INTESA SANPAOLO

Forecast Note
Countries with ISP Subsidiaries

September 2016

Quarterly note

Intesa Sanpaolo
International Research Network

In the CEE/SEE region, GDP is forecast to only slightly decelerate after the strong 1H16 performance, while below target inflation supports low policy rates. Russia is moving out of recession. The EGP is expected to depreciate.

Given the GDP dynamics seen in the first half of 2016 and the release of the most recent high frequency indicators, economic growth expectations for the CEE/SEE countries with ISP subsidiaries have been revised upwards to 3.1% (from 2.9% projected in June) for 2016 and left unchanged (at 2.9%) for 2017. The slight deceleration is expected to occur as a consequence of a weaker-than-previously expected growth in the Euro zone and a still-modest domestic demand for investments. As anticipated in our June Note the Brexit referendum result – due to the areas' limited trade and financial links with the UK – is only seen to have contained effects on growth.

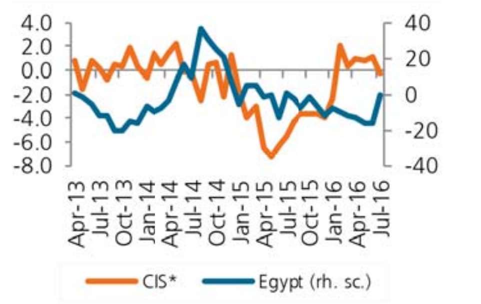
Outside the CEE/SEE region, in Russia, thanks to the anticipated recovery of the oil price, we now forecast a more contained fall in GDP this year (-0.5%) together with the return to an expansionary path (1%) in 2017. In Egypt, we have revised upwards our GDP forecasts for 2017 (to 4.7% from 4.2%). Growth is expected to be sustained by infrastructure investments and additional financial support from Gulf states (in particular, Saudi Arabia) and international institutions (the World Bank and, following the recent Staff-Level Agreement, the IMF).

The average inflation rate is forecast to remain below zero, or quite low, in all the countries of the CEE/SEE region in 2016 and generally move to higher levels, but still below central bank targets, in 2017. Both domestic (low price dynamics) and external factors (prolonged easy monetary policy from the ECB) strongly support a parallel continuing easy stance among the central banks of the region. Outside of the area, inflationary pressures are expected to recede in Russia, encouraging cuts in interest rates, and to accelerate in Egypt, supporting rate rises. Exchange rates are forecast to remain quite stable in Europe. A sharp depreciation is projected in Egypt, as a result of a more flexible exchange rate management by the CBE, following the package of measures contained in the above-mentioned agreement with Egypt by the IMF.

The loans dynamics is forecast to show signs of only weak recovery in the CEE/SEE region. In 2016 in Slovenia, Hungary and Croatia, credit growth rates are still forecast to be in negative territory, due to the ongoing process of portfolio restructuring at banks and (in the latter two countries) to *ad hoc* measures undertaken to tackle the Swiss franc appreciation issue. In 2017 in all the countries of the region, loan growth rates are projected to move into positive territory. In the CIS area, the loan growth rate is forecast to stay below inflation both in Russia and (especially) Ukraine.

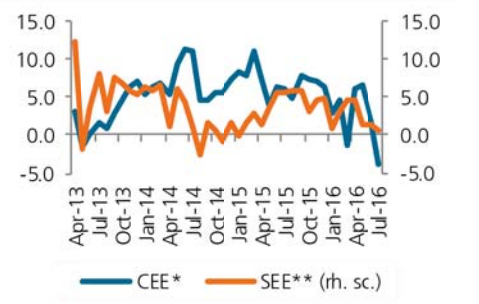
Deposits are expected to remain on a positive trend in all the countries with ISP subsidiaries in 2017, and generally above the loan growth dynamics. As a consequence the loans/GDP and the loans/deposits ratios are seen to decline further, along with a rebalancing between internal *vs* external bank funding. In a context of prolonged low inflation/low monetary rates, bank interest rate spreads are projected to narrow further.

Industrial production % y/y – CIS - Egypt



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

Industrial production % y/y – CEE - SEE



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

The figures in this document have been updated to 9 September 2016.
See the final page for important information.

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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 CSI Countries and Egypt among MENA Countries.

Cross Country Analysis

Recent developments

Gianluca Salsecci, Giancarlo Frigoli, Antonio Pesce and Davidia Zucchelli

In the first half of 2016, the GDP dynamic was above expectations in most countries with ISP subsidiaries in the CEE/SEE region. Among the CEE countries, in Slovakia and Slovenia, GDP still grew at significant rates in 2Q (3.7% and 2.7%, respectively) after the positive growth experienced in 1Q (3.4% and 2.3%). In Hungary, after a lower-than-expected GDP growth rate (0.9% y/y) in 1Q16, economic growth gained momentum in 2Q (2.6%). Although the CEE economies remain growth outperformers in the European Union, the region is starting to show some signs of weakness. Industrial production growth has slowed with respect to the 2Q average in Slovakia (2.2% y/y in June) and even turned negative in Hungary (-0.3% y/y in June), partly due to weaker growth across the Euro zone which has been affecting demand for CEE exports. In June, the export dynamic in CEE countries was below the 2Q average. Regarding forward-looking indicators, in Hungary in August, the manufacturing PMI was below the value in February (54.6, a record for the year) even if still above 50. In the same month, the ESIs in Slovakia and Slovenia were close to but still below the historical highs of last year.

Economic growth continued in the CEE and consolidated in the SEE area in 2Q16

In the SEE countries, economic growth consolidated in 2Q16, bringing the GDP growth in 1H16 above previous expectations. It continued to accelerate in Romania (5.9% in 2Q16 after 4.3% in 1Q) and improved slightly in Croatia (2.8%), while in Serbia, it lost momentum in comparison with the robust performance in 1Q (3.8%), while remaining strongly positive in 2Q (2.0%). Currently, for Albania and Bosnia Herzegovina, data on GDP are only available with reference to 1Q (3.0% and 2.1%, respectively). As in CEE countries, in almost all SEE countries, industrial production remained on a positive trend in June/July, but below the 2Q average.

Inflation slowdown continued in July

In July, annual consumer price inflation still experienced negative rates in the CEE countries (-0.3% in Hungary, -0.1% in Slovenia and -0.9% in Slovakia) and in most SEE countries (-1.0% in Bosnia, -1.5% in Croatia and -0.8% in Romania), the exceptions being Albania and Serbia, at 1.9% and 1.2%, respectively. In the latter cases, the levels remained in any case below the ranges set by the central banks. In general, low inflation is still supported by lower energy prices in comparison to the last year.

All the central banks of the CEE/SEE countries with ISP subsidiaries are maintaining easy monetary conditions and monetary rates have fallen to historical lows. Exchange rates are quite stable in the whole region and CDS have declined slightly further with respect to the values recorded three months ago.

Easing process expected to resumes in Russia. Inflation target well within reach in Ukraine. Inflationary pressures building up in Egypt. New rate hikes are in Egypt

In the CIS region, in Russia, industrial production fell unexpectedly in July (-0.3%), after three consecutive months of yearly gains, following the drop in manufacturing output (-1.5%). This weakness seems temporary, as the manufacturing sector PMI rebounded above the critical level of 50 in August, to 50.8. Annual inflation slowed to 6.9% in August from 7.2% in July. The slowdown process is likely to continue in the remaining months of 2016 and the 6% official year-end target looks to us to be within reach. Receding inflationary pressures reinforce the view that the central bank will resume its easing cycle later this month, when we expect the benchmark one-week repo rate to be cut by 50bp to 10.00%.

In Ukraine, industrial production fell for the second consecutive month in July, mainly following the drop in manufacturing output. In the first seven months of 2016, industrial production was, on average, 1.7% higher than in the same months of 2015, mainly sustained by construction activity (+11%). Yearly inflation accelerated to 8.4% in August from 7.9% in July. The National Bank of Ukraine has maintained its headline inflation projection unchanged at 12% by the end of 2016 and 8% by the end of 2017, notwithstanding that in 1H16, inflation slowed more rapidly than projected. According to the monetary authority, annual headline inflation will accelerate, returning to target by year-end, mainly as a result of the planned new hike in utility tariffs.

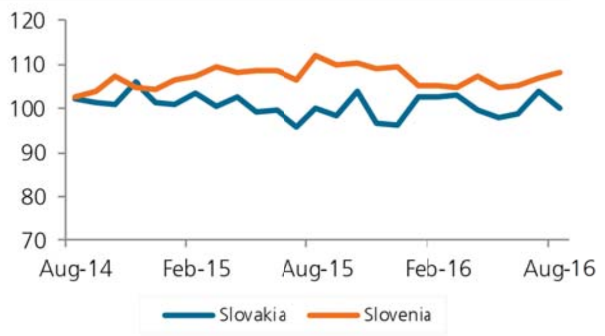
In **Egypt,** business activity shrank for the 11th consecutive month in August, as data for output, new orders and employment deteriorated, with purchase prices rising sharply amid a shortage of hard currency. In addition in August, the Purchasing Managers Index (PMI) for the non-oil private sector was 47.0 points, down from July's 48.9 points, still below the 50-point mark that separates growth from contraction. Annual inflation jumped to 15.5% in August from 14% in July. The acceleration mainly reflected higher food prices. New inflationary pressures are expected in the near future, after Parliament recently approved the introduction of a value-added tax under an IMF-sponsored plan and due to the ongoing reform in the energy/food price subsidies.

With reference to **banking aggregates** in the regions with ISP subsidiaries**, loans** showed a mixed dynamic in the last month. In Slovakia, Bosnia, Romania and Egypt, we observed a slight deceleration in lending, while in Slovenia – where the corporate sector continues to be particularly fragile - Hungary and Ukraine the pace, even if the stock of loans contracted, was less intense than in previous months. In contrast, in Serbia, we have seen an acceleration in lending (+5.3% yoy in July from +4.6% yoy in June) in both the corporate and in the household sectors. **Deposits** were resilient in many countries in July, particularly in Romania (+11.2% yoy) and still over +8% yoy in Slovakia. NPL ratios remained high, particularly in Albania and Serbia (both over 20%).

In the CIS area, positive changes in the main banking aggregates were mainly due to the accounting effects of the past exchange rate depreciation. In Russia, loans rose nominally, by 8.2%, in May, but net of fx effects, they are estimated to have increased by only 1%. Russian banks should benefit from the key interest rate cut which occurred last June (by 50bp, to 10.5%) because it indicates a decreasing cost of funding, and this could support demand for new loans. In Ukraine, where the banking sector is under particular stress, loans decreased by -8.5% in July, but net of the fx depreciation, they fell by 19%. Deposits increased by 6.2% yoy (but fell by 3% net of fx depreciation). Nonperforming loans rose to 30.4% in June, putting further pressure on capital.

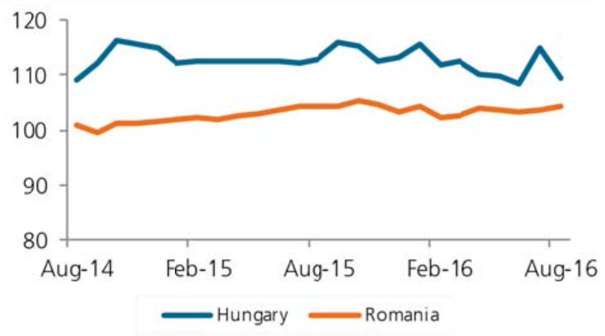
In the last month, **foreign liabilities** continued to decline significantly, both in some CEE countries (in Slovenia, -13%, and in Hungary, -10%) and in some SEE countries (in Croatia, -37%, and in Albania, -19%). Among CEE countries, foreign liabilities grew in Slovakia (+15.6%). In Russia, they increased nominally, by 4%, in May (but fell by 22% yoy net of exchange rate depreciation). In Ukraine, the trend in foreign liabilities was strongly negative in nominal terms (-15% yoy in July) and net of the exchange rate effect (over -30%). On the liability side, in several cases, the decrease in foreign funding was partly offset by the resilience of deposits.

Economic Sentiment Indicator



Source: European Commission

Economic Sentiment Indicator



Source: European Commission

The International Outlook Underlying the Scenario

GDP growth forecast to slow slightly in 2017. ECB expected to extend QE if necessary

GDP growth and monetary policy in the main advanced countries. The ECB's staff has trimmed the GDP growth rate forecast in 2017 to 1.6% from the 1.7% forecast in June, after revising upwards the growth rate projected in 2016 to 1.7% from previous 1.6%. The slight slowdown expected in 2017 owes largely to lower external trade rather than to a shift in domestic demand. The ECB's staff has also marginally revised downward the forecasts on consumer inflation, with the average CPI in 2017 expected to be 1.2% (from 1.3% in June). The rise in inflation - with respect to the 0.2% projected for 2016 - is essentially due to oil price recovery. At its last meeting in September, the ECB kept the policy rates unchanged. It also reaffirmed that it will continue to run the APP purchases at a pace of 80 Bn a month until March 2017, but left the door open to an extension beyond "if necessary and in any case until the Governing council sees a sustained adjustment in the path of inflation consistent with its inflation aim".

In the US, after recent strong labour market figures and speeches by members of the Fed in favour of a gradual normalisation of monetary policy amid rising inflation expectations, the Fed is expected to resume its tightening cycle after a nine-month-long interval pause. Uncertainties remain nevertheless, among market participants, on the pace. Relatively tame industrial activity and domestic demand figures suggest that this year GDP growth will slow significantly from the 2.4% recorded last year. After the modest 1% recorded in 1H16, the full-year GDP growth in the US is expected to slow to around 1.5% before accelerating to 2.2 in 2017.

Uneven GDP dynamics expected in emerging countries. Markets still vulnerable to expectations of Fed moves

Growth and monetary policies in main emerging countries. As far as growth prospects in emerging economies are concerned, recent statistics point to an unequal performance among countries. In Asia, China's real GDP is now expected to grow by 6.5% circa in 2016 and to further slowdown ton 6.2% in 2017, while India's economy is projected to outperform that of China with a GDP growth rate around 7.5%both in 2016 and 2017. In Latin America, in Brazil, GDP shrank for the sixth consecutive quarter in 2Q (-3.8% after -5.4% in 1Q) but investments rose for the first time since 2013, fuelling hopes of an impending recovery. In the MENA region, in Saudi Arabia the GDP growth, hit by lower oil revenues and by deficit trimming measures, is sharply slowing down in 2016. A timid recovery is expected in 2017, conditional on oil price rebound. In the same region growth is expected instead to gain momentum in Iran, after the recent removal of sanctions. Finally, in Sub-Saharian Africa, Nigeria, the largest economy in the region, is heading into recession while South Africa is forecast at an almost zero GDP growth in 2016. Overall, growth in emerging countries is expected to stay around 4% in 2016 and to slightly move beyond in 2017, mainly thanks, however, to a few large economies, namely Brazil and Russia, seen exiting recession, and conditional to further recovery in commodity prices.

In recent weeks, volatility in emerging markets has increased again, following uncertainties about future moves by the Fed. Should the US tightening cycle prove to be stricter than expected, this would very likely trigger new waves of capital outflows to advanced economies, affecting bond yields, stock indexes and exchange rates. Pressures are expected nevertheless to be milder than in the past, based on the view that the Fed will eventually act but with extreme caution and expectations of prolonged recovery in commodity prices.

Economic Outlook

GDP growth and inflation

GDP growth slightly revised upwards in the CEE/SEE region in 2016. Slight slowdown projected in 2017

For the whole CEE/SEE area with ISP subsidiaries, following the GDP dynamics observed in 1H16, the growth forecast has been revised slightly upwards for full-year 2016, from the 2.9% expected in June to 3.1%. GDP growth is projected to slightly lose momentum in 2017 at 2.9% (in line with June forecasts), due to weaker-than-expected growth across the Euro zone, which will reduce demand for CEE/SEE exports, and still fragile domestic demand for investments.

The revised CEE/SEE GDP forecast for 2016 is the result of two different profiles seen for the CEE and SEE sub-regions. Among the CEE countries, the GDP growth rate is expected to decelerate to 2.6% (in comparison with the 2.4% deceleration projected in June) *vs* the 3.1% recorded in 2015. The slowdown looks to be related to a slower recovery of the EA (affecting exports), but also to weaker domestic investments. Growth in the CEE region is forecast to accelerate slightly in 2017 (to 2.7%), thanks in Hungary to some space left to be exploited in the public budget and to a higher contribution with respect to 2016 expected from EU structural funds. However, growth is forecast to decelerate in Slovakia and Slovenia.

Among the SEE countries, GDP is expected to jump in 2016 by 3.6% (revised upwards from the 3.2% projected in June) with respect to the 2.8% recorded in 2015, due to higher than previously forecast GDP profiles in 2016 in Romania (4.4% from 4.0%), Croatia (2.3% from 1.8%), Serbia (2.6% from 2.3%) and Albania (3.0% from 2.8%). Growth in the region is forecast to consolidate around 3% in 2017.

Better growth prospects in Russia

In the CIS area, higher than previously expected oil quotations and improving consumer and business confidence in a more stable financial environment are expected to provide additional support to economic recovery in Russia. We now forecast a more contained than previously expected fall in GDP this year (-0.5%) and a return to an expansionary path in 2017 (+1%). However, structural shortcomings continue to weigh on medium-term prospects. In Ukraine, the significant acceleration in GDP growth in 2Q (+1.6%) sustained the previous forecast of a rebound in GDP growth this year (+1.5%) gaining steam in 2017 (2.5%).

A boost to GDP from construction in Egypt

In the MENA region, we revised upwards our forecast for GDP growth in 2016 (to 4.4% from 3.4%) for Egypt, following much stronger than previously projected growth in the first nine months of fiscal year 2015/2016. The main boost was provided by the construction sector, mainly by public works partly financed by foreign capital. Infrastructure investments planned by the government, together with financial support from Gulf countries (in particular, from Saudi Arabia, which has been reported to have signed with Egypt a SAR 60Bn investment fund) and from international institutions (a USD 3Bn three-year loan from the World Bank and a USD 12Bn three-year Extended Fund Facility from the IMF following the recent Staff-Level Agreement reached by Egypt) are expected to sustain growth also in 2017 (now projected at 4.7%).

Inflation forecasts have generally been revised downwards in 2016 for the countries with ISP subsidiaries. The average inflation rate in 2016 is expected to be below zero in Slovakia (-0.6%) and Slovenia (-0.4%) among CEE countries, and in almost all SEE countries with the exceptions of Albania and Serbia (1.3% and respectively 1.1%), generally further downwardly revised from previous expectations. Inflation is projected to revive in the CEE and SEE regions in 2017, in particular in Hungary and Romania, due to significant base effects, while remaining, however, in most cases, much below the lower limits of the ranges set by the respective central banks.

In the CIS area, inflationary pressures are now receding at a faster than previously expected pace in Russia with the yearly average rates expected to be 7.2% in 2016 and 5.7% in 2017. In Ukraine, we confirm the previous forecast for an average inflation rate this year of 14%, but we have raised to 10.5% (from 9%) our projections for 2017, in line with the indications from the country's 2017 budget. In the MENA region, in Egypt, following the jump in annual inflation seen in recent months and due to new pressures from the planned introduction of the VAT tax, new likely cuts in subsides and a weaker currency, we have significantly revised upwards our inflation forecasts, with the average rates now projected at 13.2% in 2016 and 15% in 2017.

Monetary policy and financial markets

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

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 keep current (negative) policy rates unchanged for an extended period of time and to prolong (if necessary) the QE Programme beyond March 2017. The forecast, in addition, is strongly supported by current (and expected) local trends in inflation (significantly below targets). As a consequence of this, monetary rates are forecast to stay negative in Slovakia and Slovenia and below 1% in all the other countries in 2016 and 2017 (with the only exception being Serbia, where they are projected to be at around 4%).

For the CIS area, we have revised marginally higher the short-term profile of the MOSPRIME rate in Russia to 11.3% (vs 11% expected in June) based on the central banks appearing more cautious in recent months. The medium-term downward trend of policy and monetary rates has been confirmed on the basis of declining inflation and a stable exchange rate. In Ukraine, we confirm the downward trend in short term rates indicated in the June forecasts. In the MENA region, in Egypt we see instead higher than previously forecast short-term rates (the annual average for the 3M T-bill rate has been raised to 14% and the 2016 year-end to 15%), due to stronger inflationary and currency pressures.

Long rates are expected to remain low in 2016 and 2017 on average, but start to move upward later in 2017 or early in 2018

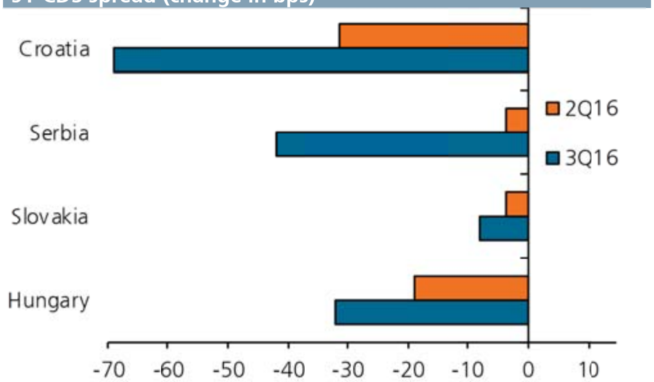
Long-term rates are still expected to remain generally low in 2016 in CEE and SEE countries – in line with June forecasts - and start to move upward only late in 2017 or early in 2018 based on robust evidence of reversals in inflationary trends. Turbulence that occurred in financial markets following the Brexit referendum mainly affected equity markets (especially banking sector indices) and government bonds but only slightly and in a transient way (in particular, 10Y German bunds, whose yields have fallen into negative territory). In the CIS region, easing inflationary pressures and progress towards financial stabilisation should favour a drop in long-term yields in Russia this year and over the forecasting horizon.

The rouble is on a recovery path, the hryvnia is expected to gradually depreciate, the Egyptian pound could go sharply lower

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 seems to have been only transient.

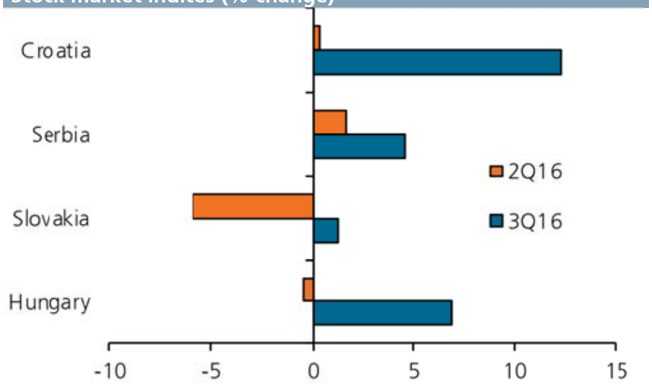
In the CIS area, we now forecast a slightly stronger rouble this year and in 2017 in Russia, helped by the more rapid recovery in the oil price. We continue to expect the Ukraine's hryvnia to be stable in the near term but to follow then a depreciation path, based on a significantly higher inflationary profile than for trading partners. For Egypt, we finally expect a large devaluation of the currency (around 20% against the USD) in the next few months as a result of more flexible exchange rate management, following the package of measures included in the above-mentioned preliminary agreement with the IMF aimed at rebalancing the economy.

5Y CDS spread (change in bps)



Source: Bloomberg (*) 3Q16 up to mid-September

Stock market indices (% change)



Source: Thomson Reuters. (*) 3Q16 up to mid-September

Aggregates and bank rates

Loan performance expected to recover slightly

The **Private sector loan stock dynamics** in the CEE/SEE region are expected to only slightly improve in 2016 with respect to 2015. The persistently slow recovery is – as stated in previous forecast notes – mainly a result of the long-lasting processes of deleveraging occurring in the private sector (from the demand side) and of reductions in NPLs within the banks' portfolios (from the supply side). In some countries (mainly Slovenia, Hungary and Croatia), loan growth rates are still expected to remain in negative territory in 2016, due to the impact of the ongoing process of banks' portfolio restructuring, and in addition (in the case of Croatia and Hungary) to the *ad hoc* measures adopted by the authorities to tackle the Swiss franc appreciation issue. In 2017 in all the countries, loan growth rates are projected to improve and move to positive territory, even if at a still generally mild pace (except for Slovakia, where a stronger pace is expected). These forecasts seem to be supported by the recent IIF composite index profile for EM bank lending conditions, which has improved, particularly in EM Europe, moving by over 50 pts in 2Q16.

Aggregates in the CIS area expected to remain weak

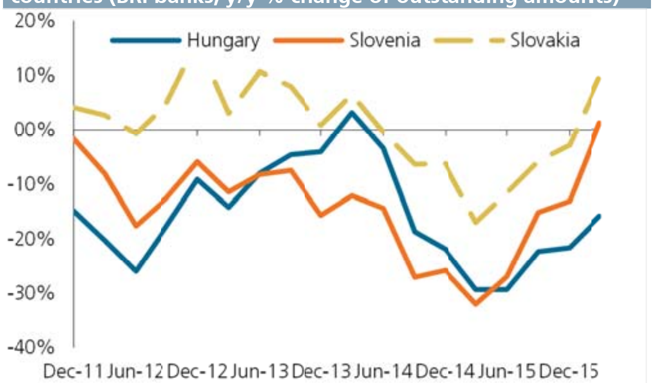
In the CIS area, the pace of the loan recovery is forecast to be weak in 2016, at a rate still below inflation in Russia, and especially in Ukraine. In 2017, the reduction of key interest rates and the recovery of growth are expected to support the demand for new loans in Russia. In Ukraine, loans are forecast to recover particularly in the household sector. In Egypt, a still significant increase in loans (although at a decelerating rate) is forecast in 2016 (+14%, after +18% in 2015), which is still below the nominal GDP dynamics, followed by a lower +13% in 2017.

Deposits growth rates are forecast to be positive in 2016 (even if lower than in 2015) and to regain overall momentum in 2017, in both years however staying well above the loans' dynamics. The loans/GDP and loans/deposits ratios are expected to decline further, together with further rebalancing between internal *vs* external bank funding.

Banking interest rate spreads are expected to narrow further

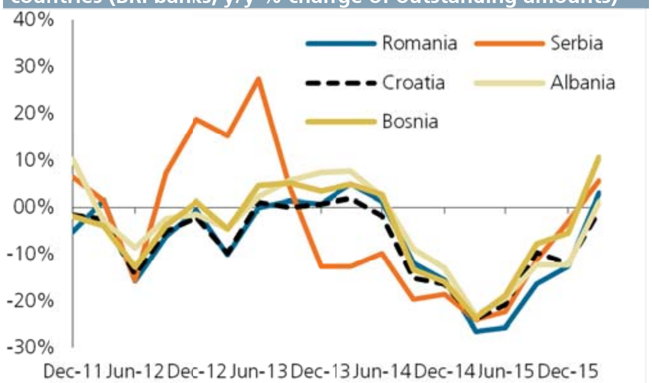
In line with declining/low policy rates, banking interest rates are expected to decline/remain low also in 2017, especially on the lending side, while interest rates on deposits, having already reached very low levels, are expected to be more resilient. Therefore, interest rate spreads are generally expected to shrink, squeezing the expected net interest margin in most CEE/SEE countries.

Consolidated positions on counterparties resident in CEE countries (BRI banks, y/y % change of outstanding amounts)



Source: Intesa Sanpaolo processing of Bank for International Settlements data

Consolidated positions on counterparties resident in SEE countries (BRI banks, y/y % change of outstanding amounts)



Source: Intesa Sanpaolo processing of Bank for International Settlements data

Country Specific Analysis

Albania

Real Economy

Kledi Gjordeni

The Albanian economy and financial markets have performed overall in line with expectations in the first half of 2016. Economic activity expanded in 1Q16 by 3%, inflation was on an upward trend, to 1.9% in July, and the accommodative monetary policy resulted in a liquid financial environment with low interest rates. Economic growth is expected to be around 3% in 2016, driven by improving activities in services and construction. The trend also reflects the improvement in confidence in the economy, with the ESI moving to 100.1 in 2Q16 from 93.8 in 1Q. The GDP growth rate is projected to be only slightly lower in 2017 at 2.8%, affected by some slowdown in the Euro area. Inflation is forecast to increase further, up to a 2% average in 2017, driven by a strengthening of domestic demand.

Financial Markets

Monetary policy will continue to ease, with the central bank ready to respond to market risks. Money market rates (3M TBills) are projected to continue their declining trend, even if less sharply. The decrease will be a result of stronger fiscal consolidation and possible cuts to the REPO rate by the BoA to further stimulate credit growth. According to the Albanian Association of Banks (AAB), the 2Q interest rate for business loans in LEK declined to an average of 7.51% from 8.19% and in euros to 5.52% from 6.14% yoy. LEK interest rates on household loans declined to an average of 6.92% from 8.93% and EUR rates fell to 4.46% from 5.31% a year ago.

The LEK/EUR exchange rate is forecast to remain stable over the next period (October 2016-December 2017), with a slight depreciation likely in 2017, mainly due to an expected cut in the key LEK (REPO) interest rate during 2017 and a fall in domestic consumption (resulting in increased demand for imported goods).

Banking Sector

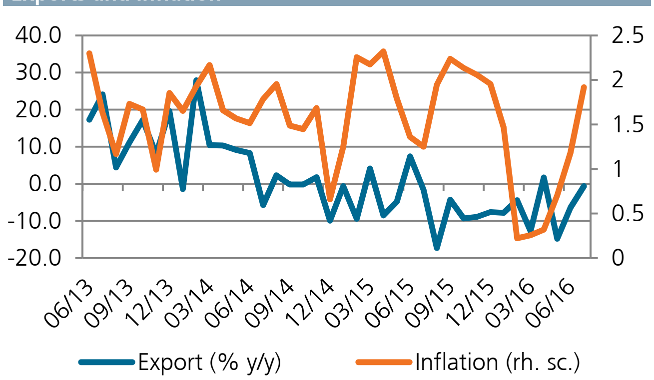
During the first half of 2016, the gross loan portfolio reported by the BoA showed an increase of 2%. Growth is mainly generated by the retail segment. During the same period, the NPL stock showed an increase of 11.7%. After reaching 18.22% at the end of 2015, the NPL ratio increased to 19.96% in June 2016. Such an upward trend remains a key concern and, together with low domestic demand, is hindering credit growth. In this situation, credit growth will likely continue to be sluggish, as banks are showing particular focus on credit quality. Total deposits in June 2016 registered 0.5% increase: -0.3% for household loans and +5.5% for corporate loans.

Forecasts

	2015	2016F	2017F
Real GDP yoy	2.6	3.0	2.8
CPI avg	1.9	1.3	2.0
Euro exchange rate avg	139.8	137.7	139.2
Euro exchange rate (end of period)	137.7	138.2	140.2
Short-term rate (avg)	2.7	0.9	0.9
Short-term rate (end of period)	2.2	0.9	0.9
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	0.5	2.0

Source: Intesa Sanpaolo Research Department forecasts

Exports and inflation



Source: INSTAT

Bosnia and Herzegovina

Real Economy

Ivana Jovic

Although 2Q high frequency data indicate solid growth in exports (5.7% yoy), imports of capital goods (1.2% yoy) and retail trade (4.7% yoy) thus signalling an improvement in investments and private consumption, we have slightly lowered our 2016 growth estimate to 2.4% yoy, mainly based on a high 2Q15-3Q15 base and in line with 1Q16's 2.1% rate. We expect that positive economic developments will continue in 2017, supported mainly by exports and investments (construction agreements have been signed regarding several TPP/HPP investment projects) thus leading to c.2.7% growth. The main risk to our baseline scenario is political instability, which could hamper the structural reforms agenda, as well as any unforeseen slowdown in BH's major trading partners. In the medium term, we expect that growth will be supported by a new economic programme within the EUR 550mn IMF-EFF agreement, as the focus will be improvement of the business environment, fiscal consolidation and financial sector stability.

As the average 12-month CPI declined in July at-1.4% yoy, we estimate that the 2016 average inflation rate will be as low as -1.2% for the fourth consecutive year. In line with the expected recovery in oil prices and the announced hike in excise duties on fuel (currently undergoing parliamentary process), the inflation rate is expected to return to positive territory in 2017 (0.2% yoy).

Banking Sector

Ana Lokin

Total loans to households in June and July continued to experience a slowdown in pace, reflecting market saturation: the annual growth rate for consumer loans slipped from 5.8% in May to 4.9% in July; the rate for housing loans fell from 3.0% to 0.9% in the same period. After a slowdown in 2Q amid pronounced deleveraging of public companies, loans to non-financial corporations surprised to the upside in July, marking a 3.6% yoy increase. As such developments were broadly in line with our expectations, the forecast for private sector loan growth in 2016 was left unchanged at 2.5% yoy. In 2017, we see a moderate pick-up of demand, with the loan growth rate at 3.0% yoy, supported by sustained strong growth of consumer loans and a solid rise in housing loans, as well as the recovery of corporate loan activity on the back of stronger GDP growth expectations.

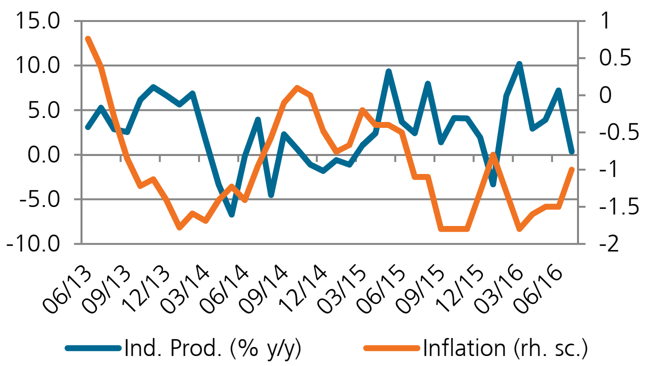
The private sector deposit dynamics in 2Q were disappointing, especially in the corporate segment, where the growth rate dropped from 8.8% in March to 3.4% yoy in June. July brought a seasonal revival of companies' deposits (+8.9% yoy), whereas household deposits appear to be losing some steam, a bit earlier than we anticipated. Hence we have cut our 2016 and 2017 deposit growth rate forecasts to 4.7% and 5.7% yoy, respectively.

Forecasts

	2015	2016F	2017F
Real GDP yoy	3.2	2.4	2.7
CPI avg	-1.0	-1.2	0.2
Euro exchange rate avg	2.0	2.0	2.0
Euro exchange rate (end of period)	2.0	2.0	2.0
Short-term rate (avg)	n.a.	n.a.	n.a.
Short-term rate (end of period)	n.a.	n.a.	n.a.
L/T bond yields (avg)	n.a.	n.a.	n.a.
Bank loans yoy (end of period)	2.2	2.5	3.0
Bank deposits yoy (end of period)	7.8	4.7	5.7

Source: Intesa Sanpaolo Research Department forecasts

Industrial production and inflation



Source: Labour and employment agency

Croatia

Real Economy

Ivana Jovic

As the first half of 2016 brought a stronger-than-expected rebound in investments (5.3% yoy), accompanied by solid personal consumption growth (3.1% yoy), we have upgraded our 2016 estimate by 0.5 pp, to 2.3% yoy. Although goods exports started to signal more moderate growth rates, July tourism statistics indicated a significant boom in services exports, as arrivals increased by 17.6% and overnight stays by 12.2% yoy, pushing consumer spending growth to 4.5% yoy, which, if reaffirmed by August-September data, represents a significant tailwind - possibly pushing growth towards 3%.

Even though the economy has so far been resilient, an expected slowdown in German growth as well as the sluggish Italian recovery suggest that 2017 growth could witness a slowdown to 2.1% yoy. However, balance of risks is at the moment more towards the positive, as we expect that the new government, although most probably formed between the same parties as the previous one (centre right HDZ and junior independent MOST), will be much more stable and supportive of growth. That being said, positive stimulus from both the external environment (low interest rates and a tourism dividend) and recovering domestic demand (primarily EU funds-financed investments) could be utilised to support a reform agenda and lead to sustainable growth that would support the stabilisation of public debt and the country's rating recovery. As both imported and internal deflationary pressures remain strong, we keep 2016 average CPI at -1.4% yoy, whereas, following the expected increase in oil prices, we foresee inflation to return to positive territory in 2017 (0.6% yoy).

Financial Markets

Ana Lokin

For FY16, we estimate the average 3M Zibor at 0.8% (-40 bps y/y). In 2017, in an environment of negative Euribor and a dovish stance by the CNB, we see interest rates remaining largely unchanged. The kuna should continue to be strong by the end of 2016, at an average rate of around 7.55, but slower export growth and high public debt due in 2017 are likely to push the level towards 7.59.

Banking Sector

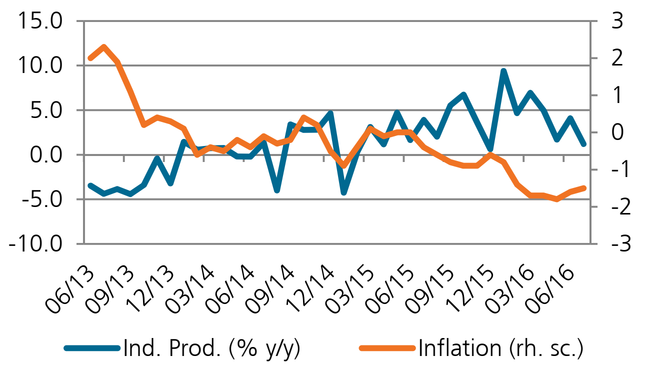
We expect loans to narrow by 4.8% yoy in 2016: in spite of some encouraging trends we have witnessed over the past few months, the portfolio is shrinking due to the CHF conversion and sale of NPLs. In 2017, a small revival of private sector demand is expected of +1.1% yoy, based on a positive economic outlook. We estimate 2016 to end with a moderate rise in deposits of 2.5% yoy. The trend is expected to be largely sustained in 2017, when the rise in corporate deposits will slow down and retail deposit growth will be limited by lower interest rates. Thus, the increase in deposits is expected to be a bit lower, at 2.4% yoy.

Forecasts

	2015	2016F	2017F
Real GDP yoy	1.6	2.3	2.1
CPI avg	-0.5	-1.4	0.6
Euro exchange rate avg	7.6	7.6	7.6
Euro exchange rate (end of period)	7.6	7.6	7.6
Short-term rate (avg)	1.2	0.8	0.8
Short-term rate (end of period)	1.2	0.8	0.8
L/T bond yields (avg)	3.7	3.6	3.4
Bank loans yoy (end of period)	-3.1	-4.8	1.1
Bank deposits yoy (end of period)	6.4	2.5	2.4

Source: Intesa Sanpaolo Research Department forecasts

Industrial production and inflation



Source: EC

Egypt

Real Economy

Emil Eskander

The real GDP growth rate increased by 3.6% in Q3 2015/16 compared to 3.3% in Q3 2014/15. The construction sector, which represents c. 34% of the GDP, was the main driver behind the GDP performance improvement, growing by 12% in Q3 2015/16. We now forecast the GDP to grow by 4.4% in calendar year 2016 and accelerate towards 4.7% in 2017. The government is planning new investments, partly sustained by Gulf countries and international institutions, targeting a more than 5% GDP growth rate during the FY 2016/17.

The annual headline inflation rate remained relatively unchanged at 14% in July compared to June, but jumped to 15.5% in August, the highest rate since January 2009. Medical care prices rose by 31% (yoy) in July 2016, in addition to the rise in food and beverage prices by 18%. The Egyptian parliament has approved the value-added tax (VAT) at a rate of 13% for FY 2016/17, to be raised to 14% starting from FY 2017/18. Due to the effect of the VAT, which is expected to be applied by October 2016, the government estimates a rise in inflation ranging between 0.5% for low-income Egyptians and up to 2.3% for wealthier individuals.

Financial Markets

The Central Bank of Egypt's (CBE) Monetary Policy Committee kept its benchmark interest rates unchanged during its last meeting on 28 July, with overnight deposit and lending rates at 11.75% and 12.75%, respectively, and the discount rate at 12.25%. Higher monetary rates are nevertheless expected to tackle the increasing inflationary pressures.

The EGP continued its depreciation in the black market against the USD, hovering around EGP 12/USD 1, due to the shortage of the foreign currency in the market and increasing demand. This is despite the CBE's efforts to combat the black market and the amendments recently made to a law regulating foreign exchange markets, setting prison sentences of to up to 10 years and EGP 1Mn-5Mn fines for trading foreign currency in the black market. The EGP eventually stabilised at EGP 8.88/USD 1 in the official market, but is expected to depreciate sharply in the next few months, following a more flexible management of the fx rate. The Egyptian cabinet approved plans to issue USD 3Bn-5Bn of Eurobonds during the current FY 2016/17, aiming to diversify the country's sources of foreign currency.

Banking Sector

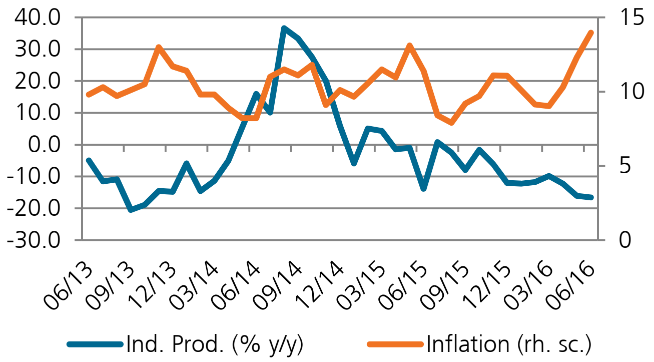
Total bank loans to customers increased by 7% in May 2016 compared to April 2016, reaching EGP 920.7Bn in May (+30.5% yoy). Private sector loans, which represented 70.9% of total loans at the end of May, grew by 1.3% compared to April (+14.7% yoy). Total deposits increased by 3.2%, to EGP 2.08Tn in May 2016 vs April 2016 (+22.3% yoy), with private sector deposits rising by 1.6% in May compared to April (19.6% yoy).

Forecasts

	2015	2016F	2017F
Real GDP yoy	3.6	4.4	4.7
CPI avg	10.4	13.2	15.0
USD exchange rate (avg)	7.7	8.9	10.4
USD exchange rate (end of period)	7.8	9.8	10.6
Euro exchange rate avg	8.5	9.9	11.9
Euro exchange rate (end of period)	8.5	10.8	12.4
Short-term rate (avg)	11.3	14.0	14.5
Short-term rate (end of period)	11.4	15.0	14.0
L/T bond yields (avg)	n.a.	n.a.	n.a.
Bank loans yoy (end of period)	18.0	14.0	13.0
Bank deposits yoy (end of period)	20.4	18.0	16.0

Source: Intesa Sanpaolo Research Department forecasts

Industrial production and inflation



Source: Ministry of Planning, CAPMAS

Hungary

Real Economy

Sandor Jobbagy

Hungary's GDP showed an upward correction in Q2 (2.6%), following an unexpectedly weak Q1. Despite the correction, the full-year performance looks set to be lower than in 2015: we forecast 2.0-2.1%. While recent industrial performance increased concerns about the overall growth rate, the outlook is improved by fiscal easing announcements and the ongoing positive dynamics of domestic demand, including household consumption. The fallout of EU-funded state investments still weighs on construction. Also, private investments are still slow in picking up. The contribution of exports and industry (manufacturing) decreased. Still, we see room for a faster growth rate in 2017 due to further fiscal stimulus (with a deficit planned to be 0.4 pp above this year's targeted gap), the reviving utilisation of EU funds, 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 be sustainable over upcoming years, given poor investments and the lack of sufficient improvement in terms of potential GDP.

Headline inflation remained close to 0% even after Q2 this year and the summer months delivered further negative performances. The lack of any upward 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% – and is 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 core levels, to above 1.5%.

Financial Markets

The NBH left the 3M policy rate on hold at 0.90% during the summer months, after having announced the end of the latest mini easing cycle. Further rate cuts are unlikely this year and in 1H17 as well. Should any further room for easing emerge, the central bank is more likely to deliver unconventional monetary measures, as happened with the announcement of limiting the main (3M) facility, effective from August and October. Recent monetary actions and global market fluctuations left the forint little changed, close to EUR 1/HUF 310, with modest potential for significant divergence during the rest of 2016. Government bond yields remained supported by monetary actions, boosting domestic purchases.

Banking Sector

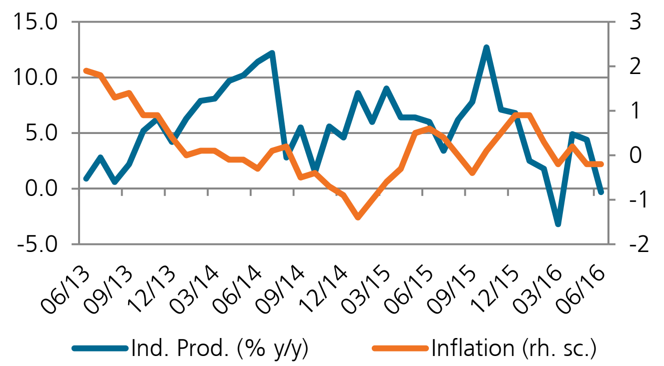
Real economic developments lent some support to the demand side of the loan market. But given the ongoing cautious approach of the private sector, we expect overall corporate credit market activity to show modest dynamics. Customer deposits look set to increase further this year. Corporate, retail clients 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, is experiencing momentum so far in 2H16.

Forecasts

	2015	2016F	2017F
Real GDP yoy	2.9	2.1	2.5
CPI avg	-0.1	0.5	1.6
Euro exchange rate avg	310.0	312.5	312.5
Euro exchange rate (end of period)	312.0	313.0	312.0
Short-term rate (avg)	1.7	1.0	0.6
Short-term rate (end of period)	1.4	0.8	0.5
L/T bond yields (avg)	3.4	3.1	3.1
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

Sebastian Maneran

The summer holidays did not have a significant effect on the Romanian economy. Heavy fiscal stimulus is still feeding through the data, with industrial production feeble and industry productivity declining. Meanwhile, the positive developments in headline inflation are still hiding much stronger inflationary pressures, in our view.

Although the industry data from the start of 2H are showing a deceleration, the strength seen in retail spending is the confirmation that the Romanian economy is consuming above its current production capacity. GDP in 2Q recorded 5.9% yoy growth (1.5% qoq), driven by investments (+10.6% yoy) and private consumption (+11.2% yoy).

Financial Markets

The current economic mix contains some factors seen in the past: loose credit conditions and a willingness to disregard risk. Low volatility in the fx market is perhaps understandable, due to a slowdown in domestic economic activity during the summer holidays. Local currency bonds have not experienced the volatility that those in peer countries have exhibited, most likely due to the fact that the US Fed is still reluctant to raise interest rates, while money market rates (specifically, the ROBOR 3M) reached a new historical low. Moreover, Romania benefits from one of the strongest GDP growth rates in the EU, with low debt levels compared to other similar economies.

General elections in December (specifically, the market is watching to see if more stimulus measures will be adopted) and the divergent path in interest rates between the European Central Bank and the US Fed are likely to lead the current market pricing for Romanian assets going forward. In this context, a strong re-pricing in the fx market vs the current level of around LEU 4.45/EUR 1 seems highly unlikely. The data currently available suggests a stable market with the potential to move a bit higher.

Banking Sector

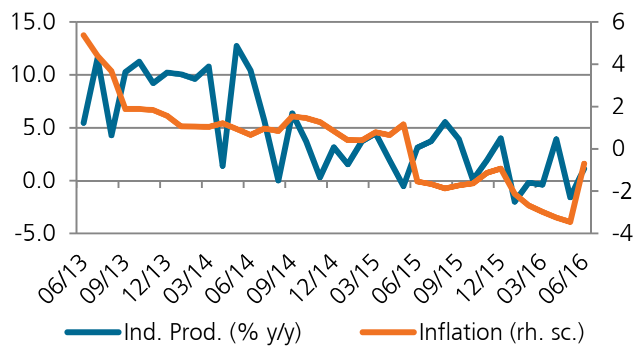
The law that allows debtors to walk away from a mortgage (most likely the ones that were in arrears) has not had a lasting impact on credit creation (as far as pricing is concerned). However, the legal aspect related to the one-sided backtracking by borrowers allowed by the law is likely to have a significant long-term effect. In terms of data, credit creation was negative in July, but it is still positive on an yearly basis, helped mostly by the strong demand from the household sector. The outlook for domestic household spending however is unlikely to keep rising at the same rate.

Forecasts

	2015	2016F	2017F
Real GDP yoy	3.8	4.4	3.4
CPI avg	-0.6	-1.6	2.1
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	0.6	0.6
Short-term rate (end of period)	0.8	0.6	0.6
L/T bond yields (avg)	3.5	3.3	3.3
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

Industrial production and inflation



Source: NBR

Russia

Real Economy

Anna Mokina

June and July were marked by positive GDP dynamics and the trend is expected to continue in coming months. According to Rosstat, in 2Q16, Russian GDP fell by 0.6% yoy. Preliminary estimates for 3Q16 are around 0%. We estimate the GDP to drop by 0.5% in 2016, in line with the forecasts of the central bank (from -0.3% to -0.7%) and the Ministry of Economic Development (around -0.6%).

Growth is then forecast of 1.0% in 2017. Export-oriented industries and agriculture will be the main economic drivers. Annual inflation dynamics have been improving, from 9.8% in January to 6.9% in August (except for a slight acceleration in June). By the end of the year, inflation is expected to slow to 6%, with an average inflation rate of 7.2%.

Financial Markets

The current key rate of 10.5% was left unchanged at the previous meeting of the CBR BoD in late July. The CBR's decision took into consideration the following trends: 1) the inflation rate is slowing, according to the CB baseline forecast, which is mainly due to a stable situation in Russian financial markets, weak consumer demand, and indexation of tariffs in accordance with the plan; 2) monetary conditions remaining moderately tight; 3) industrial production is not uniform in different sectors; and 4) inflationary risks are still rather high. The next CBR BoD meeting on the issue of key rates will be held in mid-September. Even though inflationary risks do exist, a 50 bps rate reduction is reasonably likely.

Banking Sector

Declines in both lending and deposit rates will continue throughout 2H16 and 2017, in our view. A cut in the cost of funding via the CBR's key rate cut by the end of the year should be followed by growing demand for lending. But, the growth rate is unlikely to exceed the inflation rate. Corporate lending is expected to be the main driver, as the retail sector is only starting to recover.

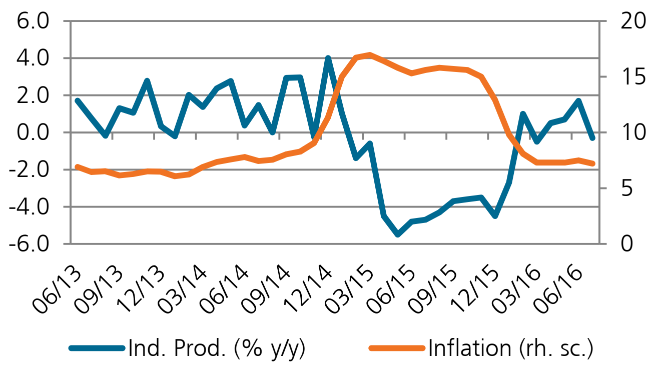
On the other hand, potential growth of household deposits will be limited due to rate decreases connected with liquidity provisons in the banking sector expected in 2H16 and early 2017, and increases of contributions to the Deposits Insurance Agency

Forecasts

	2015	2016F	2017F
Real GDP yoy	-3.7	-0.5	1.0
CPI avg	15.5	7.2	5.7
USD exchange rate (avg)	61.3	67.6	64.5
USD exchange rate (end of period)	72.9	65.0	64.0
Euro exchange rate avg	68.0	75.0	73.5
Euro exchange rate (end of period)	79.5	71.5	74.9
Short-term rate (avg)	13.5	11.3	9.4
Short-term rate (end of period)	11.8	9.8	9.0
L/T bond yields (avg)	11.4	8.9	8.2
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

Industrial production and inflation



Source: State Statistics Federal Service

Serbia

Real Economy

Branka Babic

Real GDP increased by 2.0% yoy in 2Q16, mainly driven by the manufacturing, construction and service sectors, while the growth rate for 1Q16 was revised upwards from 3.5% to 3.8%. The National Bank of Serbia projects GDP growth to accelerate from 0.7% in 2015 to 2.5% for 2016, owing to industry and construction as well as agriculture, taking into account results achieved so far. On the expenditure side, new investments and stronger exports will push up the growth, supported by a modest contribution from private consumption for the first time after four years.

Year-over-year CPI amounted to 1.2% in August 2016, the same level as recorded in July, climbing from only 0.3% in June 2016, which is the lowest level so far this year. The NBS forecasts a gradual rise of inflation and its return to within the target band (4%, ±1.5%) in 2017, supported by the low base effect from prices of petroleum product, recovering domestic demand and inflation abroad.

Financial Markets

In September 2016, the NBS decided to maintain unchanged the key policy rate at 4.0% for the second consecutive month, after a cut by 0.25 pp in July, when the interest rate corridor was also narrowed from ±1.75% to ±1.5% in order to stabilise the interest rates in the interbank money market. Throughout this year, the domestic currency has been relatively stable, which was carefully controlled by timely interventions on the fx market: in 2016, the NSB sold EUR 870Mn and bought EUR 495Mn, of which EUR 355Mn occurred in July, due to stronger appreciation pressures influenced by higher exposure of foreign investors to dinar government securities and a smaller-than-normal amount of fx purchases by domestic enterprises.

Banking Sector

After temporarily slowing at the beginning of the year, lending activity gradually accelerated to 5.3% yoy in July 2016, with lending rising in both the corporate and household segments. Corporate loan demand was guided primarily by loans intended for liquidity and current assets financing, as well as investment loans, while the increase in retail loans was driven by a significant amount of cash loans.

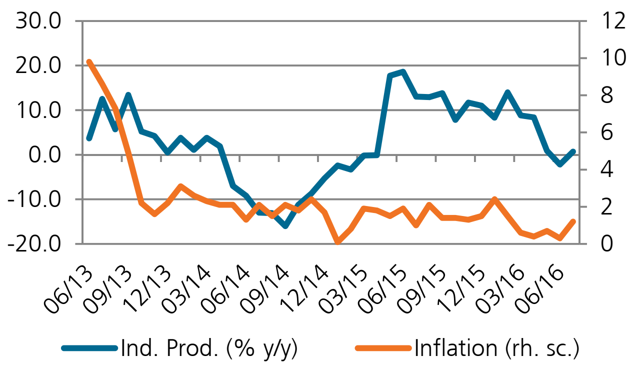
Further growth of credit activity is expected in the coming period, although a still high share of NPLs in total loans should limit the improvement. However, since the start of the year, the NPL share has decreased by 0.6 pp to 20.2% in June 2016, as a result of collection, restructuring, write-offs and sale of a part of NPLs, but also due to an increase in new lending.

Forecasts

	2015	2016F	2017F
Real GDP yoy	0.7	2.6	2.7
CPI avg	1.4	1.1	2.0
Short-term rate (avg.)	6.3	4.1	4.0
Short-term rate (end of period)	4.5	4.0	4.0
L/T bond yields (avg)	0.0	0.0	0.0
Bank loans yoy (end of period)	3.0	3.0	3.2
Bank deposits yoy (end of period)	7.1	4.2	4.5

Source: Intesa Sanpaolo Research Department forecasts

Industrial production and inflation



Source: Statistical Office, National Bank of Serbia

Slovakia

Real Economy

Zdenko Štefanides

The Slovak economy continues to surprise on the upside, growing 0.9% in 2Q qoq and 3.7% yoy. Relative to expectations, growth has been stronger by a few tenths and caused a slight upward revision to the full–year GDP projection. Acceleration in real GDP growth was driven by exports (of cars) and investment (also mainly in the car industry). Previously disappointing consumer spending nonetheless finally also posted a sizable gain, albeit this is not reflected in consumer prices, which continue to decline. Indeed, in July, consumer price inflation fell to a new all-time low of -0.9% yoy, due mainly to a cut in the state-regulated price of natural gas.

Households meanwhile continue to put money into residential property, prices of which posted a hefty increase in 2Q at 3.3% qoq (not annualised) and 4.8% yoy, the fastest pace since the boom in 2007. However, despite recent spikes, on average, property prices are still some 10-15% lower than during their peak in mid-2008, and thanks to a significant decline in mortgage rates, housing remains more affordable than ever.

The latter factor is also supported by an improving labour market, which is actually fast approaching full capacity in some sectors. The unemployment rate overall decreased in 2Q to single digits (9.6%) for the first time since the boom era. In fact, the number of jobless is now below the corresponding quarter in the pre-crisis period, implying that a potential scarcity of employees could be ahead.

Financial Markets

The Slovak financial market continues to be driven by the ECB's QE programme and yields thus remain low – in fact, they are negative up to the eight-year maturity.

Banking Sector

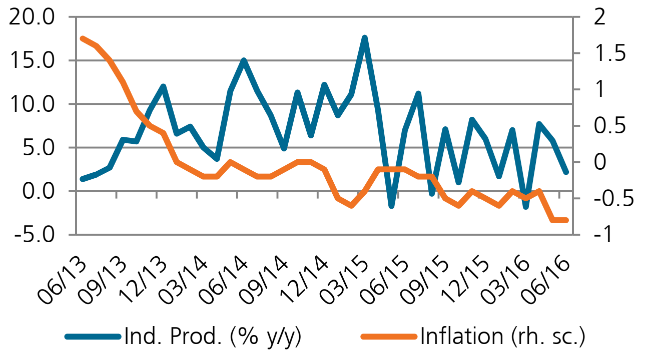
A low interest rate environment obviously negatively affects the profitability of the Slovak banking sector, which relies on net interest income for 80% of its revenues. Headline bank profit figures are clearly still strong, posting a strong increase yoy as banks grow loans aggressively (eg, new mortage production doubled in 2Q yoy) and also book one-off revenues (eg, sale of stakes in VISA Europe in June). As these factors fade, however, the profitability of Slovak banks could deteriorate quite rapidly. Besides margin pressure, the operating environment for banks looks set to worsen, due to the impact of regulations on the access of clients to consumer and mortgage loans. Direct regulatory costs are also rising, as the government has recently decided, contrary to the previous plan to cut it, to keep the bank levy and is now also putting in place a special levy on the insurance business.

Forecasts

	2015	2016F	2017F
Real GDP yoy	3.6	3.5	3.3
CPI avg	-0.3	-0.6	0.3
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	0.5	0.5
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

Nastja Benčič

The positive dynamic in the Slovenian economy continued in 2Q16. Growth of 2.7% was mainly driven by exports; household consumption was relatively high as well. Government spending may be hindering recovery in the upcoming period, due to lower inflows of funds from the EU budget. According to the forecasts, growth could remain slightly above 2% in the next few years.

After a reversal in June, when inflation returned to positive territory after two years (+0.1%), it fell slightly below zero again in the following two months (-0.1% and -0.2% in July and August, respectively). The rise in inflation was primarily attributable to rising service prices, but in the past few months, the negative contribution of energy prices has prevailed. Inflation is expected to still be slightly negative by the end of the year and to start increasing in 2017.

Financial Markets

In 2Q, the 3M Euribor continued to slowly decrease, falling even more deeply into negative territory, where it has been since April 2015. Currently, it is around -0.30%, and considering the ECB's accommodative monetary policy, it is expected to remain stable and close to this level till the end of the year and even beyond, possibly until September 2018. Long-term interest rates also continued to decrease. The 10-year Slovenian government bond yield is currently around 0.80%, which is on average c.60 bps lower with regard to three months ago. If it remains at the current level until the end of the year, it is expected to reach a 2016 annual average value of around 1.2%. The significant reduction of Slovenia's borrowing costs, achieved in August, was mainly due to the debt swap operation undertaken by the government, which comprised buying back old dollar debt that is not eligible for ECB purchase and replacing it with new euro bonds. In the last three months, the Slovenian five-year CDS spread slightly decreased as well and is currently moving around 90 bps.

Banking Sector

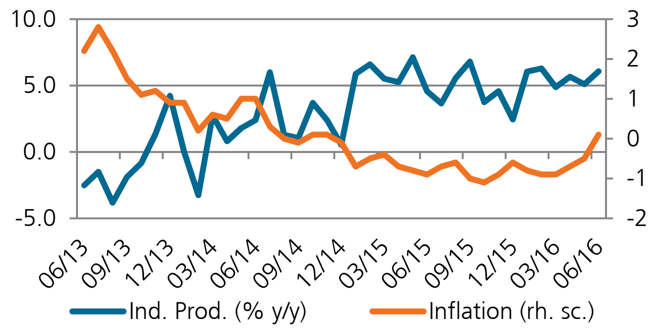
Growth in lending activity remains negative: the decline in corporate loans has increased in recent months, while lending to households has remained relatively stable. Loan volumes are expected to start gradually increasing over the next few years. On the other hand, the stock of both household and corporate deposits is continuing to increase, despite low interest rates. Rising corporate deposits may reflect the lack of profitable investment projects as well as the lack of confidence in economic developments and companies being cautious regarding the future recovery of the economy. Growth in deposits is expected to continue over the next few years, with interest rates remaining at historically low levels in 2017 and then starting to gradually increase from 2018.

Forecasts

	2015	2016F	2017F
Real GDP yoy	2.9	2.3	2.1
CPI avg	-0.8	-0.4	0.5
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	1.2	1.1
Bank loans yoy (end of period)	-5.2	-6.0	1.0
Bank deposits yoy (end of period)	5.8	6.0	4.8

Source: Intesa Sanpaolo Research Department forecasts

Industrial production and inflation



Source: Statistical Office of the Republic of Slovenia

Ukraine

Real Economy

Giancarlo Frigoli

According to preliminary figures, real GDP rose by 0.8% yoy in the first half of 2016, as economic activity accelerated by 1.6% yoy in 2Q, after hedging 0.1% higher in 1Q. Real GDP is expected to grow by 1.5% in 2016 and by 2.5% in 2017. In 2H16, private consumption is expected to pick up slightly, supported by a rapid slowdown of inflation. The external environment will be more favourable for Ukraine, mainly on account of higher than previously projected global prices for its main export commodities. At the same time, the rally in global energy prices and the adjustment of heating and gas tariffs to cost-recovery levels will encourage the development and deployment of energy-saving technologies.

Financial Markets

The removal of capital controls, rising military tensions in the Donbas, and uncertainty regarding payment of the IMF's third loan tranche (that has been continuously delayed due to the government's ongoing struggle to implement the mandated reforms) led to depreciation of the UAH in August, whereby the currency lost 3.5% of its value against the USD. The Ukraine central bank considers this weakness as temporary. The currency is expected to remain stable in the short term and to only slightly depreciate in the near future, also helped by the IMF board's recent decision to release a tranche worth USD 1Bn (reduced from the previous USD 1.7Bn). The Monetary Authority cut its policy rate for the fourth consecutive time this year at the end of July to 15.5% (from 16.5%). New rate easing in the final months of this year is likely, as inflation is well within the official year-end target.

Banking Sector

Davidia Zucchelli

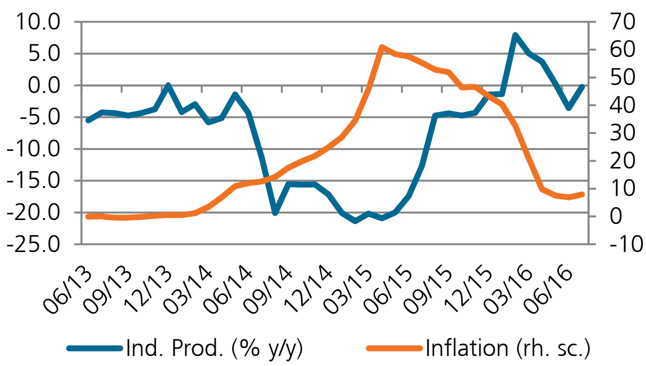
Banking aggregates remain weak. Nominal loans decreased by 8.5% yoy in July (from -7.7% in June) both in the corporate (-5.2% yoy) and in the household sector (-20.7% yoy); net of the exchange rate effect, loans declined by 19%. Deposits also showed a nominal increase (6.2% yoy in July), but fell (c.-3% yoy) net of the exchange rate. According to the latest lending survey conducted by the central bank, in 2Q16, the standards of corporate lending became tougher compared with 1Q16, and the most stringent standards were for loans to large enterprises and fx loans. The terms for loans to SMEs and LC loans softened. Over the next 12 months, banks expect corporate lending to decrease and retail lending to increase. In 2Q16, aggregate corporate sector demand for loans grew, thanks to lower interest rates, a need for debt restructuring, and borrowers' demand for working capital. Demand for SME loans and LC loans increased the most. In 2Q16, households' demand for both consumer loans and mortgages increased further, due to lower interest rates and rising expenses on durable goods. Expectations for improved quality of credit portfolios persist primarily in the corporate segment. Most banks expect deposit growth, especially in the corporate segment.

Forecasts

	2015	2016F	2017F
Real GDP yoy	-10.0	1.5	2.5
CPI avg	48.0	14.0	10.5
USD exchange rate avg	22.0	25.6	26.8
Euro Exchnage rate avg	24.4	28.5	30.5
Short-term rate avg	25.9	21.4	17.0
L/T bond yields avg	0.0	0.0	0.0
Bank lending	-3.8	2.0	3.0
Bank deposits	1.5	5.0	4.0

Source: Intesa Sanpaolo Research Department forecasts

Industrial production and inflation



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 chg yoy				FX reserves chg**			CA bal ance***	
	2Q16	1Q16	2015	Last	mth	2Q16	Last	mth	2Q16	Last	mth	2Q16	2015	2Q16	1Q16	2015	2Q16	1Q16
CEE																		
Slovakia	3.7	3.4	3.6	2.2	Jun	5.2	2.1	Jun	6.5	-0.9	Jul	-0.7	-0.3	n.s.	n.s.	n.s.	n.a.	-149
Slovenia	2.7	2.3	2.3	6.1	Jun	5.6	2.7	Jun	5.5	-0.2	Aug	-0.4	-0.8	n.s.	n.s.	n.s.	850	726
Hungary	2.6	0.9	2.9	-0.3	Jun	3.0	4.9	Jun	5.5	-0.3	Jul	-0.1	-0.1	n.a.	-2771	-4256	n.a.	1740
SEE																		
Albania	n.a.	3.0	2.6	n.a.	n.a.	n.a.	-0.6	Jul	-6.6	1.9	Jul	0.7	1.8	n.a.	n.a.	609	n.a.	n.a.
Bosnia H.	n.a.	2.1	3.0	0.4	Jul	4.7	-4.4	Jul	5.7	-1.0	Jul	-1.5	-1.0	92	-7	399	n.a.	-183
Croatia	2.8	2.7	1.6	1.2	Jul	3.6	11.0	May	n.a.	-1.5	Jul	-1.7	-0.5	-262	-508	1019	n.a.	-1588
Romania	5.9	4.3	3.7	1.1	Jun	1.1	4.9	Jun	5.3	-0.8	Jul	-2.5	-0.6	n.a.	n.a.	-3990	n.a.	-1472
Serbia	2.0	3.8	0.7	0.7	Jul	2.4	1.8	Jul	9.0	1.2	Jul	0.5	1.4	-121	-698	171	-387	-249
CIS MENA																		
Russia	-0,6	-1.2	-3.7	-0.3	Jul	1.0	-19.8	Jun	-25.6	6.9	Aug	7.4	15.8	484	9478	-18340	n.a.	11700
Ukraine	1,6	0.1	-9.9	-0.2	Jul	0.1	-10.3	Jun	-11.7	7.9	Jul	8.1	48.5	-525	-729	5741	917	-1101
Egypt	n.a.	3.8	3.5	-16.6	Jun	-15.0	1.9	Jun	0.2	14.0	Jul	12.2	10.4	985	116	1112	n.a.	-5549
m.i. E. A.	*1.6*	*1.6*	*1.7*	*0.4*	*Jun*	*0.8*	*-2.2*	*Jun*	*-0.4*	*0.2*	*Jul*	*-0.1*	*0.0*					

Source: Datastream, Reuters, Bloomberg; *Wda data for Slovakia, Slovenia; Bosnia, Croatia, Egypt; **USD for Russia, Egypt, Ukraine, Romania; ***USD for Russia, Egypt, Ukraine

Markets and Ratings

	S/T rates*		L/T rates**		Foreign exchanges***			Stock markets		CDS spread		Rating
	06/09	chg bp 3M	06/09	chg bp 3M	06/09	3M chg%	1Y chg%	3M chg%	1Y chg%	06/09	07/06	S&P
CEE						Vs Euro						
Slovakia	-0.3	0.0	0.3	-0.5	Euro	Euro	Euro	-0.4	23.6	38	46	A+
Slovenia	-0.3	0.0	0.8	-0.6	Euro	Euro	Euro	5.5	6.7	90	94	A
Hungary	0.9	-0.1	2.9	-0.4	*309.9*	-0.2	-1.4	5.6	34.1	121	153	BB+
SEE												
Albania	0.9	-0.6	n.a.	n.a.	137.4	-0.7	-1.6	n.a.	n.a.	n.d.	n.d.	B+
Bosnia H.	n.a.	n.a.	n.a.	n.a.	1.96	Board	Board	n.a.	n.a.	n.d.	n.d.	B
Croatia	0.9	0.1	3.5	-0.2	7.5	-0.4	-1.1	7.5	5.3	207	276	BB
Romania	0.6	0.0	3.0	-0.6	4.5	-1.2	0.4	7.3	-0.4	97	117	BBB-
Serbia	4.0	-0.3	n.a.	n.a.	123.4	0.0	2.5	0.6	-10.7	231	273	BB-
CIS MENA						Vs USD						
Russia	10.7	-0.7	8.3	-0.5	64.7	-2.1	-4,3	*7.8*	28.8	215	277	BB+
Ukraine	19.1	-2.2	9.7	0.0	26,8	7,5	22,0	7.7	-17.1	n.a.	n.a.	B-
Egypt	14.6	1.6	17.5	0.3	8.9	0.0	13.4	7.4	14.5	488	487	B-
m.i.A.E.	*-0.3*	*0.0*	*-0.1*	*-0.2*	*1.12*	*1,1*	*0,7*	*2.6*	*-0.8*	*11.6*	*12.4*	

Source: Datastream, Reuters, and Bloomberg;* The data for Albania refers to april and the difference is respect to January**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 Chg yoy %			NPL/Loans %			Foreign Liab. Chg yoy %			Deposits Chg yoy %			Loans rate[1]-NewB*. %				DepositsRate[1]-NewB*. %				Loans/Dep %		
	Last	Mth	2015	Last	mth	2015	Last	mth	2015	Last	Mth	2015	Last	mth	2015	S*	Last	mth	2015	S*	Last	mth	2015
CEE																							
Slovakia	7.3	Jun	8.7	5.0	Jun	5.1	15.6	Jul	1.1	8.2	Jun	9.9	2.81	Jun	2.83	C[2]	0.63	Jun	0.75	H[2]	90.6	Jun	90.0
Slovenia	-7.1	Jul	-5.2	8.0	May	9.9	-13.0	Jul	-20.7	7.7	Jul	5.8	3.1	Jul	3.45	C[2]	0.2	Jul	0.28	H[2]	0.8	Jul	89.2
Hungary	-5.7	Jul	-12.3	0.1	Mar	0.1	-9.9	Jul	-8.1	6.9	Jul	7.5	3.78	Jul	4.1	C	0.52	Jul	1.0	A	90.5	Jul	90.8
SEE																							
Albania	-0.1	Jun	-2.6	20.0	Jun	18.2	-18.7	Jun	-14.4	0.5	Jun	1.0	10.08	Jun	8.35	A	0.73	Jun	1.27	H	55.4	Jun	54.2
Bosnia H.	2.2	Jun	2.2	13.2	Mar	13.7	-7.8	Jun	-11.7	5.9	Jun	7.8	4.61	Jun	4.99	C	0.66	Jun	1.06	H	114.2	Jun	114.4
Croatia	-6.5	Jul	-3.1	15.0	Jun	16.6	-36.6	Jul	-25.1	5.8	Jul	6.4	4.56	Jul	5.08	C	1.5	Jul	2.15	H	82.9	Jul	86.5
Romania	1.0	Jul	2.7	13.5	Mar	13.5	-14.1	Feb	-10.2	11.2	Jul	9.1	3.94	Jul	4.32	C	1.01	Jul	1.48	H	88.2	Jul	89.5
Serbia	5.3	Jul	3.0	20.2	Jun	21.6	-15.6	Jul	-6.3	9.8	Jul	7.1	5.31	Jul	6.24	C	3.15	Jul	4.17	H	110.0	Jul	111.4
CIS MENA																							
Russia	8.2	May	8.2	9.7	Jun	8.3	-3.0	Mar	-0.8	16.5	May	18.8	13.06	May	13.8	C	7.04	May	8.43	H	109.8	May	108.1
Ukraine	-8.5	Jul	-3.8	29.7	Mar	28.0	-15.5	Jul	6.3	6.2	Jul	1.5	24.88	Jul	26.09	R[3]	17.18	Jul	20.06	R[3]	139.6	Jul	146.3
Egypt	14.7	May	18.0	6.8	Dec	6.8	97.4	May	91.6	19.6	May	20.4	13.4	Jun	11.8	C	7.5	Jun	6.8	H	39.5	May	38.8
m.i. E. A.	*0.6*	*May*	*0.9*	*n.a.*	*n.a.*	*n.a.*	*n.a.*	*n.a.*	*n.a.*	*3.0*	*May*	*3.3*	*1.3*	*May*	*1.5*	*C*	*0.6*	*May*	*0.6*	*H*	*82.0*	*May*	*83.1*

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

Country Outlook

The economy

GDP (% yoy)	2013	2014	2015	2016F	2017F
CEE					
Slovakia	1.4	2.5	3.6	3.5	3.3
Slovenia	-1.1	3.0	2.9	2.3	2.1
Hungary	1.9	3.7	2.9	2.1	2.5
Average	1.3	3.2	3.1	2.6	2.7
SEE					
Albania	1.1	2.0	2.6	3.0	2.8
Bosnia Herzegovina	2.4	1.1	3.2	2.4	2.7
Croatia	-1.1	-0.4	1.6	2.3	2.1
Romania	3.5	3.0	3.8	4.4	3.4
Serbia	2.6	-1.8	0.7	2.6	2.7
Average	2.5	1.5	2.8	3.6	3.0
CIS					
Russia	1.3	0.7	-3.7	-0.5	1.0
Ukraine	0.0	-6.8	-10.0	1.5	2.5
Average	1.1	-0.3	-4.5	-0.2	1.2
MENA					
Egypt	1.5	4.3	3.6	4.4	4.7
Average ISP Subsidiaries	1.4	0.8	-2.0	1.0	2.0

Inflation (average)	2013	2014	2015	2016F	2017F
CEE					
Slovakia	1.5	-0.1	-0.3	-0.6	0.3
Slovenia	1.9	0.4	-0.8	-0.4	0.5
Hungary	1.7	-0.2	-0.1	0.5	1.6
SEE					
Albania	1.9	1.6	1.9	1.3	2.0
Bosnia Herzegovina	0.0	-0.9	-1.0	-1.2	0.2
Croatia	2.2	-0.2	-0.5	-1.4	0.6
Romania	4.0	1.1	-0.6	-1.6	2.1
Serbia	7.9	2.1	1.4	1.1	2.0
CIS					
Russia	6.8	7.8	15.5	7.2	5.7
Ukraine	-0.3	12.2	48.0	14.0	10.5
MENA					
Egypt	9.5	10.1	10.4	13.2	15.0

Market

Exchange rate (average)	2013	2014	2015	2016F	2017F
CEE					
Slovakia					
Slovenia					
Hungary	297.0	308.6	310.0	312.5	312.5
SEE					
Albania	140.0	140.4	139.8	137.7	139.2
Bosnia Herzegovina	2.0	2.0	2.0	2.0	2.0
Croatia	7.6	7.6	7.6	7.6	7.6
Romania	4.4	4.4	4.4	4.5	4.5
Serbia	113.1	117.3	120.8	123.4	124.8
CSI MENA					
Russia (USD)	31.8	38.6	61.3	67.6	64.5
Ukraine (USD)	8.2	12.0	22.0	25.6	26.8
Egypt (USD)	6.9	7.1	7.7	8.9	10.4

Interest rate (average)	2013	2014	2015	2016F	2017F
CEE					
Slovakia	0.2	0.2	0.0	-0.3	-0.3
Slovenia	0.2	0.2	0.0	-0.3	-0.3
Hungary	4.3	2.4	1.7	1.0	0.6
SEE					
Albania	4.3	3.0	2.7	0.9	0.9
Bosnia Herzegovina	0.0	0.0	0.0	0.0	0.0
Croatia	1.3	0.7	1.2	0.8	0.8
Romania	4.0	2.3	1.1	0.6	0.6
Serbia	11.1	8.8	6.3	4.1	4.0
CIS MENA					
Russia	7.0	10.6	13.5	11.3	9.4
Ukraine	11.4	17.9	25.9	21.4	17.0
Egypt	12.3	11.2	11.3	14.0	14.5

Bank

Loans to private sector (% change yoy)	2013	2014	2015	2016F	2017F
CEE					
Slovakia	5.7	6.4	8.7	6.2	6.4
Slovenia	-17.4	-13.4	-5.2	-6.0	1.0
Hungary	-4.4	-0.3	-12.3	-2.5	0.5
SEE					
Albania	-1.2	2.2	-2.6	1.5	2.5
Bosnia Herzegovina	2.6	1.9	2.2	2.5	3.0
Croatia	-1.5	-2.0	-3.1	-4.8	1.1
Romania	-3.4	-3.7	2.7	2.5	3.5
Serbia	-4.9	4.4	3.0	3.0	3.2
CIS					
Russia	17.4	25.4	8.2	3.0	5.0
Ukraine	13.5	10.9	-3.8	2.0	3.0
MENA					
Egypt	7.1	12.7	18.0	14.0	13.0

Deposit by private sector (% change yoy)	2013	2014	2015	2016F	2017F
CEE					
Slovakia	4.3	3.8	9.9	4.5	4.8
Slovenia	0.0	6.6	5.8	6.0	4.8
Hungary	-1.0	1.3	7.5	2.3	2.5
SEE					
Albania	2.1	2.9	1.0	0.5	2.0
Bosnia Herzegovina	8.9	6.4	7.8	4.7	5.7
Croatia	4.9	2.3	6.4	2.5	2.4
Romania	9.3	8.9	9.1	5.0	5.5
Serbia	3.3	9.7	7.1	4.2	4.5
CIS					
Russia	16.4	27.9	18.8	5.5	6.0
Ukraine	18.5	-1.8	1.5	5.0	4.0
MENA					
Egypt	18.3	16.6	20.4	18.0	16.0

Source: Intesa Sanpaolo Research Department forecasts

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