
<b>m.i.E.A.</b>	-0.3	0.0		-0.1	-0.2		1.11	-2.3	-0.3	-3.3	-22.2	12.8	12.1	

Source: Datastream, Reuters, and Bloomberg; \* The data for Albania refers to April \*\*For Ukraine, the long-term rate refers to a government issue in dollars; \*\*\* The (-) sign indicates appreciation. Sources: Thomson Reuters-Datastream, Bloomberg

Aggregates and bank rates for the private sector																							
	Loans		NPL/Loans		Foreign Liab.		Deposits		Loans rate <sup>1</sup> -NewB*			DepositsRate <sup>1</sup> -NewB*			Loans/Dep								
	Chg yoy %	Last Mth	2015	%	Last mth	2015	Chg yoy %	Last mth	2015	Last	mth	2015	S*	Last	mth	2015	S*						
<b>CEE</b>																							
Slovakia	8.3	Apr	8.7	5.1	Apr	5.1	18.8	Apr	1.1	8.6	Apr	9.9	2.8	Apr	2.83	C <sup>2</sup>	0.68	Apr	0.75	H <sup>2</sup>	90.3	Apr	90.0
Slovenia	-7.4	Apr	-5.2	8.2	Mar	9.9	-16.5	Apr	-20.7	7.5	Apr	5.8	3.18	Apr	3.45	C <sup>2</sup>	0.2	Apr	0.28	H <sup>2</sup>	85.0	Apr	89.2
Hungary	-6.4	Mar	-12.3	0.1	Dec	0.1	-10.2	Mar	-8.1	5.9	Mar	7.5	4.1	Mar	4.1	C	0.83	Mar	1.0	A	93.6	Mar	90.8
<b>SEE</b>																							
Albania	-1.8	Apr	-2.6	20.0	Apr	18.2	-15.5	Apr	-14.4	0.2	Apr	1.0	9.67	Apr	8.35	A	0.93	Apr	1.27	H	54.8	Apr	54.2
Bosnia H.	2.9	Apr	2.2	13.2	Mar	13.7	-12.1	Apr	-11.7	7.2	Apr	7.8	5.16	Apr	4.99	C	0.74	Apr	1.06	H	114.3	Apr	114.4
Croatia	-6.2	Apr	-3.1	16.1	Mar	16.6	-34.2	Apr	-25.1	4.8	Apr	6.4	4.4	Apr	5.08	C	1.76	Apr	2.15	H	87.1	Apr	86.5
Romania	2.2	Apr	2.7	13.5	Mar	13.5	-14.1	Feb	-10.2	10.4	Apr	9.1	4.07	Apr	4.32	C	1.12	Apr	1.48	H	0.9	Apr	89.5
Serbia	2.9	Apr	3.0	20.4	Apr	21.6	-8.9	Apr	-6.3	7.6	Apr	7.1	6.2	Apr	6.24	C	3.43	Apr	4.17	H	110.6	Apr	111.4
<b>CIS MENA</b>																							
Russia	5.8	Mar	8.2	9.3	Apr	8.3	-3.0	Mar	-0.8	12.7	Mar	18.8	13.24	Mar	13.8	C	7.46	Mar	8.43	H	112.6	Mar	108.1
Ukraine	-10.4	Apr	-3.8	29.7	Mar	28.0	-22.1	Mar	6.3	2.2	Apr	1.5	25.92	Mar	26.09	R <sup>3</sup>	18.92	Mar	20.06	R <sup>3</sup>	149.9	Mar	146.3
Egypt	16.3	Mar	18.0	6.8	Dec	6.8	106.7	Mar	91.6	19.6	Mar	20.4	12.5	Mar	11.8	C	7.1	Mar	6.8	H	39.2	Mar	38.8
<b>m.i. E. A.</b>	0.5	Apr	0.9	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	3.2	Apr	3.3	1.4	Apr	1.5	C	0.6	Apr	0.6	H	81.9	Apr	83.1

Source: Central Banks, IMF, Moody's; <sup>1</sup>monthly average; <sup>2</sup>lending rate on current account overdraft; on deposits up to 1 year; <sup>3</sup>does not include banks

\*Sector A=All, C=Corporates, H=Household, PS=Private Sector, R=Residents.

## Country Outlook

The economy											
	2013	2014	2015	2016F	2017F		2013	2014	2015	2016F	2017F
<b>GDP (% yoy)</b>						<b>Inflation (average)</b>					
<b>CEE</b>						<b>CEE</b>					
Slovakia	1.4	2.5	3.6	3.3	3.5	Slovakia	1.5	-0.1	-0.3	-0.3	0.6
Slovenia	-1.1	3.0	2.9	2.0	2.1	Slovenia	1.9	0.4	-0.8	-0.4	0.8
Hungary	1.9	3.7	2.9	2.0	2.5	Hungary	1.7	-0.2	-0.1	0.5	1.5
<i>Average</i>	1.3	3.2	3.1	2.4	2.8						
<b>SEE</b>						<b>SEE</b>					
Albania	1.1	2.0	2.6	2.8	2.8	Albania	1.9	1.6	1.9	1.3	1.9
Bosnia Herzegovina	2.4	1.1	3.2	2.6	2.7	Bosnia Herzegovina	0.0	-0.9	-1.0	-1.2	0.4
Croatia	-1.1	-0.4	1.6	1.8	1.9	Croatia	2.2	-0.2	-0.5	-1.2	0.7
Romania	3.5	3.0	3.7	4.0	3.4	Romania	4.0	1.1	-0.6	-1.4	1.0
Serbia	2.6	-1.8	0.7	2.3	2.7	Serbia	7.9	2.1	1.4	1.3	2.0
<i>Average</i>	2.5	1.5	2.8	3.2	3.0						
<b>CIS</b>						<b>CIS</b>					
Russia	1.3	0.7	-3.7	-0.7	1.0	Russia	6.8	7.8	15.5	7.5	6.0
Ukraine	0.0	-6.8	-9.9	1.5	2.5	Ukraine	-0.3	12.2	48.0	14.0	9.0
<i>Average</i>	1.1	-0.3	-4.5	-0.4	1.2						
<b>MENA</b>						<b>MENA</b>					
Egypt	1.5	4.3	3.6	3.4	4.2	Egypt	9.5	10.1	10.4	11.0	11.5
<b>Average ISP Subsidiaries</b>	1.4	0.8	-2.0	0.7	1.9						

Market											
	2013	2014	2015	2016F	2017F		2013	2014	2015	2016F	2017F
<b>Exchange rate (average)</b>						<b>Interest rate (average)</b>					
<b>CEE</b>						<b>CEE</b>					
Slovakia						Slovakia	0.2	0.2	0.0	-0.3	-0.3
Slovenia						Slovenia	0.2	0.2	0.0	-0.3	-0.3
Hungary	297.0	308.6	310.0	313.5	314.5	Hungary	4.3	2.4	1.7	1.0	1.0
<b>SEE</b>						<b>SEE</b>					
Albania	140.0	140.4	139.8	138.4	140.2	Albania	4.3	3.0	2.7	1.0	1.0
Bosnia Herzegovina	1.96	1.96	1.96	1.96	1.96	Bosnia Herzegovina	0.0	0.0	0.0	0.0	0.0
Croatia	7.57	7.63	7.61	7.55	7.58	Croatia	1.3	0.7	1.2	0.9	0.9
Romania	4.4	4.4	4.4	4.5	4.5	Romania	4.0	2.3	1.1	0.7	0.7
Serbia	113.1	117.3	120.8	123.6	124.8	Serbia	11.1	8.8	6.3	4.1	4.0
<b>CSI MENA</b>						<b>CIS MENA</b>					
Russia (USD)	31.8	38.6	61.3	68.0	65.5	Russia	7.0	10.6	13.5	11.0	9.2
Ukraine (USD)	8.2	12.0	22.0	25.6	26.8	Ukraine	11.4	17.9	25.9	21.4	17.0
Egypt (USD)	6.9	7.1	7.7	8.7	9.3	Egypt	12.3	11.2	11.3	13.5	14.4

Bank											
	2013	2014	2015	2016F	2017F		2013	2014	2015	2016F	2017F
<b>Loans to private sector (% change yoy)</b>						<b>Deposit by private sector (% change yoy)</b>					
<b>CEE</b>						<b>CEE</b>					
Slovakia	5.7	6.4	8.7	6.2	6.4	Slovakia	4.3	3.8	9.9	4.5	4.8
Slovenia	-17.4	-13.4	-5.2	-4.5	1.0	Slovenia	0.0	6.6	5.8	5.5	4.8
Hungary	-4.4	-0.3	-12.3	-2.5	0.5	Hungary	-1.0	1.3	7.5	2.3	2.5
<b>SEE</b>						<b>SEE</b>					
Albania	-1.2	2.2	-2.6	1.5	2.5	Albania	2.1	2.9	1.0	1.5	2.0
Bosnia Herzegovina	2.6	1.9	2.2	2.5	3.0	Bosnia Herzegovina	8.9	6.4	7.8	7.2	6.7
Croatia	-1.5	-2.0	-3.1	-3.6	1.3	Croatia	4.9	2.3	6.4	1.9	2.5
Romania	-3.4	-3.7	2.7	2.5	3.5	Romania	9.3	8.9	9.1	5.0	5.5
Serbia	-4.9	4.4	3.0	2.0	3.0	Serbia	3.3	9.7	7.1	3.5	4.5
<b>CIS</b>						<b>CIS</b>					
Russia	17.4	25.4	8.2	3.0	5.0	Russia	16.4	27.9	18.8	5.5	6.0
Ukraine	13.5	10.9	-3.8	2.0	3.0	Ukraine	18.5	-1.8	1.5	2.0	3.5
<b>MENA</b>						<b>MENA</b>					
Egypt	7.1	12.7	18.0	13.5	12.0	Egypt	18.3	16.6	20.4	13.3	13.2

Source: Intesa Sanpaolo Research Department forecasts



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