INTESA SANPAOLO

Monthly Note

Countries with ISP Subsidiaries

July 2017

Monthly note

Intesa Sanpaolo
International Research Network

Business cycle indicators strengthen further overall. Increasing, but within range inflation rates still support easy monetary conditions in CEE/SEE areas. Egypt raises rates again to contain inflationary risks.

In May, high frequency indicators generally confirmed a further strengthening of the business cycle in the CEE area and a consolidation in the SEE region, with still-robust growth of industrial production sustained by rising exports and retail sales. In addition, forward-looking indicators still signal expectations of an expansionary phase of the business cycle in the whole region. The ESI increased in most cases and the Hungarian Manufacturing PMI remained above the threshold level of 50 in June. GDP growth is expected to remain robust in 2Q.

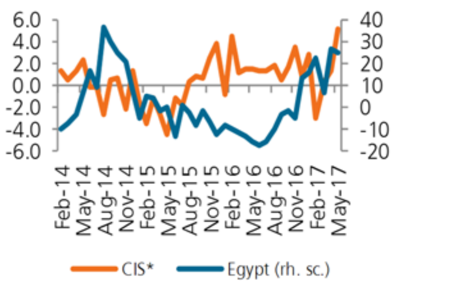
In the CIS area, the latest production figures in Russia were stronger and consistent with GDP growth of over 1% in 2Q. In Ukraine, industrial production also accelerated in May, supported by manufacturing activity, but the blockade in the Donbass continues to weigh on mining and utility services. In the MENA region, in Egypt, industrial output is also increasing, thanks to rising revenue from tourism, even if the PMI in June still points to a contraction in the non-oil private sector.

In June, inflation continued on a positive trend in all CEE/SEE countries, while partially retreating, however, in most cases from the peaks observed in the first months of the year, mainly due to energy price moves. CBs in the region are keeping easy monetary conditions, and no interest rate reversals are generally expected in the short term. Due to the current inflation rate above the central value of the corridor target, the Czech National Bank is likely to be the first CB to reverse course on interest rates in the region. Exchange rates are quite stable, with a slightly appreciating pattern generally prevailing (except in Romania, due to the recent political turmoil).

In the CIS area, in Russia, headline inflation accelerated to 4.4% in June, but core inflation slowed. In Ukraine, the CPI also increased in June (to 15.6%). The CBs of the two countries are nevertheless likely to cut interest rates further. In Egypt, the MPC unexpectedly raised its main policy rates by 200 bps in early July, following persisting inflation risks, mainly related to possible second round effects, as core inflation indeed accelerated to 31.95% in June.

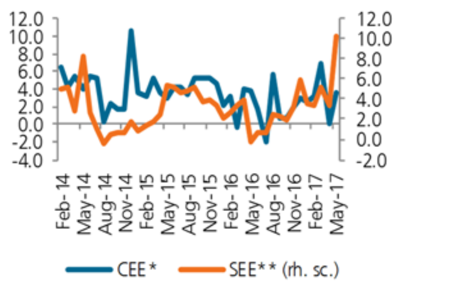
Growth of banking aggregates also showed further improvements in the CEE/SEE region, but still suffered the effects of past recessions in Russia and Ukraine. In the former case, loans often accelerated—slightly in some countries (such as Romania), but strongly in several others (such as Slovakia and Czech Republic). In Slovenia and Hungary, the positive trends that began in February were confirmed by data in May. A recovery in lending is also signaled by transaction data in countries with still-negative growth of loan stocks (eg, Croatia), mainly affected by cleaning operations. Consumer loans and mortgages to households were generally the most dynamic items, while corporate lending remained weaker in many countries (particularly Croatia). On the funding side, deposits from the private sector also accelerated. The increase in corporate deposits continued to be strong, especially in Albania and Serbia among SEE countries. Only in Slovakia did corporate deposits decrease again among CEE countries. In all the countries (with Bosnia and Hungary the only exceptions), foreign liabilities continued to decrease.

Industrial production % yoy – CIS – Egypt



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

Industrial production % yoy – CEE – SEE



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

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

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

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

Cross Country Analysis

CEE area

Antonio Pesce

In the CEE countries with ISP subsidiaries in May, industrial production and export dynamics remained buoyant, most often close to or even above the performance recorded in 1Q17. In June, Economic Sentiment Indicators (ESI) were near the maximums for the year for all the countries in the region.

In more detail, in Czech Republic in May, industrial production accelerated to 8.1% yoy from 5.9% in the previous month while retail trade rose by 9.3% yoy (in real terms), which was above the average recorded from January. In the same month, exports performed very well (10.1% yoy in nominal terms), and more than offset the contraction observed in April (-3.3%).

In Hungary, industrial production also accelerated significantly in May (6.2% yoy from 2.5% the previous month). The mining and quarrying sector exhibited the strongest growth rate (40.0%), followed by manufacturing (8.8%), while the energy sector contracted (-3.0%). In addition, exports expanded by 19.0% yoy (in nominal terms), reaching a record high since the beginning of the year. In June, after the peak observed in May (62), the manufacturing PMI fell to 57, but was still well above the 50 level, reflecting expansionary expectations regarding business activity.

In Slovakia, high frequency data also confirmed a positive tone. Industrial production in May grew by 5.1% yoy, recovering from the contraction seen in April (-3.2%). In the same month, export dynamics also moved back into positive territory (4.1% yoy, after -1.6% in previous month). In June, the ESI remained, finally, close to the maximum of the last years.

In Slovenia, the industrial production profile surged (7.4% in May in wda data). Manufacturing grew by 8.4% yoy and exports accelerated significantly, by 14.1% (from 4.3% in April), above the average of the first five months of this year. Retail sales growth was also strong (7.6% yoy in real terms). In June, the ESI improved further, moving to 113 from 110.

Regarding inflation, in June, the CPI decelerated slightly in all CEE countries, ranging from 0.9% in Slovenia to 2.3% in Czech Republic. The more volatile components, energy and food, which remain on a soft trend, kept headline inflation below core inflation in Slovakia and Hungary.

Following the last Governing Council of the ECB, monetary policy is expected to remain expansionary in the EA (and therefore in Slovakia and Slovenia) in 2017, and the interest rates to stay at present level well past the horizon of the ECB's Asset Purchase Programme. The ECB reiterated the continuation of the APP until December 2017-or beyond, if necessary. In the near term, monetary policy is expected to remain accommodative in Hungary as well. At its meeting in June 2017, the Council of the Hungarian Central Bank lowered the upper limit on the stock of three-month central bank deposits to HUF 300bn (from HUF 500bn) as at the end of 3Q17 to reinforce loose monetary conditions. Due to inflation currently being above the central value of the corridor target, the National Bank of Czech Republic could be the first monetary authority in the CEE region to reverse the course of interest rates. Stable financial conditions are signalled in the region, based on stable CDS.

Davidia Zucchelli

In May, banking aggregates improved further in the CEE region. Lending growth accelerated in many countries, still supported mostly by the household sector. In contrast, interest rates are following different dynamics.

In Czech Republic, loans performed well (7.8% yoy in May from 7.3% yoy in April). Growth of loans denominated in foreign currency continued to be very strong (34%), especially in the household sector (60%). In the corporate sector-where loans denominated in foreign currency account for around 30% of the total-lending growth increased significantly as well (33% yoy). Czech banks benefit from a large, stable deposit funding base and plenty of liquid assets. Deposits continued to be dynamic (10.3% yoy in May from 10.4% yoy in April), particularly from households (9.8%), supported by improving labour market conditions, despite low interest rates.

The LTD ratio continued to be very modest (76%). Interest rates on lending to corporates increased in May, while the deposit rate to households decreased, supporting the interest margin.

In Hungary, loans continued to experience positive changes (2.2% from 1.8% yoy in April), due to a further increase of loans to corporates (4.2%). We would note that loans to households increased for the first time in the last few years, even if the change was still minimal (0.1%). Deposits, however, exhibited a strong rise of 10.7% (from 10% yoy in April), particularly by businesses (14.7% in May) and households (7.4%).

In Slovakia, lending performed well (12.4% yoy in May from 11.7% in April) fuelled by economic growth and low interest rates, both in the corporate (by 9.8%) but especially in the household (by 14.4%) sectors, with the latter result based on a further increase in mortgages. Deposits also grew (3.3% yoy from 3.8% yoy in April), particularly among households (7.0%), despite the increasing competition from other savings products. In the corporate sector, they decreased by 2.1% yoy, reflecting a more intense use of funds.

In Slovenia as well, loans once again showed a slight increase, after a long period of negative monthly changes (2.3% yoy from 1.8% yoy as of April), due to a further increase in household loans (5.9% yoy). In contrast, the outstanding amount of corporate loans decreased further, by 1.2% yoy. As far as deposits are concerned (6.2% yoy in the private sector), corporate deposits increased strongly again in May (7.8% from 7.2% yoy in April). Deposits from households increased by 5.6% yoy from 6.1% yoy.

SEE area

Antonio Pesce

Among SEE countries with ISP subsidiaries, high frequency indicators generally confirmed a consolidation of the economic cycle in May.

In Croatia, after a soft contraction recorded in April, industrial production grew again by 3.3% yoy in May, well above the 1Q average. In the same month, exports were almost stagnant, but this followed several months of double-digit growth. Still in May, real retail sales grew by 3.5% yoy supported by both low inflation and improving labour market conditions. In May, the ESI remained close to the maximum of the last months.

In Romania in May, both industrial production and exports continued to show strong trends (15.3% and 19.3%, respectively). The ESI remained at the maximum level in May, close to the highs seen in 2016. In late June, Romanian political tensions eased after Parliament ratified the appointment of a new Prime Minister, Mr. Mihai Tudose. In Serbia in May, industrial production grew by 2.5% yoy and recovered from the contraction of the previous month (-2.6%). In the same month, exports grew by 18.7% (in nominal terms), above the average of 1Q. In Bosnia, there were mixed signals. Industrial production contracted in May (-1.1% yoy) for the first time this year. In the same month, exports continued to grow, and at high rate (20.5%). in Albania, in 1Q17, GDP stayed at 3.9%, the same growth rate of previous quarter. The exports dynamic was negative in June, but it followed several months of double-digit expansion.

Regarding inflation, the CPI growth rate decelerated in Croatia in June (to 0.7% from 1.1%), while it increased slightly in the other countries in the region, ranging from 2.2% in Albania to 3.6% in Serbia (for Bosnia, the 2.2% refers to May). Current inflation is inside the corridor target of central banks, although slightly above the central value for Albania and Serbia. At the latest board meetings, all the central banks of SEE countries with ISP subsidiaries confirmed their intention to maintain easy monetary conditions. Exchange rates vs the euro appreciated slightly in the whole area, with the only exception being Romania, due to the recent political turmoil. CDS spreads fell further in the region.

Davidia Zucchelli

In May, lending showed signs of improvement in SEE countries (with Albania and Croatia the only exceptions) and deposits grew in every country, despite low interest rates. The dynamics of banking interest rates for new business diverged among countries, but also among corporates and households.

In Albania, loans declined further (-1.4% yoy in May from -0.6% yoy in April) because of a decrease in the corporate sector (-3.6% yoy, which accounted for 70% of loans to the private sector) while loans continued to show dynamic growth in the household sector (3.8%). Loans in foreign currency experienced a strong decrease (-8% yoy), particularly in the corporate sector (-9.5% yoy, where they accounted for 57% of total loans to this sector) while in the household sector, the reduction was lower (-3.3%). Deposits continued to grow (2% yoy in May), driven by deposits from businesses (22%), while deposits from households remained unstable, showing a deeper decrease (-1.2% yoy from -0.34% in April).

In Bosnia, loans continued to follow an accelerating path (6.1% yoy in May from 4.9% yoy in April) both in the corporate (6.5% yoy) and the household (5.7% yoy, particularly consumer loans) sectors. Deposits intensified their increase as well (9% from 8.1% yoy in April).

In Croatia, loans continued to decrease, falling by 2.6% (from a fall of 1.2% yoy in April), but transaction data estimated by the CB showed positive signs (9% mom in May). Lending growth remained negative, both in the corporate (-4.9%) and again in the household sectors after the positive change showed in April (-0.8% yoy from +0.02% yoy in April). Deposits continued to grow (2.1% from 3% yoy in April), particularly from businesses (8.5%), while households remained broadly stable (0.3%).

In Romania, loans increased in May (3.1% yoy from 3.0% yoy in April) supported by households (5.6% yoy), while loans to corporates were still weak though positive (0.4% yoy from 0.6% yoy in the previous month). Deposits continued to perform well (11.4% from 10.8% in April).

In Serbia, loans continued to grow (3.3% yoy in May from 3.8% yoy in April), driven by loans to households which accelerated (11.5% yoy) while loans to corporates declined (-2.6% yoy). Deposits continued to perform extremely well (17% from corporates and 5.5% from households). Foreign liabilities continued to decline (-8.6% yoy in May), but the share remained close to 17% of total deposits (declining from 54.5% in March 2010).

CIS and MENA areas

Giancarlo Frigoli

In Russia, headline inflation accelerated to 4.4% yoy in June, but core inflation eased last month to a record low of 3.5% yoy, from 3.8% yoy in May. The drop in core inflation suggests that spare capacity in the economy and relatively weak domestic demand are keeping underlying price pressures subdued. These numbers sustain the expectation of additional rate cuts before year-end.

May's activity data were generally a bit stronger than expected and added to evidence that the economic recovery continued to strengthen in Q2. Industrial production grew by 5.6% yoy, up from 2.3% yoy in April, helped by a strong boost from manufacturing. Retail sales rose by 0.7% yoy in May, up from 0.1% yoy in April. May's industrial production data showed the strongest year-on-year expansion since February 2012, while retail sales are now growing for the first time since 2013. May's numbers were inflated by a favourable year-on-year comparison (one more working day this year compared to last year). According to preliminary data, activity was strong in June as well. Last month, industrial production rose by 3.5% yoy while construction jumped by 5.3% (compared to 3.8% in May). All told, Russia's Central Bank expects GDP growth to have closed in on 1.3% yoy in 2Q17, and to accelerate to 1.3-1.8% in the third quarter.

Inflation in Ukraine accelerated to 15.6% yoy in June from 13.5% in May and 12.2% in April. The agency said the main reason for the inflation increase was the rise in prices for fruit and vegetables and housing rents. The National Bank expects that inflation trend to remain high in the first three quarters, due to base effects, and to return to a single-digit level in the fourth quarter of4Q17.

Industrial production in Ukraine in May 2017 grew by 1.2% yoy against a 6.1% decrease in April 2017 from April 2016 and a 2.7% decrease in March 2017 from March 2016. With adjustment for the effect of more calendar days, industrial production in May 2017 remained unchanged compared to May 2016. The return to positive dynamics in May was due to 6.1% growth in the processing industry, while the mining industry posted a 4.6% decline, along with a 9.6% decrease in the supply of electricity, gas, steam and conditioned air. These industries continued to feel the effect of the blockade of the Donbass regions. Overall, industrial production in Ukraine in the first five months of 2017 fell by 1.3% yoy. The mining industry posted a 7.4% decrease, while the supply of electricity, gas, steam and conditioned air declined by 5%.

On 13 July, the Rada, the Ukraine Parliament, voted on the first reading of the long-awaited pension reform. The second and final reading is expected to take place in September, after the summer recess. The preliminary approval eased investor concerns regarding the government's commitment to implement reforms. Once the pension reform becomes law, Ukraine is expected to receive the next tranche of the IMF loan worth USD 1.9bn.

In Egypt, in its meeting held on 6 July, the Monetary Policy Committee (MPC) raised Egypt's main policy rates by 200 bps, with the maximum rate (the overnight lending rate) jumping to 19.75%. The Committee highlighted persisting inflation risks, due to second round effects. Annual headline inflation remained stable in June (at 29.7%), but core inflation accelerated to 31.95% from 30.57% in the preceding month, remaining somewhat higher than the level consistent with achieving the CBE's target of annual inflation of 10% in the medium term. As soon as underlying inflation starts to moderate, the MPC envisages a measured easing of the monetary stance to allow for a reduction in interest rates.

Industrial output accelerated in May to 25.2%, thanks in particular to increasing revenue from tourism, but the Purchasing Managers' Index (PMI) for the non-oil private sector dipped further to 47.2 points in June from 47.3 points the previous month, remaining below the 50 mark that separates growth from contraction for the 21st consecutive month. New orders also fell, but at a slower pace. New export orders continued to rise for the third month in a row, suggesting external demand has grown since the central bank's decision to float the currency in November 2016.

Davidia Zucchelli

In Russia, bank lending decreased again in April, but a lower rate (-0.9% yoy from -3.1%) because of a significant decrease in the corporate sector (-2.4% from -5% at March), which accounts for around 75% of loans to the private sector. Household lending showed a further increase, of 4.1% yoy, which was stronger than in March (3% yoy). In April, deposits increased by 3% yoy (from 3.4% in March). In line with official rates, interest rates on new loans to businesses declined to 11.02% (from 11.41%), but the interest rate on deposits from households increased to 6.3% (from 5.9%).

In Ukraine, lending data for May are not yet available. Deposits confirmed the changes that occurred in the previous month, increasing by 6.0% (6.3% yoy in April) both from corporates (5.7% from 5.8% in April) and households (6.1% from 6.5%). The NPL ratio, calculated according to the new accounting rules, increased to well over 50%. Coverage is significant (around 70%), but the "NPL net of provisions to capital" ratio was 87% at March.

In Egypt in March, loans and deposits grew strongly (nominally by 39.1% and 40.6%, respectively), due to the accounting effect of the local currency depreciation (net of that effect, the performances are estimated at 6.4% and 13.7%, respectively). The fx effect was stronger in the corporate sector, where loans in foreign currency account for almost 45% of total loans, while in the household sector, they accounted for just 3% of the total. Deposits increased both from corporates (29.3%, but -13% net of the exchange rate effect) and households (44%, 15% net of the fx effect) The LTD ratio remained very low (39%). In line with official rates, lending interest rates on new business increased to 16.7% in April (from 16.6% in March), but deposit interest rates decreased to 10.9% (from 11.3% in March).

Country-Specific Analysis

Albania

Real Economy

Kledi Gjordeni

Economic growth in 1Q17 (3.94%) was higher than expected, whereas inflation for May and June was almost stable, at 2.0% and 2.2%, respectively. The economy is being driven by favourable domestic financing conditions and a positive external environment. The expansion of consumption and investments benefited from labour market improvements, a pickup in confidence, and a rise in FDI. In June 2017, exports contracted, however, by 0.3 % compared with the same period of the previous year, especially due to the negative contribution of "Minerals, fuels, electricity" (-11.4%) while imports expanded by 8.4%. The trade deficit was LEK 34bn, implying an increase of 15.1 % compared with June 2016.

Financial Markets

In the foreign exchange market, we continue to notice appreciation of the local currency against the euro and USD. In June, the LEK/EUR rate appreciated by 3.45% yoy, due to a large supply of euros, supported by FDI flows, income from portfolio investments and tourism. In July 2017, the Supervisory Council of the CB kept the monetary policy rate unchanged at 1.25%. The accommodative monetary policy has contributed to reducing financing costs for economic agents. The pass-through to the financial market is reflected in lower interest rates on both deposits and loans. On the other hand, yields on government securities in the primary market showed a slight increase (1Y period), mainly generated by the temporary imbalances of demand and supply. Yet, the volatility in T-bill yields has not been transmitted to other segments of the financial market. Judging from the available information, the Supervisory Council intends monetary policy to remain accommodative and the intensity of monetary stimulus will not be reduced before 1Q18.

Banking Sector

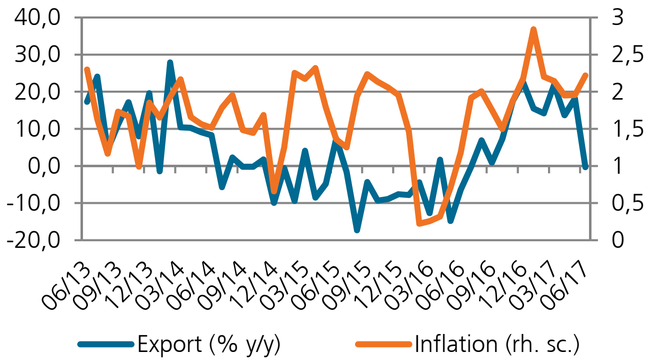
The monetary accommodation has contributed to growth in the loan portfolio. The volume of LEK loans in May expanded by almost 7% in annual terms, offsetting the contraction in foreign currency loans. The uptrend in LEK loans remains a welcome development, but the distribution of this growth is concentrated in the household segment, whereas loans to enterprises remain sluggish. Loans to households in May increased by 3.8% yoy, while loans to corporates shrank by 3.6%. Total loans in May contracted by 1.43%. According to the CB, cleansed of the write-off effects, annual growth of the total loan portfolio in Aprilwas 3%. The conditions of banks' credit supply are expected to ease, helped by the measures taken for reducing NPLs. The NPLs ratio fell to 15.9% in May from 19.5% a year ago. Total deposits in May increased by 2%, with household deposits falling by 1.16%, but corporate deposits rising by 21.5%.

Last macroeconomic indicators

%	Last value	1Q 2017	4Q 2016
Industrial production, wda yoy	n.a.	n.a.	n.a.
Export of goods, nominal yoy	-0.3 (Jun)	15.7	15.7
Unemployment rate	n.a.	n.a.	14.2
Inflation rate, average yoy	2.2 (Jun)	2.4	1.9
Loans (private sector, yoy, eop)	-1.4 (May)	-0.1	0.2
Deposits (private sector, yoy, eop)	2.0 (May)	1.5	2.7

Source: INSTAT, Central Bank of Albania

Export and inflation



Source: INSTAT

Bosnia and Herzegovina

Real Economy

Ivana Jović

In line with our expectations, 1Q GDP increased by 2.7% yoy, reflecting strong growth in gross value added in wholesale and retail trade (+8.8% yoy), financial and insurance activities (+6.1% yoy) and manufacturing industry (+3.9% yoy), while transportation and storage and professional activities recorded 6.4% and 2.4% declines in value added, respectively. On a quarterly basis, GDP maintained 0.6% qoq growth, as in the previous two quarters.

Although 2Q high frequency data indicate a slowdown in industrial production (following 4.4% yoy in April, industrial production declined by 1.2% yoy in May, driven by a 14.7% decline in energy production, while manufacturing grew by 1.8% yoy, slightly stronger than in April), robust personal consumption demonstrated 4.3% growth in real retail trade, while exports skyrocketed by 20.5% yoy. In the coming months, dry summer conditions should lower energy production, thus leading to somewhat less favourable developments in overall industrial production growth. However, manufacturing production will likely maintain its 2% growth level, driven by robust domestic and foreign demand.

The inflation rate in May increased to 2.2% yoy (1.0% mom), reflecting higher prices in transportation (+7.9% yoy), housing (+5.8%), beverages and tobacco (+4.6% yoy) and food (+1.5% yoy).

Banking Sector

Ana Lokin

Loan growth continued to accelerate in May, when loans to the private sector marked a 6.1% yoy increase (4.9% yoy in April). The higher growth rate can be attributed to both a rise in demand from corporate and retail, as loans to non-financial corporations grew by 6.5% yoy while the loans to households increased by 5.7% yoy. The breakdown of retail loans by purpose shows that the trend of a strong rise in consumer loans is continuing (8.1% yoy) while card loans recovered and after four months of negative yoy rates posted a 1.4% yoy increase. Other types of loans continued to narrow (housing loans -1.0% yoy, business activity loans -4.4% yoy).

The growth in deposits from the private sector increased as well, reaching 9.0% yoy in May. The deposits of non-financial corporations surged by 11.3% yoy (8.6% yoy in April), and deposits from households grew by 8.1% yoy.

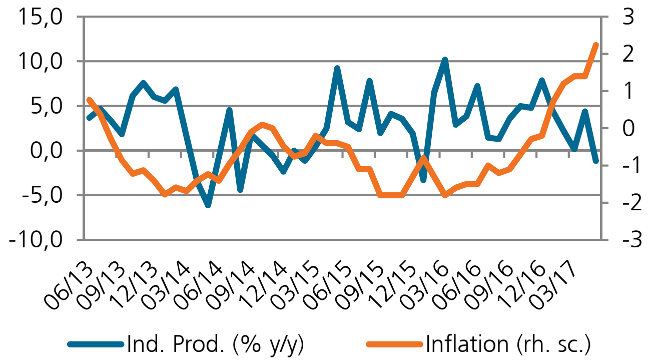
The improvement in loan quality continued in 1Q17, with the total NPL ratio falling by 0.3 pp qoq, to 11.5%. Corporate NPLs dropped by 0.4 pp qoq, to 14.3%, and for household by 0.3 pp qoq, to 8.3%. The decline and rise in NPL in lending pushed ROE and ROA upwards in 1Q17, to 13.6% and 2.0% (2.4 and 0.4. pp yoy, respectively).

Latest macroeconomic indicators

%	Last value	1Q 2017	4Q 2016
Industrial production, wda yoy	-1.1 (May)	2.2	5.9
Export of goods, nominal yoy	20.5 (May)	17.4	11.3
Retail trade, real, wda yoy	4.3 (May)	5.9	8.1
Inflation rate, average yoy	2.2 (May)	1.1	-0.4
Loans (private sector, yoy, eop)	6.1 (May)	4.8	3.4
Deposits (private sector, yoy, eop)	9.0 (May)	8.4	7.4

Source: BHAS, CBBH

Industrial production and inflation



Source: Labour and employment agency

Croatia

Real Economy

Ivana Jović
Ivan Odrčić

Following a decline in industrial production (-0.6% yoy) and a slowdown in real retail trade (2.8% yoy) in April, both indicators improved and recorded 3.3% and 3.5% yoy growth, respectively, in May. Within industry production, manufacturing recorded 4.9% yoy growth (as its main component Food production recovered to 7.7% growth yoy) while electricity production declined by 5.9% yoy. Robust retail trade growth reflects improved consumer confidence, as labour market conditions improved (3.5% growth in real net wages, unemployment rate down to 11.7%) and the tourist season started. At the same time, foreign demand remained supportive, as goods exports increased by 8.4% yoy, according to preliminary data. We expect that favourable foreign demand, combined with another record-breaking tourist season and solid labour market developments, will support growth in the coming months partially mitigating the negative spillover from the Agrokor crisis. In line with the ongoing Agrokor crisis, Fitch kept its country rating unchanged at BB, with a stable outlook. CPI in June slowed to 0.7% yoy (from 1.1% in May), as a decline in electricity prices (amid a lower VAT rate) outweighed the rise in food prices, resulting in a 1H17 average annual inflation rate of 1.1%.

Financial Markets

Ana Lokin

Liquidity remained ample in June, with the daily surplus exceeding HRK 16-17bn as a result of two CNB interventions in the foreign exchange market, where the central bank bought EUR 374m (HRK 2.8bn) from banks in order to prevent a steeper exchange rate decline. Thus, money market rates recorded only small changes, and average 3M Zibor increased by 2 bps mom, to 0.61%, maintaining similar levels in July. As the peak of tourist season approaches, appreciation pressures strenghtened and the kuna gained in value vs. the euro, lowering the average rate to 7.40 and prompting another CNB intervention to the amount of EUR 101.5m on 14 July.

Banking Sector

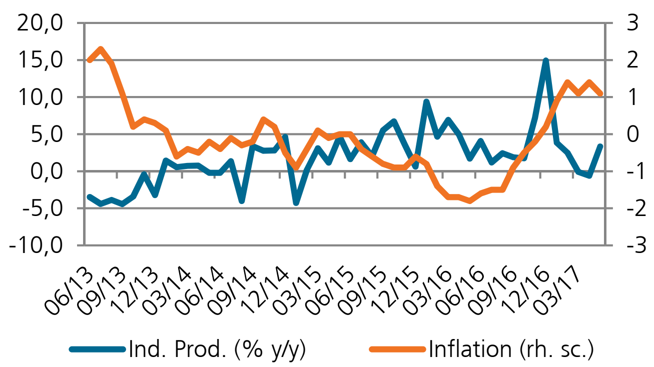
The pace of the decline in private sector loans accelerated to -2.6% yoy in May (-1.2% mom) due to the high volume of sold claims in May by one large bank. The majority of sold portfolios were corporate loans which recorded a 4.9% yoy fall (-2.9% yoy in April); household loans slipped back into negative territory (-0.8% yoy) as a result of sales as well as a notably stronger kuna, affecting indexed loans (EUR/HRK down by 0.9% yoy). Transaction data show that the growth of private sector demand continues to rise (1.6% yoy, 0.4 pp mom). The deposit growth rate slowed to 2.1% yoy, due to weaker growth of deposits from households (0.3% yoy), the result of kuna strengthening (fx-adjusted, retail deposits grew by 1.0% yoy). The rise in corporate deposits continued to be robust at 8.5% yoy.

Latest economic indicators

%	Last value	1Q 2017	4Q 2016
Industrial production, wda yoy	3.3 (May)	2.0	7.8
Export of goods, nominal yoy	0.4 (Apr)	22.4	12.9
Retail trade, real, wda yoy	3.5 (May)	5.2	4.7
ESI (index)	115.8 (Jun)	119.0	115.5
Inflation rate, average yoy	0.7 (Jun)	1.1	-0.2
Loans (priv sector, yoy, eop)	-2.6 (May)	-2.3	-4.3
Deposits (priv sector, yoy, eop)	2.1 (May)	2.8	2.8

Source: CBS, EC, CNB

Industrial production and inflation



Source: EC

Czech Republic

Real Economy

Zdenko Štefanides

The Czech economy continues to perform well. The latest round of real activity data confirmed the economy is on track to retain growth momentum of close to 3%. Indeed, after the relatively weaker opening of 2Q, activity bounced back in May, with industrial production posting 8.1% yoy growth and retail sales rising by 5.7%. Adjusting for a lower number of working days, the bounce was even more significant, confirming that the April moderation was only temporary. Acceleration in industrial output was driven primarily by foreign demand-driven sectors, including automotive and machinery manufacturing, confirming the cyclical support to the economy from foreign demand. The bounce in retail sales is linked to the expansion of domestic demand.

Real GDP growth of close to 3% is running slightly over the potential and is thus leading to further tightening of the labour market. The unemployment rate on a seasonally adjusted basis dropped in May to 3.0%, representing both Czech- and European-low rates. Unsurprisingly, in this environment, wage growth is picking up. All-economy nominal wage growth in 1Q17 rose to 5.3% yoy from 3.7% in the previous quarter, and partial data hint at further acceleration ahead. In May, for example, average gross monthly wages in industry rose to 9.2% yoy growth from 8.1% in April and 5.6% in March.

Financial Markets

Against this backdrop, price growth is also picking up, with CPI inflation stubbornly above the CNB's 2% target (2.3% in June). While in previous communications, the CNB was rather calm, arguing that koruna appreciation will keep monetary conditions tight and thus inflation in check, in recent weeks, it has changed its stance. Indeed, at the press conference on 29 June, the Board delivered a statement saying that "it is likely that the CNB will increase interest rates in line with the prediction": that is, the prediction presented in the May quarterly Inflation Report, which counted on rising interest rates from 3Q17 onward. The market did take this new hawkish CNB communication seriously, with some observers now predicting the CNB could move as early as the next policy meeting scheduled for 3 August.

Banking Sector

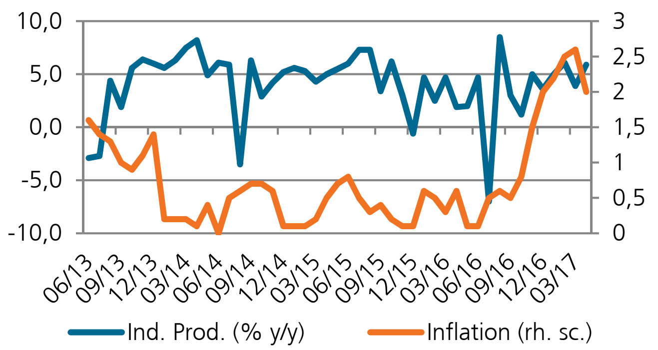
The Czech banking sector meanwhile continues to power ahead in volume growth, with loans for house purchases rising in May to 9.5% yoy. The story continues to be about the CNB trying to steer the market to moderate the pace of retail lending, but to not much avail, as tighter LTV limits that the CNB recommends are not legally binding for banks. An attempt to gain more regulatory power in this area via an amendment to the CNB Act has not yet been successful, as the amendment remains stuck in parliament and probably will remain so until the parliamentary elections which will be held in October. In this respect, one could argue for a rate hike to serve as a mitigating factor for potential risks stemming from the booming real estate/credit markets.

Latest economic indicators

%	Last value	1Q 2017	4Q 2016
Industrial production, wda yoy	8.1 (May)	5.0	3.3
Export of goods, nominal yoy	10.1 (May)	6.7	-0.4
CNB reference rate	0.05 (18th Jul)	0.0	0.0
ESI (index)	106.9 (Jun)	106.5	108.9
Inflation rate, average yoy	2.3 (Jun)	2.4	1.4
Loans (priv sector, yoy, eop)	7.8 (May)	6.7	6.7
Deposits (priv sector, yoy, eop)	10.3 (May)	10.2	5.8

Source: CBS, EC, CNB

Industrial production and inflation



Source: EC

Egypt

Real Economy

Emil Eskander

The Egyptian economy grew by 4.3% in 1Q17 compared to 3.6% in the same period last year, according to the Planning Minister. The improvement was supported by the recovery witnessed in the tourism, construction, telecommunication, transportation and manufacturing sectors. As a part of its economic reform programme, Egypt's government decided on 29 June to raise fuel prices by a range between 5.6% and 55.3% for the second time since floating the Egyptian pound in November 2016. The government also announced new hikes in electricity prices for households, ranging between 18.2% and 42.1%, to be effective as of July 2017. These decisions are motivated by the government's target to contain its budget deficit, as well as its commitment to fully remove subsidies on fuel products by FY18/19 as per its agreement with the International Monetary Fund (IMF). The IMF then approved disbursing USD1.25bn to Egypt, reflecting its satisfaction regarding the measures taken by the Egyptian government to reform the economy. Of the USD 12bn loan approved by the IMF last November, Egypt has so far received a total of USD 4bn.

Financial Markets

In its 6 July meeting, the Central Bank of Egypt (CBE) raised the overnight deposit and overnight lending rates by 200 bps, to 18.75% and 19.75%, respectively, the third rise of interest rates after floating the Egyptian pound last November. The decision aims at containing the inflationary pressures expected to result from the latest rise in energy prices.

The annual headline inflation rate remained broadly unchanged in June 2017, at 29.76% compared to 29.71% in May 2017, supported by a favourable base year effect. The Prime Minister stated that the inflation rate is expected to rise by a range of 4-5% in the coming months, after the latest rise in fuel prices at the end of June 2017. However, the annual inflation rate is expected to ease at the end of the year starting November, due to base year effects.

Banking Sector

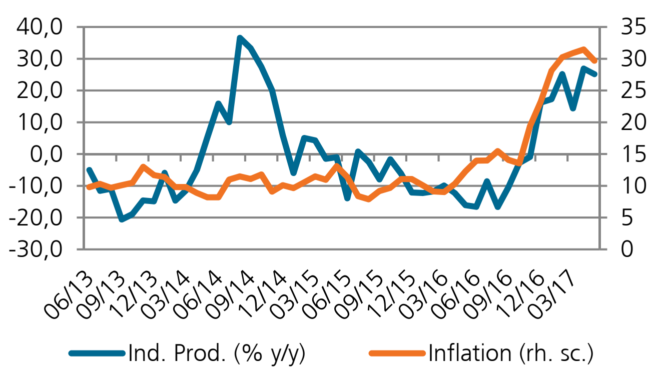
Banks have started to grant foreign currency exchange for individuals without requiring proof of travel, allowing up to USD 2,000 per person in some banks, with no official limit in other banks, to be subject to the heads of branch's approval, signaling the confidence of the CBE in the ongoing stabilisation of the fx market. Total deposits from the private sector were EGP 2.28tn in March 2017, growing by 40.6% compared to March 2016, with 79.5% of this coming from the household sector. Total bank loans to the private sector increased by 39.1% in March 2017, to a record EGP 883bn, compared to March 2016, when loans to corporates formed 73.8% of total loans to the private sector.

Latest economic indicators

%	Last value	1Q 2017	4Q 2016
Industrial production, wda yoy	25.2 (May)	19.0	4.2
Nom exports yoy	8.4 (Apr)	20.8	8.2
Retail sales yoy	n.a.	n.a.	n.a.
Inflation rate yoy	29.8 (Jun)	29.8	18.8
CB reference rate	18.8 (18th Jul)	14.8	14.8
Loans (priv sector, yoy, eop)	39.1 (Mar)	39.1	42.8
Deposits (priv sector, yoy, eop)	40.6 (Mar)	40.6	41.4

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 came in at 4.1% yoy (3.7% yoy adjusted for calendar effects) in 1Q17. The growth was well above expectations, supported by industrial production and services. Agriculture stagnated. Net exports made a positive contribution, as import growth is still relatively moderate, due to weak private investment activity. The qoq rise (1.3%) was the strongest in the last two years. Growth data were in line with the dynamic rise of sentiment indicators in 1Q17, though they showed mixed movements and a partial halt in June.

Headline CPI was 1.9% in June, matching market consensus and moving further down compared to February (multi-year peak of 2.9%) and recent months. At the same time, core inflation continued to move higher (2.4%). Domestic demand is also getting stronger, primarily due to higher wages. Inflation is expected to continue fluctuating in the range of 2-3% over the rest of the year. Industrial production reported a strong performance in May (6.2% yoy). External and internal balances remained strong amid volatile monthly export performances.

Financial Markets

The NBH left the policy rate unchanged (0.90%) in July, similar to the past year. The official statement reflected an unchanged macroeconomic outlook and a dovish monetary stance of the Monetary Council. The effective end-Q3 target for the 3M depo facility remained at HUF 300bn as set in June. The market adjustment is ongoing; short-dated T-bill rates and money market rates are close to zero in some cases, as the NBH's strategy is channeling liquidity to the interbank and FI markets. The long end of the yield curve has already begun to rise. The forint has become stronger recently, primarily supported by external market factors. The EUR/HUF cross rate has been fluctuating mostly below the 310 level since the middle of May, still close to the average range of the last year.

Banking Sector

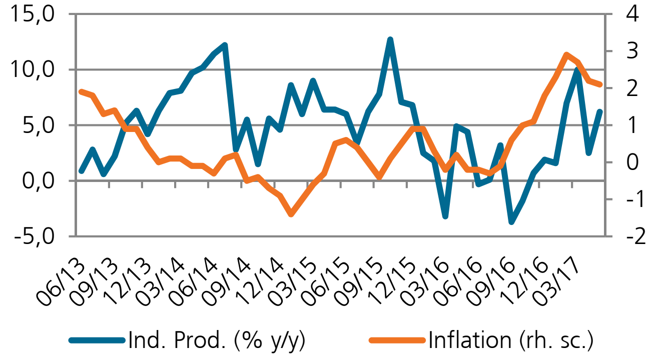
Loan stock to the private sector showed modest changes in May compared to the preceding month, still recording moderate rises on a yoy basis. Lending continued to households, while regarding the corporate sector, a probably temporary halt emerged. Deposits volumes continue to rise, despite the low level of interest rates. Real economic developments 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 now below 10%, according to the latest available data.

Latest economic indicators

%	Last value	1Q 2017	4Q 2016
Ind production yoy	6.2 (May)	6.2	0.3
Nom exports yoy	19.0 (May)	12.8	4.0
ESI (index)	118.6 (Jun)	115.7	112.4
Retail sales yoy	5.4 (May)	3.3	3.5
Inflation rate yoy	1.9 (Jun)	2.6	1.3
CB reference rate	0.9 (18th Jul)	0.9	0.9
Loans (priv sector, yoy, eop)	2.2 (May)	0.1	-1.9
Deposits (priv sector, yoy, eop)	10.7 (May)	9.6	6.3

Source: CSO, NBH, Bloomberg

Industrial production and inflation



Source: CSO

Romania

Real Economy

Sebastian Maneran

Incoming economic data continue to suggest the Romanian economy is still in an expansionary mode. The industrial production data for May 2017 showed very significant 15.3% yoy growth. However, the seasonality effect, on top of strong domestic stimulus, is likely to have played a big role. Retail sales more than doubled their growth pace in May 2017 to 12.3% yoy (from +6.1% yoy in April 2017) also on the back of the abovementioned factors. Exports continued to perform well in May 2017, rising by 19.3% yoy, outpacing import growth by a whisker, a sign that the higher fx rate (from a longer historical perspective) is having a positive effect.

Inflation continued to rise in June 2017, reaching 0.85% yoy (up from 0.64% yoy the previous month). The inflation data continue to print in line with broad market expectations that are rather well calibrated by the Romanian central bank. Furthermore, the June data point to the feeble impact of the statistical base effect, but also the asymmetric impact of the higher EUR vs RON exchange rate (specifically phone bills). Inflation is expected to come in below 2% at the end of the year.

Financial Markets

Domestic money market interest rates have stayed marginally firmer over June and July (some 5 bps above the deposit facility rate of 0.25%). Although the trending higher inflation rate (and as a consequence, a central bank that is calibrating liquidity in order to keep the market connected with fundamentals) is the fundamental story, the main focus was on cash flow movements determined by the primary debt market and maturing debt issues over the above-mentioned period.

The EUR/RON fx rate continues to be elevated (from a historical perspective) with the market focused on the significant domestic events. Even though 4.6 seems to be a line in the sand that the market is not yet willing to cross convincingly, the price movement seems to indicate a base building well above 4.5 level. Furthermore, it is noticeable that the EUR/RON fx rate is hovering above the 4.5 level with little appetite to descend below 4.55 for an extended period. Hence, the price movement seems to tell the story of a market that is willing to move higher on domestic risks while keeping an eye on the international events calendar.

Banking Sector

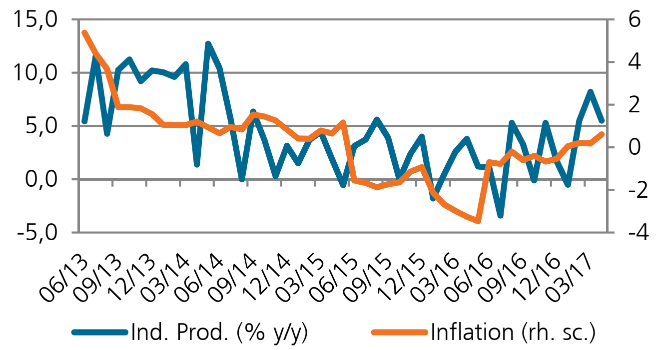
May 2017 data continue to print well within market expectations. Local currency credit continues to expand, whereas fx credit continues to contract. Households continue to lead the gains, with corporates lagging behind. Notwitstanding this, a key point is the somewhat tighter credit conditions for households pointed to by the quarterly central bank survey, and expectations are that the trend will continue.

Latest economic indicators

%	Last value	1Q 2017	4Q 2016
Ind production yoy	15.3 (May)	4.4	2.3
Nom exports yoy	19.3 (May)	10.0	7.7
ESI (index)	105.4 (Jun)	105.4	104.1
Retail sales yoy	12.3 (May)	7.2	8.9
Inflation rate yoy	0.8 (Jun)	0.1	-0.5
CB reference rate	1.8 (18th Jul)	1.8	1.8
Loans (priv sector, yoy, eop)	3.1 (May)	2.7	0.6
Deposits (priv sector, yoy, eop)	11.4 (May)	11.2	8.5

Source: National Statistical Institute, NBR

Industrial production and inflation



Source: NBR

Russia

Real Economy

Anna Mokina

The most significant contribution to Russian GDP in 1Q17 was made by household consumption and capital investments. Industrial production and retail turnover continued to grow in May (5.6% and 0.7%, respectively). In June, inflation accelerated to 4.4% yoy against 4.1% in May mainly driven by food price growth (4.8% against 3.9%), as inflation for services showed very little change (4.1% against 4%) while for non-food goods slowed (from 4.4% to 4%).

The acceleration of food inflation was due to rapid growth of prices for fruits and vegetables in April-June to 8.3% mom. The positive effect from large stocks from last year and the favourable dynamics of the ruble were exhausted. Additional pressure on annual food inflation came from a base effect, the gradual recovery of consumer demand and adverse weather. Cold weather in spring and summer can lead to a partial loss of a harvest, which, together with a lower level of stocks, could lead to an acceleration in inflation at the end of 2017, keeping it above 4% yoy. Inflation expectations in June nevertheless remained at the level recorded in May, according to the central bank, and core inflation continued to slow (from 4.1% yoy in April to 3.8% in May and 3.5% in June).

Financial Markets

The Bank of Russia is likely to take into consideration the risk of accelerating inflation in the short run due to food price increases. This might be an additional argument for the maintenance of the rate at 9% for longer at the September meeting. However, a further reduction of the policy rate, by at least 0.25 pp, is expected in the short term if no further acceleration of inflation occurs. The inflationary risks are actually on both sides: possible downward dynamics regarding the ruble (related to oil price weakness), tightness of Fed policy, and modest forecasts for the harvest this year increase the risks, while upward moves of the ruble (in case of energy price hikes) and a lack of recovery in consumer demand push them downwards.

Banking Sector

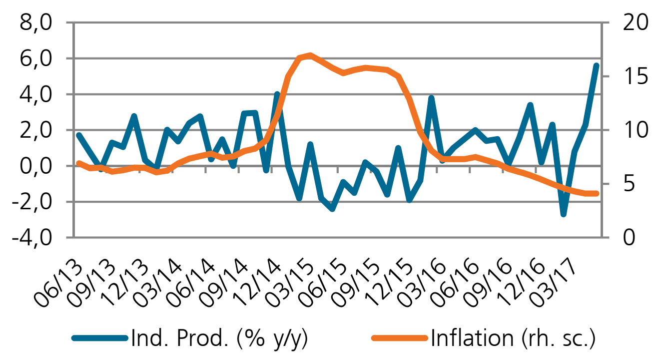
Real incomes did not decrease in May 2017 vs last year, though in April and May, retail turnover grew for the first time since the end of 2014. The growth of consumer lending, which might have supported the retail turnover in the context of stagnating real incomes, is viewed as a risk for the financial positions of households. Household lending increased in April, by 4% vs the previous year, whereas corporate lending slowed down by 2.5%. In April, the liability side was characterised by a 7% increase in deposits by individuals and a reduction in corporate deposits by 2.2% vs the previous year.

Latest economic indicators

%	Last value	1Q 2017	4Q 2016
Ind production yoy	5.6 (May)	0.1	1.7
Nom exports yoy	20.0 (Apr)	36.6	1.7
Retail sales yoy	0.7 (May)	-1.6	-4.6
Inflation rate yoy	4.4 (Jun)	4.6	5.8
CB reference rate	9.0 (18th Jul)	9.8	10.0
Loans (priv sector, yoy, eop)	-0.9 (Apr)	-3.1	-4.2
Deposits (priv sector, yoy, eop)	3.0 (Apr)	3.4	-3.9

Source: State Statistics Federal Service, Central Bank of Russia

Industrial production and inflation



Source: State Statistics Federal Service

Serbia

Real Economy

Marija Savic

Real GDP increased by 1.2% yoy in 1Q17, slowing down from 2.5% in 4Q16. Observed by activities, the highest yoy growth was recorded in financial and insurance (4.5%), wholesale and retail trade, repair of motor vehicles, transportation and storage, accommodation and food service (all by 2.8%). On the other hand, yoy declines were recorded in construction (-5.1%) and agriculture (-2.2%). This temporary slowdown in economic activity was primarily a consequence of adverse weather conditions, and as these effects passed, economic and foreign trade activity recovered in 2Q17.

Yoy inflation amounted to 3.6% in June 2017, still exceeding the midpoint of the inflation target tolerance band (3±1.5%) for the fifth consecutive month. Consumer prices gained 0.2% in June, due to seasonal movements in prices of travel packages and fresh fruit while lower prices for petroleum products and fresh meat worked in the opposite direction. Inflation should continue to move within the target tolerance band, with the expected drop to the 3% target occurring at the beginning of 2018. The main inflationary impact in the forthcoming period will come from a gradual increase in domestic aggregate demand and inflation abroad, while the high base for petroleum product prices will act as a dampener.

Financial Markets

In July 2017, the NBS left the key policy rate unchanged at 4.0%, in line with market expectations. The last move in the key rate was in July 2016, when it was cut by 0.25 pp, marking total rate reductions during 2016 at 0.5 pp. Choosing to keep the rate on hold, the central bank judged that it is currently at an appropriate level based on the effects of past monetary easing, current inflation movements, and projections that inflation will continue to move within the target tolerance band (3±1.5%).

The dinar has appreciated vs the euro by 2.3% since the beginning of the year while the NBS has sold EUR 345mn and bought EUR 640mn on the fx market in order to mitigate excessive daily volatility of the exchange rate. The dinar strengthened as a result of a favourable macroeconomic environment, increased interest of foreign investors in purchasing of long-term dinar securities, banks' increased euro-tied assets, and seasonal demand for foreign currencies.

Banking Sector

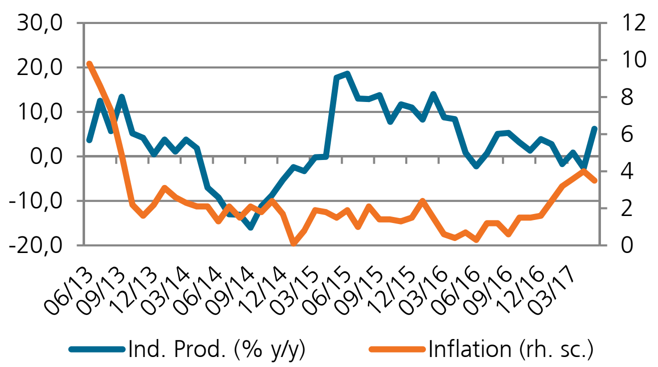
Loans to the private sector expanded by 3.3% yoy in May 2017, supported by household lending (11.5% yoy) while loans to the corporate sector declined (-2.5% yoy) due to NPL write-off effects. Deposits rose by 9.0% yoy, both from households (5.5% yoy) and the corporate sector (16.7% yoy). Economic recovery, lower cost of financing, and competition among banks in the lending market should continue to be the main drivers of bank lending this year.

Latest economic indicators

%	Last value	1Q 2017	4Q 2016
Ind production yoy	6.2 (May)	0.7	2.8
Nom exports yoy	18.7 (May)	12.8	15.8
Retail sales yoy	6.1 (May)	3.6	6.5
Inflation rate yoy	3.6 (Jun)	3.1	1.5
CB reference rate, eop	4.0 (18th Jul)	4.0	4.0
Loans (priv sector, yoy, eop)	3.3 (May)	4.5	2.4
Deposits (priv sector, yoy, eop)	9.0 (May)	12.0	11.5

Source: Statistical Office, National Bank of Serbia

Industrial production and inflation



Source: Statistical Office, National Bank of Serbia

Slovakia

Real Economy

Andrej Arady

The Slovak economy continues to perform well, with the latest round of real activity data confirming growth maintaining momentum of above 3%. Similar to its neighbouring countries, industrial output bounced back in May from the low levels of Easter-affected April. Indeed, jumping 3.9% over the month, industrial output in May returned to yoy growth exceeding 5%. All sectors grew over the monthvs contracting in April, particularly metal manufacturing, food production and automotive. Sales in retail outlets have also grown well, accelerating in May to 7.8% yoy, up from 6.5% in April and 5.5% in 1Q17. Expansion of retail sales and private consumption in general resulted from the favourable developments in the labour market, which boosted employment and thus household confidence. Indeed, the latest data revealed that employment increased to a new all-time high in 1Q17, while the unemployment rate, measured on labour offices' data, dropped in May to an historical low of 7.35%.

The changed fortunes in the domestic labour market meanwhile translated into higher wage demands. In late June, Slovakia saw its biggest strike ever in the private sector, as employees at VW Slovakia, the country's largest non-financial company by turnover, went on strike, demanding a 16% wage increase. While the eventual deal was short of this demand, it only underscores that wage costs for employers in Slovakia will be rising (last reported nominal wage growth rate was 3.5% yoy in 1Q17). Against this backdrop, consumer inflation remained surprisingly tame, down a tenth in June, to 1.0% yoy. The other measure of inflation, property price inflation, however, continued to pick up. Especially steep rises were seen regarding property prices for apartments, growth of which picked up to 12% yoy in 1Q17.

Financial Markets

Slovak interest rates continue to be driven by general monetary developments in the Eurozone. Short interest rates move with Euribor rates, while long yields remain linked to German bunds. As the latter rose in late June, after the hawkish statement of ECB President Mario Draghi in Sintra on 27 June, so did Slovak bonds. Yields of 10Yr Slovak bonds thus rose to above 1% from c.0.80% before the speech, maintaining c.60 bps spreads to bunds.

Banking Sector

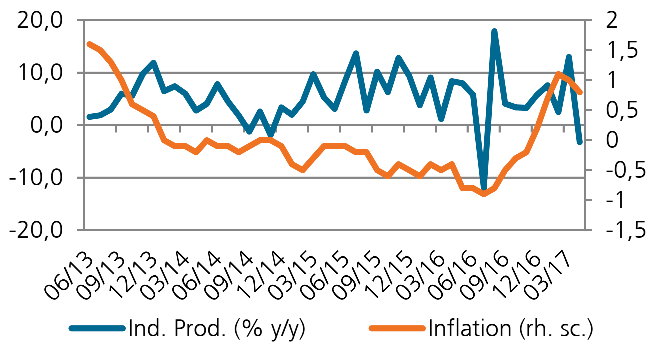
Regarding loan volumes, the Slovak banking sector continued to power ahead. In May, loan growth rose to 12.4% yoy from an already-steep 11.6% recorded in the previous month and 11.5% in 1Q. While the latest acceleration in lending growth relates to the corporate sector (10.1% yoy in May vs 8.1% in April), lending to households remains strong, at a 14.4% yoy rate, despite the efforts of the central bank to slow it down via tighter LTV and other lending conditions. Meanwhile, deposit growth slowed to 3.3% yoy growth in May from 4.0% in April and 4.5% in 1Q. The trend of the gross loans/primary deposits ratio thus continued to rise and in May actually exceeded 100% for the first time.

Latest economic indicators

%	Last value	1Q 2017	4Q 2016
Ind production, wda yoy	5.1 (May)	7.7	4.2
Nom exports, yoy	4.1 (May)	11.3	4.5
ESI (index)	102.3 (Jun)	104.6	102.8
Retail sales, yoy	6.5 (Apr)	5.5	3.0
Inflation rate, yoy	1.0 (Jun)	0.9	-0.1
ECB refi rate	0.0 (18th Jul)	0.0	0.0
Loans (priv sector, yoy, eop)	12.4 (May)	11.4	10.3
Deposits (priv sector, yoy, eop)	3.3 (May)	4.7	4.6

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

Nastja Benčič

Growth in foreign demand and competitiveness gains continued to boost the growth of exports, which strengthened further in May (14.1%). At the beginning of the year, construction investment started to rebound. In addition to the continuation of growth in housing investment, which started last year with the revival in the housing market, non-residential investment is also on the rise. Yoy inflation stood at 0.9% in June, due to higher prices for energy and services. Price growth for services is mainly related to the strengthening of private consumption. Price rises were recorded particularly for services related to leisure (accommodation and food service activities). The favourable economic trends are reflected in strong growth in general government revenue, which, amid moderate expenditures growth, contributed to a further decline in the general government deficit. In the first four months of 2017, the general government deficit amounted to EUR 85mn which is down significantly compared to the same period last year (when it stood at EUR 444.6mn). The strong revenue growth was mainly due to favourable economic conditions, including the situation in the labour market.

Financial Markets

Short-term interest rates remained deep in negative territory. The 3M Euribor rate is currently at -0.331% with no sign of recovery. The yield on Slovenia's benchmark 10Y government bond increased by 0.339 bps (to 1.204%) vs three months ago (0.865% on 13 April). Reuters published that Slovenia hopes to get European Commission approval to postpone the sale of its largest bank, state-owned Nova Ljubljanska Banka (NLB), until the end of 2020. Slovenia has committed to selling off 50% of NLB this year and another 25% in 2018 in exchange for the Commission's approval of state aid to the bank in 2013. Moody's reported that it maintains a stable outlook on Slovenia's banking system as loan quality improves and the economy grows. Slovenian 5Y CDS slipped to 72.3 bps, due to robust economic data.

Banking Sector

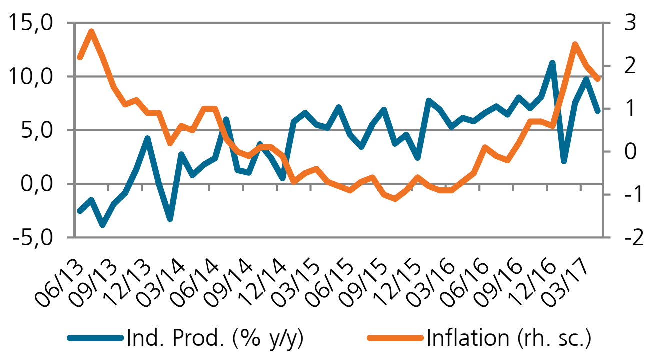
In May, total loans to the private sector were higher yoy (by 2.3%) based on higher mortgage and consumer loans, while corporate loans remained approximately EUR 100mn below last year's volumes (however, the decline in corporate volumes is slowing). In April, the share of NPE amounted to 7.9%. The increased share is due to changes in methodology: ie, the harmonisation of the definition of non-performing exposures with that of the European Banking Authority. According to this definition, loans classified as non-performing exposures are all the material exposures that are more than 90 days past-due or/and the debtor is assessed as unlikely to pay its credit obligations in full without realisation of collateral, regardless of the existence of any past-due amount or of the number of days past due. Total deposits at the end of May amounted to EUR 23bn (6.2% yoy). The loan/deposit ratio remained stable at 81%.

Latest economic indicators

%	Last value	1Q 2017	4Q 2016
Ind production, wda yoy	7.4 (May)	6.5	8.8
Nom exports yoy	14.1 (May)	11.9	4.5
ESI (index)	112.9 (Jun)	112.9	109.0
Consumer Confidence Indic.	-3.0 (Jun)	-6.0	-10.3
Inflation rate yoy	0.9 (Jun)	2.0	0.7
ECB refi rate	0.0 (18th Jul)	0.0	0.0
Loans (priv sector, yoy, eop)	2.3 (May)	1.6	-2.7
Deposits (priv sector, yoy, eop)	6.2 (May)	7.2	7.2

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

Giancarlo Frigoli

In the first five months of 2017, industrial production in Ukraine fell by 1.3% yoy. The mining industry posted a 7.4% decrease, while the supply of electricity, gas, steam and conditioned air declined by 5%. At the same time, the manufacturing industry showed a 2.6% increase. Industrial production in the Luhansk region decreased by 28% yoy, and in the Donetsk region by 13%. Construction activity remained particularly strong, jumping by 20.8% in May, its 14th consecutive two-digit gain, and by 22.8% in the first five months of 2017. The Central Bank of Ukraine recently cut its forecast for real GDP growth in 2Q to 1.5% compared to a previous projection of 2.4%. The central bank also cut its real GDP growth projections for the whole year. According to the bank, economic growth will slow to 1.6% in 2017. The weaker growth forecast reflects the poorer economic performance, particularly in services, and the revised crop yields assessments. Industries most susceptible to the breach of production ties with the uncontrolled territories of Donbas (the mining and metals sector, energy industry, transport industry) should continue to underperform. Real GDP growth should rebound to 3.2% in 2018.

Financial Markets

At its policy meeting in early July, the Board of the National Bank of Ukraine decided to keep its key policy rate unchanged at 12.5%. This decision resulted from the need to reduce inflation risks. Headline inflation rose to 13.5% in May and 15.6% in June. These figures were slightly higher than those projected by the NBU in its Inflation Report (April 2017). In the meantime, core inflation was stable at 6.5%. The NBU has not changed its inflation projections for 2017-18, forecasting inflation rates of 9.1% for 2017 and 6.0% for 2018.

Banking Sector

Davidia Zucchelli

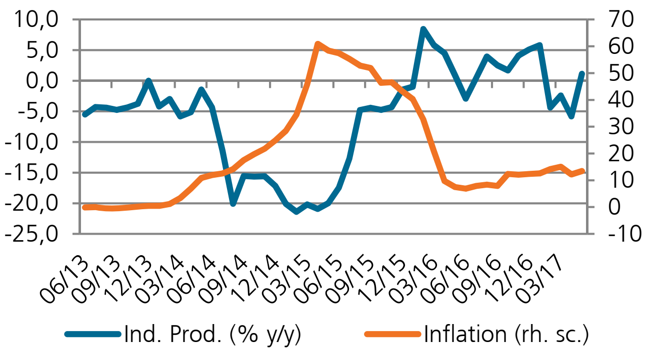
Lending data as of May are not available on the website of the NBU. According to the last Financial Stability Report, over the last six months, the main risks to the banking sector have subsided. Nevertheless, the NPL rate (57% in April) remained very high. Write-offs require amendments to legislation to protect banks from negative tax implications. A new mechanism of financial (out-of-court) restructuring was launched in March. Banks have been asked to develop a strategy for handling NPLs. The portfolio of corporate loans has remained practically unchanged in the last few months. This is mainly due to the heavy debt burden on businesses, slow economic recovery, and weak protection of creditors' rights. At the same time, retail lending has started to grow—mainly consumer and credit card loans. The recovery of mortgage lending has been slow. The banking sector's funding base remains stable; almost all bank liabilities are sourced from the domestic market. Total deposits increased by 6% as of May, both in the corporate (5.7% yoy) and the household (6.1% yoy) sectors. However, most funds attracted by banks from households and businesses are short term in nature: over 50% of all household funds are current accounts or deposits maturing in less than one month.

Latest economic indicators

	Last value	1Q 2017	4Q 2016
Ind production yoy	1.2 (May)	-0.3	3.6
Nom exports yoy	25.9 (May)	38.4	-5.6
PMI manufacturing	n.a.	n.a.	n.a.
Retail sales	10.7 (May)	3.3	2.9
Inflation rate yoy	15.6 (Jun)	14.0	12.3
CB reference rate	12.5 (18th Jul)	14.0	14.0
Loans (priv sector, yoy, eop)	-3.2 (Apr)	-5.0	2.0
Deposits (priv sector, yoy, eop)	6.0 (May)	5.6	9.1

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

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[1]. chg.yoy			Export nom. ch yoy			Inflation chg yoy				FX reserves chg (mln €)[2]			CA bal. (mln €)[3]	
	1Q17	4Q16	2016	Last	mth	1Q17	Last	mth	1Q17	Last	mth	1Q17	2016	1Q17	4Q16	2016	1Q17	4Q16
CEE																		
Czech Rep.	2.9	1.9	2.4	8.1	May	5.0	10.1	May	6.7	2.3	Jun	2.4	0.7	n.a.	n.a.	n.a.	n.a.	n.a.
Hungary	4.1	1.6	2.0	6.2	May	6.2	19.0	May	12.8	1.9	Jun	2.6	0.4	n.a.	n.a.	n.a.	n.a.	688
Slovakia	3.1	3.0	3.3	5.1	May	7.7	4.1	May	11.3	1.0	Jun	0.9	-0.5	n.s.	n.s.	n.s.	190	-590
Slovenia	5.3	2.6	2.5	7.4	May	6.5	14.1	May	11.9	0.9	Jun	2.0	0.2	n.s.	n.s.	n.s.	767	548
SEE																		
Albania	3.9	4.0	3.5	n.a.	n.a.	n.a.	-0.3	Jun	15.7	2.2	Jun	2.4	1.3	n.a.	-153	n.a.	n.a.	-240
Bosnia H.	2.7	2.6	2.1	-1.1	May	2.2	20.5	May	17.4	2.2	May	1.1	-1.1	-148	44	473	-168	-180
Croatia	2.5	3.4	3.0	3.3	May	2.0	0.4	Apr	22.4	0.7	Jun	1.1	-1.1	2558	475	-193	-1528	-679
Romania	5.6	4.7	4.8	15.3	May	4.4	19.3	May	10.0	0.8	Jun	0.1	-1.5	699	-1046	-350	-3248	-1440
Serbia	1.2	2.5		6.2	May	0.7	18.7	May	12.8	3.6	Jun	3.1	1.1	-549	600	-52	-624	-390
CIS MENA																		
Russia	0.5	0.3	-0.2	5.6	May	0.1	20.0	Apr	36.6	4.4	Jun	4.6	7.1	12732	-14323	-1356	23283	10124
Ukraine	2.5	4.8	2.3	1.2	May	-0.3	25.9	May	38.4	15.6	Jun	14.0	14.9	-440	263	-466	-808	-953
Egypt	4.3	3.8	3.8	25.2	May	19.0	8.4	Apr	20.8	29.8	Jun	29.8	13.7	4261	4673	7820	-3529	-4666
m.i. E. A.	1.7	1.8	1.8	4.0	May	1.3	0.0	May	10.7	1.3	Jun	1.8	0.2					

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

Markets and Ratings

	S/T rates[1]		L/T rates[2]		Foreign exchanges[3]			Stock markets		CDS spread (bp)		Rating
	18/07	chg bp 3M	18/07	chg bp 3M	18/07	3M chg%	1Y chg%	3M chg%	1Y chg%	18/07	18/04	S&P
CEE						Vs Euro						
Czech Rep.	0.0	-0.3	1.0	-0.1	26.1	-2.5	-3.5	3.4	15.0	37.5	37.6	AA-
Hungary	0.2	0.0	3.1	-0.1	306.5	-2.0	-2.8	10.4	32.6	100.9	104.5	BBB-
Slovakia	-0.3	0.0	1.0	0.0	Euro	Euro	Euro	9.4	7.3	38.8	38.9	A+
Slovenia	-0.3	0.0	1.2	0.4	Euro	Euro	Euro	4.4	15.9	72.3	75.9	A+
SEE												
Albania	1.2	0.0	n.a.	n.a.	132.4	-2.1	-3.1	n.a.	n.a.	n.a.	n.a.	B+
Bosnia H.	n.a.	n.a.	n.a.	n.a.	1.96	Board	Board	n.a.	n.a.	n.a.	n.a.	B
Croatia	0.6	0.0	2.9	-0.1	7.4	-0.3	-1.2	-4.4	7.8	154.4	175.8	BB
Romania	0.7	0.0	3.9	0.0	4.6	1.0	2.1	-1.2	22.8	94.5	94.5	BBB-
Serbia	4.0	0.0	n.a.	n.a.	120.2	-2.7	-2.5	-4.9	19.5	149.0	199.2	BB-
CIS MENA						Vs USD						
Russia	9.2	-0.8	7.8	-0.2	60.2	7.0	-4.7	0.6	0.2	153.2	155.9	BB+
Ukraine	16.2	-1.0	9.7	0.0	26.0	-3.1	4.7	-4.4	11.4	611.0	1253.8	B-
Egypt	0.0	-19.3	18.7	1.6	18.0	-1.1	102.3	8.2	89.9	364.4	326.4	B-
m.i.A.E.	-0.3	0.0	0.5	0.4	1.1	7.0	3.4	2.6	12.5	6.0	12.1	

Source: Datastream, Reuters;[1] The data for Albania refers toJanuary, for Egypt refers to july, for Czech Republic refers to july; [2]For Ukraine, the long-term rate refers to a government issue in dollars; [3] The (-) 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*. %				DepositsRate[1]-NewB*. %				Loans/Dep %		
	Last	Mth	2016	Last	mth	2016	Last	mth	2016	Last	Mth	2016	Last	mth	2016	S[4]	Last	mth	2016	S[4]	Last	mth	2016
CEE																							
Czech Rep.	7.8	May	6.7	4.8	Dec	4.8	33.3	Nov		10.3	May	5.8	1.92	May	1.86	C	0.85	May	0.91	A	75.6	May	76.6
Hungary	2.2	May	-1.9	9.0	Dec	9.0	5.4	May	-7.0	10.7	May	6.3	2.31	May	3.12	C	0.37	May	0.54	A	84.9	May	83.8
Slovakia	12.4	May	10.3	4.5	May	4.7	-2.4	May	0.8	3.3	May	4.6	2.48	May	2.6	C[2]	0.4	May	0.49	H[2]	97.3	May	94.9
Slovenia	2.3	May	-2.7	7.9	Apr	8.5	-11.8	May	-17.9	6.2	May	7.2	2.55	May	2.81	C[2]	0.1	May	0.23	H[2]	81.4	May	81.0
SEE																							
Albania	-1.4	May	0.2	15.9	May	18.3	-8.6	May	-13.2	2.0	May	2.7	7.56	May	7.01	A	0.75	May	0.78	H	53.0	May	52.3
Bosnia H.	6.1	May	3.4	11.5	Mar	11.8	2.8	May	-5.3	9.0	May	7.4	3.96	May	4.62	C	0.36	May	0.55	H	110.5	May	110.1
Croatia	-2.6	May	-4.3	13.9	Mar	13.8	-22.4	May	-26.6	2.1	May	2.8	4.39	May	4.47	C	1.06	May	1.26	H	82.9	May	80.5
Romania	3.1	May	0.6	9.5	Dec	9.5	-13.4	May	-21.8	11.4	May	8.5	4.02	May	3.72	C	0.8	May	0.9	H	83.9	Mar	83.0
Serbia	3.3	May	2.4	16.1	May	17.0	-8.6	May	-9.1	9.0	May	11.5	5.7	May	5.42	C	2.79	May	3.01	H	103.0	May	102.3
CIS MENA																							
Russia	-0.9	Apr	-4.2	9.7	Mar	9.4	-12.5	Oct		3.0	Apr	-3.9	11.02	Apr	11.83	C	6.25	Apr	6.5	H	105.4	Apr	107.7
Ukraine	-3.2	Apr	2.0	55.1	Mar	30.5	-12.4	Mar	-8.0	6.0	May	9.1	21.18	Apr	22.88	R[3]	14.62	Apr	16.31	R[3]	133.2	Apr	136.8
Egypt	39.1	Mar	42.8	5.7	Mar	5.8	144.5	Mar	256.6	40.6	Mar	41.4	16.7	Apr	16.3	C	10.9	Apr	10.3	H	38.8	Mar	39.2
m.i. E. A.	1.5	Apr	1.0	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	2.4	Apr	3.3	1.4	Apr	1.4	C	0.4	Apr	0.4	H	81.9	Apr	81.9

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
[4]Sector A=All, C=Corporates, H=Household, PS=Private Sector, R=Residents.

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