Monthly Note
Countries with ISP Subsidiaries

October 2018

Monthly note

Intesa Sanpaolo
International Research Network

High frequency indicators signal a moderation of a still robust business cycle overall. Inflation is accelerating slightly, supporting expectations of gradual removal of easy monetary stances in the CEE/SEE area.

The most recent business cycle indicators confirm, overall, a deceleration of the economic activity among CEE/SEE countries on a lower, but still robust sustainable path, as expected in our September Forecast note. In August, industrial production growth slowed to 3.5% yoy from the 7.4% recorded in July, and in September, the PMIs and ESIs fell below the peaks recorded in the previous months.

In September, inflation was accelerated slightly from 2.3% in 2Q, ranging from 1.9% in Poland to 3.6% in Hungary for CEE countries and from 1.4% in Croatia to 5.0% in Romania among SEE countries. With the only exception being Romania, which though even if on a decelerating path, it is still above the upper bound of the target, inflation is within the ranges set by the CBs (and still often below the central values in the SEE area).

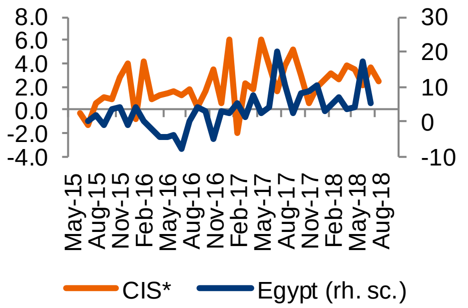
At their last board meetings, the CBs of CEE/SEE area countries have overall confirmed easy stances of monetary policy, with the exception of the CBs of Czech Republic and Romania, where tightening cycles had already started in August 2017 and January 2018, respectively. In other CEE countries, as in the the case of the MNB in Hungary and the ECB in the Euro Area, the CBs have started to remove some of the extraordinary measures previously adopted.

Expected changes in monetary stances and in risk premia are affecting long-term yields which have increased overall in the CEE region in the last three months in a range from 0.1-0.2pp in Poland and Czech Republic to a max of 0.4pp in Hungary. Regarding FX markets, the Hungarian exchange rate has recovered slightly, towards 320 in the last few weeks, though it is c.5% weaker against the euro vs a year ago.

In the CIS area, in Russia, GDP growth is estimated to have slowed to 1.5% in 3Q compared to 1.9% in 2Q, and inflation rose to 3.4% in September. In Ukraine, inflation eased further in September (to 8.9%), but it is expected to jump in November, following the hike in gas tariffs as part of a new deal with the IMF. In the MENA region, Egypt's headline inflation jumped to 16% in September, the upper limit of the CBE's target range, and weak foreign demand sent T-bill rates higher.

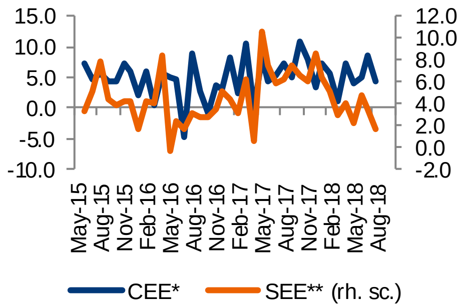
Banking aggregates strenghtened further as of August. Loans showed a slight acceleration in all countries with the only exception of Albania (-3.3% yoy), partly affected by the appreciation of the exchange rate. The performance has been strong in Hungary (+9.5%), due to the corporate sector, and in Slovakia (+9.4%), due to the household sector. Loans to households also accelerated in Serbia (+10.4% yoy), Bosnia (+7.3%) and Russia (19.7% yoy in July). Deposits also increased overall, in particular in Hungary (+16.1%) and Romania (+10.3%). The increase in deposits remained strong overall among corporates in Hungary (+20.6% yoy) and Bosnia (+16.3%), and among households (over +10% yoy) in Hungary, Romania and Ukraine. NPLs have remained at rather critical levels in Ukraine (56%), though these are concentrated among state-owened banks and mostly covered. In Egypt, bank lending in July accelerated in the private sector (+10.8%) while deposits' growth remained significant (+19.9%).

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 and Czech Republic among the CEE countries, with the addition however of Poland where ISP is present with a Branch, Albania, Bosnia, Croatia, Serbia and Romania among SEE countries; Russia and Ukraine among CIS countries; Egypt among MENA countries.

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

Cross Country Analysis

CEE area

Antonio Pesce

In the **CEE region**, readings of most recent coincident and forward-looking business cycle indicators confirm our view of an economic dynamic that is still strong, but starting on a more moderate path towards more sustainable growth. In August, on average, industrial production decelerated to 4.2% yoy from 8.6% in July while exports and retail sales softned to 3.1% and 2.1% from, respectively, 5.3% and 2.3%. Finally, in September, the Economic Sentiment Indicator (ESI) fell on average to 108.4 from 109.4 in August. On inflation, in September, it remained stable, with a regional average of 2.3%, the same as the consumer price dynamic recorded in the previous two months. At the same time, core inflation recorded a slight increase, to 0.8% from 0.7%.

Beyond this general picture, there are some differences among CEE countries. In **Czech Republic**, in August, industrial production grew by 1.9% yoy, below the 2Q average (2.3%) and July data (6.7%), with in particular the automotive sector (-6.0% yoy) negatively affected the performace of the general index, while production of electrical and electronic goods remained strongly positive (7.7% yoy and 20.5% yoy respectively). In the same month, exports grew by 2.5% yoy in nominal terms, after expansion of 10% yoy in July. The ESI, however, rose to 109.1 in September from 107.3 of the previous month. In **Hungary,** in August, industrial production and exports weakened to 1.5% yoy and 0.9% yoy from, respectively, 6.2% yoy and 11.0% yoy in July; in working days-adjusted terms, however, industrial production growth remained robust and even accelerated, to 4.5% from 3.9%. In September, the PMI remained above the threshold of 50, though it edged down to 53.8. In **Poland**, in September, the industrial production trend also remained positive (2.8% yoy), but was below the previous month (5.0%) and lower than the Q3 average (6.1%). At the same time, the ESI decreased slightly, but remained close to the historical high.

In **Slovakia**, industrial production decelerated again in August (2.1% yoy) and exports softened to 5.8% yoy in nominal terms, after the recod high for the year seen in July (14.3%). In **Slovenia,** ndustrial production decreased by 6.8% yoy from the previously recorded 7.9% yoy in raw data, but accelerated in working days-adjusted terms to 7.0% (from 5.4%). In September, the ESI fell slightly with respect to August in both Slovakia and Slovenia.

Regarding **inflation**, in September, in the region it reached on average 2.3% (a slight acceleration from 2.1% in Q2) ranging between 1.9% in Poland, where the core component decreased to 0.8% from 0.9% in the previous month, to 3.6% in Hungary, where core inflation increased to 2.4% from the previous 2.2%, with both price indeces signalling inflationary preassure risks. Inflation is within the ranges set by the CBs, with the only exceptions being Slovakia and Slovenia.

The central banks of the CEE countries have maintained easy stances overall, but measures have been put in place in some cases or are expected to occur in others, pointing to a gradual removal of monetary accommodation. In **Czech Republic** – where inflation was rising in previous months – the CB actually started a tightening cycle in August last year and through several steps increased the policy rate up to 1.5%. After the recent pause, sustained by a decelerating inflation rate, a further increase is expected by year-end. At its October meeting, in **Hungary,** the CB started to partially remove the unconventional monetary policy measures previously adopted. By the end of the year, the maximum limit that credit institutions can deposit at the MNB (currently set at HUF75bn) will be removed. Moreover, by the end of 2018, the mortgage bond purchase programme will also terminate. In the meantime, however, a new edition of the "Funding for Growth" programme will be launched for a total of HUF1,000bn in 2019, with the aim of supporting loans to small and medium-sized enterprises. However, this programme will not generate more liquidity in the system because the MNB will implement sterilisation. In **Slovakia** and **Slovenia**, the removal of extraodinary monetary conditions follows the end of the

QE announced by the ECB. Expected changes in monetary stances and in risk premia are affecting long-term yields, which have increased in the region as of 17 October with respect to three months ago by 0.2-0.4pp on average, in parallel with an increase in the Euro Area benchmark by 0.2pp. The highest increase occurred in Hungary, where long-term interest rates moved upwards by 0.4pp, to 3.9%. Over the last few months, the Hungarian **exchange rate** has remained weaker vs the euro with respect to one year ago, but it has recovered slightly recently, to 322.3 as of 17 October from the peak of 327 reached at the end of August-early September.

Davidia Zucchelli

In the **CEE region,** the dynamics of banking aggregates accelerated further as of August. Lending growth continued to be supported, particularly by households in Slovakia, Slovenia and Czech Republic, and by the corporate sector in Hungary. The increase in deposits was still dynamic, especially in Hungary. Bank interest rates generally remained low, in line with money market rates, though a slight increase occurred in Czech Republic.

In **Czech Republic,** lending growth was in line with previous months (6.3% yoy as of August from 6.2% in July), supported particularly by the household sector (7.5% yoy) which accounts for almost 60% of total loans to the private sector, while growth of corporate loans was lower, but strengthening, to 4.5% yoy (from 1.6% yoy as of May). Deposit growth was also dynamic (+5.4% yoy in August from +5.6% yoy in July), decelerating among corporates (to 0.5% yoy from 1.4% yoy in the previous month), but marginally accelerating among households (to 7.6% yoy from 7.5%).

In **Hungary**, loans accelerated further as of August (+9.5% yoy from +9.1% yoy in July), supported by the improving macroeconomic situation, particularly to corporates (15.5% yoy), while loans to households increased slightly (3% yoy) sustained by loans in local currency (+3.1% yoy which, following the conversion measures of the last years, now covers over 99% of total loans to households). The dynamics of deposits remained strong (+16.1% yoy) both for corporates (+20.6%) and households (12%). In **Poland**, loans accelerated slightly (+6.1% yoy in August from 5.7% yoy in July) both in the corporate (+6.4% yoy) and the household (+6% yoy) sectors. Deposits increased as well (+7.4% yoy in August from 7.1% yoy in June), both among households, at +7.6% yoy, and corporates (+6.8%).

Lending growth continued to be strong in **Slovakia** as well (9.4% yoy in August from 9.6% in July), fueled by economic growth and low interest rates, especially in the household sector (by 12.8%), driven by a further rise in mortgages. Loans to corporates increased by 4.8%. Deposits also grew (6.2% yoy) among both households (5.6%) and corporates (7.2%). In **Slovenia**, total loans confirmed a a more moderate dynamic (+2.7% yoy), driven by strong households' performance (+6.5%). Corporate lending decreased by 1.1% yoy in August because of write-offs, but they appeared to be improving according to flow data on new lending. NPLs amounted to 4.6% of total loans, gradually declining from 6% as of December 2017. Deposits (+7.4% yoy in August in the private sector) remained dynamic in both the corporate (9.2% yoy) and the household (by 6.7% yoy, as in the previous month) sectors.

SEE area

Antonio Pesce

As for CEE countries, high frequency economic data and surveys have confirmed, overall, the deceleration of economic activity among **SEE** countries on a lower, but still robust, sustainable path. In August, industrial production and export dynamics declinde on regional averages to 1.7% yoy and 3.5% yoy from, respectively, 3.5% and 10.6% in July. The retail sales trend decreased as well on average, to 2.1% from 4.2%.

The export growth rate remained in double digits in **Albania** (10.7% yoy in August) while decelerating in **Bosnia** (to 1.0% in August from 11.9% recorded in July). In **Croatia**, industrial production contracted again in August (-2.5% yoy); however, export growth was still strong in July (7.9% yoy), even if lower with respect to the Q2 average (8.7%). In **Romania,** in August, industrial production and exports decelerated to 3.7% yoy and 4.3% yoy from, respectively, 7.3% and 12.9% in the previous month. But in September, the ESI remained high, close to the previous month's level. In **Serbia** in August as well, industrial production contracted (-4.3% yoy) for the first time in more than a year; exports continue to increase strongly, by 8.2% yoy, but were nevertheless below the growth rate recorded in July (13.3%).

In September, **inflation** decelerated slightly on a regional average, to 3.5% from 3.7% in August and to 3.8% in Q2 (to 1.6% from, respectively, 2.2% and 1.8% if Romania is excluded from the basket), ranging from 1.4% in Croatia to 5.0% in Romania, where it remained close to a five-year high and well above the upper bound of the central bank's corridor target (2.5% +/- 1.0%). In the SEE region, inflation was primarily driven by energy prices, while core inflation was stable, and still low in several cases, such as Croatia (0.8%) or Serbia (1.1%).

At their last meetings, the boards of the central banks of SEE countries confirmed easy **monetary policies** supportd by the still low readings for inflation, quite often below central bank targets. The only exception was Romania, where due to inflationary pressures, the CB started a tightening cycle in January and, in several steps, increased the policy rate up to 2.5%. **Exchange rates** were roughly stable vs the euro in the past few months, though a slight but continuous appreciation has been seen for the Albanian lek at 125.3 on 17 October, representing appreciation of 6% yoy.

Davidia Zucchelli

Banking aggregates generally followed an increasing path in SEE countries, with the only exception being Albania, where both loans and deposits, partly due to an exchange rate effect, contracted, and corporate loans in some countries, ie, Croatia and Serbia, where, partly due to write-offs, they still recorded weak performances.

The performance of banking aggregats in **Albania** continued to be the most fragile in the region. Lending decreased further (-3.3% yoy as of August), particularly to corporates (-6.7% yoy) and even, though still positive, decelerated to households (+4.2% yoy). The lek's appreciation (-5% yoy recorded in August) partly explains the loan performance. When considering that 50% of lending was denominated in foreign currency, net of the exchange rate effect, loans fell by 0.7%. The NPL ratio decreased marginally, to 12.9%. Deposits decreased further in the private sector (-1.3% yoy from -1.8% yoy), pushed down by household deposits (-2.4%), while deposits from businesses increased (by 3.7%). When considering that more than 50% of deposits was denominated in euros, net of the exchange rate effect, total deposits increased by 1.4% (by 0.3% in the household sector). In **Bosnia**, the upward trend of banking aggregates continued. Loans increased by 6.4% yoy in August and deposits rose by 9.8% yoy (by 16.3% yoy for corporates and 7% yoy for households).

In **Croatia** loans increased by 2.1% yoy as of August (from 1.8% yoy in July). Corporate loans remained weak (-1.4% yoy) while household loans accelerated by 4.6% yoy. Deposits continued to grow (4.9% from 4.3% yoy in July), both from corporates (at 5.7%) and households (4.7% yoy). In **Romania**, loans increased in August by 7.1% yoy (from 6.7% yoy in July), particularly in the household sector, at 9.4% yoy, while loans to corporates increased by 4.1% yoy (3.6% yoy in July). NPLs continued to decrease (to 5.7% of total loans). Deposits performed well (10.3% yoy, although decreasing slightly). Loans performance continued to be supported by households (10.4% yoy) in **Serbia,** while loans to corporates decreased (-0.8% yoy, therefore cancelling improvements seen in previous months) so that total loans increased by 4.2%. Loans in foreign currency increased by 5.2% yoy, which led the share of loans denominated in foreign currency to 67.5% of total loans to the private sector. Deposits continued to perform well (8.1% yoy, 8.7% from corporates and 7.8% from households). Euroisation remained high among deposits (around 70% of the total).

CIS and MENA areas

Giancarlo Frigoli

In **Russia**, the softness of recent activity data suggests that GDP growth slowed to 1.5% in Q3 from 1.9% (revised from 1.8%) in Q2. In September, manufacturing output fell by 0.1%, the first negative number since last December. Retail sales rose by 2.2% yoy, down from 2.8% in August; construction activity edged higher to 0.1% from -0.8% in August. Agricultural production recorded a new significant fall (-6% after -10.8% in August). The only bright spot was mining activity, which gained 6.9% in September, following a 4.6% increase in August, mainly helped by oil extraction.

Annual inflation accelerated to 3.4% yoy in September from 3.1% in August, and core inflation increased from 2.6% to 2.8%. The headline rate is, however, expected to rise above 4% at the start of next year, due to the announced VAT hike (from 18% to 20%) starting in January. At its meeting on 26 October, the CB left interest rates unchanged after the 25bps increase on 14 September, which was motivated by increasing inflationary preassures, risks posed by external conditions, and local currency weakness. Since then, the ruble has strengthened to 65.5 vs the US$ from its peak (c.70 against the US$) on 10 September.

In mid-October, IMF staff and the **Ukrainian** authorities reached agreement on economic policies for a new 14-month Stand-By Arrangement (SBA). The new SBA will replace the arrangement under the Extended Fund Facility (EFF) approved in March 2015 and set to expire in March 2019. Assistance under an SBA compared to assistance provided under the EFF features a shorter programme engagement and a shorter repayment period. The new SBA, with a requested access of UAH2.8bn (equivalent to US$3.9bn) will also enable Ukraine to access financing from other international institutions. The agreement is subject to approval by the IMF Executive Board, which is expected later this year, following Ukraine's parliamentary approval for the budget for 2019, consistent with IMF staff recommendations. On Friday, October 19, the government decided to raise gas prices for households by 23.5% from 1 November, but the new level is still significantly lower than market prices. nflation slowed slightly, to 8.9% yoy in September compared with 9% in August, below the central bank target of 10.7% at end-2017. Core inflation was 8.7% yoy in September. The household gas price hike is expected to push the annual inflation rate higher. The deal with the IMF opens the door to monetary policy easing in 2019. Part of the reason for Ukraine's five policy rate hikes this year relate to the Ukrainian National Bank's (NBU) dissatisfaction over the government's stalled cooperation with the IMF. On 25 October, the NBU at its meeting revised its 2018 inflation forecast upwards, from 8.9% to 10.1%, discounting the impact of the increase in gas tariffs, but it left its main policy rate unchanged at 18%.

In **Egypt**, the annual inflation rate accelerated for the third month to an eight-month high. Consumer prices rose by 16% in September, their fastest pace since January. That puts the annual figure at the ceiling of the central bank's target range of 13% +/- 3%. Core inflation, a measure that strips out volatile and regulated items, slowed slightly, to 8.6% from 8.8% a month earlier. That suggests food prices were the main reason for the jump in the headline rate. With inflation at such a level, the CBE is unlikely to cut policy rates this year (the next policy meeting is 16 November) or even early next year. Such a step would also risk deepening the flight of foreign cash pumped into Egyptian treasury bills and bonds, an outflow that reached around US$7bn from April to August. This outflow is associated with recent volatility in capital flows to some emerging markets. The PMI index returned to below the 50 threshold in September, dropping to 48.7 from 50.5, on weak export orders. At the most recent auction, the 91-day Treasury bill rate rose to 19.7%, its highest level in more than a year, following weak foreign demand for Egyptian assets, reflecting a slowing appetite for emerging countries' high-yielding assets in world financial markets.

Davidia Zucchelli

In **Russia**, loan performance remained strong in July (+10.6% yoy from +9.7% in June) both in the corporate (+7.5% yoy) and the household (+19.7%) sectors. Good loans performance supported NPL ratio improvement (at 10.8% from 10.9% seen in the last three months). Deposits also increased significantly (+8.4% yoy in July), both among corporates (7.8%) and households (8.9%). Interest rates on new loans to businesses remained at 8.75% in July, declining slightly from 9.4% in December 2017, as did the interest rate on deposits from households (to 5.04%in July from 5.5% in January). An increase is expected in the near future, driven by official rate increases that occurred in September.

Thanks to improving macroeconomic conditions, lending in **Ukraine** intensified its recovery (+10.3% yoy as of July from 8.3% yoy in June), particularly in the household sector (+17.1% yoy from 15.1% in June), but also among corporates (+8.8% from 6.7% in June). A high NPL rate (55.7% at the end of June) is associated with state-owned banks and is mostly covered. Deposits increased by 13% (vs 10.9% yoy in June), both from corporates (13% in July from 7.9%) and households (13% from 12.4%) still supported by remittances. The LTD ratio remained high, despite decreasing recently (125% from 129% as of May).

In **Egypt**, loans and deposits grew by 10.8% and 19.9%, respectively, as of July (from 10.4% and 20.7% in June). But, in real terms, net of around 14% inflation, changes remained negative in lending and around 6% in deposits. Deposits increased (+20% yoy) both from corporates (13.8%) and households (21.4%). The LTD ratio remained very low (34%). Lending interest rates on new business decreased to 17.6% in August (from 19.8% in December) and deposit interest rates fell to 11.9% (from 13.6% at the end of 2017).

Country-Specific Analysis

Albania

Real Economy

Kledi Gjordeni

The 2Q18 growth data showed that GDP grew at 4.3% vs 4.1% in the same period last year and 4.5% in 1Q. Economic activity has been supported by both domestic (consumption and investments) and external (exports) demand. Employment and wage increases have supported consumption (+3.4% in 2Q from 2.3% in 2Q17).

Moving to business indicators in 3Q, exports increased in August by 10.7% yoy while imports decreased by 2.5%, with an improvement of the trade deficit by 10.3. Positive contributions to exports came from minerals, fuels and electricity, with a negative contribution made by textiles and footwear.

The good performance by the economy has been accompanied by a build-up of domestic inflationary pressures. The annual rate of the consumer price index in September was 2.1% vs 1.6% a year ago. Inflation in September was pushed up mainly by food, housing, water and electricity inputs.

Financial Markets

Interest rates for the Albanian lek have remained stable in the last three months. Despite a downward shift of the balance of risks in the short term, the decisions of the CB in its monetary policy meeting of 3 October to maintain an accommodative stance and intervene in the FX market have been transmitted to the market.

In October 2018, the Albanian government has successfully achieved its third Eurobond issue in the international markets with a yield of 3.5% and a maturity of seven years. The demand was higher (at about €1bn) with respect to the €500m required by the Albanian government. The bond issue allows more liquidity in the Albanian market.

Banking Sector

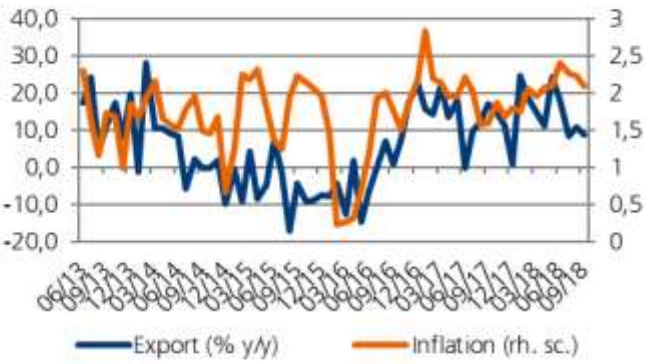
Credit demand remained sluggish. Loans to the private sector remained negative, although credit risk has been moving downwards, as shown by the drop-off (though still high) in the ratio of non-performing loans to 12.9% in August 2018 from 13.2% in December 2017. Total loans to the private sector in August 2018 shrank by 3.3% yoy. The negative impact continued to come from corporate loans which decreased by 6.72 % in August while household lending expanded by 4.18%. Deposits in August 2018 shrank by -1.32% yoy. Household deposit decreased by 2.37% while corporate deposits advanced by 3.75%.

Last Economic Indicators

%	Last value	2Q 2018	1Q 2018
Ind production, wda yoy	n.a.	n.a.	n.a.
Export of goods, nominal yoy	10.7 (Aug)	17.9	19.0
Unemployment rate	n.a.	12.4	12.5
Inflation rate, average yoy	2.1 (Sep)	2.2	1.9
Loans (priv sector, yoy, eop)	-3.3 (Aug)	-2.6	0.2
Deposits (priv sector, yoy, eop)	-1.3 (Aug)	-1.6	-1.4

Source: INSTAT, Central Bank of Albania

Exports and inflation



Source: INSTAT

Bosnia and Herzegovina

Real Economy

Ivana Jović

The most recent GDP data showed a significant revision of (the already) revised 2017 growth: July data caused a revision of growth from 3.0% to 2.6% yoy, but October data caused a bounce-back to a higher 3.2% yoy. The main push came from a substantial upward revision in value added growth in the manufacturing industry, construction and retail & hospitality services. And while inconsistently low 1Q18 growth remained unchanged (2.0% yoy, compared to growth of 3.7% in Federation and 3.1% yoy in Republika Srpska), 2Q growth accelerated to 3.4% yoy, or 1.1% qoq. By industry, the main positive contributions can be attributed to retail, transport and hospitality services (+8.6% yoy overall), while agriculture, recovering after five consecutive quarters of decline, finally recorded 8.5% yoy GVA growth.

High-frequency data paint more mixed picture, as after increasing 3.7% yoy in July, industrial production declined 2.5% yoy in August (manufacturing dived by 5.9% yoy), dragging export growth down to only 1% yoy (vs 10.8% in July). However, personal consumption remained strong, as real retail trade increased by 8.9% and 9.2% yoy in July and August, respectively. Thus, our FY18 growth estimate (+2.8%) remains on track. However, as expected, general elections held on 7 October added significant uncertainty with regard to the formation of new governments in both Federation and at the state level, raising downside risks to our 2019 outlook (3.0% yoy).

Banking Sector

Ana Lokin

Loans marked a small acceleration in August compared to July, with a 6.4% yoy rise. Corporate loans maintained a similar pace of growth as in the month before, at 5.4% yoy, whereas household loan growth continued to rise (+7.3% yoy). Consumer loans stagnated at 8.0% yoy while housing loans continued to recover gradually, expanding by 7.7% yoy. This year's sharp rise in housing loans (which account for only 20% of household loans) can partly be explained by the fact that late last year entities' agencies limited the maximum duration (to 10 years) and amount (to BAM 50ths) of uncovered non-purpose loans. So, since meeting stricter housing credit eligibility criteria became more difficult for the vast majority of citizens due to their low incomes, a segment of consumer loans, excluding financing of current needs, was used for housing financing as well, raising credit risk on bank books. Deposits rose by 9.8% yoy in August, as household deposits growth rose by 7.1% yoy, whereas growth of corporate deposits continued to ease, coming in at 16.3% yoy.

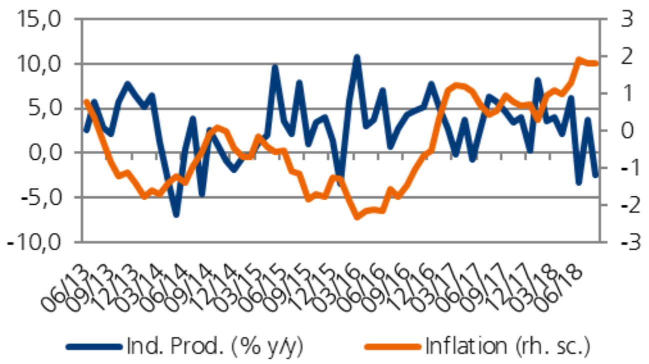
The quality of loans improved in 2Q18 due to the economy growing, a strong rise in new loans and an active approach by banks via write-offs, more efficient collection and refinancing. The overall NPL ratio narrowed by 0.4pp qoq, to 9.3%, with the share of NPLs in household loans down by 0.2pp qoq, to 7.2%, and of loans to legal entities by 0.5pp qoq, to 11.2%.

Latest Economic Indicators

%	Last value	2Q 2018	1Q 2018
Ind production, wda yoy	-2.5 (Aug)	1.5	5.2
Export of goods, nominal yoy	1.0 (Aug)	11.9	12.0
Retail trade, real, wda yoy	9.2 (Aug)	8.5	5.3
Inflation rate, average yoy	1.8 (Aug)	1.4	0.8
Loans (priv sector, yoy, eop)	6.4 (Aug)	7.0	7.2
Deposits (priv sector, yoy, eop)	9.8 (Aug)	9.8	8.1

Source: BHAS, CBBH

Industrial production and inflation



Source: BHAS

Croatia

Real Economy

Ivana Jović

Negative trends in industrial production deepened as in August, IP declined by 1.0% yoy (July: -0.9%), largely reflecting a significant decline (-13.5%) in the production of capital goods (reflecting a troubled shipbuilding industry, as well as a decline in the production of fabricated metals) and a fall in production of consumer durables and nondurables. However, goods exports in the same month advanced by 6.3% yoy (preliminary), as foreign demand remained healthy. The import growth rate (+8.1% yoy, the same as in July), meanwhile, continues to reflect strong domestic demand and tourist season's peak, as retail trade volume strengthened by 3.1% yoy (+2.2% in July).

Inflation eased to +1.4% yoy in September amid slower price growth for food and a fading effect of last year's increase in fees for renewable energy sources as well as a stronger decline in the prices of clothing and footwear. The average annual inflation rate in 3Q remained at 1.9%, as was the case in 2Q.

Financial Markets

Ana Lokin

Money market remains quiet, supported by generous liquidity. Average 3M Zibor in September and October was 0.5%. The FX rate remained stable in September, as falling tourism inflows were balanced by the net foreign positions of banks being at all-time highs and improving fiscal conditions. The average EUR/HRK rate was 7.42, +0.1% mom. In October, the rate was 7.41. The spread between the 10Y kuna government bond and the Bund fell by 10bps mom in September, while average yield remained at 2.2% in September and October.

Banking Sector

Loans rose by 2.1% yoy in August, due to stronger household lending (+4.6% yoy), whereas corporate loans, affected by elevated NPL ratios and high volumes of sold claims, slipped by 1.4% yoy. Housing and cash loan growth remained strong (+3.2% and +10.5%, respectively) and overdrafts and card loans saw slight recoveries (+0.4% and +1.7%). Breaking down the corporate portfolio reveals that investment and other loans rose moderately (1.0% and +1.8%) while working capital loans fell 5.4% yoy. Transaction data show cumulative yoy growth of placements to the private sector rising to 4.5% in August, with corporates flattish at +2.6% and households at +6.0%. Deposits in August accelerated to 5.0% yoy (corporate +5.7%, household +4.7%) due to a surge (+22.0%) in sight deposits.

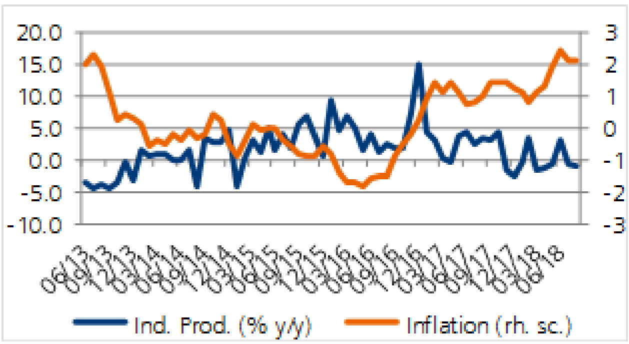
The NPL ratio in 2Q18 fell by 0.2pp qoq, to 11.2%, as a 0.1pp rise in corporate loans (to 22.1%) was offset by a 0.4pp drop in household loans (to 7.8%). In the corporate portfolio, quality rose in almost all the main activities (construction -0.1pp, to 53.5%; trade -0.7pp, to 19.0%; accommodation -0.6pp, to 9.6%; other -1.2pp, to 33.2%). Hence, the total ratio grew amid a decline in quality for professional, scientific and technical activities (+5.7pp, to 23.4%). An improvement in NPL share in household loans related to a 1.4pp qoq lower share in other loans (to 27.4%) and a 0.3pp fall in housing loans (to 5.9%).

Latest Economic Indicators

%	Last value	2Q 2018	1Q 2018
Ind production, wda yoy	-1.1 (Aug)	0.4	0.3
Export of goods, nominal yoy	7.9 (Jul)	8.7	-3.0
Retail trade, real, wda yoy	3.1 (Aug)	4.6	3.1
ESI (index)	115.8 (Sep)	116.5	114.8
Inflation rate, average yoy	1.4 (Sep)	1.9	1.0
Loans (priv sector, yoy, eop)	2.1 (Aug)	2.2	0.7
Deposits (priv sector, yoy, eop)	5.0 (Aug)	4.5	3.6

Source: CBS, Eurostat, CNB

Industrial production and inflation



Source: Eurostat, CBS

Czech Republic

Real Economy

Zdenko Štefanides

After a marked deceleration of GDP growth in 2Q, real activity in the first two months of the third quarter points to stabilisation or even acceleration. Industrial production was highly volatile during the summer months, due to the different timings of vacations compared to the previous year, on average, though, growth posted a solid pace of 6.1% yoy in July/August, well above 2.6% yoy average in the first half of the year. Unlike the neighbouring Slovak economy, growth does not rely solely on automotive. With a few exceptions, growth is well distributed among individual manufacturing sectors. Very good performances, for example, were posted by production of electronic, electrical equipment and basic metals. Moreover, the outlook appears strong, evidenced by new factory orders, which in July/August accelerated to nearly 7% yoy growth – double the pace of the first half of the year. Also, confidence indicators recovered from temporary weakness in July and overall posted an improvement through the third quarter. To sum up, despite increasing global risks, export- oriented sectors in Czech Republic thus far have posted solid performances, with no signs of cooling. Domestic-oriented sectors meanwhile remain strong as well. Indeed, retail sales and construction are both growing at a double-digit pace.

The labour market meanwhile clearly remains overheated. The unemployment rate in August was 2.5%, close to the all-time low of 2.2% in March. Labour shortages remained intense through the third quarter and pressures on wage growth are thus unlikely to ease any time soon. Inflation remains high. The decline in the headline CPI rate in the latest measure (from 2.5% yoy in August to 2.3% in September) related to volatile items (holiday packages) and administrative measures (new subsidies for transportation fares for pensioners and students), but not to core inflation.

Financial Markets

With real activity remaining strong, labour market overheating, and inflation above the 2% CNB target, the case for tighter monetary policy remains in place. As the Czech koruna remains weaker than assumed in the CNB forecast, a tightening of policy could mean another rate hike. Market expectations are that the next rate hike (the fourth in row) could indeed be delivered at the next meeting at the beginning of November. Some may argue that increased downside global risks could be reflected in changed quarterly forecasts. We continue to look for a rate hike in any case either in November or December and two more next year.

Banking Sector

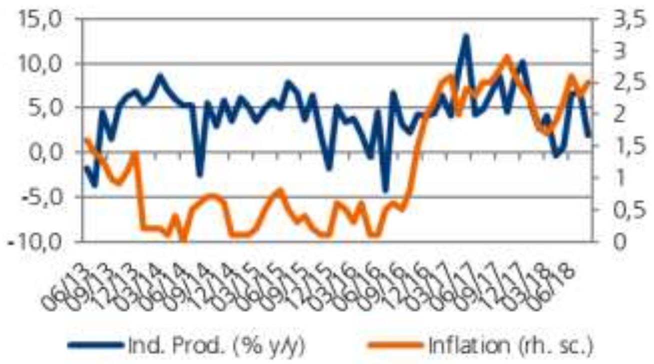
Not much has changed in the banking sector over the past few months. Similar to the neighbouring Slovak economy, in October, the CNB imposed new, stricter regulations on the mortgage market. Banking variables have not, however, reflected any changes in trends so far.

Latest Economic Indicators

%	Last value	2Q 2018	1Q 2018
Ind production, wda yoy	1.9 (Aug)	2.3	4.0
Export of goods, nominal yoy	2.5 (Aug)	1.8	-1.0
ECB refi rate	1.5 (22th Oct)	1.0	0.8
ESI (index)	109.1 (Sep)	109.8	109.9
Inflation rate, average yoy	2.3 (Sep)	2.2	1.9
Loans (priv sector, yoy, eop)	6.3 (Aug)	6.1	5.5
Deposits (priv sector, yoy, eop)	5.4 (Aug)	5.7	4.8

Source: CBS, EC, CNB

Industrial production and inflation



Source: EC

Egypt

Real Economy

Samer Halim

The International Monetary Fund (IMF) released its World Economic Outlook Report for October 2018 in which it projected strong growth for Egypt's economy over 2018-2023, rising to 5.3% in FY2017/18 and 5.5% in FY2018/19, up from 4.2% in FY2016/17. This improvement reflects the recovery in tourism, a rise in natural gas production, and a continued increase in confidence in the Egyptian economy, due to the successful implementation of the ambitious reform programme, supported by the IMF's Extended Fund Facility. Also, the Petroleum Minister, Tarek El-Molla, announced that Egypt has stopped importing Liquefied Natural Gas (LNG) in light of recent discoveries, including the giant "Zohr" offshore field, which will save around US$1.5bn a year. The current account deficit declined by US$8.4bn, to US$6bn in FY2017/2018, reflecting the continuous positive impact of the currency liberalisation decision, as the services surplus rose by 98.1% and net current transfers rose by 21.2%, and the trade deficit stabilised at US$37.3bn. The capital and financial account saw a net inflow of US$22bn (compared with US$31bn in FY2016/2017). These developments resulted in an overall balance of payments surplus of US$12.8bn in FY2017/18. The Egyptian government chose to postpone listing state-owned shares in Eastern Tobacco Company on the Egyptian Stock Exchange as part of its intended IPO programme which aims at boosting state revenues and modernising the public sector, after the weak performance of the Egyptian Stock Market over the past months on the back of the emerging markets crisis.

Financial Markets

Annual headline inflation (urban areas) increased to 16% in September 2018 (at the ceiling of the central bank's target range of 13% +/- 3%) compared to 14.2% in August. On the other hand, annual core inflation declined slightly, to 8.6% in September compared to 8.8% in August. The Monetary Policy Committee (MPC), at its end September meeting, decided to keep the overnight deposit rate, overnight lending rate, and the rate of the main operation unchanged at 16.75%, 17.75% and 17.25%, respectively. The discount rate was also kept unchanged at 17.25%. The next MPC meeting is scheduled for 15 November. The Egyptian pound's exchange rates against major currencies remained relatively stable, at EGP 17.91 and 20.58 per US dollar and euro, respectively, in October

Banking Sector

The value of private loans rose 10.8% yoy, to EGP995.5bn in July 2018, with household and corporate loans increasing 16.5% and 8.8%, respectively. Private deposits also rose 19.9%, to EGP2.9tn in July. Moody's Investors Service has changed its outlook for Egypt's banking system to Positive from Stable, as economic growth picks up, supporting credit growth, banks' profitability, and internal capital generation. The positive outlook also reflects the strong links between the banks and the government of Egypt's improving credit profile due to the large exposure that Egypt's banks have to the country's government through investments in securities and loans, which stood at 40% of total banking system assets as of June 2018.

Latest Economic Indicators

%	Last value	2Q 2018	1Q 2018
Ind. production, yoy	-4.7 (Aug)	8.2	5.0
Nom exports yoy	41.0 (Jun)	31.5	22.7
Retail sales yoy	n.a.	n.a.	n.a.
Inflation rate yoy	16.0 (Sep)	13.0	14.9
CB reference rate	16.8 (22th Oct)	16.8	16.8
Loans (priv sector, yoy, eop)	10.8 (Jul)	10.4	7.6
Deposits (priv sector, yoy, eop)	19.9 (Jul)	20.7	24.4

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

In Hungary, industrial production and export performance remained volatile in the past few months, with a relatively weak performance in August, following a double-digit export pick-up in the preceding month. Industrial production grew by 1.5% in August, but the raw figure was largely driven by the calendar effect, as the adjusted data posted 4.5% growth yoy. PMIs and other forward-looking indicators showed modest downtrends, but were still not too far below their historical peaks, with some of the most recent figures (August PMI) even showing some re-acceleration. This continues to imply an ongoing expectation of robust growth for 2018. The GDP growth rate in 2Q18 (4.8% yoy) also underpinned this outlook. Economic growth continued to be boosted by market-based services. On the other hand, EU funds remain a strong driver of growth amid accommodative fiscal and monetary policy. Wage growth has remained in double-digit territory, though with some deceleration in August and September. Headline inflation has remained above 3% since June, hitting a more than 5.5-year peak at 3.6% in September. This is still within the NBH's 3% +/-1pp target, with core inflation well below that (2.4%). Inflation was primarily driven by oil prices and the base effect, but the performances of the forint and wages also point to increasing inflation risks. External and internal balances looked set to remain in good shape, though the fiscal balance improvement of the preceding years appears to have ceased this year.

Financial Markets

The 3M policy rate of the central bank (NBH) has been left on hold at 0.90% this year so far (as in 2017) as has the more functional O/N depo rate (-0.15%). Market players are increasingly speculating about the time of the end of the current easing phase. This process has been supported by the forint's depreciation since May/June. The central bank remained dovish, but also highlighted the need for being cautious given the recent global (especially EM) market turbulence and the related weakening of the forint. In September, the NBH announced the reshuffling of some its non-conventional tools: the MIRS (swap) and the mortgage purchase programme will cease at the end of 2018, but a new lending programme will start (NHP Fix). The significant rise of BUBOR rates (and partly of bond yields of longer maturities) stopped or slightly slowed down in tandem with the partial positive correction of the forint (still above EUR/HUF 320 in June/July). The 10Y spread vs German Bund yields still climbed above 300bps.

Banking Sector

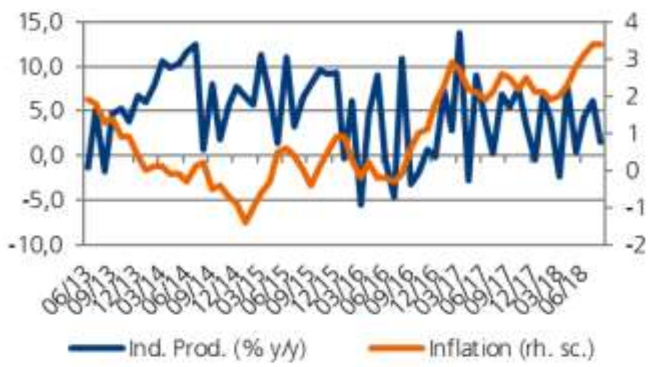
Hungary's banking sector continued to perform well with regard to lending activity in 3Q18 amid the ongoing strengthening of domestic consumer confidence and demand. Growth looks set to continue over the rest of this year, with similar dynamics to 2017. Some loan segments (including mortgages and personal loans) are showing especially dynamic pick-ups. Asset quality continues to improve, with NPLs already close to 4%. The sector has continued to reflect strong liquidity and show strong capital positions.

Latest Economic Indicators

%	Last value	2Q 2018	1Q 2018
Ind production yoy	1.5 (Aug)	4.1	2.8
Nom exports yoy	0.9 (Aug)	6.8	3.8
ESI (index)	116.6 (Sep)	123.0	120.6
Retail sales yoy	6.3 (Aug)	6.1	7.7
Inflation rate yoy	3.6 (Sep)	2.7	2.0
CB reference rate	0.9 (22th Oct)	0.9	0.9
Loans (priv sector, yoy, eop)	9.5 (Aug)	8.6	5.1
Deposits (priv sector, yoy, eop)	16.1 (Aug)	15.8	13.4

Source: CSO, NBH, Bloomberg

Industrial production and inflation



Source: CSO

Poland

Real Economy

Sandor Jobbagy

Forward-looking indicators for the Polish economy fell slightly, but remained relatively close to the highest levels recorded since the end of the global crisis. The EU Economic Sentiment Indicator showed a level of 107.7 in September. Hence, expectations still point to strong future growth. The dynamics of industrial production also recorded a downtrend, despite the improving mom figures. Overall economic growth was also down modestly from the 5.2% peak of 1Q18 to 5.1% in 2Q18, though still supported by relatively strong private consumption. Investments also showed strong performances. Judicial reforms and conflicts with the EU have so far not had an adverse impact on overall GDP growth and the outlook. Fiscal policy remained in check, as shown by the annual deficit.

Domestic demand and rising wages have had a limited impact on inflation so far: CPI reached 2% in June and July, but returned to 1.8-1.9% in August and September. We expect inflation to remain in check, with the annual average close to 2%.

Financial Markets

The NBP left its policy rate unchanged at 1.50% till the end of October, similar to the whole of 2017. However, the most recent monetary decisions and comments as well as market expectations suggest a rising probability that a tightening cycle will start in 1H19. The approaching end of the ECB's QE programme also supports these expectations. The central bank is concerned about food price growth, which has been on the rise since the end of last year, and also about accelerating wage growth. The zloty stabilised at around the €1/PLN 4.30 level. After following the weakening experienced in June and July, due to the poor global sentiment on EM, the EUR/PLN exchange rate has returned close to the average of last year.

Banking Sector

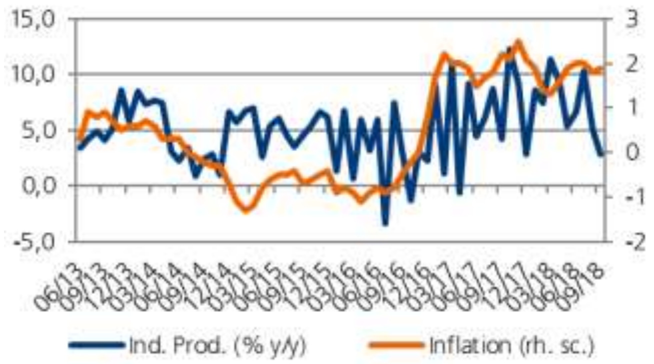
Polish lending dynamics have remained strong, even accelerating (to above 6% in August), in the banking system despite there already being the highest loan/deposit ratios in the CEE region, at above 100%. This situation is likely to produce stronger results compared to the previous year in tandem with the improved GDP growth outlook, fueled by consumption. Loan stocks to the private sector showed persistent rises for households as well as for the corporate sector. Deposit volumes also continued to increase, and these are likely to maintain momentum throughout 2018 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. The banking sector is likely to experience further consolidation, as the sector's concentration is still seen as too low.

Latest Economic Indicators

%	Last value	2Q 2018	1Q 2018
Ind production yoy	2.8 (Sep)	7.1	9.1
Nom exports yoy	-6.2 (Dec)		
ESI (index)	107.7 (Sep)	109.9	110.0
Retail sales yoy	4.8 (May)		
Inflation rate yoy	1.9 (Sep)	1.8	1.5
CB reference rate	1.5 (22th Oct)	1.5	1.5
Loans (priv sector, yoy, eop)	6.1 (Aug)	5.6	4.5
Deposits (priv sector, yoy, eop)	7.4 (Aug)	6.5	4.7

Source: CSO, NBH, Bloomberg

Industrial production and inflation



Source: CSO

Romania

Real Economy

Sebastian Maneran

The increase in international trade tensions over the course of 2018 has led to weaker external demand which showed up in a decelerating dynamic for industrial production to +3.9% yoy in August 2018, down from +9.8% in August 2017. Higher domestic inflation, at 5.03% in September 2018, has led to lower disposable incomes, depressing consumer spending, as shown by the retail sales dynamic, at +1.7% yoy in August 2018, down from +12.3% in August 2017. Hence, business cycle indicators point to a moderation in growth in 3Q18 while setting up low expectations for 4Q18 GDP. In the fourth quarter, inflation is expected to slow further, with help from positive base effects. Consumer spending is likely to have found a floor, since the Consumer Confidence Indicator showed improvement to -19.9 in September 2018 vs -26.4 in January of this year.

Financial Markets

Increased risk aversion in international financial markets has led (a) the EUR/RON FX rate to near all-time historical highs, above RON4.66/€1, (b) bond yields to rise and long-term bond yields September 2018 average to 4.86%, up from 4.41% in December 2017, and (c) money market rates to increase, with the average ROBOR 3M rate in September set at 3.13%, up from a 2.13% average in December 2017. The early start of the tightening cycle, which took the policy rate from 1.75% to 2.50%, managed to support Romania's financial markets regarding the risk aversion manifested in core financial markets. Headline inflation is expected to decrease, due to favourable base effects, but should also be helped by a stabilisation in international energy prices, while growth is slowing down. The Romanian central bank recently signaled a pause in its tightening cycle, with the policy rate held at 2.5%. We note that short-term rates are managed via open market operations with a one-week maturity.

Banking Sector

The ripple effect of the 2017 stimulus continues to support household loan demand: local currency household loans rose 20.2% yoy in August, despite the high interest rates (8.51% in August). Still-low financing costs (2.09% for FX credit and 6.02% for local currency credit in August) supported corporate credit demand, driving total non-government credit to some RON245.8bn, a new record high, for the eighth month in a row.

Total private sector deposits increased 1.3% mom and 10.5% yoy, to RON314.29bn at the end of August, driven mainly by higher household revenues (households: +11% yoy), with an increasingly clouded outlook supporting higher savings rates (corporates: +8.6% yoy). We would note that FX deposit growth led by a wide margin at +16.9%, as local currency yields do not seem to motivate savers, increasing by only 7.6% yoy in August.

Latest Economic Indicators

%	Last value	1Q 2018	4Q 2017
Ind production yoy	1.2 (May)	5.2	9.6
Nom exports yoy	5.2 (May)	10.0	8.8
ESI (index)	101.5 (Jun)	101.4	103.8
Retail sales yoy	6.4 (May)	6.7	12.9
Inflation rate yoy	5.4 (Jun)	4.7	3.1
CB reference rate	2.5 (20th Jul)	2.3	1.8
Loans (priv sector, yoy, eop)	6.4 (May)	6.1	5.6
Deposits (priv sector, yoy, eop)	10.4 (May)	10.6	10.4

Source: National Statistical Institute, NBR

Industrial production and inflation

Source: NBR

Russia

Real Economy

Irina Lekareva

The GDP growth rate in August dropped to 1.0% yoy vs 1.8% yoy a month earlier. The slowdown resulted from the decline in agricultural output (-10.8% yoy) mainly due to the poor dynamics of crop production. Industrial production saw decelerations to 2.7% yoy in August and 2.1% in September after 3.9% yoy in July. Chemical and food production showed high growth rates, but metallurgy demonstrated increased volatility and manufacturing growth in August slowed to 2.2% yoy compared to 4.6% yoy in July.

In September, inflation continued to accelerate, to 3.4% yoy from 3.1% yoy in August, which is still within our expectations. The increase was largely due to the weak ruble in August, low crops and expectations of the VAT increase. The rise in prices was mostly observed for non-food products with a high import component and services which are sensitive to exchange rate fluctuations. The consumer confidence index in 3Q18 fell from -8 to -14. The greatest impact was made by the deterioration of public opinion regarding the changes that have occurred and are expected to occur in the Russian economy (weak currency, tax increase).

Financial Markets

The CBR unexpectedly raised the key rate by 25bps, to 7.5% on 14 September. We believe that the rate increase did not automatically trigger a tightening cycle. The key rate increase, the suspension of currency purchases under the Budget rule, and rising oil prices led to the RUB strengthening. In the second half of September, the RUB showed in fact stronger dynamics compared to other EM currencies (gaining 3.1% against 1.7% on average for EM currencies). In addition, in September, the Brent oil price increased by almost 10% and exceeded US$85/bbl for the first time since November 2014. Given the strengthening RUB and stabilising financial markets, the key rate was kept at the current level at the 26 October CBR meeting .

Banking Sector

In July, the volume of loans to the private sector increased by 10.6% yoy, after a 9.8% yoy increase in June. In July, household loans grew by 19.7% yoy, due to active mortgage lending, significantly outstripping the volume of corporate lending (+7.5% yoy in July). As for deposits attracted from the private sector in July, the Russian banking sector showed a relatively weak result: +8.4% yoy compared to +14.4% yoy in June. Household and corporate deposits grew at a slower pace compared to previous months (+8.9% and +7.8% yoy, respectively). The share of NPL in the banking sector remained stable in July at 10.9%, but recorded a decrease to 10.8% in August.

Latest Economic Indicators

%	Last value	2Q 2018	1Q 2018
Ind production yoy	2.1 (Sept)	3.3	3.0
Nom exports yoy	39.5 (Jul)	30.5	23.3
Retail sales yoy	2.8 (Aug)	2.9	2.3
Inflation rate yoy	3.4 (Sep)	2.4	2.3
CB reference rate	7.5 (28th Sep)	7.3	7.3
Loans (priv sector, yoy, eop)	10.6 (Jul)	9.7	8.9
Deposits (priv sector,yoy,eop)	8.4 (Jul)	9.1	7.7

Source: State Statistics Federal Service, Central Bank of Russia

Industrial production and inflation

Source: State Statistics Federal Service

Serbia

Real Economy

Branka Babic

Robust economic growth in the first half of the year, with GDP growth hitting 4.9% yoy, surpassed all expectations, partly reflecting low base effects following the poor performances of the agriculture and energy sectors in the first half of the previous year. In the coming quarters, a slowdown of GDP growth can be expected, due to the waining of the base effects. However, we still expect to see solid growth. As in the first half of 2018, economic activity will continue to be driven by a recovery in private consumption and investments (public and private), supported by amore expansionary fiscal stance.

Yoy inflation amounted to 2.1% in September 2018, slowing from 2.6% in August, as a result of a monthly drop due to a seasonal decline in prices of travel packages and unprocessed food. Core inflation stood at 1.1%, unchanged relative to August, indicating still-weak inflationary pressures. Looking ahead, inflation is expected to move in the lower half of the target band while it might temporarily reach the midpoint of the target range in early 2019.

Financial Markets

In October 2018, the National Bank of Serbia kept the key policy rate unchanged, broadly in line with market expectations. The central bank underlined current and expected inflation movements, a strong economic situation, and uncertainties in the external emerging market landscape as key reasons behind its "on hold" decision. With inflation moving as currently anticipated and no significant recovery in core inflation, the next move is likely to be roughly synchronised with the ECB rate normalisation process. The cautious monetary approach will be maintained, mandated by the challenging environment, an escalation of trade tensions, Fed/ECB divergent policy, and volatile global oil prices.

After appreciation pressures that had prevailed since April, the NBS started to intervene in September to curb RSD depreciation caused by stronger FX demand in corporate and financial sectors recently. During the first nine months of 2018, the dinar appreciated only marginally against the euro (by 0.05%) and depreciated against the US dollar (by 2.5%) while the NBS intervened on the FX market via net-buying of €1.6bn. Some depreciation pressures on the €/RSD rate from seasonally induced demand for euros can be expected in the last quarter of the year, but the central bank is likely to tame any excessive volatility and the dinar is forecast at around 118.5 per euro in 2018.

Banking Sector

Looking at the latest available data for 2018, bank lending continued to grow, accelerating to 4.2% yoy in August 2018. A positive trend is expected to continue as a result of relaxed monetary policy, the continuation of the solid economic performance, accompanied by a gradual improvement in the labour market, lower NPLs (currently at a level of 6.5%), low interest rates in the euro area, and interbank competition.

Latest Economic Indicators

%	Last value	2Q 2018	1Q 2018
Ind production yoy	-4.3 (Aug)	2.5	6.0
Nom exports yoy	8.2 (Aug)	6.2	9.9
Retail sales yoy	5.5 (Aug)	3.4	3.4
Inflation rate yoy	2.1 (Sep)	1.8	1.6
CB reference rate, eop	3.0 (22th Oct)	3.0	3.3
Loans (priv sector,yoy,eop)	4.2 (Aug)	4.4	2.2
Deposits (priv sector,yoy,eop)	8.1 (Aug)	7.6	3.0

Source: Statistical Office, National Bank of Serbia

Industrial production and inflation

Source: Statistical Office, National Bank of Serbia

Slovakia

Real Economy

Andrej Arady

Despite rising fears of global risks, real activity in Slovakia's export-oriented economy remains strong, albeit mainly due to the automotive sector, with a rebound in industrial performance in August, holding the yoy growth pace relatively stable in the first two months of 3Q at around 2%, slightly above the average for 1H18. A positive picture is supported by new orders (again primarily due to the automotive sector): in August, they posted 10.8% mom growth, raising the yoy growth pace to 15.8%. Also, domestic-oriented sectors – trade and construction – continue to post solid activity. Retail sales growth continues to be relatively stable. Construction output accelerated further, currently growing at double-digit rates. While hard data have remained solid, deteriorating sentiment represents warning sign. The overall mood in the Slovak economy has been deteriorating in the past five months: in September, we saw the lowest value since January 2016. Confidence decreased in all sectors except households.

On the price front, the overall picture of the Slovak economy remains unchanged. In headline terms, European harmonised inflation edged down from the previous peak of 2.9% yoy to 2.7% yoy in September, but this was primarily due to lower air fares. As the weight of this volatile component in the consumer basket significantly increased from the beginning of this year, volatility is passed through to the headline index. The underlying trend of inflation however remains unchanged. Employment continues to grow at a fast pace, above 2%. Employers can no longer find available skilled labour in the local market and therefore are turning more towards hiring foreigners. The number of foreign workers in August increased by 41.5% yoy. Also, Slovaks working temporarily abroad are now returning home: c. 7% returned home over the past year. This is however still not sufficient to address employer needs. Labour shortages are a common limiting factor in the Slovak economy, putting pressure on wage growth, which now, according to monthly indicators, exceeds 7% yoy.

Financial Markets

Yields on Slovak government bonds increased at the end of the summer and thereafter stabilised at around 1% in the past weeks, c.30bps above the minimum recorded in late August. Tensions in European debt markets stemming from Italian country risk meanwhile reversed the rising trend of German yields, which translated into widening of spreads between Slovak and German yields by c.17bps, to 58bps, in line with our expectations.

Banking Sector

The Slovak mortgage market was hit by another tsunami at the beginning of the summer. Concerns about newly imposed stricter regulations in July 2018 pushed forward the prospective demand to the summer. The data covering August activity still reflect this effect, as pre-approved mortgages, which were subjected to the old rules, were still in process of completion. However, activity in bank branches has already calmed. Moreover, regulation is likely to tighten even more in the future. Currently accepted exemptions to rules will be gradually stopped.

Latest Economic Indicators

%	Last value	2Q 2018	1Q 2018
Ind production, wda yoy	2.1 (Aug)	3.0	0.4
Nom exports, yoy	5.8 (Aug)	9.9	4.0
ESI (index)	98.5 (Sep)	102.8	103.0
Retail sales, yoy	3.0 (Aug)	2.5	4.8
Inflation rate, yoy	2.7 (Sep)	2.9	2.4
ECB refi rate	0.0 (22th Oct)	0.0	0.0
Loans (priv sector,yoy,eop)	9.4 (Aug)	9.8	9.3
Deposits (priv sector,yoy,eop)	6.2 (Aug)	6.2	6.0

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

Ivana Jović

Robust economic performance continued over the summer and industrial production in August grew by 6.9% yoy as growth in manufacturing and electricity production rose to 7.3 and 3.0% yoy, respectively. As is generally the case, goods exports in August were a bit thinner compared to previous months, but the annual growth was strong, at 9.2% yoy. Meanwhile, real retail trade rose by 4.4% yoy, supported by favourable labour market developments.

The annual HICP inflation rate in September amounted to +2.2%, amid accelerating housing prices (+6.0%, driven by 6.7% higher prices for natural gas) and 2.4% higher food and transportation prices. The October EDP data were confirmed at a 0.1% surplus and at a 74.1% GDP/public debt ratio in 2017and indicates further improvement in the current year as the surplus is forecast at 0.5% and debt at 70.3% of GDP.

Financial Markets

Ana Lokin

Short-term rates were unchanged in September and October and 3M Euribor remained at -0.32%. The average 10Y government bond yield rose by 10bps mom, to 1.0% in September, closely following the benchmark, and surpassed 1.1% in October. The 5Y CDS spread crept up by 4bps mom in September, to an average of 74bps, and towards 76bps in October.

Banking Sector

Loans continued to linger near the +3% yoy area, marking a 2.7% yoy increase in August. Corporate loans stagnated on a monthly level, keeping the annual rate unchanged at -1.1% yoy. Central bank data showed that corporate financing is on the rise. However, a largest proportion of financing needs is currently covered via accumulated own resources and only a small part with loans from domestic banks. Household loans accelerated by 6.5% yoy, with housing loans expanding by 3.9%, consumer loans by 11.4% and other loans by 8.4%. The rise in deposit softened to 7.4% yoy in August (overnight +12.7%, agreed maturity -5.3%), as the corporate deposits rise eased to 9.2% yoy and household deposits advanced by 6.8% yoy.

Slovenian banks performed well in 1H18, judging by the net profit of the banks rising by 25% yoy, and ROA and ROE increasing to 1.7% and 14.0%, respectively, up by 0.3pp and 2.5pp yoy. Asset quality is sound as well: the share of non-performing claims in 2Q18 declined by 0.3pp qoq, to 2.9%. The share in corporate portfolios declined by 0.5pp qoq, to 4.5% (o/w construction -2.0pp qoq to 16.7%, manufacturing -0.5pp qoq to 3.1%, trade -0.4pp qoq to 3.6%), while the share for households slipped by 0.2pp qoq, to 2.4%. The NPE ratio (EBA definition) in 2Q fell by 0.5pp qoq, to 4.9%, and further to 4.6% at the end of August. According to survey, the volume of non-performing claims should continue to fall over the rest of the year and in 2019, owing to the sale of claims, repayments and collateral liquidation.

Latest Economic Indicators

%	Last value	2Q 2018	1Q 2018
Ind production, wda yoy	7.0 (Aug)	6.6	8.6
Nom exports yoy	16.1 (Jul)	11.3	10.7
ESI (index)	108.4 (Sep)	113.6	113.3
Consumer confidence indices	-8.9 (Sep)	1.3	1.5
Inflation rate yoy	2.2 (Sep)	2.1	1.5
ECB refi rate	0.0 (22th Oct)	0.0	0.0
Loans (priv sector,yoy,eop)	2.7 (Aug)	2.6	2.8
Deposits (priv sector,yoy,eop)	7.4 (Aug)	7.7	6.1

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

Industrial production and inflation

Source: Eurostat, Statistical Office of the Republic of Slovenia

Ukraine

Real Economy

Giancarlo Frigoli

Industrial production fell by 0.6% yoy in August, mainly due to a 6.4% yoy decline in electricity generation. Other sectors of the economy have been better performers in recent months. Agricultural output rose by 4.9% yoy in September and by 2% in Q3. Retail sales jumped by 6.6% in September and by 6.7% in Q3. In August, construction activity increased by a solid 5.7% yoy on top of the 6.3% gain recorded in July. All of these numbers point to solid growth in GDP in Q3, after the 3.8% annual increase seen in Q2. The IMF in its October's WEO report raised its forecast for GDP growth in 2018 to 3.5% from 3.2% previously, but it lowered the projection for 2019 to 2.7% from 3.3%, discounting some negative impact on domestic demand due to fiscal consolidation measures.

Financial Markets

The Ukraine hryvnia saw little affect from the turbulence that hit other currencies with large current account shortfalls in recent months. The currency was supported by the proceeds from exported goods (half of which must be converted to the local currency) and by the increase in interest rates, which fueled capital inflows to domestic bonds. As a result of the high inflation, the effective real exchange rate appreciated by over 10% in the last year, despite remaining below its long-term average; however, this gap is likely to narrow, due to the continued inflationary pressure. In the medium/long term, a gradual depreciation of the nominal exchange rate is expected to defend the competitive position. The government calculated its budget for next year with a UAH/US$ rate of 29.4 at the end of 2019 (compared to the current quotation of 28). The new agreement with the IMF is likely to alleviate some downside pressures on the Ukraine hryvnia.

Banking Sector

Davidia Zucchelli

Thanks to improving macroeconomic conditions, lending in Ukraine strengthened (+10.3% yoy as of July from 8.3% yoy in June) particularly in the household sector (+17.1% yoy from 15.1%), but also among corporates (+8.8% from 6.7%). A high NPL rate (55.7% at the end of June) is connected to state-owned banks and is mostly covered. The committee addressing the resolution of state-owned banks' non-performing loans held its first meeting at the National Bank on 22 October. The committee is expected to address the NPLs of state-owned banks. NPLs make up nearly 70% of state-owned banks' portfolios. As highlighted by the First Deputy Governor, the difficulty arises from the existence of joint borrowers servicing their loans at certain private banks rather than state-owned banks. Loans to such borrowers have to be restructured. Deposits increased by 13% (vs 10.9% yoy in June), both from corporates (13% in July from 7.9%) and households (13% from 12.4%), still supported by remittances. The LTD ratio remained high, despite decreasing to some extent (125% from 129% as of May).

Latest Economic Indicators

	Last value	2Q 2018	1Q 2018
Ind production yoy	-0.6 (Aug)	2.6	2.5
Nom exports yoy	12.4 (Aug)	12.7	17.0
PMI manufacturing	n.a.	n.a.	n.a.
Retail sales	7.1 (Aug)	6.1	7.6
Inflation rate yoy	8.9 (Sep)	11.6	13.8
CB reference rate	18.0 (28th Sep)	17.0	17.0
Loans (priv sector, yoy, eop)	10.3 (Jul)	8.3	6.6
Deposits (priv sector, yoy, eop)	13.0 (Jul)	10.9	10.7

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]	
	2Q18	1Q18	2017	Last	mth	2Q18	Last	mth	2Q18	Last	mth	2Q18	2017	2Q18	1Q18	2017	2Q18	1Q18
CEE																		
Czech Rep.	2.4	4.0	4.3	1.9	Aug	2.3	2.5	Aug	1.8	2.3	Sep	2.2	2.5	n.a.	-163.8	46256	n.a.	2310
Hungary	4.8	4.6	4.0	1.5	Aug	4.1	0.9	Aug	6.8	3.6	Sep	2.7	2.4	n.a.	-984	-3858	772	840
Poland	5.1	5.2	4.5	2.8	Sep	7.1	5.0	Aug	8.7	1.9	Sep	1.8	2.0	n.a.	3888	-7143	n.a	1573
Slovakia	4.2	3.6	3.4	2.1	Aug	3.0	5.8	Aug	9.9	2.7	Sep	2.9	1.4	n.s.	n.s.	n.s.	n.a	n.a
Slovenia	3.8	4.5	4.9	7.0	Aug	6.6	16.1	Jul	11.3	2.2	Sep	2.1	1.6	n.s.	n.s.	n.s.	1055	708
SEE																		
Albania	4.3	4.5	3.7	n.a.	n.a.	n.a.	10.7	Aug	17.9	2.1	Sep	2.2	2.0	85	-142	n.a.	-173	-165
Bosnia H.	3.4	2.0	3.2	-2.5	Aug	1.5	1.0	Aug	11.9	1.8	Aug	1.4	0.8	110	168	524	-176	-216
Croatia	2.9	2.5	2.9	-1.1	Aug	0.4	7.9	Jul	8.7	1.4	Sep	1.9	1.1	214	774	2192	212	-2003
Romania	4.1	4.0	6.9	3.7	Aug	3.1	4.3	Aug	10.4	5.0	Sep	5.3	1.3	-5830	2480	3895	-3781	-967
Serbia	4.8	4.9	1.9	-4.3	Aug	2.5	8.2	Aug	6.2	2.1	Sep	1.8	3.2	541	551	-689	-255	-746
CIS MENA																		
Russia	1.9	1.3	1.5	2.1	Sep	3.3	39.5	Jul	30.5	3.4	Sep	2.4	3.7	924	21,237	38,476	19,064	30,305
Ukraine	3.8	3.1	2.5	-0.6	Aug	2.6	12.4	Aug	12.7	8.9	Sep	11.6	14.5	495	9	3,688	155	-510
Egypt	5.3	5.4	5.0	-4,7	Aug	8.2	41.0	Jun	31.5	16.0	Sep	13.0	29.6	1,647	5,591	12,755	n.d.	-1,931
m.i. E. A.	*2.1*	*2.5*	*2.4*	*0.9*	*Aug*	*2.4*	*5.6*	*Aug*	*4.5*	*2.1*	*Sep*	*1.7*	*1.5*					

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
	17/10	chg bp 3M	17/10	chg bp 3M	17/10	3M chg%	1Y chg%	3M chg%	1Y chg%	17/10	17/07	Moody's
CEE						Vs Euro						
Czech Rep.	1.5	0.6	2.2	0.2	25.8	0.0	0.3	0.6	3.0	36.2	35.2	A1
Hungary	0.2	-0.1	3.9	0.4	322.3	-0.2	4.7	7.6	-3.9	80.9	82.4	Baa3
Poland	1.9	0.3	3.2	0.1	4.3	-0.1	1.5	0.7	-12.3	61.1	59.5	A2
Slovakia	-0.3	0.0	1.0	0.4	Euro	Euro	Euro	-1.9	8.4	43.5	41.5	A2
Slovenia	-0.3	0.0	1.1	0.2	Euro	Euro	Euro	-7.5	0.3	67.7	60.5	Baa1
SEE												
Albania	1.2	0.0	n.a.	n.a.	125.3	-0.6	-6.3	n.a.	n.a.	n.a.	n.a.	B1
Bosnia H.	n.a.	n.a.	n.a.	n.a.	1.96	Board	Board	n.a.	n.a.	n.a.	n.a.	B3
Croatia	0.5	0.0	2.2	0.0	7.4	0.3	-1.3	-0.8	-3.7	96.9	93.3	Ba2
Romania	3.0	-0.2	5.0	0.0	4.7	0.1	1.9	8.3	7.5	88.4	82.9	Baa3
Serbia	3.0	0.0	n.a.	n.a.	118.4	0.4	-0.6	-0.6	8.1	115.6	109.8	Ba3
CIS MENA						Vs USD						
Russia	8.3	0.9	8.6	1.0	65.5	5.3	14.8	3.4	15.8	138.9	120.1	Ba1
Ukraine	18.8	0.3	14.5	0.0	27.9	6.5	5.5	0.9	6.5	514.2	498.0	Caa2
Egypt	19.7	0.1	18.3	0.8	17.9	0.1	1.5	-4.3	-5.6	360.9	350.4	B3
m.i.A.E.	*-0.3*	*0.0*	*0.5*	*0.2*	*1.2*	*-1.3*	*-1.9*	*-4.8*	*-8.4*	*5.2*	*6.4*	

Source: Datastream, Reuters;[1] The data for Albania refers to january, for Egypt refers to september, for Czech Republic refers to september; [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	2017	Last	mth	2017	Last	mth	2017	Last	Mth	2017	Last	mth	2017	S[4]	Last	mth	2017	S[4]	Last	mth	2017
CEE																							
Czech Rep.	6.3	Aug	6.5	3.3	Aug	4.0	9.3	Jun	70.2	5.4	Aug	7.6	2.81	Aug	2.33	C	1.04	Aug	0.66	H	73.6	Aug	75.8
Hungary	9.5	Aug	6.0	4.1	Jun	5.3	5.8	Aug	12.2	16.1	Aug	10.8	2.32	Aug	2.5	C	0.2	Aug	0.24	H	79.0	Aug	80.1
Poland	6.1	Aug	3.2	3.9	Jun	3.9	3.4	Aug	-13.0	7.4	Aug	3.7	3.61	Aug	3.66	C	1.71	Aug	1.65	H	101.2	Aug	98.3
Slovakia	9.4	Aug	9.6	3.6	Aug	4.0	-13.1	Aug	-6.0	6.2	Aug	5.2	2.16	Aug	1.97	C[2]	0.06	Aug	0.07	H[2]	101.4	Aug	98.8
Slovenia	2.7	Aug	3.2	4.6	Aug	6.0	-16.2	Aug	-13.4	7.4	Aug	7.0	2.13	Aug	2.41	C[2]	0.18	Aug	0.14	H[2]	77.2	Aug	78.3
SEE																							
Albania	-3.3	Aug	0.5	12.9	Aug	13.2	3.9	Aug	0.0	-1.3	Aug	-1.3	8.89	Aug	8.12	PS	0.56	Aug	0.8	PS	52.5	Aug	53.3
Bosnia H.	6.4	Aug	7.3	9.3	Jun	10.0	13.1	Aug	4.6	9.8	Aug	9.0	3.06	Aug	3.51	C	0.23	Aug	0.23	H	106.9	Aug	108.4
Croatia	2.1	Aug	-0.1	11.2	Jun	11.4	-14.3	Aug	-17.8	5.0	Aug	2.4	6.46	Aug	6.41	PS	0.46	Aug	0.68	PS	77.0	Aug	78.6
Romania	7.1	Aug	5.6	5.7	Jun	6.4	-7.4	Aug	-9.1	10.3	Aug	10.4	7.43	Aug	5.88	PS	2.12	Aug	1.08	PS	78.2	Aug	76.7
Serbia	4.2	Aug	2.1	6.5	Aug	9.8	28.6	Aug	14.4	8.1	Aug	3.1	8.66	Aug	8.2	PS	2.61	Aug	2.85	PS	100.9	Aug	101.3
CIS MENA																							
Russia	10.6	Jul	5.2	10.8	Aug	10.0	-5.5	May	-17.5	8.4	Jul	8.1	8.75	Jul	9.43	C	5.04	Jul	5.27	H	106.7	Jul	104.8
Ukraine	10.3	Jul	0.9	55.7	Jun	54.5	-5.3	Jul	-23.5	13.0	Jul	12.1	18.28	Jul	17.51	PS	11.85	Jul	9.56	PS	124.6	Jul	123.0
Egypt	10.8	Jul	7.1	4.3	Jun	4.9	5.2	Jul	1.1	19.9	Jul	23.8	17.6	Aug	19.8	C	11.9	Aug	13.6	H	34.0	Jul	33.9
m.i. E. A.	*2.8*	*Aug*	*2.2*	*n.a.*	*n.a.*	*n.a.*	*10.1*	*Aug*	*-2.8*	*3.3*	*Aug*	*1.8*	*1.2*	*Aug*	*1.3*	*C*	*0.3*	*Aug*	*0.4*	*H*	*81.4*	*Aug*	*81.9*

Source: Central Banks, IMF, Moody's ;[1]monthly average; [2]lending rate on current account overdraft; on deposits up to 1 year
[4]Sector C=Corporates, H=Household, PS=Private Sector.

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