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Monthly note

Intesa Sanpaolo
International Research
Network

High frequency indicators further strengthen in the CEE/SEE area. Inflation rates are rising but remain below targets, still supporting easy monetary conditions. CZK is expected to appreciate. EGP rebounds.

Industrial production, exports and retail sales marked, in December, a re-acceleration in economic activity in the CEE region, and is strengthening further in the SEE area. This picture was confirmed by the flash estimates of GDP growth in 4Q16, which moved in a range of 1.6% in Hungary to 3.1% in Slovakia in the CEE and of 2.5% in Serbia to 4.8% in Romania in the SEE area. In January, forward-looking indicators signalled expectations of a still buoyant business cycle in the region, in line with Euro Area developments. The ESI indicators also increased in most of the countries while the Manufacturing PMI jumped to 56.5 in Hungary. In parallel, the Composite PMI referred to the Eurozone has increased to 56.

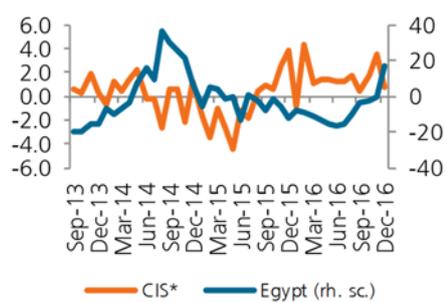
In the CIS area, the most recent data suggest that the economic recovery is likely to be sluggish in Russia while it is gaining steam in Ukraine, where according to preliminary estimates GDP growth jumped to 4.7% in 4Q16, significantly higher than expected. Still weak is the real business cycle in Egypt, where capital inflows have been resuming, supporting the EGP rebound.

In January, consumer prices were finally on a positive footing among the CEE/SEE countries (with the only exception Bosnia), mainly incorporating the first effects of the partial recovery of energy prices. Among the CIS countries, prices further decelerated in January in Russia to 5% but rose slightly in Ukraine to 12.6% (from 12.4% in December) leading the CB to revise upwards its 2017 inflation target to 9.1% from a previous 8% goal. In the same month, due to the recent EGP sharp depreciation, in Egypt inflation jumped to 28.1% (from 23.3% in December).

In CEE/SEE countries, all the CBs are maintaining supportive monetary conditions supported by still below-target inflation rates and the ECB's easy monetary policy expected to continue for an extended period. Long-term yields increased slightly in the region, in line with EA benchmarks keeping spreads substantially unchanged. Appreciating pressures are holding against the CZK whose current cap against the Euro is expected to be removed. In Russia, the hawkish statement by the CBR, which in February accompanied the decision to leave the policy rate on hold for the fifth consecutive month, indicates that a rate cut is unlikely in the near term.

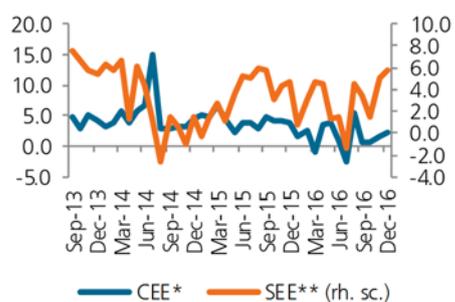
Lending activity increased modestly in several countries (Romania, Bosnia, and Serbia), despite the macroeconomic recovery of the region, and grew more significantly in Slovakia and in the Czech Republic, but continued to fall in Slovenia, Croatia and Hungary, mostly due to bank portfolio restructuring and deleveraging in the private sector. Mortgages generally remain the most dynamic segment in the banking market, gaining momentum even in Russia where loans increased on average by 0.4% and mortgages by 13% in 2016. On the funding side, the persistent drop in foreign liabilities, in particular in Croatia and Romania, was partially offset by the increase in deposits. In most CEE/SEE countries, the increase in corporate deposits continued to be strong even though decelerating. All this, when considering the contemporary fall in corporate loans, can be interpreted as sign of still weak corporate investment.

Industrial production % yoy – CIS – Egypt



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

Industrial production % yoy – CEE – SEE



Sources: National Statistics Offices; note * weighted average on Slovakia, Slovenia Hungary and Czech Rep. 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 single 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 CIS countries; and Egypt among MENA countries.

The figures in this document have been updated as of 20th February 2017.

Cross Country Analysis

CEE area

In the **CEE countries** with ISP subsidiaries, in December the **growth** rates of industrial production, exports and retail sales remained on positive trends, and in January the levels of Economic Sentiment Indicators (ESI) were frequently above the values seen in Q416. The 4Q16 GDP flash estimates confirm in the quarter a re-acceleration of economic activity in Slovakia and the Czech Republic and a softening in Hungary.

Antonio Pesce

In **Slovakia** GDP grew by 3.1% yoy in 4Q16, in line with our expectations and slightly above the 3.0% reached in 3Q. In the full year, GDP grew at 3.3%. High frequency data, in December, signal that export and industrial production dynamics were above the 4Q average, in particular manufacturing (1.8% yoy in wda data) and electricity (11.4%). In the same month, exports also rose (in nominal terms) by 6.2% yoy, while retail sales accelerated (in real terms) to 4.3% yoy, thanks to an improving labour market due to a declining path in the unemployment rate (8.8% in December). The ESI increased slightly in January edging closer to previous historical highs.

In the **Czech Republic** GDP grew by 1.7% yoy in 4Q16, slightly below the 1.9% reached in 3Q. In 2016, the (quarterly average) GDP growth rate was about 2.3%. In December, however, industrial production decelerated to 2.7% yoy (from 4.5% in the previous month) together with exports (to 0.7% yoy from 3.1%), but both rates remained above the 4Q average. Finally, although softening, the retail sales profile confirmed a good trend in December (2.9% yoy in real terms). In January, the ESI decreased slightly while remaining close to the historical high.

At the moment, 4Q16 GDP is not available for **Slovenia**. In December, industrial production grew by 10.2% yoy, above both the growth rates seen in November (7.4%) and the average of 4Q16 (8.1%). In the same month, exports remained on a positive trend (4.0% in nominal terms), stronger than the 4Q16 average. The dynamic of retail sales was also very strong (10.1% yoy in real terms) and in January the ESI reached the most since H215.

Unlike other CEE countries, in **Hungary** the GDP profile was weaker in 4Q16. It grew by 1.6% yoy, below the 2.2% in 3Q, less than expected. In the full year, GDP grew at 2%. After two months of contraction, industrial production returned to a positive trend (+0.6% yoy) in November and accelerated 1.9% in December. In addition, exports, after falling by 1.3% yoy in October, expanded by 5.8% yoy in November and accelerated further in December (7.7% in nominal terms). In January manufacturing PMI jumped to 56.5, still reflecting expansionary expectations. The ESI increased slightly, also signalling higher confidence in the economy.

Moving to **inflation** data, in January, the CPI remained in positive territory in all CEE countries ranging from 0.7% in **Slovakia** to 2.3% in **Hungary**. The more volatile components, energy and food, on a rising trend, are still keeping headline inflation above core inflation in **Slovenia, Hungary** and the **Czech Republic**. By contrast, core inflation is above the total index in Slovakia.

Following the ECB's announcements, monetary policy is set to remain expansionary in the EA (and therefore in **Slovakia** and **Slovenia**) for an extended period and *well past the horizon* of the ECB's Asset Purchase Programme, which is expected to continue until December 2017. Since May 2016, the **Hungarian** CB Board has kept the policy rate at its historical low (0.9%), but in order to ease monetary conditions, the Council has set an upper limit of HUF 750bn on the stock of 3-month CB deposits for 1Q17. A decision for 2Q17 will be made in March 2017. At its last meeting, the Board of the **Czech** National Bank decided unanimously to keep interest rates unchanged at 0.05%. Based on the statement of the Bank, the Board expects that conditions for the fulfilment of the 2% inflation target will be met from mid-2017 onwards. Moreover, the Board states that the Bank will not discontinue the use of the exchange rate as a monetary policy instrument before Q2 17 and will maintain the exchange rate close to CZK 27 to the euro until then. Long-term yields increased slightly in the whole region, mostly in line with the EA benchmark. In forex markets the HUF has remained quite stable vs the Euro.

The main trends of banking aggregates were confirmed in December in the **CEE Region**. The fall in lending growth in December, still in general related to portfolio restructuring, slowed the speed in Hungary and Slovenia. Household lending was however still very dynamic, particularly in Slovakia, while corporate lending remained weak. Unlike lending, deposit growth continued to be significant both in the household and in the corporate sectors.

Davidia Zucchelli

In **Slovakia**, lending has been performing well (+10.3% yoy in December up from +9.4% in November), both in the corporate (up by 5.3% from 4.4%) and in the household sectors (up by 14%) thanks to an increase in mortgages. Deposits also performed robustly (+4.6% yoy in December from +5.8% in November), particularly among households (+8.5%), despite increasing competition from other savings products; in the corporate sector they decreased by 0.8% yoy (from +2.2% in November). Foreign liabilities increased again by 0.8% yoy in December (-5% in November). In the **Czech Republic** loans also put on a good performance (+6.7% yoy). Loans denominated in foreign currency were very strong (+28.8%) especially in the corporate sector (+29.1%). The NPLs ratio is one of the lowest in the CEE/SEE countries. It declined further to 4.8% in December 2016. Czech banks benefit from a large, stable deposit funding base and plenty of liquid assets. Deposits continued to be dynamic (+5.8% yoy), particularly in households (+8.4%) supported by improving labour market conditions (growing employment, rising wages) and despite low interest rates.

In **Hungary**, loans still showed a negative change but at a lower speed than in the past (-1.9% from -5.2% yoy in November), due to a decrease in loans to households (-3.2%) and corporates (-0.6%). Deposits showed a rise by 6.3% (from 5.6% yoy in November), particularly in business (+10.1% in December), and in households (3.1%). The further decline in the interest rate on lending (to 3.1% from 3.5% in November) and a stable deposit interest rate (at 0.5%) continued to push towards an interest margin contraction. In **Slovenia**, loans decreased by 2.7% yoy in December (-5% in November), due to falling corporate loans (-8%), mainly as a result of the restructuring process of banks' loan portfolios (NPLs ratio at 6.5% of total loans). The main fragility from a financial point of view remains the high level of SME indebtedness. Nevertheless, corporate deposits increased strongly again in December (+8.9% yoy). Loans to households remained on a stable path (3.4%), while deposits increased by 6.7% yoy.

SEE area

Among **SEE countries** with ISP subsidiaries, high frequency indicators generally signal an improvement of the economic cycle in December in the whole region. The 4Q16 GDP flash estimates currently available for Romania and Serbia, confirm the strengthening of economic activity in the two countries in the quarter.

Antonio Pesce

In **Croatia** – where consumer spending is currently a key growth driver – retail sales grew by 5.8% yoy in December, above the dynamic observed in November. Households' real income have been supported by both low inflation and improving labour market conditions. Industrial production jumped in December by 14.9% yoy, after a strong performance recorded in November (7.2%). In January the ESI remained stable around the highs of last year.

In **Romania**, in 4Q16 GDP grew by 4.8% yoy, unexpectedly above even the 4.6% already seen in 3Q. In the full year, GDP increased by 4.8% on average. In December both industrial production and exports decelerated but they still remained on strong positive trends (1.7% and 9.4%, respectively). The ESI slightly improved in January, close to the highs seen in 2016. In **Serbia**, the flash estimate pointed to a GDP growth rate of 2.5% yoy in 4Q16 (2.7% on average for the full year). This statistic, although preliminary, confirms the economic strengthening signalled by the high frequency indicators such as exports (+18.4% yoy in December) and retail sales growth (+6.8%). In **Bosnia**, industrial production and exports remained on a positive path and accelerated in December. In January, in **Albania**, the exports dynamic softened but was still very strong (15.5% yoy) after the impressive performance achieved in November (22.6%).

Consumer inflation was also positive for almost all the SEE countries both in December and in January. It ranged from 0.05% in Romania to 2.8% in Albania in January. The only exception is Bosnia where it was still negative (-0.2%) in December. Given the low inflation profile, all the central banks of the SEE countries with ISP subsidiaries confirmed easy **monetary conditions**. Exchange rates vs the Euro have remained roughly stable in the whole area, with only a slight depreciation seen in Serbia. CDS spreads eased slightly.

As far as the **banking aggregates** are concerned, lending showed signs of improvement (with stronger increases or less intense decreases); deposits grew everywhere despite low interest rates and the competition from other savings products. As a consequence of these dynamics, the LTD ratio dropped to below 100% in most of the countries, with Bosnia and Serbia the only exceptions (110% and 102%, respectively, but on a declining path too).

In **Bosnia**, supported by an improvement in the economy, loans showed a further increase, the highest among SEE countries (+3.4% from 2.6% yoy in November) both in the corporate (+3.0% yoy) and in the household sector (3.7% yoy). Deposits were in line with previous changes as well (+7.4% yoy from 6.9% in November). The lending growth rate decreased to 4.6% (from 5.1%). In **Croatia**, loans still decreased by 4.0% (from -5.0% yoy in November), mostly due to restructuring operations (sales and write-offs), but flows of new business are estimated by the CB to recover. Lending growth is still negative both in the corporates (-1.9%) and in households (-5.5% yoy). Deposits remained positive (+2.8% from 2.3% yoy in November), particularly in business (9.3% but down from 24.7% in August), while households showed an increase of 1%.

Despite the measures taken to limit fx lending, in **Serbia** loans in Euro increased by 2.4% in 2016 in households supporting the increase in total loans to the sector (+10.5%). Total loans to the private sector increased by only 2.4% due to the parallel decrease in corporate loans (-2.9%). Deposits continued to put on an extraordinary performance (+19% in corporates and +7.9% in households). In all the CEE/SEE countries, foreign liabilities continued to decline (-9.2% yoy in December). In **Romania**, loans increased slightly in December (0.6% yoy from 0.4% yoy in November) supported by loans to households (+4.7% yoy) while loans to corporates were still weak (-3.5% yoy from -4.2% yoy the previous month), despite the economic recovery. Romania has been one of the most active sellers of NPLs, which declined to 10% of total loans. Deposits continued to perform strongly (8.5% from 11.2% as in November).

In **Albania**, loans remained roughly stable (-0.1% yoy) in November, declining in businesses (-4% yoy), while increasing in households (10.2%), with a slowdown of loans in foreign currency (-6.0%) and an increase of loans in local currency. Bank lending survey results for 4Q16 showed a tightening of credit standards on loans to enterprises and easing credit standards on loans to households. Deposits continued to grow (+2.3% yoy in November), driven by deposits of businesses (16.5%), while deposits of households remained stable (0.1%). On the liability side, foreign liabilities continued to decline sharply (-13.2% yoy in November).

CIS and MENA areas

In the CIS and MENA countries with ISP subsidiaries, in **Russia** industrial production rose by 3.2% yoy in December but non industrial economic sectors weakened. Retail sales continued their two-year-long losing streak, falling by 5.9% yoy in December. This was broadly in line with the drop in real disposable income (-6.1% yoy). The construction sector, which had shown some sign of recovery early in 4Q16, fell by a worrying 5.4% yoy in December. High frequency data suggest that the ongoing Russian recovery will be sluggish. Indeed, the fall in the terms of trade of exported commodities (mainly hydrocarbons, which in recent months have however recovered some ground), high interest rates and, lastly, the economic effects (sanctions, capital outflows, drop in FDI) of the tense relations with Western countries caused by the Ukrainian crisis continue to hound Russia's growth prospects. Inflation continued along its decelerating trend in January falling to 5%, from 5.4% in December, moving closer to the 4% central bank

Davidia Zucchelli

Giancarlo Frigoli

target. However, the hawkish statement by the CBR that accompanied February's decision to leave the policy rate on hold for the 5th consecutive month indicates that a rate cut is unlikely in the near future.

In **Ukraine**, the preliminary estimate of real GDP annual growth in 4Q16 was 4.7%, significantly higher than expectations. On the basis of this strong reading, the Ukrainian economy probably grew by 2.1% in 2016, significantly outperforming our and market forecasts of 1.1%. Currency pressures have subsided in recent weeks, as seasonal demand for foreign exchange died out. In February, the UAH/USD exchange rate hovered around 27 and the central bank abstained from additional foreign exchange sales to support the currency. Annual inflation rose to 12.6% in January, from 12.4% in December, following the jump in foods and non-alcoholic goods prices. The central bank revised upwards its 2017 inflation target, to 9.1%, from 8% previously. Ukraine expects to reach a final deal to unlock a further batch of loans under its USD17.5 billion bailout in coming days. Disbursement of the latest tranche of USD1 billion was held up by slow budget negotiations and concerns about the delay in the implementation of reforms. So far Ukraine has received USD7.7 billion. Four tranches are planned for this year

In **Egypt**, following the erosion of the foreign currency backlog, the pound started strengthening and the EGP/USD rate fell to 15.7 in the last week of February, from a high of 18.9 at the end of January. The central bank said that commercial banks were able to attract 12.5bn dollars since the float early last November, while private businesses and households have started to sell foreign currency and remittances from abroad. Moreover, demand of foreign currency for import purposes is gradually dwindling as companies have been refilling their depleted inventories. Foreign reserves reached 26 billion at the end of January 2017, from 19 billion at end October 2016. Reserves were also boosted by the first tranche worth USD 2.75 bn received last November out of the 12 bn IMF loan. Additional currency inflows came from a 1 billion USD loan from the World Bank in January and from 4bn of Eurobonds sold in January. Inflation accelerated in January (to 28.1%, from 23.3% in December) as the impact of the currency depreciation that followed November's FX liberalisation fed through to annual inflation figures. Inflationary pressures are also stemming from the reduction in subsidies on food and energy and from the introduction of a value-added tax over the course of the 2016-17 fiscal year. Moreover, the Authorities announced in early February that subsidized prices of sugar and cooking oil will be increased by 14.3% and 20.0% respectively. Taking all of these together, we believe that inflation will continue to rise over the next few months before starting to fall in 2H17.

Regarding banking aggregates, in **Russia**, lending growth was still modest in November (0.4% from 1.4% yoy in October, still below inflation). Corporate lending remained almost unchanged (+0.1% yoy in November, accounting for around 76% of the loans to the private sector), while household lending showed a slight increase of 1.1% yoy. Good news in the household sector has been announced by the CB. In 2016, outstanding mortgages grew by 13% and Russian banks issued RUB1.5 tn new loans (a 27% increase over 2015 new issuance). In November, the nominal increase in deposits was 2.4% (from 3.4% in October) supported by an improvement in real wages. Interest rates on new loans to businesses declined to 11.7% (from 12.1%) whereas the rate on deposits from households increased to 6.6% (from 6%) squeezing the spread.

In **Ukraine**, banking aggregates improved slightly in December. Loans increased by 2% (from -4.7% in November) thanks to a recovery among corporates (+4.1% from -2.9% in November) and despite a decrease among households by 6.6% yoy. Deposits increased by 9.1% (+6.7% yoy in November) both among the corporates (10.8%) owing to the economic recovery, and households (8.2%). The LTD ratio decreased slightly to 137%, while remaining high. In **Egypt**, in October loans and deposits grew by 16% and 17% respectively. Deposits increased both in corporates (15.8%) and in households (17.5%). Foreign liabilities recorded a new jump in October (+100% yoy, according to IMF data). NPLs remain very modest (5.9% of the total loans as of September). The LTD ratio is very low (38.7%). Securities, in particular government bonds, cover a relevant share of total asset (over 40%).

Davidia Zucchelli

Country-Specific Analysis

Albania

Real Economy

The Albanian economy grew by 3.3% in the first nine months of 2016 and by 3.1% in the third quarter. According to the CB, economic growth for 2016 will be in line with that recorded in the first nine months, higher than in 2015. Growth reflected the increase in revenues from tourism and the expansion of domestic demand, supported by favourable monetary conditions, improving confidence, an increase in employment, and foreign direct investments. In January 2017 the value of exports increased by 15.5%. A positive contribution was given by "Minerals, fuels, electricity", "Textiles and footwear" and "Construction materials and metals" while a negative contribution came from "Food, beverages, tobacco" and "Leather and manufactures". Albania has made big strides in improving its business environment in key areas of regulations. According to the Doing Business 2017 survey it moved up 32 places, now ranking 58 out of 190 countries. In January the trade deficit shrank by 14 % yoy to 16 billion Lek.

Kledi Gjordeni

Inflation has been trending upwards in recent months, reaching 2.8% in January 2017 with respect to an average of 1.5% in 2016, driven by food and oil prices but also reflecting added inflationary pressures from the domestic environment and lower disinflationary pressures from the external environment. For 2017, the CB expects an average inflation rate of 2.3%.

Financial Markets

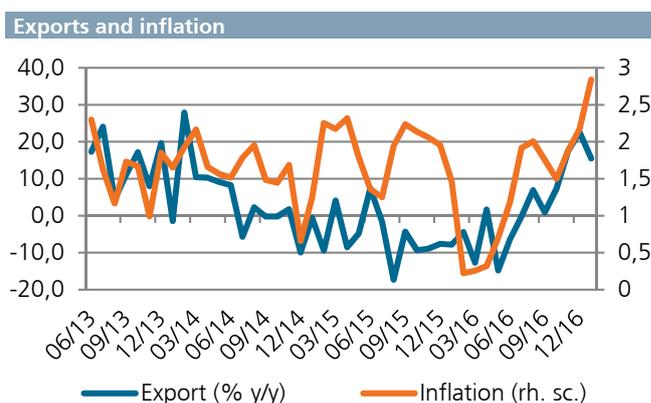
The yields on government securities in the primary market moved upward in recent months. The movement was partly due to a correction of their decline in the first half of the year. The upward trend is expected to decelerate as long as the monetary policy and the fiscal policy remain unchanged in the year. According to the Supervisory Council of the CB the intensity of the monetary stimulus will not diminish before the fourth quarter of 2017. In the foreign exchange market, the LEK slightly appreciated recently against the EUR while depreciating against the USD due to the appreciation of the Dollar against the Euro.

Banking Sector

In response to monetary policy, and reflecting the recovery in economic activity, credit in the economy has been increasing. Excluding the effect of loan write offs from balance sheets, the portfolio of credit to the private sector in November stood 3.4% higher compared with the previous year. In more detail, the 10.4% domestic currency credit growth offset the contraction by 1.4% in the foreign currency credit portfolio. In a recent official speech, the CB reported that the ratio of NPLs fell to 18.2% in December 2016. The reduction reflects the combined effects of an improvement in the economic situation, the effects of legal amendments, credit restructuring and non-performing loan write-offs from balance sheets.

Last macroeconomic indicators			
%	Last value 4Q 2016 3Q 2016		
Industrial production, wda yoy	n.a.	n.a.	n.a.
Export of goods, nominal yoy	22.6 (Dec)	15.7	2.4
Unemployment rate	n.a.		14.7
Inflation rate, average yoy	2.2 (Dec)	1.9	1.9
Loans (private sector, yoy, eop)	-0.1 (Nov)		-0.4
Deposits (private sector, yoy, eop)	2.3 (Nov)		2.2

Source: INSTAT, Central Bank of Albania



Source: INSTAT

Bosnia and Herzegovina

Real Economy

December 2016 data confirmed positive economic trends as both industrial production and real retail trade growth strengthened to 7.2% and 7.5% yoy, respectively. 4Q16 industrial production peaked at 5.7% yoy (after 4.6% yoy in 1H16 and 2.1% yoy in 3Q), while real retail trade strengthened to 8.1% yoy (following 6.3% yoy in 1H16 and 7.2% yoy growth in 3Q).

Ivana Jovic

These trends combined with 11.2% yoy growth in exports fuel expectations that last quarter's GDP growth will override the sluggish start of the year (1.8% yoy over the first three quarters). Altogether, in 2016 industrial production recorded average annual growth of 4.3% yoy, the strongest growth since 2013, while at the same time real retail trade growth amounted to 6.9% yoy. 2017 so far also started on a positive note as indicated by a 14.3% yoy increase in goods exports in January. As expected, deflationary pressures eased considerably at year end and December CPI declined by 0.2% yoy, leading to an average annual deflation rate of -1.1% yoy (4th consecutive deflation year).

Not supportive of favorable economic data, the inter-ethnic political stance in the country recently became more complex, thus threatening to endanger the already fragile structural reforms delivery. In that context potential problems may arise with the current funding arrangement with the IMF, which had already delayed the release of the second tranche because the authorities failed to meet reform targets, but there are also problems with public investments' implementation.

Banking Sector

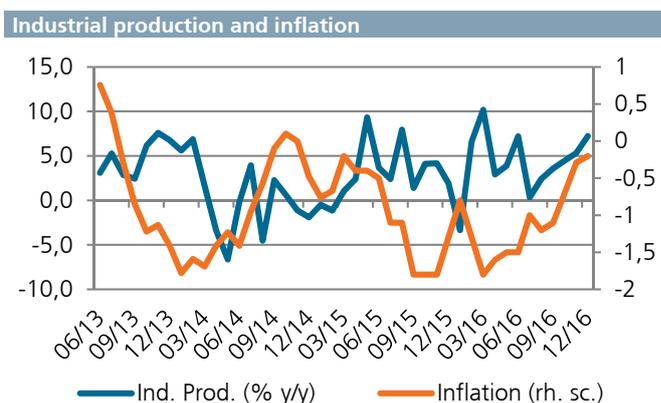
Private sector loans at the end of 2016 accelerated to 3.4% yoy, owing to a faster increase in both corporate and household loans. Loans to non-financial corporations increased by 3.0% yoy due to a 3.5% yoy advance in private corporate borrowing, while public corporations continued to deleverage and recorded loan declines of 6.1% yoy. Loans to households grew by 3.7% yoy; breakdown by purpose shows that consumer loans and card loans increased by 6.1% yoy and 1.8% yoy, whereas housing loans shrank by 2.7% yoy.

Ana Lokin

Deposits ended the year 7.4% higher yoy, as a result of a 5.6% yoy rise in deposits of non-financial corporations and an 8.1% yoy increase in deposits of households. As a result of a stronger increase in deposits than in loans, the loan to deposit ratio in 2016 narrowed by 4 p.p. yoy to 110%.

Latest macroeconomic indicators			
%	Last value	4Q 2016	3Q 2016
Industrial production, wda yoy	7.2 (Dec)	5.7	2.1
Export of goods, nominal yoy	15.1 (Dec)	11.3	1.8
Retail trade, real, wda yoy	7.5 (Dec)	8.1	7.2
Inflation rate, average yoy	-0.2 (Dec)	-0.4	-1.1
Loans (private sector, yoy, eop)	3.4 (Dec)	3.4	2.4
Deposits (private sector, yoy, eop)	7.4 (Dec)	7.4	6.6

Source: BHAS, CBBH



Source: Labour and employment agency

Croatia

Real Economy

In line with our expectations, real retail trade growth peaked in December at 5.7% yoy, leading to stable 4.7% yoy growth in 4Q and overall 4% yoy growth in 2016 (vs 2.4% in 2015). At the same time industrial production over performed in December (15% yoy) led by a sharp 17% yoy growth in intermediate goods production, 23.9% yoy growth in energy and 11.5%/46.6% yoy growth in consumer nondurables/durables production. Thus, the last quarter's rise in industrial production (7.8% yoy) strongly contributed to overall 5.0% annual growth in 2016 (vs 2.5% yoy in 2015). Stable foreign demand remained a significant contributor to 4Q performance, as following 5.6% and 5.7% yoy growth in October and November, according to preliminary data, exports strengthened to an exceptional 22.5% yoy growth in December. Overall, based on the above mentioned data we expect that 4Q GDP (flash estimate due on February 28) will post strong growth at around 3.5% yoy.

Ivana Jovic

Financial Markets

Daily liquidity surplus broke records in January as a result of CNB fx interventions in December through which additional kunas were injected into the system. Average 3M Zibor in January dipped by 14bps mom to 0.71%, and as the record liquidity lasted throughout February, 3M Zibor slipped towards 0.6%.

Ana Lokin

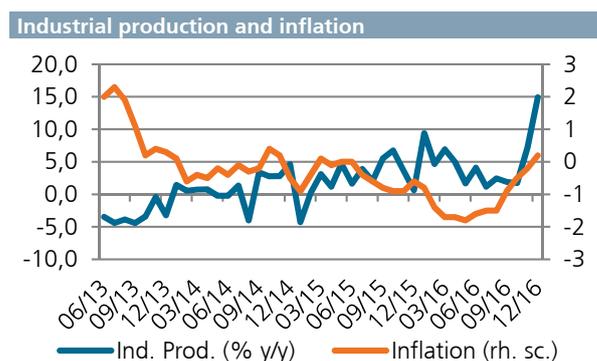
The average EUR/HRK rate in January remained unchanged mom at 7.53, however, the BOP CA surplus, positive net foreign position of banks and improved fiscal outlook are supporting kuna strengthening in the near term.

Banking Sector

Private sector loans ended 2016 4.0% lower yoy (+17.0% yoy kuna loans, -14.1% yoy indexed and fx loans) on account of a 5.5% yoy decrease in retail and 1.9% yoy drop in corporate borrowing. Housing loans fell by 11.1% yoy, while overdrafts and card loans recorded a 5.5 and 2.9% yoy drop, as citizens substituted these types of loans with cash non-purpose loans that exhibited a 2.4% yoy rise. In the corporate sector, working capital and investment loans decreased both by 1.5% yoy, and other loans by 3.3% yoy. While a loan portfolio decline reflects the conversion of CHF loans, sale and write offs of NPLs and a stronger kuna, transaction data show that claims on the private sector grew by 1.6% yoy in 2016, indicating a revival of demand. Private sector deposits were higher by 2.8% yoy in December with deposits of households up by 1.0% yoy and deposits of non-financial corporations by 9.3% yoy.

Latest economic indicators			
%	Last value	4Q 2016	3Q 2016
Industrial production, wda yoy	14.9 (Dec)	7.8	1.8
Export of goods, nominal yoy	5.7 (Nov)		2.1
Retail trade, real, wda yoy	5.8 (Dec)	4.7	4.7
ESI (index)	115.3 (Jan)	115.5	113.0
Inflation rate, average yoy	0.2 (Dec)	-0.2	-1.3
Loans (priv. sector, yoy, eop)	-4.0 (Dec)	-4.0	-6.0
Deposits (priv. sector, yoy, eop)	2.8 (Dec)	2.8	3.2

Source: CBS, EC, CNB



Source: EC

Czech Republic

Real Economy

As we begin coverage of the Czech Republic in this note, let us put the monitoring of monthly data in a bigger picture. Starting with the economy, the Czech Republic, like Slovakia and Hungary, is a manufacturing-heavy, export-driven economy with automotive the key sector and Germany the dominant trading partner. In the Czech Republic, though, the share of industry in GDP is the highest, approaching 38%. Besides automotive, other large manufacturing sectors include electrical, machinery, and chemicals.

The Czech labor market basically features full employment. The general unemployment rate is below 4%, the EU's lowest, even as the country hosts over 400 thousand foreign workers - their share in the total labor force is the highest among all CEE countries. A tight labor market manifests itself in a rather rapid growth of wages, now approaching a 5%yoy pace in nominal terms. Czech labor costs have long been the second highest in the CEE region (behind Slovenia). Adjusting for decent productivity, nevertheless, the Czech labor force still remains competitive – productivity adjusted Czech unit labor costs are roughly 60-65% of the German level.

Inflation was never really an issue in the Czech Republic. Headline inflation has been around 2% on average since 2001, core inflation has been negative since 2009. The key driver of low inflation in the country has been the currency, the koruna, which has been appreciating steadily over the years. In fact, the successful history of the koruna, dating back to 1892, is one of the reasons why joining the Eurozone has very low support among the Czech population. There is no date set for the country's adoption of the euro, even as it fulfills all Maastricht criteria.

Exceptionally strong in the EU context is the Czech Republic's fiscal position. The overall public finance as of 2016 featured a small surplus and gross public debt slipped below 38% of GDP. To be sure though, in the past, the public deficit was an issue. Since joining the EU in 2004, the Czech Republic was in the excessive deficit procedure for 8.5 years. A combination of fiscal restraint and strong economic growth in the last two years has delivered a turnaround.

The external position of the country is also strong. The trade balance, thanks to exports of manufactured products, has in recent history been in surplus. Also since 2014, the overall current account balance has posted a surplus. Net FDI inflows amounted on average over the past five years an equivalent of 3% of GDP per annum. Unsurprisingly thus, the sovereign ratings are at decent levels: A1 by Moody's, AA- by S&P and A+ by Fitch, all featuring a stable outlook.

Current activity-wise, in 2016, real GDP slowed to 2.4%yoy growth from 4.6% in the prior year. The growth slowdown though was primarily related to the boom-bust cycle in fixed investment spending co-financed with EU funds, much as occurred in other CEE countries. As of 2017, re-acceleration of GDP growth towards 3% seems likely, as EU-funded investments resume growing. Private and public consumption are growing steadily and contribute positively to GDP growth. The cyclical profile of GDP growth in 2017 should also be improved by a slightly higher contribution of exports, recovering from a temporary weakness in car exports in 2016.

Financial Markets

Given the country's strong macroeconomic fundamentals and early success in financial integration into international markets, the Czech koruna and other financial assets enjoy a safe haven status in the markets. The koruna has been under appreciation pressure for most of the past decade, official interest rates accordingly have been set by the Czech National Bank (CNB) below the ECB's to stem the pressure. CNB's key 2-week repo rate has been at "technical zero" (0.05%) since November 2012.

Zdenko Štefanides

As global deflation risks in 2013 spilled into the Czech economy and the CNB was unwilling to resort to negative rates, it decided to stop the appreciation of the koruna altogether by setting a cap of 27 CZK vs the euro in November 2013. Defending an artificially weaker exchange rate, though, the CNB was forced to sell koruna heavily thereafter, especially in recent weeks when inflation rose to the CNB’s target of 2% and speculation mounted over the imminent demise of the cap.

Unlike the Swiss central bank, which in a similar situation two years ago took the market by surprise and dismantled the franc currency cap unexpectedly, the CNB wants to guide the markets by announcing a date of koruna cap suspension well in advance. At the moment, it says, the cap will remain in place until the end of March, adding that the most likely date of cap suspension will be middle of the year. We believe the koruna cap will be suspended as early as April to stave off further speculative pressure. The exchange rate thereafter will likely be very volatile. Once the market is cleared of the post-cap volatility though, we believe that the koruna will resume an appreciating trend, towards 26.5 vs the euro by year end.

Strong interest of investors into Czech assets manifests also in the yields of Czech bonds, which in 10-year maturity trade only 30 bps above German bunds. In fact, Czech yields follow German bunds very closely and occasionally even slip below them, although they do not benefit from an asset purchase program of any sort.

Banking Sector

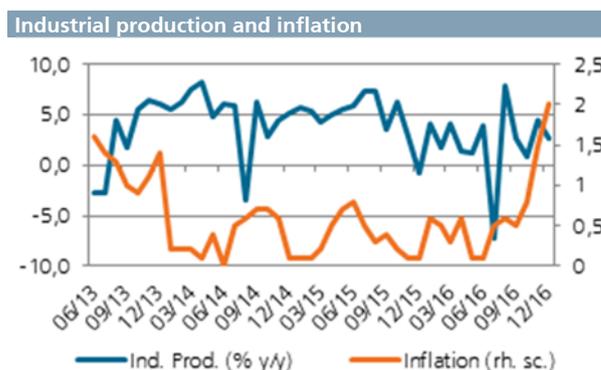
The Czech banking sector is stable, solid, well capitalized, and the most profitable in the CEE region, with outstanding operational efficiency and firm asset quality. The sector is over-liquid with a total loan-to-deposit ratio of 88% and an excess of primary deposits over loans worth the equivalent of EUR 20 bn. In terms of market development, the Czech Republic is the most mature and advanced in the region, with bank assets to GDP exceeding 125% and household indebtedness over 57% of gross income.

The Czech banking market is highly concentrated, with the top three banks controlling half the market, and the top five two thirds. Key banks are foreign-owned by established West European names, for whom Czech subsidiaries are highly prized for their solidity, efficiency, and profitability. Domestic names are niche players. Regulator, CNB, is rather EU-skeptic given the stable, self-funded banking sector, which is a net creditor to foreign parents. Bank Union, FTT, and other “optional” EU bank regulations are not really welcome in the Czech Republic.

The key issues going forward are shrinking margins. Net interest income accounts for 64% of Czech banking sector revenues and in the first three quarters of 2016 it shrank by 1.8%, even as banks grew loan volumes vigorously, by 6% over a year ago. Besides growing volumes to compensate for margin erosion, banks also try to keep the lid on costs, albeit the tight labor market and accelerating wage growth place severe constraints on this effort (personnel costs were up 1.8%yoy in 3Q). Moving digital and downsizing the branch network (branches down 4.2% yoy in 3Q) are thus alternative routes to trim costs and sustain the bottom line.

Latest economic indicators			
%	Last value	4Q 2016	3Q 2016
Industrial production, wda yoy	2.7 (Dec)	2.7	1.1
Export of goods, nominal yoy	0.7 (Dec)	-0.6	0.2
ECB refi rate	0.0 (17th Feb)	0.0	0.0
ESI (index)	108.6 (Jan)	109.1	106.3
Inflation rate, average yoy	2.2 (Jan)	1.4	0.5
Loans (priv. sector, yoy, eop)	6.7 (Dec)	6.7	6.5
Deposits (priv. sector, yoy, eop)	5.8 (Dec.)		

Source: CBS, EC, CNB



Source: EC

Egypt

Real Economy

The GDP growth rate decreased to 3.4% in Q3 2016 (Jul-Sep) compared to 5.1% in Q3 2015, according to the Minister of Planning. The decline came on the back of the drop of the Egyptian pound against the US dollar. This pressured the growth rate of consumption (the main engine of the Egyptian economy) whose contribution to economic growth fell to 2% during Q3 2016 compared to 6.2% during the same period of the previous year.

The average annual inflation rate in Q4 2016 has reached about 18.8% compared to 14.5% in Q3 2016. Inflation, which is still on a rising path following the EGP depreciation, reached 28.1% in January. This is mainly attributed to the hike in food and beverages prices, whose prices rose 37.2% (yoy) in January. The high inflation was expected due to the "shock effect" of several economic try-outs of reform that have included lifting fuel subsidies, the introduction of value added tax and the liberalisation of the exchange rate followed by a spike of the USD against the Egyptian currency.

Egypt's Net International Reserves (NIR) increased for the third consecutive month by 8.7% reaching USD 26.3 billion in January 2017 compared to December 2016. This was supported by increasing foreign currency inflows where Egypt has received USD1 billion (second tranche) from the World Bank and USD 500 million (second tranche) from the African Development Bank and around USD 4 billion from issuing Eurobonds by the Ministry of Finance.

Financial Markets

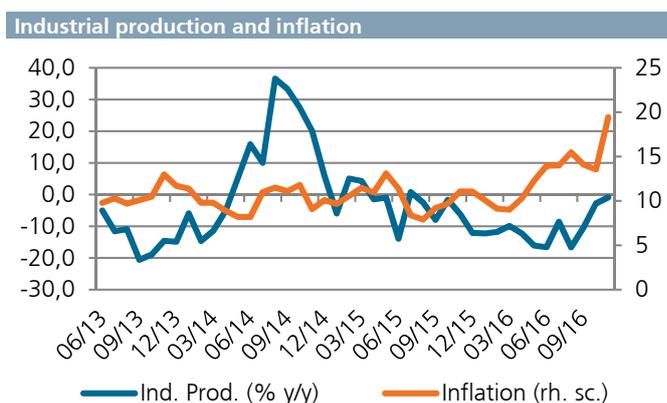
The Central Bank of Egypt's Monetary Policy Committee kept its benchmark interest rates unchanged during its last meeting held on the 29th of December, where the overnight deposit rate, overnight lending rate, and the discount rate remained at 14.75%, 15.75%, and 15.25% respectively.

Banking Sector

Total bank loans to customers recorded EGP 975.81 billion in October 2016, reflecting an increase of 1.14% compared to September 2016, (+25.41% yoy). Total loans to the private sector increased by 15.75% in October 2016 to reach EGP 682.8 billion compared to October 2015, as total loans to corporates (representing 68.8% of total loans to the private sector) increased by 15.39% (yoy). On the other hand, total deposits were EGP 2.22 trillion in October 2016 growing by 18.77% compared to October 2015. Total deposits of the private sector witnessed an increase of 17.13% in October 2016 (yoy) to EGP 1.77 trillion, where total household deposits (representing 77.84% of total private sector's deposits) increased by 17.5% (yoy).

Latest Economic Indicators			
%	Last value 4Q 2016 3Q 2016		
Industrial Production, wda yoy	-0.9 (Nov)	-1.8	-11.8
Nom. Exports yoy	12.0 (Oct)	12.0	8.0
Retail Sales yoy	n.a.	n.a.	n.a.
Inflation rate yoy	23.3 (Dec)	18.8	14.5
CB Reference Rate	14.8 (17th Feb)	14.8	11.8
Loans (priv. sector, yoy, eop)	15.7 (Oct)		16.0
Deposits (priv. sector, yoy, eop)	17.1 (Oct)		17.9

Source: Ministry of Industry & Foreign Trade, Central Bank of Egypt, HSBC



Hungary

Real Economy

Q4 GDP growth came in below the market consensus, at 1.6% yoy versus 2.2% in Q3. The lower growth rate was mainly due to weaker industrial performance, with essentially zero contribution to growth. Agriculture and services had a positive contribution to GDP growth. From the absorption side, household consumption probably kept supporting GDP. Industrial output dynamics remained weak in December, showing only a modest improvement over previous months. Output grew by 1.9% yoy, slightly above the annual average of 2016 (0.9%). Hence, last year delivered a much lower dynamic compared to 2014-15. The recovery of the construction sector continued as prospects of the sector brighten (due to rising real wages and the strengthening of the labor market), but its contribution to Q4 GDP growth remained negative.

Sandor Jobbagy

Headline CPI jumped from 1.8% to 2.3% in December, after 2016 average inflation came in at 0.4% versus two consecutive years of negative average inflation. The low base, rising oil prices and partly the increasing domestic demand factor all played a role. Core inflation came in at 1.6% yoy, also above the 2016 average level. Inflation is expected to creep even higher in the upcoming period despite the selective VAT reduction as domestic demand is set to remain strong. The average 2017 CPI is expected to be above 2%. Inflation is unlikely to hit the 3% medium term target in a lasting way until H1 2018 and unlikely to trigger a policy response.

Financial Markets

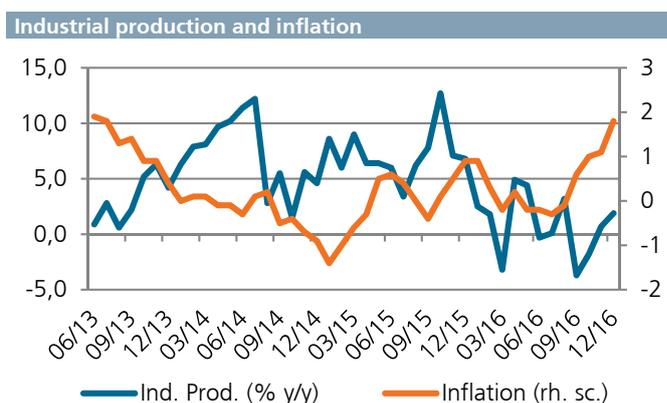
The NBH left the policy rate unchanged (0.9%) in January. The end-Q1 target for the 3M depo facility remained at HUF 750 bln. The market adjustment is ongoing, but getting closer to its limit. Short-dated T-bill rates and money market rates are close to zero in some cases, as the NBH's strategy is channeling liquidity to the interbank and FI market. The long end of the yield curve has already begun rising. The forint has remained fairly stable recently, close to EUR/HUF 308-310.

Banking Sector

Loan stock to the private sector was still lower than one year ago in December, and also dropped slightly from November, amid a temporary monthly fall in the stock of loans to the corporate sector. Deposits of both sectors rose in the same month. Real economic developments are lending support to the demand side of the loan market, meanwhile credit conditions continued to ease. Households' stronger loan demand is driven by the housing market recovery and the increased appetite for personal loans. In the corporate sector, SMEs remain the main engine, large corporates lag behind in terms of loan demand.

Latest Economic Indicators			
%	Last value	4Q 2016	3Q 2016
Ind. Production yoy	1.9 (Dec)	0.3	-0.1
Nom. Exports yoy	7.7 (Dec)	4.1	3.5
ESI (index)	112.5 (Jan)	112.4	109.7
Retail Sales yoy	3.2 (Dec)	3.4	4.4
Inflation Rate yoy	2.3 (Jan)	1.3	0.1
CB Reference Rate	0.9 (17th Feb)	0.9	0.9
Loans (priv. sector, yoy, eop)	-1.9 (Dec)	-1.9	-4.6
Deposits (priv. sector, yoy, eop)	6.3 (Dec)	6.3	7.0

Source: CSO, NBH, Bloomberg



Source: CSO

Romania

Real Economy

The Romanian economy grew by 4.8% in 2016 (up from 3.9% the previous year) marking the fastest growth pace since 2008. Strong fiscal stimulus (wage increases and tax cuts) and loose monetary conditions pushed up domestic demand which was the main driver. In 2017, fiscal policy is expected to remain supportive for growth, however inflationary pressures (both domestic as well as external) are expected to increase the financing costs. Inflation returned to positive territory in January (+0.05% yoy) as base effects start to wear off and energy prices are consolidating the uptrend, pushing up fuel prices and thus the cost of processed food items. Though industry slowed in 2016 to +1.7% yoy (from 2.7% in 2015) marking the weakest growth pace since 2009, foreign direct investments grew to EUR 3.9 billion (+31% yoy) the strongest since 2009.

Sebastian Maneran

Financial Markets

The attenuation of exogenous deflationary pressures at the end of 2016 and the start of 2017 along with fading statistical base effects of domestic tax cuts has pushed medium and long term bond yields upwards. Though long term inflation expectations are moving higher, short term inflation expectations remain stable which is likely to still require abundant liquidity conditions in the domestic money markets as Euro Area liquidity injections are expected to continue throughout 2017.

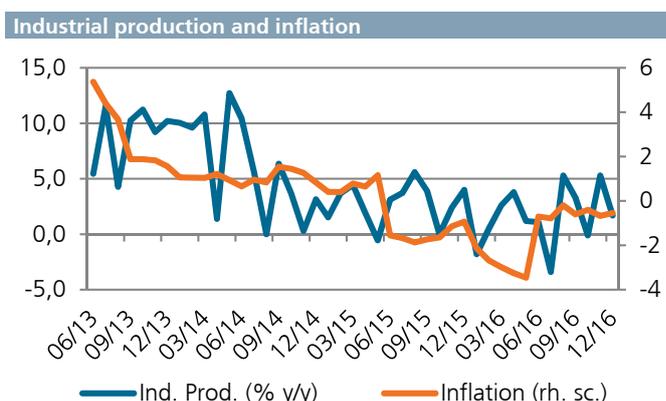
Local FX exhibited price sensitivity to domestic events as of late. The rapid RON depreciation occurred in early February was quickly followed by a correction back to previous levels. Furthermore, it is noteworthy that there was no blowout in risk spreads, indicating that the move in the FX market was, perhaps, more based on sentiment. Nevertheless, the price action in the EURRON FX is flagging that the RON value remains prone to some depreciation going forward, as the environment is filled with inflationary pressure (both domestic and external) and although the economy is on track to perform, the political risk can have an impact going forward. Noteworthy here is that Romania’s biggest trade partner, the Euro Zone, is scheduled to hold Parliamentary elections in key states such as The Netherlands, France, Germany. In the above mentioned states, with the exception of Germany, populist parties have a disruptively strong voice.

Banking Sector

Non-government credit creation was barely positive in 2016, at +1.2% yoy (+3% yoy in 2015), but the story is that RON double digit credit growth was checked lower by the FX credit contraction. In the depo market, total deposit growth decelerated to +8.2% yoy (from +8.6% yoy) with RON deposits (+10% yoy) growing at more than double the pace of FX deposits (+4.5% yoy).

Latest Economic Indicators			
%	Last value 4Q 2016 3Q 2016		
Ind. Production yoy	1.7 (Dec)	2.3	1.7
Nom. Exports yoy	9.4 (Dec)	7.7	5.2
ESI (index)	105.0 (Jan)	104.1	103.5
Retail Sales yoy	8.4 (Dec)	8.9	11.4
Inflation Rate yoy	0.0 (Jan)	-0.5	-0.5
CB Reference Rate	1.8 (17th Feb)	1.8	1.8
Loans (priv. sector, yoy, eop)	0.6 (Dec)	0.6	0.5
Deposits (priv. sector, yoy, eop)	8.5 (Dec)	8.5	10.8

Source: National Statistical Institute, NBR



Source: NBR

Russia

Real Economy

Rosstat has once again revised Russia's GDP. In 2016 it fell by 0.2% (-0.7% for the first nine months of the previous year). Such improvement in macroeconomic data is partly due to a revision of statistic data of previous years and transfer to new classifications of economic activities. As a result of this the GDP decline in 2015 was also revised up from 3% to 2.8%, starting from very first estimates which showed a decline of 3.7%. The industrial production grew at 2.3% in January following the 3.2% of the previous month. Production increased in all sectors (the index is now divided into: "extraction of minerals", "processing production", "energy, gas and steam" and "water supply and disposal") except "energy, gas and steam". Consumer prices in Russia increased by 0.6% in January 2017. During the previous three months, the inflation rate was about 0.4%. The last time it exceeded 0.6% was in January 2016 (1%). In annual terms, inflation in Russia slowed to 5% in January; on average in 2016 it was 5.4%. In the law of the federal budget inflation is expected to decline to 4% in 2017.

Anna Mokina

Financial Markets

On 3 February the Bank of Russia kept its benchmark rate unchanged at 10%. The regulator pointed at inflation slowing in line with the forecast, noting the role of temporary favourable factors. After the Committee Meeting expectations of a rate cut in the short term receded although some further easing is still expected by year-end. The reason underlying the decision lies in persisting inflation risks: inertia of inflation expectations, reducing propensity to save, economic and foreign policy uncertainty. Moreover, the Central Bank recognized the short-term risks associated with the start of foreign currency purchases in the money market by the Russian Ministry of Finance. The Ministry of Finance started to conduct transactions in the domestic market from February 2017. As long as the price of crude oil "Urals" exceeds 40 USD/bbl. foreign exchange will be purchased. If prices drop below the threshold value, the currency will be sold, but in the amount not exceeding the accumulated sum since the beginning of the operations. The monthly volume of purchases will depend on oil and gas revenue of the federal budget (purchases for the amount of additional revenue).

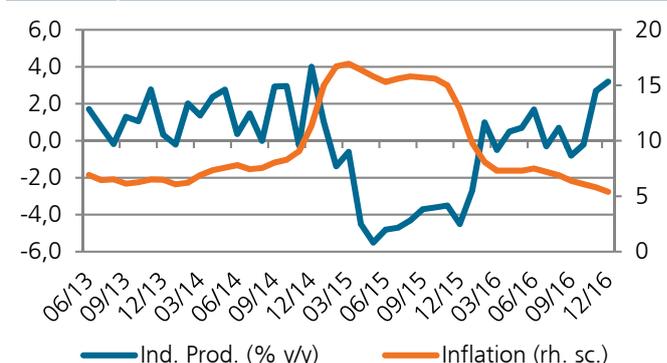
Banking Sector

In November bank assets grew by 1.5%, loans to the private sector by 0.4% (0.1% loans to non-financial organizations and 1.1% to households). Household deposits in November grew by 1.3% while the volume of organizations' deposits and funds on current accounts increased by 1.9%. The banking sector is gradually returning to normal. Sharp deterioration in asset quality has stopped. In the first 11 months of 2015 the overdue rate rose by 1.6 p.p. (from 3.8% to 5.4%) whereas in the same period in 2016 by a mere 0.3 p.p. Allocations to provisions for possible losses have been reduced: +8.6% yoy in January-November 2016 against +27.6% yoy in the previous year. The profit of the banking sector rose sharply (788 billion against 264), mostly for the accounts of Sberbank. It is worth noting the gradual transition of the sector to structural liquidity surplus driven by the proceeds from the sale of the Reserve Fund.

Latest Economic Indicators			
%	Last value	4Q 2016	3Q 2016
Ind. Production yoy	3.2 (Dec)	1.9	-0.1
Nom. Exports yoy	8.3 (Dec)	1.9	-9.6
Retail Sales yoy	-5.9 (Dec)	-4.7	-4.5
Inflation Rate yoy	5.0 (Jan)	5.8	6.8
CB Reference Rate	10.0 (31th Jan)	10.0	10.0
Loans (priv.sector, yoy, eop)	0.4 (Nov)		0.9
Deposits (priv.sector,yoy,eop)	2.4 (Nov)		3.9

Source: State Statistics Federal Service, Central Bank of Russia

Industrial production and inflation



Source: State Statistics Federal Service

Serbia

Real Economy

Full-year growth in 2016 is estimated at 2.7% based on favourable trends in industry, which was strongly supported by investments directed to tradable sectors and recovery of external and internal demand. A successful agricultural season, and the construction and services sectors should have also positively contributed to growth. In 2017, real GDP is expected to expand by around 3.0%, according to the National Bank of Serbia, owing to new investments, continued implementation of infrastructure projects, strong exports and increasing consumption underpinned by rising employment and private sector wages hikes.

In December 2016, CPI amounted to 1.6% yoy, slightly exceeding the lower bound of the new target tolerance band (3±1.5% as of January 2017), while, on average, the yoy inflation amounted to 1.1% in 2016. Inflation is forecast to rise moderately and move within the range throughout 2017 driven by low base effects, rising primary commodity prices and stronger demand.

Financial Markets

In February 2017, the National Bank of Serbia kept the key policy rate unchanged at 4.0%, as was expected. The no-change base rate decision was guided by the inflation outlook and the effects of past rate cuts, but also the prevailing uncertainties on the international market, especially after the Fed’s rate hike in December 2016 and announcements of further hikes during 2017. Forthcoming presidential elections in Serbia add to more uncertainties, suggesting that the National Bank of Serbia will not change its current monetary policy stance.

During the first month of 2017, the local currency depreciated by 0.4% against the EUR. The National Bank of Serbia intervened on the FX market by selling EUR 225 mln (more than one fifth of the total amount sold in 2016), in order to defend the dinar against further weakening mostly due to seasonal factors such as increased demand of energy by importers. The dinar fell to its lowest breaching the level of 124 dinars per euro at the beginning of February.

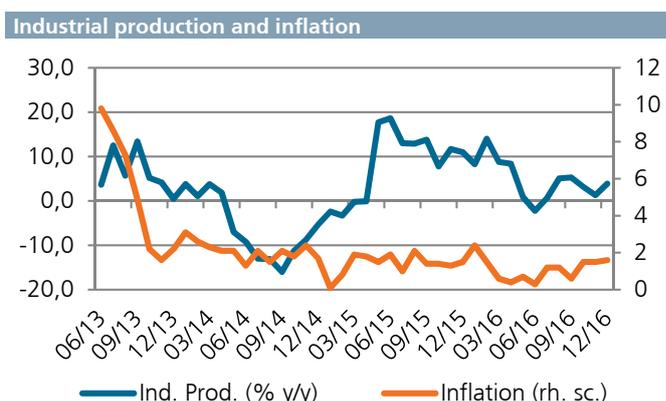
Banking Sector

Loans to the private sector increased by 2.4% yoy in December 2016 owing to lending in the household segment (10.5% yoy) as the volume of loans in the corporate sector declined (-2.9% yoy). Deposits significantly increased by 11.5% owing to both the household and corporate sectors with deposits rising by 7.9% and 18.9%, respectively. According to the preliminary data, the share of NPL amounted to 17.0% at end-2016 (vs. 21.6% at end-2015).

Branka Babic

Latest Economic Indicators			
%	Last value	4Q 2016	3Q 2016
Ind. Production yoy	3.9 (Dec)	2.8	3.7
Nom. Exports yoy*	18.4 (Dec)	15.8	10.1
Retail Sales yoy	6.8 (Dec)	6.5	6.8
Inflation Rate yoy	1.6 (Dec)	1.5	1.0
CB Reference Rate, eop	4.0 (17th Feb)	4.0	4.0
Loans (priv.sector,yoy,eop)	2.4 (Dec)	2.4	6.0
Deposits (priv.sector,yoy,eop)	11.5 (Dec)	11.5	12.2

Source: Statistical Office, National Bank of Serbia



Source: Statistical Office, National Bank of Serbia

Slovakia

Real Economy

The real activity data released over the past month, covering the final month of 2016, did not change previous trends or outlook. In headline terms, the economy keeps growing above 3% yoy. A snap estimate of 4Q16 GDP came in at 3.1%, a tad up from the previous quarter, but still significantly down from a boom period a year ago when growth was boosted by EU funded public investments. Full year 2016 GDP growth decelerated to 3.3% yoy from 3.8% yoy in 2015.

Andrej Arady

In the current year, the economy is expected to reaccelerate to 3.5% yoy, however, on persisting strong growth of private consumption and recovering investments – both public and private. Confidence in the Euro area has been firmly growing since the end of the summer, boosting also domestic sentiment and there is a good case also for persisting strong foreign demand. In any case, we will get a clearer picture on the current economic cycle once the details on 4Q16 GDP are published in early March.

The major news of the past month from the Slovak economy are related to price developments. Similar to the Euro area, inflation in January jumped up also in Slovakia, albeit from a notably lower base, from 0,2% yoy in December to 0.7% in January. Recall that the full 2016 average was at an historic low of -0.5% yoy. Its administrative part though fell deeper into negative territory, from -0.9% yoy in December to -1.7% in January on further decreasing energy prices. All of this latest growth of headline inflation thus went on its core part, growing from 0.9% yoy in December to 1.3% in January, with the contribution almost proportionally distributed among increasing food prices, fuels and finally also demand-driven parts of inflation.

Financial Markets

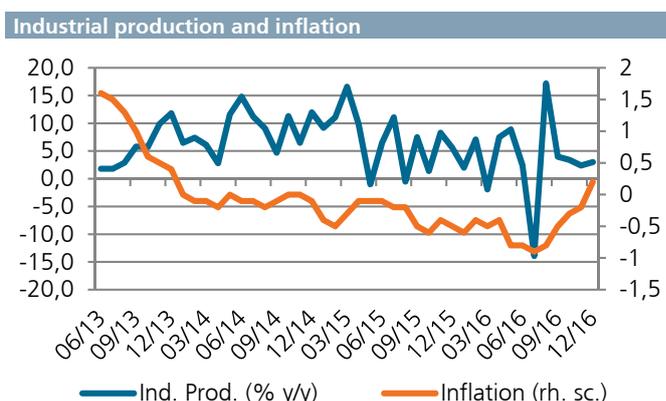
On rates, the domestic yield curve has stabilized since late 2016, following previous steepening. Spreads on government bonds versus German bunds on 10 year tenors have hovered since December around 70bps, in line with our previous expectations. We expect this level of spreads to remain in following months.

Banking Sector

After the continuous decrease in the previous year, interest rates on new housing loans have recently stabilized around the Euro area average. Some banks started to price mortgages already higher as 2017 opened, mainly in longer fixations (above 3 years) on growing bank interest rate costs on the financial market. Rates on consumer loans, still well above the Euro area average, in the meantime continued to decrease, converging to euro standards. A relevant fact is that while loan growth remained stable over 10% yoy, the deposit side of banks' balance sheets decelerated slightly which pulled the loan-to-deposit ratio to a new all-time high.

Latest Economic Indicators			
%	Last value	4Q 2016	3Q 2016
Ind. Production, wda yoy	3.0 (Dec)	2.9	2.4
Nom. Exports, yoy	6.2 (Dec)	4.9	1.8
ESI (index)	103.4 (Jan)	102.8	103.0
Retail sales, yoy	4.3 (Dec)	3.0	0.9
Inflation rate*, yoy	0.7 (Jan)	-0.1	-0.7
ECB refi rate	0.0 (17th Feb)	0.0	0.0
Loans (priv.sector,yoy,eop)	10.3 (Dec)	10.3	9.6
Deposits (priv.sector,yoy,eop)	4.6 (Dec)	4.6	7.6

Source: Statistical Office of the Slovak Republic, National Bank of Slovak Republic



Source: Statistical Office of Slovak Republic

Slovenia

Real Economy

In January 2017, the consumer confidence indicator amounted to -2, which is the highest value so far. Along with rising employment, consumer confidence is the main driver of increasing private consumption.

In November 2016, the general government deficit amounted to app. EUR 500 Mn, which is 37% less than in the same period of the previous year. The deficit is lower mainly due to higher than expected current revenues, lower than expected subsidies expenditure and a large decline in public investment (following the end of the 2007-13 EU funding period).

Measured by the harmonised index of consumer prices, in January 2017, annual inflation was 1.5% (in January 2016, it had been 0.8%). The largest upward impact on the annual inflation came from higher petroleum product prices.

Financial Markets

In the last period the 3-month Euribor continued to slowly decrease and sank even deeper into negative territory. Currently it is moving around -0.33% and it is expected to remain in negative territory for an extended period of time due to the ECB's accommodative monetary policy. The yield on the Slovenia benchmark 10-year government bond decreased to around 1% recently, in comparison to c. 1.1% one month ago, following movements in the Eurozone bond market. The Slovenian 5-year-CDS spread continued a downward trend (89.1bps mainly impacted by Standard& Poor's December decision to revise Slovenia's Outlook to Positive from Stable with the rating confirmed at A).

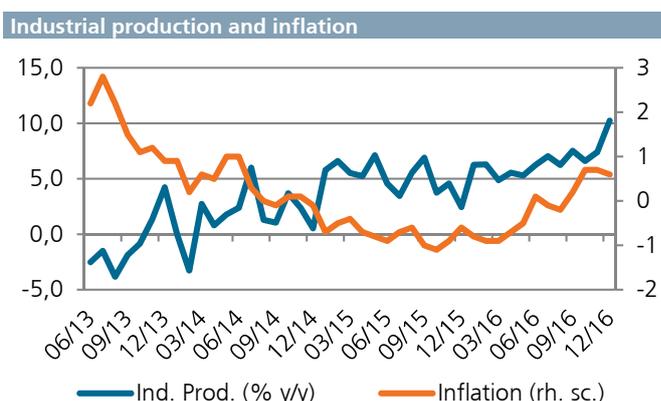
Banking Sector

Total loans to the private sector increased in December by EUR 337 Mn (or 2% mom). The increase for the household segment amounted to EUR 79 Mn and reflects the positive trend present in the course of 2016. A gradual recovery of the real estate market and low lending interest rates had a beneficial effect on mortgage loans. Their rise was followed by an increase in consumer, and later of other loans as well. The large increase of the corporate segment (EUR 258 Mn) was the result of the EUR 500 Mn loan approved to the Bank Asset Management Company. The quality of credit portfolios slightly deteriorated in November (NPLs/Loans to the Private Sector stood at 6.5%), which is still close to the lowest level in the past six years.

Total deposits from the private sector amounted to EUR 22.7 Bn in December 2016, representing a yoy increase of 7.2%. Household deposits rose by 6.7%, even more pronounced was the increase of corporate deposits (+8.9%). Considering record low deposit interest rates the increase is only evident in sight deposits, while short term and long term deposits volumes are lower compared to the same period of the previous year.

Latest Economic Indicators			
%	Last value 4Q 2016 3Q 2016		
Ind. Production, wda yoy	10.2 (Dec)	8.1	6.9
Nom. Exports yoy	4.0 (Dec)	3.0	4.1
ESI (index)	110.4 (Jan)	109.0	106.9
Consumer Confidence Indic.	-2.0 (Jan)	-10.3	-12.0
Inflation Rate yoy	1.5 (Jan)	0.7	0.0
ECB refi rate	0.0 (17th Feb)	0.0	0.0
Loans (priv.sector,yoy,eop)	-2.7 (Dec)	-2.7	-6.8
Deposits (priv.sector,yoy,eop)	7.2 (Dec)	7.2	6.6

Source: Statistical Office of the Republic of Slovenia, National Bank of Slovenia



Source: Statistical Office of the Republic of Slovenia

Ukraine

Real Economy

Following two years of severe economic recession, Ukraine's economy rebounded in 2016 (+2.1%) and we expect real GDP growth to continue to accelerate. Although there is currently no data on the GDP breakdown in 2016, manufacturing output growth accelerated to 3.2% yoy in 4Q, taking the full year reading to 3.1%. Strong production growth in agriculture (up by 6.1% in 2016) and construction (+7,7% last year) also sustained GDP. On the demand side, gross fixed capita formation was the main driver of growth (+ 15.5% in the first nine months of last year). Household consumption also recovered (+2.3% from January to September) and it is expected to remain a primary driver of economic activity this year. Among other things, household purchasing power will receive a substantial boost from a doubling of the country's minimum monthly wage, which, as of January 1, increased from UAH1,600 to UAH3,200.

Giancarlo Frigoli

Financial Markets

At its last meeting at the end of January the CB's Board kept its policy rate unchanged at 14% for the fifth consecutive month. This policy stance reflects some concerns about foreign currency volatile and inflation. In late December - early 2017, the depreciation pressure on the hryvnia gained in strength due to a number of situational factors, among others seasonally lower FX earnings from agricultural exports. The CB revised the inflation forecast for 2017 from 8.0% to 9.1% primarily due to the above mentioned minimum wage rise. Year-on-year inflation is expected to remain high in the first three quarters due to statistical base effects. It should return to single-digit figures only in Q4 2017.

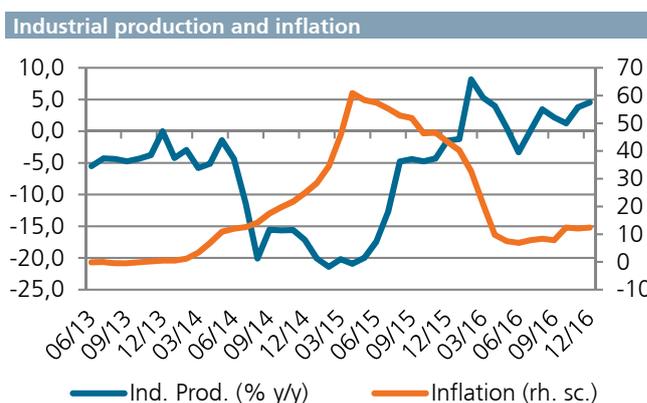
Banking Sector

Banking aggregates improved slightly in December. Nominal loans increased by 2% yoy (from -4.7% in November), but by -4.6% yoy net of the exchange rate effect. Data showed a recovery in the corporate sector (+4.1% yoy from -2.9% yoy in November) but still a decrease in households (-6.6% yoy). Deposits increased nominally by 9.1% (+6.7% yoy in November) both in the corporates (10.8%) thanks to economic recovery and revenue growth, and in households (8.2%). The LTD ratio decreased slightly to 137%, a still too high level. According to the CB (Financial Stability Report, December), systemic risks to the Ukrainian financial sector have been diminishing over 2016. The situation in the banking sector stabilized thanks to a recovery of the funding base, and compliance with recapitalization programs by almost all large banks. Furthermore, as highlighted by the CB, banks have sufficient capital and liquidity to restart lending to the economy. In November 2016, the banks' regulatory capital increased to UAH 138bn (from UAH 136 bn in October) owing to the implementation by banks of recapitalisation programmes, but the Regulatory CAR decreased slightly, from 13.78% to 13.71%. The NBU expects banks to start making profits again in 2017 after three years of losses. Interest rates declined in December, particularly on lending (from 23.4% to 22.9%).

Davidia Zucchelli

Latest Economic Indicators			
	Last value	4Q 2016	3Q 2016
Ind. Production yoy	4.5 (Dec)	3.2	1.9
Nom. Exports yoy	-4.6 (Dec)	-5.6	-8.7
PMI Manufacturing	n.a.	n.a.	n.a.
Retail Sales	3.9 (Dec)	2.9	4.6
Inflation Rate yoy	12.6 (Jan)	12.3	8.1
CB Reference Rate	14.0 (31th Jan)	14.0	15.0
Loans (Priv. Sector, yoy, eop)	2.0 (Dec)	2.0	0.7
Deposits (Priv. Sector, yoy, eop)	9.1 (Dec)	9.1	12.1

Source: State Statistics Service of Ukraine, National Bank of Ukraine



Source: State Statistics Service of Ukraine

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

Economy																		
	GDP chg yoy			Ind. Prod ¹ . chg yoy			Export nom. chg yoy			Inflation chg yoy				FX reserves chg (mln €) ²			CA bal. (mln €) ³	
	4Q16	3Q16	2015	Last	Mth	4Q16	Last	Mth	4Q16	Last	Mth	4Q16	2015	4Q16	3Q16	2015	4Q16	3Q16
CEE																		
Czech Rep.	1.7	1.9	4.5	2.7	Dec	2.7	0.7	Dec	-0.6	2.2	Jan	1.4	0.3	n.a.		9998	n.a.	
Hungary	1.6	2.2	3.1	1.9	Dec	0.3	7.7	Dec	4.1	2.3	Jan	1.3	-0.1	n.a.	-1124	-4256	n.a.	1289
Slovakia	3.1	3.0	3.8	3.0	Dec	2.9	6.2	Dec	4.9	0.7	Jan	-0.1	-0.3	n.m.	n.m.	n.m.	n.a.	
Slovenia	n.a.	2.7	2.3	10.2	Dec	8.1	4.0	Dec	3.0	1.5	Jan	0.7	-0.8	n.m.	n.m.	n.m.	548	726
SEE																		
Albania	n.a.	3.1	2.6	n.a.	n.a.	n.a.	15.5	Jan	15.7	2.8	Jan	1.9	1.8	n.a.	-56	2480	n.a.	-208
Bosnia H.	n.a.	2.4	3.1	7.2	Dec	5.7	15.1	Dec	11.3	-0.2	Dec	-0.4	-1.0	44	344	399	n.a.	-107
Croatia	n.a.	2.9	1.6	14.9	Dec	7.8	3.9	Nov	n.a.	0.2	Dec	-0.2	-0.5	n.a.	102	1019	n.a.	3345
Romania	4.8	4.6	3.7	1.7	Dec	2.3	9.4	Dec	7.7	0.0	Jan	-0.5	-0.6	n.a.		-3990	4	-3
Serbia	2.5	2.6	0.8	3.9	Dec	2.8	18.4	Dec	15.8	1.6	Dec	1.5	1.4	600	167	171	n.a.	-299
CIS MENA																		
Russia		-0.4	-3.0	3.2	Dec	1.9	8.3	Dec	1.9	5.0	Jan	5.8	15.8	-14323	3005	-18340	n.a.	404
Ukraine		2.0	-9.9	4.5	Dec	3.2	-4.6	Dec	-5.6	12.6	Jan	12.3	48.5	263	525	5741	-656	-1761
Egypt		3.4	3.5	-0.9	Nov	-1.8	11.8	Nov	12.0	28.1	Jan	18.8	10.4	4673	2046	1112	n.a.	-4983
m.i. E. A.	1.8	1.6	2.0	2.0	Dec	2.0	5.9	Dec	2.4	1.8	Jan	0.7	0.0					

Note: ¹Wda data for Slovakia, Slovenia; Bosnia, Croatia, Egypt; ²USD for Russia, Egypt, Ukraine, Romania; ³USD for Russia, Egypt, Ukraine. Source: Thomson Reuters - Datastream

Markets and Ratings														
	S/T rates ¹		L/T rates ²			Foreign exchanges ³			Stock markets		CDS spread (bp)		Rating	
	20/02	chg bp 3M	20/02	chg bp 3M	20/02	3M chg% 1Y chg%	3M chg% 1Y chg%	3M chg% 1Y chg%	20/02	17/11	20/02	17/11	S&P	
CEE														
Vs Euro														
Czech Rep.	0.3	0.0	0.8	0.2	27.0	-0.1	0.0	9.0	10.4	37.2	38.5	AA-		
Hungary	0.2	-0.4	3.6	0.3	307.8	-0.6	-0.6	13.0	46.1	109.5	115.7	BBB-		
Slovakia	-0.3	0.0	1.1	0.2	Euro	Euro	Euro	-0.8	-1.8	39.3	38.4	A+		
Slovenia	-0.3	0.0	1.0	-0.1	Euro	Euro	Euro	8.2	13.2	89.1	98.3	A		
SEE														
Albania	1.2	0.3	n.a.	n.a.	135.4	-0.5	-2.1	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	-0.3	2.8	-0.4	7.4	-0.8	-2.1	11.0	35.2	189.8	206.8	BB		
Romania	0.6	0.0	3.6	0.0	4.5	0.1	1.3	12.9	24.7	92.7	100.3	BBB-		
Serbia	4.0	0.0	n.a.	n.a.	124.1	0.7	0.7	15.0	34.3	201.6	208.8	BB-		
CIS MENA														
Vs USD														
Russia	10.5	-0.1	8.2	-0.6	57.2	-11.5	-26.6	4.7	20.0	167.4	212.2	BB+		
Ukraine	18.2	0.3	79.8	0.0	27.0	4.0	2.4	21.2	47.7	1253.8	13957.0	B-		
Egypt	18.9	4.3	16.8	-1.6	15.8	-9.3	101.9	12.3	147.0	343.7	480.0	B-		
m.i.A.E.	-0.3	0.0	0.3	0.1	1.1	-0.4	-4.2	8.2	12.6	14.8	9.5			

Note: ¹The data for Albania refers to October, for Egypt refers to January, for Czech Republic refers to January; ²For Ukraine, the long-term rate refers to a government issue in dollars; ³The (-) sign indicates appreciation. Source: Thomson Reuters - Datastream

Aggregates and bank rates for the private sector																							
	Loans		NPL/Loans		Foreign Liab.		Deposits		Loans rate ¹ -NewB*.				DepositsRate ¹ -NewB*.				Loans/Dep						
	Chg yoy %	Last Mth 2015	%	Last Mth 2015	Chg yoy %	Last Mth 2015	Chg yoy %	Last Mth 2015	Last	Mth	2015	S ⁴	Last	Mth	2015	S ⁴	Last	Mth 2015					
CEE																							
Czech Rep.	6.7	Dec	6.6	4.8	Dec	5.8	33.3	Nov	18.2	5.8	Dec	7.1	1.86	Dec	1.74	C	0.91	Dec	1.6	A	76.6	Dec	75.9
Hungary	-1.9	Dec	-12.3	11.3	Sep	13.7	-7.0	Dec	-8.1	6.3	Dec	7.5	3.12	Dec	4.1	C	0.54	Dec	1.0	A	83.8	Dec	90.8
Slovakia	10.3	Dec	8.7	4.7	Dec	5.1	0.8	Dec	1.1	4.6	Dec	9.9	2.6	Dec	2.83	C ²	0.49	Dec	0.75	H ²	94.9	Dec	90.0
Slovenia	-2.7	Dec	-5.2	6.5	Nov	9.9	-17.9	Dec	-20.7	7.2	Dec	5.8	2.81	Dec	3.45	C ²	0.23	Dec	0.28	H ²	81.0	Dec	89.2
SEE																							
Albania	-0.1	Nov	-2.6	20.4	Nov	18.2	-13.4	Nov	-14.4	2.3	Nov	1.0	12.09	Nov	8.35	A	0.69	Nov	1.27	H	53.8	Nov	54.2
Bosnia H.	3.4	Dec	2.2	12.1	Sep	13.7	-5.3	Dec	-11.7	7.4	Dec	7.8	4.62	Dec	4.99	C	0.55	Dec	1.06	H	110.1	Dec	114.4
Croatia	-4.0	Dec	-3.1	14.7	Sep	16.6	-31.3	Dec	-25.1	2.8	Dec	6.4	4.47	Dec	5.08	C	1.26	Dec	2.15	H	80.8	Dec	86.5
Romania	0.6	Dec	2.7	10.0	Sep	13.5	-21.8	Dec	-10.2	8.5	Dec	9.1	3.66	Nov	4.32	C	0.91	Nov	1.48	H	87.3	Sep	85.4
Serbia	2.4	Dec	3.0	18.9	Nov	21.6	-9.2	Dec	-6.3	11.5	Dec	7.1	5.42	Dec	6.24	C	3.01	Dec	4.17	H	102.3	Dec	111.4
CIS MENA																							
Russia	0.4	Nov	8.2	9.8	Nov	8.3	-12.5	Oct	-0.8	2.4	Nov	18.8	11.72	Nov	13.8	C	6.62	Nov	8.43	H	109.1	Nov	108.1
Ukraine	2.0	Dec	-3.8	31.0	Sep	28.0	-12.7	Nov	6.3	9.1	Dec	1.5	22.88	Dec	26.09	R ³	16.31	Dec	20.06	R ³	136.8	Dec	146.3
Egypt	15.7	Oct	18.0	5.9	Jun	6.8	100.7	Oct	91.6	17.1	Oct	20.4	16.0	Nov	11.8	C	8.8	Nov	6.8	H	38.7	Oct	38.8
m.i. E. A.	0.7	Nov	0.6	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	17.5	Nov	3.2	1.3	Nov	1.6	C	0.4	Nov	0.6	H	82.4	Nov	83.6

Note: ¹monthly average; ²lending rate on current account overdraft; on deposits up to 1 year; ³does not include banks. ⁴Sector A=All, C=Corporates, H=Household, PS=Private Sector, R=Residents. Source: Central Banks, IMF, Moody's

Intesa Sanpaolo Research Department – Head of Research Gregorio De Felice	
International Research Network Coordination	e-mail address
Gianluca Salsecci (Head)	gianluca.salsecci@intesaspaolo.com
ISP - Research Department (Milan)	
Giancarlo Frigoli (CIS, MENA and Lat. Am. Countries)	giancarlo.frigoli@intesaspaolo.com
Silvia Guizzo (Emerging Asia)	silvia.guizzo@intesaspaolo.com
Antonio Pesce (CEE and SEE Countries)	antonio.pesce@intesaspaolo.com
Wilma Vergi (Trade and Industry)	wilma.vergi@intesaspaolo.com
Davidia Zucchelli (Banks and Financial Markets)	davidia.zucchelli@intesaspaolo.com
International Subsidiaries' Research Departments:	
VUB (Slovakia)	
Zdenko Štefanides (Head)	zstefanides@vub.sk
Andrej Arady	aarady@vub.sk
PBZ (Croatia) and ISP Banka (Bosnia I Hercegovina)	
Ivana Jovic (Head)	ivana.jovic@pbz.hr
Ana Lokin	ana.lokin@pbz.hr
CIB (Hungary)	
Mariann Trippon (Head)	trippon.mariann@cib.hu
Sandor Jobbagy	jobbagy.sandor@cib.hu
Banca Intesa (Serbia)	
Marija Savic (Head)	marija.arsic@bancaintesa.rs
Branka Babic	branka.babic@bancaintesa.rs
Tijana Matijasevic	tijana.matijasevic@bancaintesa.rs
Alexbank (Egypt)	
Emil Eskander (Head)	emil.eskander@alexbank.com
Hemat El Masry	hemat.elmasry@alexbank.com
Sahar EzzElarab	sahar.ezzElarab@alexbank.com
Samer Halim	samer.halim@alexbank.com
International Subsidiaries' Research Contacts:	
Intesa Sanpaolo Bank (Slovenia)	
Nastja Benčič	nastja.bencic@intesaspaolobank.si
Banca Intesa (Russia)	
Anna Mokina	anna.mokina@bancaintesa.ru
Intesa Sanpaolo Bank (Romania)	
Sebastian Maneran	sebastian.maneran@intesaspaolo.ro
Intesa Sanpaolo Bank (Albania)	
Kledi Gjordeni	kledi.gjordeni@intesaspaolobank.al

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