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Monthly note

Intesa Sanpaolo
International Research
Network

The cycle is around the peak in CEE/SEE areas where inflation is picking up. C. Banks in CZ and RO have started to tighten. Growth is recovering in Russia and Egypt, where inflation and monetary rates look set to fall.

High frequency indicators still signal an overall robust economic cycle in CEE and SEE countries in 4Q17. The broad-based expansion is supported by both external and internal demand. Exports and industrial production are being driven by the good performance of the main Euro Area trade partners, especially Germany, and Italy more recently. On the domestic side, retail sales were generally strong – with growth rates ranging from 5.7% in Croatia in November to 7.7% yoy in Poland in December – supported by falling unemployment and increasing wages. Forward-looking indicators – such as PMIs and ESIs – were also above or close to historical highs in most cases.

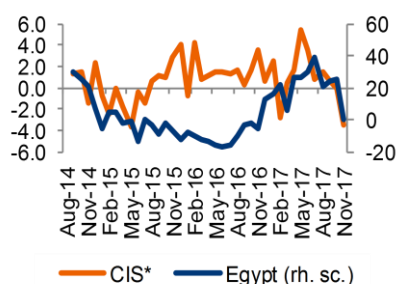
Inflation rates, which were still negative in most countries in 2016, were rising rapidly in 2017, driven by recovering oil prices, rising labour costs and buoyant demand. Changes in CPIs in Q4, nevertheless, even if often higher than in 3Q, were overall (the only exceptions being CZ and Romania) below CB targets, still supporting easy monetary stances in the CEE/SEE region. In January, in Hungary, the MNB started to implement new measures (a swap and a mortgage bond buying programme) to further target interest rates at longer maturities. In Czech Republic and Romania, CPI rose above targets, reaching 2.4% and 3.2% yoy, respectively, in December. The Czech CB opened the tightening cycle in 2H17 and in two moves the policy rate was raised to 0.50%. Further hikes are now expected in 2018. The Romanian CB, after narrowing the corridor around the policy rate in December, decided to increase it by 25bp at its meeting in January 2018.

In the CIS region, recently released activity data point to a (temporary) slowdown of GDP growth in 4Q17 both in Russia and Ukraine. Despite production cuts, the oil price recovery is still expected to support the cycle in Russia. In the MENA region, stronger-than-expected activity in 2H17 led to an upward revision (above 5%) of the official GDP growth forecast in Egypt for FY18.

On the inflation front, in the CIS area, CPI ended 2017 increasing by 2.5% (well below the 4% target) in Russia, where the CB is seen to continue to cut the policy rate in 2018. Renewed pressures meant inflation remained above the CB projection in Ukraine (13.7% at end-December). In the MENA area, in Egypt, the disinflationary process gained new steam in December, with inflation slowing to 21.9%. The Deputy Finance Minister expects inflation to hover around 10-12% during 2018. A large decline in interest rates is widely expected to take place over the year.

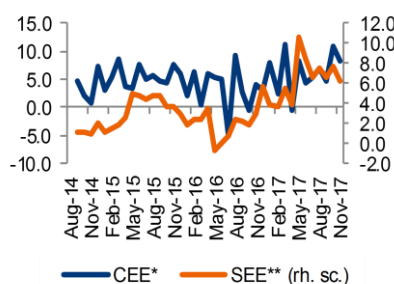
Banking aggregates generally accelerated in both the CEE and the SEE areas. Household loans were overall particularly dynamic. But, corporate loans showed a more volatile pattern in CEE countries and in Bosnia and Romania while remaining on a negative path in Albania, Croatia and Serbia. NPLs/total loans ratios continued to decline overall, but remained above 10% in several SEE countries. On the funding side, the most recent data still show significant increases of deposits from both households and corporates, often accompanied, after many years of negative changes, by a rebound in foreign liabilities in several cases. Lending growth in Russia returned to positive territory, but remained negative in Ukraine, and was still weak in Egypt, net of the accounting effect of EGP depreciation.

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, Czech Rep. and Poland 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: Slovakia, Slovenia, Hungary, Czech Republic among the CEE countries; Albania, Bosnia, Croatia, Serbia and Romania among SEE countries; Russia and Ukraine among CIS countries; Egypt among MENA countries. Among the CEE countries, it includes also Poland, where ISP is present with a Branch

The figures in this document have been updated as of 17th January 2018.

Cross Country Analysis

CEE area

The improving internal features and the positive external conditions still support solid **economic growth** in CEE countries.

Antonio Pesce

In the region, in **Czech Republic**, in November, industrial production accelerated to 8.5% yoy, above the 3Q average (5.8%). In the same month, export dynamics, though below the 3Q average, were still strong (4.7% yoy in nominal terms). Retail sales also accelerated, to 7.8% yoy in real terms, in November, supported by good conditions in the labour market, where in December the unemployment rate remained at an historical low.

High frequency indicators signal a robust economic dynamic in 4Q in **Hungary** too, where in November, industrial production and export growth, albeit below their 3Q averages, continued their strong positive growth trends (3.4% yoy and 6.1% yoy, respectively). In addition, in December, manufacturing PMI grew further, to 60, and the ESI indicator improved to 122.6. In **Slovenia**, the economic cycle is also strengthening, as both industrial production and exports grew in November (9.9% yoy and 16.2% yoy, respectively) above the 3Q average, and the ESI remained at the year's record level of 118.3 in December. Also, in **Slovakia**, economic conditions in 4Q remained solid, as highlighted by both the acceleration in industrial production to 6.2% yoy and the good performance of exports at 6.8% yoy in November. Slovak job market conditions improved further in November and the unemployment rate decreased to 5.9%.

In **Poland**, in December, industrial production slowed to 2.7% yoy, although in 4Q average growth (8.0%) was higher than in 3Q (6.4%). In the same month, retail sales confirmed a positive trend (7.7%), above the 3Q average (7.1%), sustained by falling unemployment (6.5% in December, the low for the year). The ESI improved further in December to 107.3.

Inflation declined in December in Hungary and Poland (2.1% in both countries) and Czech Republic (2.4%). In the same month, the CPI was roughly stable in Slovakia (1.9%) and increased in Slovenia (1.7%). In general, thanks to low imported inflationary pressures, inflation, even though stronger than in 3Q, is still low, with the only exception being Czech Republic, where the actual inflation rate remained above the CB's target (2.0%) in December. The National Bank increased the Czech policy rate by 20bp in July, to 0.25%, and by a further 25bp in November, to 0.50%. Following a pause in December, the Czech National Bank is likely to continue with the tightening cycle at February's meeting. **Monetary policy** in the remaining countries in the CEE region is still accommodative. This month, the Hungarian central bank initiated two new measures, announced at the November meeting, to loosen policy: a mortgage bond purchase programme and a set of interest rate swap facilities with five- and 10-year maturities.

Exchange rates vs the euro were in general stable over the last few months, with only small appreciations seen for Czech Republic and Poland, supported by export dynamics. CDS spreads decreased overall in the area.

The most recent data, as of November/October, highlighted still-positive changes in banking aggregates, although these were decelerating in the **CEE region**. Lending growth was supported by both the household and the corporate sector. Interest rates remained low, in line with money market rates.

Davidia Zucchelli

In **Czech Republic**, loans growth decelerated slightly (5.2% yoy in November from 5.6% yoy in October), supported particularly by the household sector (7.8% yoy, as in the previous month). The NPL ratio remained very low (3.9%) and on a decreasing path. This has been highlighted by rating agencies. Deposits were also dynamic (+7.7% yoy in November after +8.8% yoy in October), increasing at the same speed in the household and the corporate sectors (7.7%) despite low interest rates.

In **Hungary**, the recovery of the economy supported growth in loans to both corporates (8.4%) and households (+2.5%) which accelerated their dynamics, switching from negative changes in the first months of 2017. Total loans increased to 4.9% (from 5.1% yoy in October). NPLs continued to decrease, thanks to write- and sell-offs. Deposits remained strong (12.8% from 13.5% yoy in October), particularly from businesses (18.8% in November), but also from households (7.6%).

In **Poland**, loans showed a stable increase of around 4% yoy in the last few months, particularly in the corporate sector (+6.1% yoy in October) while the household sector recorded a lower increase (by 2.8% yoy in October). NPLs remained very low (4.1% of total loans as of June). In the case of deposits, households showed an increase of 5.3% yoy and corporates an acceleration by 6.1% yoy (from +3.4% yoy in September). Foreign liabilities continued to decline (-8.8% yoy as of October from -7.2% in September).

Lending growth continued to be strong in **Slovakia** as well (9.8% yoy in November from 10.1% in October) fuelled by economic growth and low interest rates, both in the corporate sector (by 6.9%) and especially in the household sector (by 12.7%), driven by a rise in mortgages. Deposits also grew (5.5% yoy from 4.3% yoy in October), from both households (4.9%) and corporates, (6.7% yoy). Foreign liabilities increased by 9.5% yoy in November for the first month in 2017. In contrast, foreign liabilities remained strongly negative in **Slovenia** (-14.9% yoy in November). The recovery of total loans has been confirmed (+5.5% yoy from +5.7% in October), particularly in households (+6.9%) while loans to corporates increased by 4.1% yoy in November. NPLs amounted to 6.7% of total loans as of November. As far as deposits are concerned (+7.4% yoy in November in the private sector), corporate deposits accelerated (11.8% from 9.8% yoy in October) while deposits from households increased by 5.9% yoy (as in the previous month).

SEE area

Among **SEE** countries, the consolidation of the **economic cycle** has been confirmed by the latest high frequency data as well. In **Romania**, industrial production (9.2% yoy), exports (8.9% yoy) and retail trade (11.7% yoy) remained strong in November and above the 3Q average. Moreover, the unemployment rate was at its lowest level (4.0%) in the year. In December, the ESI was still very high, albeit slightly lower than the year average.

Antonio Pesce

In **Serbia**, in November, industrial production continued its strong positive growth trend (5.5%), though it was below the 3Q average (see exports at 9.0% yoy in November). In the same month, retail trade accelerated (to 2.9% yoy from 2.5% yoy in October).

In **Croatia**, in November, after six months of positive growth trends, industrial production recorded a negative change, but this was mainly due to a base effect. Preliminary data on exports signal still strong growth, above 10% yoy in November. In the same month, retail trade accelerated to 5.7% yoy, above the 3Q average growth rate. The export dynamic remained very strong in double digits in November in **Albania** and **Bosnia** as well (11.1% yoy and 15.8% yoy, respectively).

In December, **inflation** was roughly stable and remained above 3Q averages in the SEE region. However, it surged in Romania, where it climbed to a four-year high of 3.3%. It is now approaching the upper end of the central bank's target interval (2.5%+/-1.0%). With the economy growing rapidly and inflation pressure rising, in January, the Romanian CB decided to raise the policy rate by 25bp, to 2.0%, for the first time in nine years. We now expect further monetary tightening, although prudent, in the next months. At their last board meetings, all the other central banks of SEE countries with ISP subsidiaries confirmed their easing **monetary policies**.

Exchange rates in the region were roughly stable vs the euro in the last months, with some appreciation due to the good performance of exports. CDS spreads fell further in the area.

Regarding **banking aggregates**, in November, lending confirmed previous performances in **SEE countries**. The corporate sector remained fragile in Albania, Croatia and Serbia. Despite low interest rates, deposits increased in every country but at a decelerating pace.

Davidia Zucchelli

In **Albania**, loans remained unchanged (+0.1% yoy in November), but lending activity still decreased by 2% yoy in November (from -1.6% yoy in October) to corporates while accelerating slightly to +5% yoy in November from 4.7% in October to households. Despite the write-offs, NPLs remained at 14.3% of total loans. Loans in foreign currency continued to decrease (-4.6% yoy) only in the corporate sector (-6.1% yoy), where they account for 57% of total loans. In the household sector, they remained stable (+0.05%). Deposits were roughly stable in the private sector (0.05% yoy) in November; household deposits fell, however (-2.3%), while deposits from businesses increased substantially (12.9%) again, which, as highlighted in previous months, was probably connected to weak investments.

In **Bosnia**, banking aggregates continued on a positive trend, with loans increasing by 7.3% yoy in November and deposits by 8.8% yoy (by 13% yoy for corporates and by 7% yoy for households). In **Croatia**, because of tightening standard conditions, loans increased slightly, by 0.2% yoy, in November (from -0.05% yoy in October). Corporate loans remained particularly fragile (-1% yoy), but appeared to be improving, while household loans increased by 1.1% yoy. Deposits continued to grow (2.5% from 3.2% yoy in October), particularly from businesses (7.6%), while households remained stable (1%).

In **Romania**, loans increased in November (6.4% yoy from 6.2% yoy in October), particularly in the household sector (7.8% yoy), but loans to corporates confirmed a +5.0% yoy increase as in the previous month. NPLs continued to decrease (to 7.96% of total loans). Deposits performed well (11.3% from 12.7% in October).

In **Serbia**, loans grew by 2.6% yoy in November (from 2.2% yoy in October). Total loans were driven by loans to households (8.5% yoy from 8.7% yoy), while loans to corporates declined (-1.7% yoy) as a consequence of a strong decrease in loans denominated in domestic currency (-11%) and an increase of loans in foreign currency (+2.1% yoy). Deposits continued to perform well (5.3% yoy, 11.8% from corporates and 2% from households). Deposits in foreign currency accounted for 71% of the total (85% in the household sector and 46% in the corporate sector).

CIS and MENA areas

In **Russia**, GDP shrank 0.3% yoy in November, after growing 1% yoy in October. These numbers compare with a 1.8% annual increase in GDP in Q3. The slowdown seen in the final months of last year reflects the drop of mining (-1% in November), manufacturing production (-4.7% in November), utilities (output fell by more than 6% in November for weather-related reasons) and construction activity (-1.1% in November and -3.1% in October). Agriculture output, after falling by 2.1% in October, rebounded in November (+1.2%). Retail sales, sustained by low inflation and falling interest rates, remained a bright spot, posting a 2.9% gain in October-November.

High frequency indicators suggest the Russian economy will continue along an expansionary path this year. The manufacturing and the services PMI indices were well above the 50 threshold in December (at 52 and 56.8, respectively).

Inflation ended 2017 at 2.5%, well below the Russian Central Bank (RCB) target of 4%. The RCB, which cut its main policy rate again in December (by 50bp, to 7.75%) is expected to continue its easing cycle this year to achieve its objective of a key rate in the range of 6-7%. The next policy meeting is scheduled for 9 February.

Annual inflation in **Ukraine** accelerated to 13.7% last December compared with 12.4% in the same month of 2016. Average inflation also rose, to 14.4% in 2017 from 13.9% a year earlier. Due to stronger-than-expected inflationary pressures, the Ukraine Central Bank shifted its policy stance in the final months of 2017, raising its policy rate both in October and December for a total of 200bp, which ended last year at 14.5%, 50bp above the previous year's close. Industrial production, still negatively affected by the Donbass blockade, recovered some ground in the closing months of 2017 (+0.4% in October-November), but still-weak agricultural output (-2.6% in the same months) probably led to a slowdown in the pace of GDP growth in 4Q17 compared to the 2.1% yoy increase recorded in Q3.

Giancarlo Frigoli

The IMF has told the Ukrainian authorities that it does not support the draft of the law to create an anti-corruption court because the bill would not guarantee its independence. Progress on reforms stalled last year, raising concerns. The Ukrainian authorities are backtracking on commitments and unpopular policy changes in anticipation of presidential and parliamentary elections in 2019. Establishing the anti-corruption court, sticking to gas price adjustments, and implementing sustainable pension reforms are the key conditions Ukraine must meet to qualify for the next loan tranche of around USD2bn from the IMF.

In **Egypt**, a recent report showed that the planning ministry has revised up to 5.2-5.3% (from 4.8% previously) its forecast for GDP growth in FY18. This upgrade followed strong activity numbers in the first half of the fiscal year which started in July 2017 and will end in June 2018. Real GDP rose 5.2% yoy in the first quarter of the fiscal year and a similar pace was expected by the Egyptian authorities in the October-December period, the second quarter of the fiscal year. The boost mainly came from tourism-related activities and infrastructure investments. Headline inflation slowed to 21.9% in December, from 26% in November. After peaking at 33% in July 2017, inflation has started to decline which is expected to continue this year. Subsiding pressures are expected to create favourable conditions for the start of an easing cycle. The latest review by the IMF found that Egypt's economy is showing welcome sign of stabilization. The completion of the review should pave the way for the transfer of another USD2bn loan disbursement, part of a three-year, USD12bn bailout package to support the country's battered economy. The transfer would bring the total payout to Egypt since it secured the package in November 2016 to USD6.08bn.

In **Russia**, bank lending increased again in October (1.7% yoy from 1.4%) because of a new significant rise in the household sector (+9.9% yoy from 8.7% yoy). In contrast, corporate lending, which accounts for around 74% of loans to the private sector, showed a further decrease (-0.8% from -0.9% at September). In more detail, loans denominated in foreign currency declined by 19% yoy in the corporate sector, while loans in rubles increased by 8% yoy. In October, deposits increased by 4.3% yoy (from 4.4% in September). In line with official rates, interest rates on new loans to businesses declined to 9.8% (from 10.0%), but the interest rate on deposits from households continued to follow a more unclear trend, increasing to 5.67% (from 5.31%).

Davidia Zucchelli

Lending in **Ukraine** showed a further decrease in November (-0.7% from -0.9% yoy in October). Loans to corporates decreased by 1.3% (the share of corporate loans to the private sector is over 80%) while household loans increased again (by 1.9% yoy after +3.8% yoy in October). Deposits increased by 9.6% (with respect to 8.1% yoy in October) both from corporates (10.6% in November from 9.5% due to a lack of investment opportunities) and households (9.1% from 7.4%). NPLs remained unsustainable (over 56% of total loans). The spread widened to 1.5pp from 0.8pp.

In **Egypt**, in September, loans and deposits grew strongly (nominally by 33% and 45%, respectively), still due to the accounting effect of the local currency depreciation (net of that effect, performances are estimated at 3% and 21%, respectively). The FX effect was stronger in the corporate sector, where loans in foreign currency accounted for around 40% of total loans, while in the household sector, they accounted for just 3% of the total. Deposits increased, both from corporates (25%) and households (51%). The LTD ratio remained very low (35% and decreasing month on month from 39.2% in December 2016). In line with official rates, lending interest rates on new business increased to 19.6% in September (from 16.3% in December 2016) and deposit interest rates rose to 13.4% (from 10.3% in December 2016).

Country-Specific Analysis

Albania

Real Economy

In 3Q17, GDP recorded growth of 3.6%, higher than the 3.1% recorded in 3Q16, but lower than the 4.1% in 2Q17. Growth is being driven by a combination of private domestic demand, reforms that improve the business climate, strengthening of external markets, and further major construction work on large energy-related foreign direct investment, including the TAP. A recovery in the labour market and household credit, supported by accommodative monetary policy, boosted private consumption. Household consumption expanded by 3.25% in 3Q17. The unemployment rate in 3Q17 decreased to 13.6% from 14.7% in the previous year. Exports in November 2017 expanded by 11% and imports by 10.50%. The current account deficit is predominantly funded by concessional borrowing and large FDI inflows, while official foreign reserves are ample. Public debt/GDP is improving from 73.3% in 2016 to 71.5% projected for 2017.

Kledi Gjordeni

Financial Markets

The central bank continues to view the current accommodative monetary policy stance as appropriate. The policy rate has been at a historical low of 1.25% since May 2016. Monetary policy tightening is not expected to take place until at least the second half of 2018. In December 2017, the CPI was 1.8%, lower than the 2.2% recorded the previous year. However, inflation is expected to rise, due to stronger domestic demand and food price hikes. The exchange rate remains stable, with the EUR/LEK around the 133.25 level.

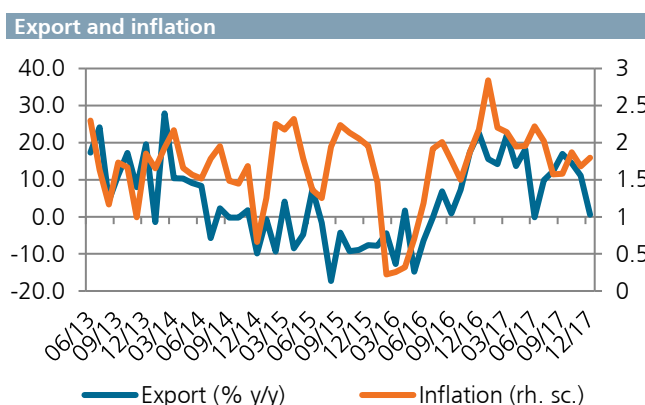
Banking Sector

According to the Albanian Association of Banks, in November 2017, total assets increased by 3.55% yoy. Total loans to the private sector grew slightly, by 0.12% yoy, thanks to an increase in households loans of 4.97%, while corporate loan shrank by 1.96%. Credit to the private sector was significantly affected by write-offs of NPL and the CB's proactive approach in facilitating the resolution of large borrowers' NPLs. NPL sales have been limited, due to low expected recovery rates and tax impediments. Banks restructured loans after sizeable haircuts.

Adjusted for write-offs, credit grew by around 3% yoy in 2Q17. Despite the easy monetary policy and excess liquidity, credit growth remains stagnant as banks continue to clean up their balance sheets and maintain prudent lending policies, though foreign placements are increasing. Credit penetration remains low by regional standards, reflecting structural challenges, such as low income, informality of the economy, lack of credit scoring, and a weak collateral execution framework. Compared to November 2016, total deposits in November 2017 remained almost unchanged, at a 0.05% increase. Corporate deposits expanded by double digits, at almost 13%, whereas household deposits shrank by 2.35% yoy.

Last macroeconomic indicators			
%	Last value 3Q 2017 2Q 2017		
Industrial production, wda yoy	n.a.	n.a.	n.a.
Export of goods, nominal yoy	11.1 (Nov)	13.2	10.5
Unemployment rate	n.a.	13.6	13.9
Inflation rate, average yoy	1.8 (Dec)	1.7	2.0
Loans (private sector, yoy, eop)	0.1 (Nov)	0.7	-1.7
Deposits (private sector, yoy, eop)	0.1 (Nov)	0.2	1.3

Source: INSTAT, Central Bank of Albania



Source: INSTAT

Bosnia and Herzegovina

Real Economy

The first days of 2018 brought extensive revisions to GDP data, as 1Q17 growth was upgraded to 3.2% (from 2.8%) and 2Q growth to 2.9% yoy (from a surprisingly low 1.7%). Revised 2Q data mainly referred to a lower decline in the agriculture sector's GVA (-6.7% vs -7.8% yoy); lower growth in the manufacturing sector's GVA (1.8% vs 3.1% yoy); a significantly better performance in construction, as GVA growth was revised from -1.1% yoy to +1.2% yoy; and stronger growth in trade, transportation and accommodation services (8.1% vs 4.4% yoy). As 3Q GDP grew by 2.9% yoy (strengthening to 1.4% qoq), our December revisions to 2017 and 2018 estimates (2017 to 2.6% from 3.0% and 2018 to 2.9% yoy from 3.2%) will most likely be exceeded. 3Q GDP growth was driven by strong performances in manufacturing (7.5% yoy) and trade, transport and accommodation services (6.9% yoy), as well as solid 1.5% yoy growth in construction. Thus, all sectors except agriculture (-3.8% yoy) and professional/support services (-3.7% yoy) recorded positive growth in GVA. According to high frequency data, 2017 closed on a similar positive note, with industrial production growth of 3.3% in October, supported by 18% yoy growth in exports (October-November) and 4.7% yoy expansion in retail trade volume.

Ivana Jović

In the meantime, as parliament adopted new Excise Law as well as the federation's 2018 budget, the only open issue for disbursement of the second tranche of the IMF's EFF (EUR76mn) remains the initiation of due diligence procedures for two state-owned telecom companies. The first review will be made by the IMF's Executive Board on 9 February.

Banking Sector

Private sector loan growth in November was consistent for the third consecutive month at +7.3% yoy. Loans to non-financial corporations rose by 7.9% yoy in November, the same level as in the previous two months. Growth of household loans was 6.7% yoy, unchanged mom. The breakdown of household loans by purpose shows that the rise in consumer loans moderated somewhat to +8.1% yoy, whereas housing and credit card loans continued to recover gradually, rising by 3.5% and 2.5% yoy, respectively. Deposit growth softened from +10.2% yoy in October to +8.8% yoy in November, mostly due to a milder increase in corporate deposits (13.1% yoy vs 16.6% a month before). Household deposits continued at their pace of +7% yoy, recording a 7.1% yoy increase in November.

Ana Lokin

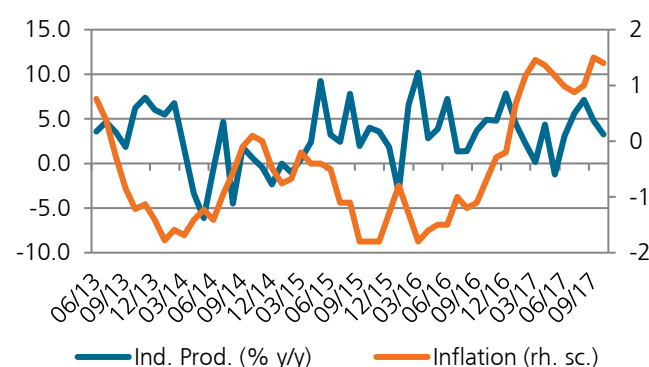
Positive developments in asset quality continued in 3Q, when the total NPL ratio dropped by 0.3 pp qoq to 10.8%. The NPL ratio of non-financial corporations fell by 0.4 pp qoq, to 13.5% and the NPL ratio of households by 0.3 pp qoq, to 7.7%. In 3Q, ROAA remained unchanged qoq at 1.7%, while ROAE decreased to 11.7%.

Latest macroeconomic indicators

%	Last value	3Q 2017	2Q 2017
Industrial production, wda yoy	3.3 (Oct)	5.8	2.1
Export of goods, nominal yoy	15.8 (Nov)	22.7	13.7
Retail trade, real, wda yoy	4.7 (Oct)	4.3	5.6
Inflation rate, average yoy	1.2 (Nov)	1.1	1.2
Loans (private sector, yoy, eop)	7.3 (Nov)	7.3	6.2
Deposits (private sector, yoy, eop)	8.8 (Nov)	8.9	9.1

Source: BHAS, CBBH

Industrial production and inflation



Source: Labour and employment agency

Croatia

Real Economy

High frequency data for 4Q17 point to a continuation of positive trends, as real retail trade rose by an average of 4.3% yoy in the October-November period (supported by improving consumer confidence, based on rising wages and declining unemployment) while exports advanced by 15% yoy in October and by 10.7% yoy in November (preliminary, with a record high coverage rate of 77.7% reported). Meanwhile, industrial production posted a somewhat more moderate growth rate of 1.3% yoy in the same period, reflecting a poor performance in manufacturing in November (which saw a decrease of 1.5% yoy).

Ivan Odrčić

Inflation eased to 1.2% yoy in December while average 2017 inflation, after three years of deflation, amounted to 1.1%, amid rising prices for food/oil as well as higher prices in catering services. Meanwhile, falling prices of housing (lower gas and electricity prices) made the largest negative contribution to the CPI.

Financial Markets

Liquidity broke records in the December-January period, boosted by two CNB FX interventions during which EUR751M was purchased from banks. The average 3M Zibor in December slipped by 2bps mom to 0.55%; in January, it has remained around 0.5%. Appreciation pressures on the kuna were strong, but the rate stabilised via FX interventions. Thus, the average EUR/HRK rate in December was unchanged mom at 7.54 (2017 average: 7.46, -0.9% yoy). In January, the kuna was at 7.4. Average 10Y government bond yield went down by 15bps mom in December, to 2.35%, in January the trend retained and the average yield declined towards 2.2%. On 12 January, Fitch upgraded its long-term rating in local and foreign currency to BB+ (from BB) with a Stable outlook, which is a return to the level held in August 2014.

Ana Lokin

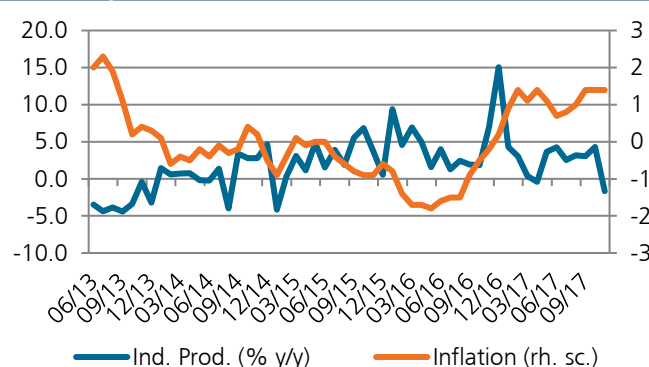
Banking Sector

Loans bounced back in November, posting a 0.2% yoy increase that was, however, solely the result of a 1.1% yoy rise in household loans. Loans to NFC continued on a volatile path, recording a 1.0% yoy drop. Housing loans, after two years of negative trends, finally gained ground in November, marking 0.9% yoy growth. Data on transactions continue to show somewhat different trends and a speed-up of private sector demand to +3.0% yoy. Deposit growth slowed to 2.5% yoy in November, due to a more moderate rise in corporate deposits of 7.7% yoy while household deposits rose by 1.0% yoy (FX-adjusted +1.5% yoy). Outflow of citizens' euro savings, which had stopped in July-September, resumed from October, mainly affected by low savings interest rates (0.4% on euro savings deposits). As a result of more sales of non-performing portfolios, the NPL ratio dropped by 1.4pp qoq, to 12.5%, due to a 2.6pp qoq fall in the corporate NPL ratio (to 25.9%) and a 1.3pp qoq decline in the household ratio (to 8.8%).

Latest economic indicators			
%	Last value	3Q 2017	2Q 2017
Industrial production, wda yoy	-1.6 (Nov)	2.9	2.5
Export of goods, nominal yoy	15.0 (Oct)	11.6	8.0
Retail trade, real, wda yoy	5.7 (Nov)	5.6	4.8
ESI (index)	118.4 (Dec)	116.4	115.8
Inflation rate, average yoy	1.2 (Dec)	1.1	1.1
Loans (priv. sector, yoy, eop)	0.2 (Nov)	0.3	-1.3
Deposits (priv. sector, yoy, eop)	2.5 (Nov)	3.1	1.9

Source: CBS, EC, CNB

Industrial production and inflation



Source: EC

Czech Republic

Real Economy

The Czech economy continues to boom. In 3Q17, GDP printed 5.0% yoy growth, up from an already torrid 4.7% gain in the previous quarter. Strong growth continued in the final quarter of 2017 as well, with industrial production up 8.5% yoy in November and retail sales up 7.8%. Inflation decelerated a bit, to 2.4% in December from 2.6% in November and 2.9% in October. However, this deceleration is mainly a result of base effects linked to increased prices for food and restaurant services a year ago. The underlying strong inflation story remains intact.

Zdenko Štefanides

Other inflation indicators remained strong as well. Nominal wages grew by 6.8% yoy in 3Q, reflecting the extremely tight labour market, with an EU-low unemployment rate of 2.5% for November. Real estate prices continued their fastest growth rates in the EU. Especially fast growing are property prices in Prague: prices for new flats in the city were up 16.4% yoy in 3Q17 from an already torrid 14.1% growth rate in 1H17. Prices for older flats have eased, with yoy growth down from the 18.0% pace in 1H17. But, growth is still strong at 16.0% yoy. CNB research estimates that property prices in Prague are some 10-15% overvalued. In addition, property prices outside the capital continued to rise, at 15.2% yoy in 3Q.

Financial Markets

Given a booming economy and above-target inflation, the CNB remains hawkish and prospective rate hikes remain a question of when rather than if. CNB representatives recently mooted at least two rate hikes this year. After a pause in December, when only two of seven board members voted for a hike, it looks very likely that a rise will be agreed at the meeting on 1 February, the third since the beginning of the tightening cycle in August of last year. The repo rate, currently at 0.50%, is likely to remain well below the CNB-estimated neutral rate of 3.0% and therefore even CNB board members admit it is possible that there will be more rate hikes this year. In addition to the economy, the rate path depends mainly on the koruna exchange rate, which continues to appreciate and therefore delivers part of the needed monetary tightening. At 25.40 vs the euro, the koruna has gained a further 0.5% in value this year.

Banking Sector

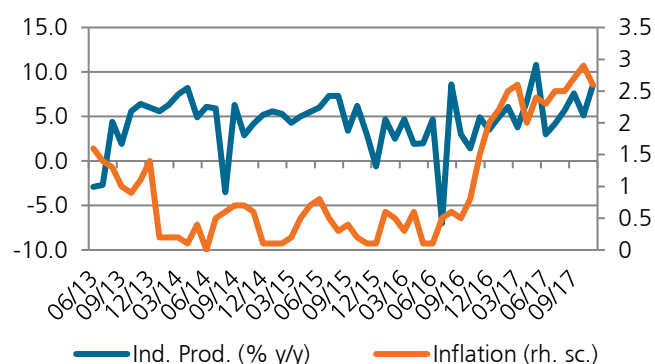
The fast-growing credit market is the key factor fueling the property market boom. The central bank is thus trying to slow it down by tightening credit conditions. It nonetheless remains that some measures the CNB is trying to deploy are not legally binding for banks. An attempt to gain more regulatory power last year in this area through an amendment to the CNB Act was not been successful, as parliament, divided by upcoming parliamentary elections in October, rejected it. Nonetheless, the CNB aims to make a second attempt at revisions in order to provide it with broader a mandate to regulate the mortgage market.

Latest economic indicators

%	Last value	3Q 2017	2Q 2017
Industrial production, wda yoy	8.5 (Nov)	5.8	6.8
Export of goods, nominal yoy	4.7 (Nov)	4.8	4.6
ECB refi rate	0.5 (23th Jan)	0.2	0.0
ESI (index)	108.4 (Dec)	108.4	106.9
Inflation rate, average yoy	2.4 (Dec)	2.6	2.2
Loans (priv sector, yoy, eop)	5.2 (Nov)	6.5	7.3
Deposits (priv sector, yoy, eop)	7.7 (Nov)	8.9	9.6

Source: CBS, EC, CNB

Industrial production and inflation



Source: EC

Egypt

Real Economy

GDP grew 5.2% in 1Q FY2017/18 compared to 3.4% in 1Q FY2016/17, supported by improvements in different sectors, especially tourism (Egypt's tourism revenues increased in 2017 by 123.5% yoy, to USD7.6Bn, with expectations of further improvement after the resumption of flights between Egypt and Russia) and constructions (which was positively affected by the expansion in infrastructure projects all over the country). The floating of the Egyptian pound in November 2016 also helped restore the economy's competitiveness, with exports rising by almost 16% in 2017 compared with 2016. The Egyptian government targets to accelerate economic growth to 5.3-5.5% in FY2017/18 and aims to attract more foreign investment, to reach around USD12bn. In January 2018, Fitch revised its outlook on Egypt's Long-Term Foreign Currency Issuer Default Rating (IDR) to Positive from Stable, and affirmed the IDR rating at 'B'.

Samer Halim

Financial Markets

Annual headline inflation continued to decrease for the fifth month in a row, to a record 21.9% in December 2017, compared to 26% in November 2017. The deputy finance minister has expressed expectations that inflation will hover around 10-12% during 2018, and fall below 10% in 2019. At its 28 December meeting, the Monetary Policy Committee kept the overnight deposit and lending rates unchanged at 18.75% and 19.75%, respectively. A downward trend in interest rates is expected to be considered in the upcoming period on the back of the fall in inflation, with the chairman of the stock exchange expecting an aggressive decline in core interest rates.

The USD exchange rate against the EGP has stabilised, reaching EGP17.70 on average since the beginning of 2018. Net international reserves stood at their highest level since 2011, at USD37.02bn in December 2017.

Banking Sector

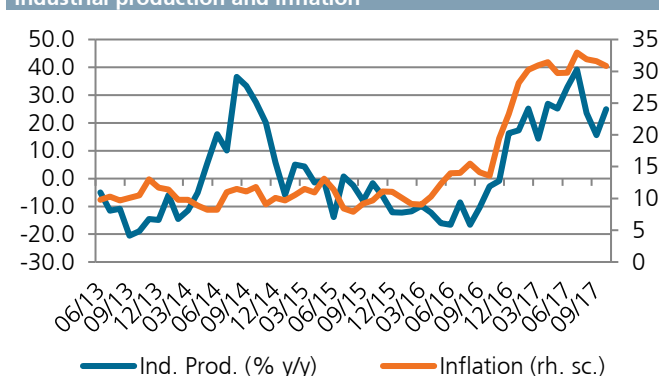
Total bank loans to the private sector reached EGP 901.4bn in September 2017, up 33.4% yoy, while private sector deposits reached EGP 2.5tn, up 45.3% yoy, impacted by the value increase of FC loans and deposits after the currency devaluation (FC loans and deposits rose by 65.3% and 103.5%, respectively). Total loans to the corporate sector accounted for 73% of total private loans, while household deposits accounted for 81% of total private deposits. The IMF's second review regarding Egypt's reform programme revealed that the banking sector is resilient to moderate shocks and banks' capital and operating profits are sufficient to absorb possible loan impairments.

Latest economic indicators

%	Last value	3Q 2017	2Q 2017
Industrial production, wda yoy	24.9 (Oct)	26.1	28.3
Nom exports yoy	21.5 (Oct)	13.7	4.8
Retail Sales yoy	n.a.	n.a.	n.a.
Inflation rate yoy	21.9 (Dec)	32.1	30.3
CB eference rate	18.8 (23th Jan)	18.8	16.8
Loans (priv sector, yoy, eop)	33.4 (Sep)	33.4	37.0
Deposits (priv sector, yoy, eop)	45.3 (Sep)	45.3	43.3

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

Industrial production and inflation



Source: Ministry of Planning, CAPMAS

Hungary

Real Economy

Sandor Jobbagy

GDP growth surged to 3.9% yoy in 3Q17, following a 3.3% (both upwardly revised) result in the second quarter of the year. The revised 3Q figure was higher than expected, with a significant +0.3pp revision vs the preliminary figure. Growth was primarily driven by market-based services. The value added of industry also rose – not only in the case of car production, but in all major branches. In addition to EU-funded projects, investment dynamics are becoming more broad-based. While private investments are still weaker, investments in construction, machinery and equipment rose in 3Q17.

The rise of sentiment indicators continued in 3Q17 as well as in the last quarter of 2017. External balances remained solid, with both exports and imports on the rise. Fiscal policy also provided more support to growth than in 2016.

Headline CPI was 2.1% in December, making the 2017 full-year average 2.4%. Core inflation remained above the headline in Q4, but the annual average was only 2.3%. Domestic demand also appears to be getting stronger, primarily due to higher wages. Industrial production reported a weaker-than-average performance in November (3.4% yoy).

Financial Markets

The NBH left the policy rate unchanged (0.90%) in Q4. The O/N depo rate also remained at -0.15% in this period. The end-Q4 target for the 3M depo was cut to HUF75bn and no further changes appear to be planned for 2018. The NBH has started to implement new measures (a swap programme and a mortgage paper buying programme) to target longer maturities too. The market adjustment has been ongoing, with essentially the entire yield curve close to historical lows. The forint has remained in its 305-315 range vs the euro, staying close to the middle of this band most recently.

Banking Sector

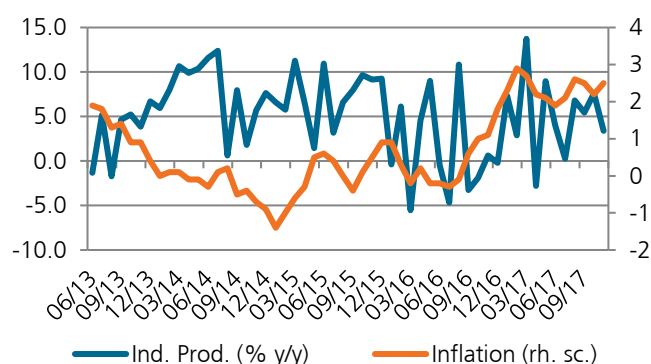
Loan stocks to the private sector showed persistent rises from May to November, with the yoy dynamics reaching close to 5%. Lending continued to households, and also revived in the corporate sector. Deposit volumes have continued to increase, despite the low interest rates. Real economic development lent support to the demand side of the loan market; credit conditions continued to ease. Household demand for housing and personal loans remained relatively strong. The quality of the banking sector's entire loan portfolio continued to improve, with NPLs below 7%, according to the latest data.

Latest economic indicators

%	Last value	3Q 2017	2Q 2017
Ind production yoy	3.4 (Nov)	4.2	3.4
Nom exports yoy	6.1 (Nov)	6.9	7.5
ESI (index)	122.6 (Dec)	121.9	118.6
Retail sales yoy	6.4 (Nov)	4.8	4.8
Inflation rate yoy	2.1 (Dec)	2.4	2.1
CB reference rate	0.9 (23th Jan)	0.9	0.9
Loans (priv sector, yoy, eop)	4.9 (Nov)	4.6	2.3
Deposits (priv sector, yoy, eop)	12.8 (Nov)	13.5	11.3

Source: CSO, NBH, Bloomberg

Industrial production and inflation



Source: CSO

Poland

Real Economy

Sandor Jobbagy

GDP growth jumped to 4.9% yoy in 3Q17, the highest level so far in 2017, following a 4.0% performance in the second quarter of the year. Economic growth was supported by relatively strong private consumption. Industrial performance also improved, though investments struggled to rise despite the low 2016 base. Judicial reforms and conflicts with the EU have so far not had an adverse impact on overall GD growth and the outlook. The rise of sentiment indicators also continued at a strong pace in 4Q17, similar to the situation in the preceding quarters of 2017. External balances deteriorated somewhat in terms of trade, while the current account balance showed a consistent moderate deficit. Fiscal policy remained in check, as shown by the annual deficit.

Headline CPI edged down to 2.1% in December, making the 2017 full-year average 2.0%. Core inflation remained below 1% in Q4, as it did in most of 2017. Domestic demand and rising wages have had a limited impact on inflation so far. Industrial production showed some slowdown towards the year-end (3.5% yoy in December).

Financial Markets

The NBP left its policy rate unchanged (1.50%) in Q4 and in January, similar to its stance over the whole of 2017. The most recent monetary decisions continued to be supported by the moderate rise of domestic price levels, in addition to favourable external conditions, in particular, the loose policy of the ECB. At the same time, the central bank expressed concern about food price growth (which has been markedly higher than in the preceding quarters of 2017) and accelerating wage growth. Policymakers' comments suggest that they may tighten in 2018.

Partly in connection with monetary expectations, the zloty appreciated in 4Q17, though this process slowed down slightly (in the range of 4.15-20 vs the euro) at the beginning of 2018.

Banking Sector

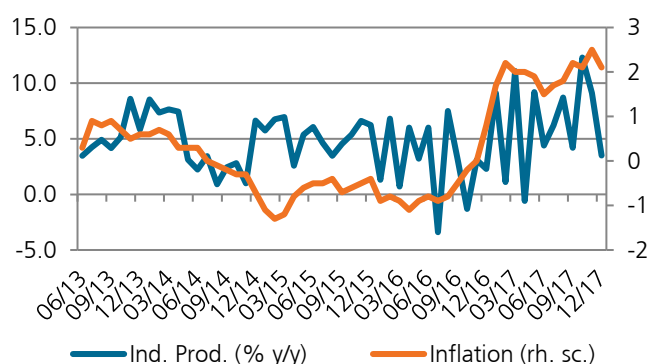
Loan stocks to the private sector showed persistent rises throughout 2017, though at a somewhat moderated pace in September and October. The yoy dynamic has been close to 4%. Lending activity slowed down somewhat to both households and the corporate sector. Deposit volumes have continued to increase, despite relatively low (though not decreasing) interest rates. The quality of the banking sector's entire loan portfolio remained solid, with low average NPL ratios.

Latest economic indicators

%	Last value	3Q 2017	2Q 2017
Ind production yoy	3.5 (Dec)	6.4	4.3
Nom exports yoy	8.8 (Aug)	7.4	1.8
ESI (index)	107.3 (Dec)	105.4	104.0
Retail sales yoy	7.7 (Dec)	7.1	6.6
Inflation rate yoy	2.1 (Dec)	1.9	1.8
CB reference rate	1.5 (23th Jan)	1.5	1.5
Loans (priv sector, yoy, eop)	3.9 (Oct)	4.2	3.9
Deposits (priv sector, yoy, eop)	5.5 (Oct)	4.9	4.6

Source: CSO, NBH, Bloomberg

Industrial production and inflation



Source: CSO

Romania

Real Economy

The Eurozone's robust growth and widespread domestic fiscal stimulus continue to be the main drivers of Romania's (top of the EU) economic growth. Although industrial production slowed somewhat in November 2017 (to 9.2% yoy from 11.6% yoy the previous month), the sector continues to be supported by external demand. The strong fiscal stimulus is most clearly seen in the retail sales performance (+11.4% yoy in November 2017), with pressures on the inflation rate (+3.32% yoy in December). GDP for 4Q17 is likely to have been well supported, and real growth for the full year (2017) looks to be on track to be the strongest since 2008.

The increase in public expenses in 2017, financed by temporary revenues, has reduced the fiscal space in 2018 required to achieve the 3% budget deficit target. Consequently, market expectations are that additional revenue sources will likely be introduced over the course of 2018 -- for example, by administered price increases with possible further pressure on inflation.

Financial Markets

Higher public sector wages and entitlement policies pushed up demand for imports and thus the trade deficit increased, putting pressure on the nominal exchange rate of the RON. Political noise compounded an already unfavourable RON environment, and the EUR/RON exchange rate reached new all-time highs. Higher inflation (and rapidly growing inflation expectations) put upward pressure on money market rates and on local currency bonds.

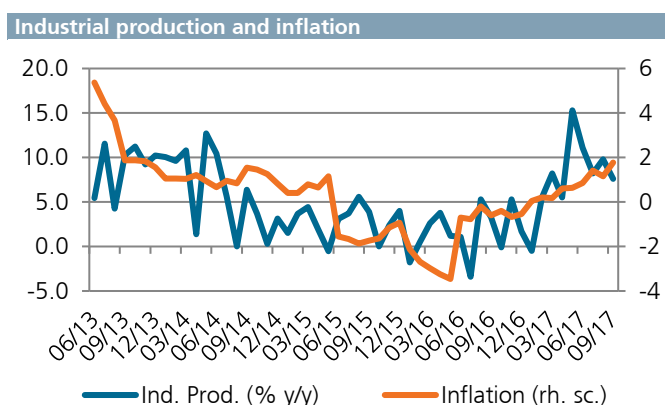
The inflationary environment also activated the reaction function of the NBR, which started a tightening cycle (by narrowing the monetary policy rate corridor, in two consecutive 25bp moves, and by a 25bp policy rate hike to 2.00%). Although inflationary pressures are expected to abate somewhat after 1Q18, it is likely that inflationary pressures will be persistent enough to keep upward pressure on local currency bond yields and downward pressure on the purchasing power of the RON, and thus the central bank will likely continue its tightening cycle through 2018.

Banking Sector

The higher RON rates environment is likely to be a net positive for the banking industry in 2018. While the corporate sector's capacity to borrow and to negotiate is likely to generate new business (November 2017 new loans reached RON107.3bn vs new deposits of RON102.1bn), the household sector is likely to be motivated to save in a higher rates environment (November 2017 new loans of RON121.6bn vs new deposits of RON173.9bn). Hence, the loan/deposit ratio is likely to stay stable near the current levels (November 2017 was 82.96%).

Latest Economic Indicators				
%	Last value	3Q 2017	2Q 2017	
Ind. Production yoy	9.2 (Nov)	7.3	8.7	
Nom. Exports yoy	8.9 (Nov)	8.4	7.8	
ESI (index)	104.1 (Dec)	104.9	105.4	
Retail Sales yoy	11.7 (Nov)	11.2	8.3	
Inflation Rate yoy	3.3 (Dec)	1.4	0.7	
CB Reference Rate	2.0 (24th Jan)	1.8	1.8	
Loans (priv. sector, yoy, eop)	6.4 (Nov)	7.1	3.8	
Deposits (priv. sector, yoy, eop)	11.3 (Nov)	11.8	8.9	

Source: Intesa Sanpaolo Research Department forecasts



Source: NBR

Russia

Real Economy

Industrial production for November showed an unexpected decrease of 3.6% which was mainly caused by temporary factors. In December, yoy inflation remained at the November level (2.5%), reaching the lowest level in the recent history of Russia which reflects a good basic performance from the economy. The Bank of Russia expects that inflation will be around the target level of 4% by the end of 2018 and has signalled that monetary policy will be gradually moving from moderately tight to neutral. In 4Q17, the increased supply volumes on the agricultural market continued to put downward pressure on growth rates of consumer prices. This situation was associated with increased crops and a shortage of storage capacity. Most of the factors associated with the crop of 2017 will cease to exert disinflationary influence in 1H18. The contribution of exchange rate dynamics to the slowing of annual inflation decreases will be exhausted in 1Q18. Inflationary expectations decreased, but are still unstable. The market believes the CBR will continue to cut the key rate to 7% in 2018.

Anna Mokina

Financial Markets

The ruble strengthened in 2017, appreciating by around 4% yoy by the end of the year, while the price of Brent increased by around 20%. The correlation between the ruble and Brent oil has weakened. Two years ago, it was about 80%. In recent months, it has dropped to about 30%. The ruble is expected to be stable within the year and will be influenced by two main factors: a low level of capital outflows and the budget rule. Capital outflows are low for a number of reasons: a decreasing amount of external debt payments, lower domestic demand for foreign assets, a higher level of domestic real rates, and decreasing "grey" outflows (thanks to measures for better transparency of the banking sector). As for the budget rule (the revenues from crude oil priced higher than USD40/bbl will be directed by the Ministry of Finance to replenish the reserves), if oil prices stay close to the current levels in 2018, the reserves will be replenished by about USD40bn. This is a significant amount which is expected to mitigate the strengthening of the ruble exchange rate.

Banking Sector

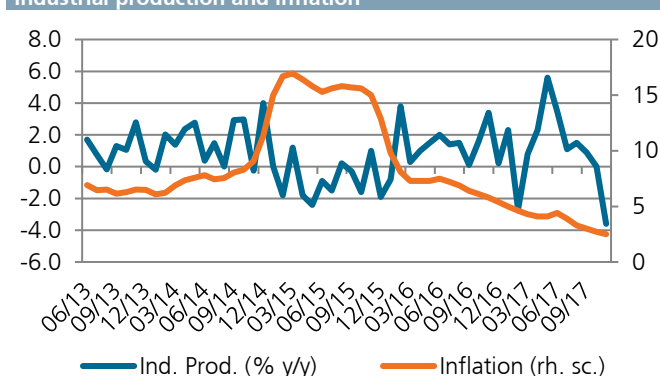
In October, lending grew by 1.74% vs 2016, with household lending increasing by 9.86% and corporate decreasing by 0.85%. Deposits recorded 4.27% growth (households +5.92%, corporate +2.07%). In the medium term, retail lending will continue to be the driver of growth in lending to the economy given lower rates. While the growth of corporate lending is likely to be low and unstable till mid-2018, weak dynamics of growth in deposits by individuals in recent months is associated with a reduction in interest rates on deposits and as a result individuals choosing alternative ways of allocating savings such as federal loan bonds, individual investment accounts. In addition, the reorganisation of two large private banking groups (Otkritie and BIN) caused some investors to become concerned about choosing deposits for investing their funds.

Latest economic indicators

%	Last value	3Q 2017	2Q 2017
Ind production yoy	-3.6 (Nov)	1.2	3.8
Nom exports yoy	27.1 (Oct)	18.7	23.5
Retail sales yoy	2.7 (Nov)	2.1	1.0
Inflation rate yoy	2.5 (Dec)	3.4	4.2
CB reference rate	7.8 (29 Dec)	8.5	9.0
Loans (priv sector, yoy, eop)	1.7 (Oct)	1.4	0.1
Deposits (priv sector, yoy, eop)	4.3 (Oct)	4.4	4.8

Source: State Statistics Federal Service, Central Bank of Russia

Industrial production and inflation



Source: State Statistics Federal Service

Serbia

Real Economy

Based on the Statistical Office's preliminary estimate, Serbia's GDP grew by 1.9% yoy in 2017. Economic growth was primarily driven by industry, notably manufacturing, as well as services, especially trade, transportation and tourism, while agriculture made a negative contribution equivalent to around a 1pp fall in GDP due to drought.

Marija Savić

Average yoy inflation in 2017 amounted to 3%, remaining low and stable throughout the year and moving within the new, lower target tolerance band which was lowered from $4\pm 1.5\%$ to $3\pm 1.5\%$ at the beginning of 2017. After picking up to 3% in December 2017, yoy inflation is likely to decrease substantially, moving below the target midpoint of 3% in 1H18, mainly as a result of negative base effects in food and fuel, but recovering towards the 3% target in the second half of the year.

Financial Markets

In January 2018, the NBS decided to keep the key policy rate unchanged at 3.5% for a third month in a row. The central bank will most likely keep the key rate at the current level in the coming months, due to an expected gradual pickup in inflation in the second half of the year, stronger economic growth figures, and more relaxed fiscal policy, potentially reversing its monetary policy trend in last months of the year.

In 2017, the dinar appreciated against both the euro and the dollar by 4.3% and 18.2%, respectively. The NBS has sold a total of EUR630mn on the FX market to bolster domestic currency and bought EUR1,335m to avert the dinar's sharp one-day rises. Since the beginning of 2018, the EUR/RSD rate continued to move around the 118.5 area. The domestic currency is expected to remain relatively stable through 2018, supported by stable macro and fiscal fundamentals and increased dinar lending.

Banking Sector

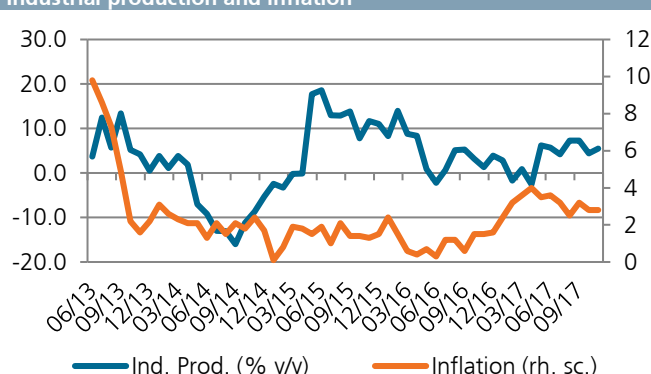
Growth of the deposit base outpaced credit growth, while interest rates, both on dinar and FX loans, reached historical lows in 2017. According to an NBS lending survey, deposits are expected to grow at a similar pace while demand for loans should be stronger in 2018, supported by the effects of past monetary policy easing, an expected rise in economic fundamentals, competition among banks, and low interest rates in the international money market, remaining fully covered by organic growth of the deposit base. The share of NPLs in total loans decreased to below the pre-crisis level (from 17% at end-2016 to 11.1% at end-November 2017). The continuation of NPL resolution efforts will stimulate further recovery of credit activity in 2018.

Latest economic indicators

%	Last value	3Q 2017	2Q 2017
Ind production yoy	5.5 (Nov)	6.3	3.1
Nom exports yoy	9.0 (Nov)	12.7	13.2
Retail sales yoy	2.9 (Nov)	3.7	3.5
Inflation rate yoy	3.0 (Dec)	3.0	3.7
CB reference rate, eop	3.5 (23th Jan)	3.8	4.0
Loans (priv sector, yoy, eop)	2.6 (Nov)	0.8	2.2
Deposits (priv sector, yoy, eop)	5.3 (Nov)	5.1	7.4

Source: Statistical Office, National Bank of Serbia

Industrial production and inflation



Source: Statistical Office, National Bank of Serbia

Slovakia

Real Economy

Economic activity data released since our December forecasts note was in line with expectations. Along with a recovery in car production, overall growth of industry accelerated further in November. Moreover, solid growth of new orders supported our view that 2017 ended strongly, with growth extending into 2018. Construction continued to rise significantly, based on both residential and civil projects. The labour market grew further and labour shortages have become a political issue. Unemployment claimants dropped below 200k and the registered jobless rate fell to 5.94% in December, a new all-time low. To ease pressures, industry representatives are asking for an easing of inward migration rules regarding foreign workers. PM Fico has spoken of an “execution amnesty” that would allow people walk free of their debt arrears towards State institutions. These people are currently discouraged to work in the official labour market as their income would be seized by a bailiff. The Government estimates that the amnesty could return 40-70k debt-laden Slovaks to the labour market. Rising income levels for households support spending, evidenced by the 6% yoy growth in retail sales in November, well above the average growth of 2.2% yoy in 2016.

Andrej Arady

Regarding price development, inflation held steady at 1.9% yoy in December. The economic story has not changed. The key drivers remained food prices and demand-sensitive items. Starting from January, administrative prices will also contribute positively which should cause headline inflation to pick up to above the 2% threshold.

We would note that economic sentiment slipped at year-end 2017 from its post-crisis high reached in October. Overall, it remains supportive. Confidence in all sectors except services remains at decent levels. In surveys, businesses in the service sector reported significant drops in activity in the final quarter of 2017.

Financial Markets

The situation in financial markets has not changed much since our latest commentary. Yields on Slovak government bonds continue to be driven primarily by ECB purchases (APP). Along with normalising policy in the future, we expect not only rising rates on government bond, but also increasing spreads vs German bunds, back to pre-APP levels in the 60-80bp range.

Banking Sector

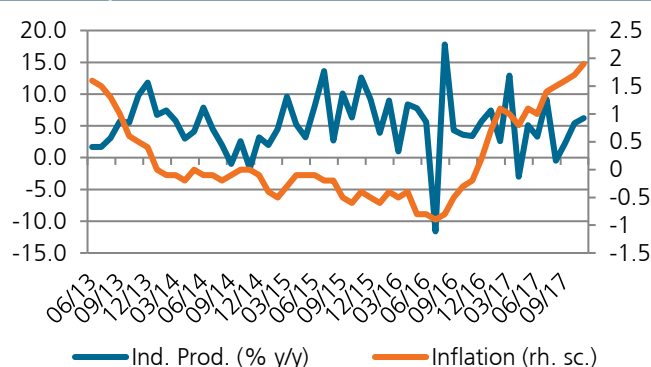
Growth of loan volumes in the Slovak banking sector continued to decelerate. Nevertheless, the pace of growth is still in double digits. The story behind this has not changed. Household debt has already exceeded that of peer countries, limiting the space for further buoyant growth despite the improved financial situation of households. Interest rates on lending continued to decrease slightly, based on competition among lenders. Growth of deposits has picked up slightly. Interest rates paid on deposits were unchanged.

Latest economic indicators

%	Last value	3Q 2017	2Q 2017
Ind production, wda yoy	6.2 (Nov)	3.7	1.8
Nom exports, yoy	6.8 (Nov)	7.9	1.9
ESI (index)	103.3 (Dec)	104.8	102.3
Retail sales, yoy	6.0 (Nov)	5.5	7.3
Inflation rate, yoy	1.9 (Dec)	1.5	1.0
ECB refi rate	0.0 (23th Jan)	0.0	0.0
Loans (priv sector, yoy, eop)	9.8 (Nov)	10.7	12.0
Deposits (priv sector, yoy, eop)	5.5 (Nov)	4.3	4.0

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

Industrial production and inflation



Source: Statistical Office of Slovak Republic

Slovenia

Real Economy

Following a mild slowdown in October, retail trade volume increased by 5.8% yoy in November. Thus, in the January-November 2017 period, real retail trade posted strong +9.0% yoy growth (o/w in retail trade of non-food products by +5.7%), supported by rising consumer confidence, 2.9% higher net wages, and declining unemployment (-14% yoy). Industrial production growth in November slowed slightly, to +9.9% yoy (after +10.2% yoy in October) as a result of decreased output in the electricity, gas & water supply category (+2.2% in November vs +8.2% in October). Exports in November advanced by 16.2% yoy, thus (with the exception of February and April) continuing the positive trend of reporting double-digit growth rates, resulting in a January-November 2017 external trade surplus of EUR0.8bn.

Ivan Odrčić

After two years of deflation, an average inflation rate of 1.4% yoy was reported in 2017 (+1.7% yoy in December), amid rising prices for primarily imported commodities, as food prices increased by 2.3% yoy and transport by 1.9% yoy.

Financial Markets

Ana Lokin

3M Euribor was flat at -0.33% in December, while the average 10Y government bond yield continued to decline, marking a 10bp mom fall in December, to 0.74%. The yield rose slightly in January, to 1.0%. The average 5Y CDS spread in December recorded only a small decrease mom, of 60bp, and in January, it slipped towards 51bp.

Banking Sector

The pace of loan growth increased moderated for the third month in a row in November, at +5.5 yoy, as a result of a deceleration in the corporate loan growth increase to +4.1% yoy. Loans to households increased by 6.9% yoy, with growth in consumer loans strengthening to 13.0% yoy, housing loans continuing to slow (recording a 4.4% yoy increase), while other loans rose by 7.8% yoy. Deposits growth accelerated to +7.4% yoy in November as a result of a surge in corporate deposits (+11.8% yoy): term deposits rose by 16.3% yoy and overnight and redeemable at notice increased by +10.2% yoy. Growth of household deposits remained unchanged compared to the previous month at +5.9% yoy. The decline in term deposits softened to -13.2% yoy; the overnight and redeemable at notice deposits increased moderated to +16.6% yoy.

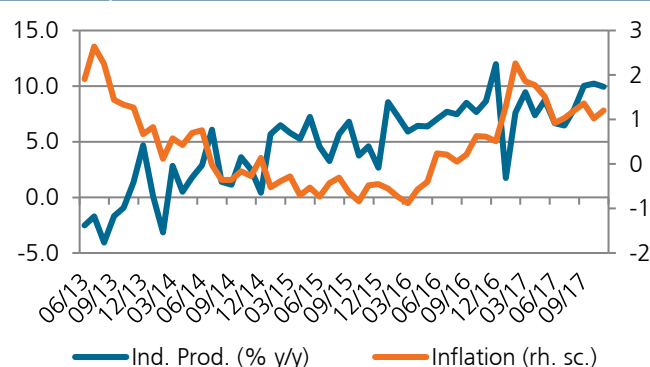
According to media reports, Slovenian banks have started to tighten household credit standards. In order to meet credit eligibility criteria, banks now take into account not only borrowers' indebtedness and total living costs, but also their capacity to withstand the expected 1.75pp Euribor increase in the upcoming period.

Latest economic indicators

%	Last value 3Q 2017 2Q 2017		
Ind production, wda yoy	9.9 (Nov)	8.2	7.6
Nom exports yoy	16.2 (Nov)	14.3	10.5
ESI (index)	118.3 (Dec)	114.1	112.9
Consumer confidence indices	0.5 (Dec)	-4.6	-4.8
Inflation rate yoy	1.7 (Dec)	1.2	1.4
ECB refi rate	0.0 (23th Jan)	0.0	0.0
Loans (priv sector, yoy, eop)	5.5 (Nov)	5.9	3.4
Deposits (priv sector, yoy, eop)	7.4 (Nov)	7.5	6.1

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

Industrial production and inflation



Source: Statistical Office of the Republic of Slovenia

Ukraine

Real Economy

Due to the lower harvest of late grain and other crops, real GDP growth probably slowed in 4Q17 compared to the 2.1% increase recorded in 3Q17. Recent data releases have shown that manufacturing output rose by 4.4% in 4Q17 vs 3.1% in Q3. Retail sales also accelerated (to 9% compared with 8.2% in the previous quarter), while construction activity, although remaining strong, slowed, rising by 22.3% in Q4, down from +24.6% in Q3. Following the release of these numbers, the National Bank of Ukraine (NBU) recently stated that it saw increased risks that real GDP growth in 2017 could be slightly lower than 2.2% (the forecast made by the NBU in October 2017).

Giancarlo Frigoli

Financial Markets

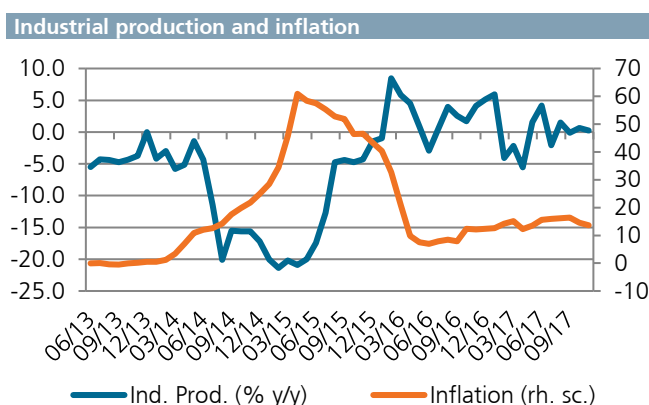
In recent weeks, the Ukraine currency has come under downward pressure, with the UAH/USD exchange rate coming close to 29 compared with an average rate of 26.6 in 2017. According to the authorities, which intervened to support the currency, the weakening of the hryvnia is seasonal and caused by such factors as the significant excess liquidity in the market as a result of the following: active settlements by budget-sustained and commercial companies to close the financial year; value-added tax refunds to exporters at the end of the year; foreign currency purchases by non-residents to withdraw dividends; and peaks of speculative demand on the cash market. The NBU expects inflows of foreign currency will start in February due to income from exports, and the rate will begin to strengthen to UAH27.9-27.9/USD1. Prospects for the hryvnia will also depend on the signing of a reviewed programme with the IMF.

Banking Sector

Loans decreased slightly in November again (-0.7% from -0.9% yoy in October, but net of the exchange rate effect, -4.1% yoy). We would highlight a further new increase in household loans (by 1.9% yoy in November from +3.8% yoy in October). The NBU – as highlighted in the Financial Stability Report Presentation – is monitoring the developments in retail lending and, if necessary, will tighten requirements on credit risk assessments for retail loans or apply macroprudential measures to limit excessive credit growth. The NBU does not yet see a need to act to restrain bank consumer lending, in our view. Loans to corporates decreased by 1.3% (the share of private sector loans is over 80%), but leverage is no longer critical for most industries, as pointed out by the NBU. The chemical industry and construction showed higher risk. NPLs remained at an unsustainable level (over 56% of total loans). Deposits increased by 9.6% (vs 8.1% yoy in October) both from corporates (10.6% in November from 9.5%) and households (9.1% from 7.4%). The LTD ratio decreased slightly, to 128%, a level that is still too high. The NBU highlighted that over two-thirds of total bank liabilities and four-fifths of hryvnia liabilities are short term (up to three months) and therefore efficient liquidity management is required. As of September 2017, the number of loss-making banks has declined considerably (17 from 35 as of September 2016).

Davidia Zucchelli

Latest economic indicators			
	Last value	3Q 2017	2Q 2017
Ind production yoy	0.2 (Nov)	-0.2	0.1
Nom exports yoy	20.6 (Nov)	21.4	25.6
PMI manufacturing	n.a.	n.a.	n.a.
Retail sales	6.8 (Nov)	8.2	8.6
Inflation rate yoy	13.7 (Dec)	16.2	13.8
CB reference rate	14.5 (29th Dec)	12.5	12.5
Loans (priv sector, yoy, eop)	-0.7 (Nov)	-2.4	-1.4
Deposits (priv sector, yoy, eop)	9.5 (Nov)	7.9	7.8



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. ch yoy			Inflation chg yoy				FX reserves chg (mln €) ²			CA bal. (mln €) ³	
3Q17 2Q17 2016				Last	mt	3Q17	Last	mt	3Q17	Last	mt	3Q17 2016	3Q17	2Q17	2016	3Q17	2Q17	
CEE																		
Czech Rep.	5.0	4.7	2.4	8.5	Nov	5.8	4.7	Nov	4.8	2.4	Dec	2.6	0.7	n.a.	n.a.	n.a.	n.a.	n.a.
Hungary	3.9	3.3	2.2	3.4	Nov	4.2	6.1	Nov	6.9	2.1	Dec	2.4	0.4	-1235	-937	-5938	806	1868
Poland	4.9	4.0	2.8	2.7	Dec	6.4	8.8	Oct	7.4	2.1	Dec	1.9	-0.6	n.a.	n.a.	n.a	n.a.	n.a.
Slovakia	3.4	3.7	3.3	6.2	Nov	3.7	6.8	Nov	7.9	1.9	Dec	1.5	-0.5	n.s.	n.s.	n.s.	n.a.	n.a.
Slovenia	4.5	4.6	3.1	9.9	Nov	8.2	16.2	Nov	14.3	1.7	Dec	1.2	-0.1	n.s.	n.s.	n.s.	872	785
SEE																		
Albania	3.6	4.1	3.5	n.a.	n.a.	n.a.	11.1	Nov	13.2	1.8	Dec	1.7	1.3	38	-76	47	-133	-231
Bosnia H.	2.9	2.9	3.1	3.3	Oct	5.8	15.8	Nov	22.7	1.2	Nov	1.1	-1.1	115	115	473	-129	-251
Croatia	3.3	3.0	3.2	-1.6	Nov	2.9	15.0	Oct	11.6	1.2	Dec	1.1	-1.1	926	-2044	-193	3868	154
Romania	8.6	5.9	4.8	9.2	Nov	7.3	8.9	Nov	8.4	3.3	Dec	1.4	-1.5			-350		
Serbia	2.1	1.4	2.8	5.5	Nov	6.3	9.0	Nov	12.7	3.0	Dec	3.0	1.1	787	-183	-52	-384	-336
CIS MENA																		
Russia	1.8	2.5	-0.2	-3.6	Nov	1.2	25.2	Nov	18.7	2.5	Dec	3.4	7.1	7677	12910	-1356	-2509	2338
Ukraine	2.1	2.3	2.3	0.2	Nov	-0.2	20.6	Nov	21.4	13.7	Dec	16.2	14.9	1037	2344	-466	-1656	-250
Egypt	5.2	5.0	3.8	24.9	Oct	26.1	21.5	Oct	13.7	21.9	Dec	32.1	13.7	5230	2779	7820	-1639	-2396
<i>m.i. E.A.</i>	<i>2.5</i>	<i>2.1</i>	<i>1.8</i>	<i>3.2</i>	<i>Nov</i>	<i>3.7</i>	<i>7.7</i>	<i>Nov</i>	<i>6.0</i>	<i>1.4</i>	<i>Dec</i>	<i>1.5</i>	<i>0.2</i>					

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

Markets and Ratings												
	S/T rates ¹		L/T rates ²		Foreign exchanges ³			Stock markets		CDS spread (bp)		Rating
	17/01	chg pp 3M	17/01	chg pp 3M	17/01	3M chg%	1Y chg%	3M chg%	1Y chg%	17/01	17/10	S&P
CEE												
	Vs Euro											
Czech Rep.	0.8	0.3	1.8	0.4	25.4	-1.4	-6.0	5.6	20.8	33.2	36.5	AA-
Hungary	0.0	0.0	2.0	-0.6	309.0	0.4	0.4	1.6	20.6	77.0	88.3	BBB-
Poland	1.7	0.0	3.3	0.1	4.2	-1.4	-4.6	2.8	24.5	45.9	83.3	A-
Slovakia	-0.3	0.0	0.8	0.0	Euro	Euro	Euro	9.2	7.2	36.8	38.9	A+
Slovenia	-0.3	0.0	1.0	0.1	Euro	Euro	Euro	2.3	13.2	51.1	62.0	A+
SEE												
Albania	1.2	0.0	n.a.	n.a.	134.0	0.2	-2.3	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	0.5	-0.1	2.3	-0.3	7.4	-0.9	-1.2	1.6	-9.7	91.2	104.9	BB
Romania	1.8	0.2	4.3	0.0	4.7	1.7	3.5	3.1	16.1	77.5	90.7	BBB-
Serbia	3.5	0.0	n.a.	n.a.	118.4	-0.7	-4.3	12.2	15.4	118.6	129.3	BB
CIS MENA												
	Vs USD											
Russia	7.9	-0.8	7.4	-0.1	56.4	-1.2	-5.4	11.3	6.8	104.3	122.7	BB+
Ukraine	17.3	1.2	9.7	0.0	28.7	8.5	4.0	7.0	-15.6	360.5	588.5	B-
Egypt	18.4	-0.3	15.4	-0.2	17.7	0.3	-5.9	3.8	-5.0	313.8	346.2	B-
m.i.A.E.	-0.3	0.0	0.5	0.1	1.2	4.2	14.5	1.2	7.6	5.1	5.1	

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

Aggregates and bank rates for the private sector																
	Loans Chg yoy %			NPL/Loans %			Foreign Liab. Chg yoy %			Deposits Chg yoy %			Loans rate ¹ -NewB* %			
	Last	Mth	2016	Last	mt	2016	Last	mt	2016	Last	Mth	2016	Last	mt	2016	S ⁴
CEE																
Czech Rep.	5.2	Nov	6.7	3.9	Nov	4.8	77.4	Nov	38.4	7.7	Nov	5.8	2.24	Nov	1.86	C
Hungary	4.9	Nov	-1.9	6.6	Jun	9.0	19.6	Nov	-7.0	12.8	Nov	6.3	2.56	Nov	3.12	C
Poland	3.9	Oct	5.3	4.1	Jun	4.0	-8.8	Oct	-0.8	5.5	Oct	9.2	3.68	Aug	3.57	C
Slovakia	9.8	Nov	10.3	4.2	Nov	4.7	9.5	Nov	0.8	5.5	Nov	4.6	2.41	Nov	2.6	C ²
Slovenia	5.5	Nov	-2.7	6.7	Nov	8.5	-14.9	Nov	-17.9	7.4	Nov	7.2	2.4	Nov	2.81	C ²
SEE																
Albania	0.1	Nov	0.2	14.3	Nov	18.3	1.6	Nov	-13.2	0.1	Nov	2.7	7.73	Nov	7.01	PS
Bosnia H.	7.3	Nov	3.4	10.8	Sep	11.8	8.8	Nov	-5.3	8.8	Nov	7.4	3.64	Nov	4.62	C
Croatia	0.2	Nov	-4.3	12.5	Sep	13.8	-17.2	Nov	-26.6	2.5	Nov	2.8	6.56	Nov	7.03	PS
Romania	6.4	Nov	0.6	8.0	Sep	9.6	-14.3	Nov	-21.8	11.3	Nov	8.5	5.94	Nov	4.93	PS
Serbia	2.6	Nov	2.4	11.1	Nov	17.0	16.5	Nov	-9.1	5.3	Nov	11.5	8.99	Nov	8.45	PS
CIS MENA																
Russia	1.7	Oct	-4.2	10.1	Oct	9.4	n.a.	n.a.	n.a.	4.3	Oct	-3.9	9.82	Oct	11.83	C
Ukraine	-0.7	Nov	2.0	56.4	Sep	30.5	-25.6	Oct	-8.0	9.5	Nov	9.1	16.92	Nov	17.25	PS
Egypt	33.4	Sep	42.8	5.5	Jun	5.8	105.1	Sep	256.6	45.3	Sep	41.4	19.6	Sep	16.3	C
m.i. E.A.	1.8	Oct	1.0	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	2.8	Oct	3.3	1.2	May	1.4	C

Source: Central Banks, IMF, Moody's; ¹monthly average; ²lending rate on current account overdraft; on deposits up to 1 year

⁴Sector C=Corporates, H=Household, PS=Private Sector.

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