

PBZ Weekly Analysis

Number 504, February 15, 2016

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Weekly overview

- As the data for 2014 and 2015 at the state budget level are not comparable by scope, (due to the exclusion of the Croatian Health Insurance Fund - HZZO) and the data for consolidated general government have not yet been released, the data provided here for the consolidated central government level are taken over from the Ministry of Finance. According to these data, total deficit of consolidated central government (according to GFS2001 methodology and cash principle) in 2015 amounted to 9.6 billion kuna, or around 2.9% of the estimated GDP. Compared with the 2015 plan (12.5 billion) deficit is significantly lower, mainly due to a strong growth in revenues.

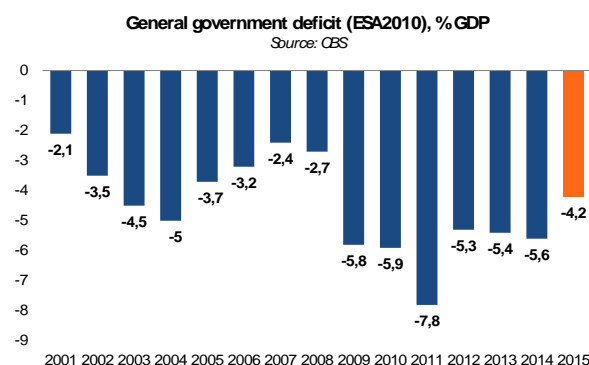
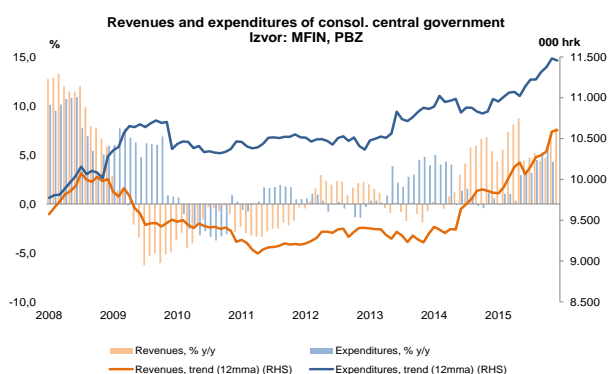
Notes on methodology:

The indicated deficit may not be methodologically comparable with the general government deficit according to the ESA2010 methodology, which is used by the European Commission in its assessment of the Excessive Deficit Procedure, and therefore they must be clearly distinguished. In fact, ESA2010 has a wider scope of the general government which, in addition to the central government (state budget + off-budget funds) and local and regional government units includes some public companies/institutions, such as HAC, ARZ, HRT, HŽ Infrastruktura and HBOR. Also, there is a series of methodological differences in terms of recording according to the cash or calculation principle and, for instance, the treatment of revenues achieved by transferring contributions (for insured persons under early retirement schemes) from II to I pension system pillar. Specifically, according to ESA2010 the indicated transfer is excluded from total revenues. Also, depending on the movements of past due and unpaid liabilities the deficit amount is subject to change. The first data on deficit movements according to ESA2010 will be released in mid-April, while the current estimate of the European Commission indicates a deficit of 4.2% of GDP, which would be the first deficit reduction over the past three years.

The reduction of deficit was mainly due to a growth on the revenue side by 9.2 billion kuna (+7.7% compared with 2014), to the amount of 127.3 billion kuna. Around 53% of this growth, i.e. 4.8 billion kuna accounts for the increase in tax revenues where the largest growth of 2.6 billion (+6.3%) was recorded in VAT, whereas the revenues from excise duties rose by 1.1 billion or 8.4% (of which 61% of the increase accounts for excise duties on petroleum products, and 29% on tobacco products). While we can explain the increase in the indicated revenues by a rise in consumption (tourism) and more dynamic economic movements than those recorded in 2014, excise duties also recorded an increase in their amount. Although the income tax also recorded an increase in revenues, the issue is actually in the statistical treatment of tax returns which were recorded on the expenditure side in 2015, while prior to 2015 they were recorded through reduced revenues (gross vs net principle). Therefore, it is not possible to record the effects of tax changes in the income tax system accurately. Slightly better financial results of entrepreneurs influenced the growth of revenues from profit tax (by 10.3% in 2015). According to the data, revenues from contributions fell by 1.8% compared with 2014, but if we exclude the effect of transferring a part of contributions from II pillar to I pillar (in 2014 around 3 billion, and in 2015 around 1.8 billion kuna) and the low-base effect in 2014 (over the first four months the health contribution was calculated at a rate of 13%, and afterwards at a rate of 15%), revenues from contributions have in fact remained at almost the same level as in 2014. A significant revenue growth came from a withdrawal of the EU funds

and direct agricultural payments, therefore, in 2015 the withdrawal of funds increased by 1.9, compared with the year before, which is a total of 4.2 billion kuna. Along with tax revenues, the largest rise (of even 3.2 billion kuna) were recorded by other revenues which amounted to a total of 13.9 billion kuna in 2015. This category of revenues also saw a series of changes which involve the exclusion of earmarked revenues for the financing of mandatory health insurance (supplemental insurance, participation in healthcare costs etc.) and the inclusion of a part of earmarked revenues in the science system; revenues of budget users who have not been financed from the budget prior to 2015 (e.g. own revenues of universities, faculties etc.) and state medical institutions pursuant to contractual obligations with HZZO.

At the same time, the consolidated central government total expenditure increased by 3.5% or 4.5 billion, reaching 132.4 billion kuna. A detailed comparison of particular types of expenditures in 2015 and 2014 is practically impossible, mostly as a result of a different HZZO expenditure classification than in 2014, and therefore is meaningless, so we have to wait for the release of the consolidated general government data (although there is a fear that these data will not be entirely comparable as the scope of local units has been changed). The only expenditure category we may highlight are interest expenses which amounted to 11.2 billion kuna, or 7% (728 million) in 2015, more than the previous year.

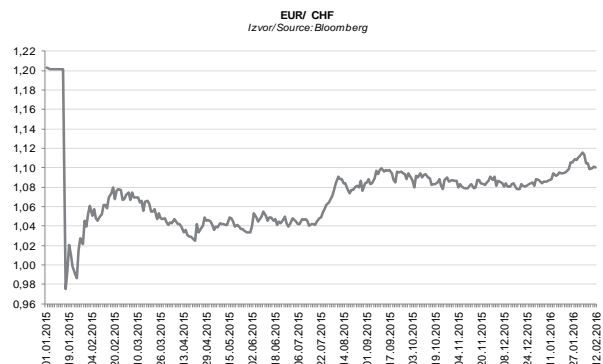
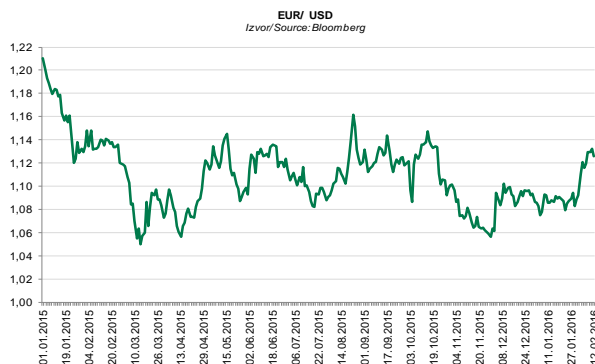


- According to the data of the Croatian Bureau of Statistics, November saw a greater annual growth rate of imports of goods (+14.1%) than exports (+11.3%). Over the first eleven months of 2015, total exports rose by 11.5% (to 80.4 billion kuna), while total imports rose by 7.1% (to 129.6 billion kuna). The trade deficit during the indicated period amounted to 49.1 billion kuna, which is an increase of 0.3 billion kuna from the same period of 2014, whereas the coverage rate amounted to 62.1% (59.6% in the first eleven months of 2014). The lowest level of exports was recorded only in a few categories over the first eleven months of 2015, compared with the same period the year before, where the categories *Manufacture of coke and refined petroleum products* (-14.8%) and *Manufacture of metal* (-24%) had a significant share.
- In December 2015, there were 615 building permits issued, which is a rise of 3% yoy. The number of building permits issued for buildings amounted to 462 (-7.8% yoy), while 153 building permits were issued for civil engineering works (+59.4% yoy). Throughout the entire 2015, 6,328 building permits were issued (-4% compared with 2014), of which 5,133 permits

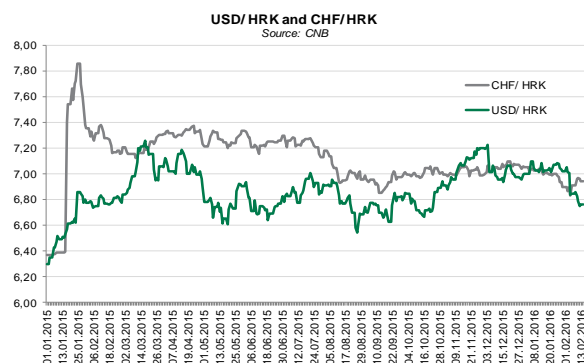
were issued for buildings (-8.1% compared with 2014) and 1,195 permits for civil engineering works (+19.3% compared with 2014). The total anticipated value of works in 2015 amounted to 20.87 billion kuna, whereas in 2014 the value amounted to 20.21 billion kuna, which is up by 3.3%. Given the indicated movements, we anticipate a slower and longer recovery of the construction activity than expected.

Dollar plunges deeper, kuna slightly strengthens

Last week, the concerns of investors about global growth and the consequential increase in risk aversion led to a fall in the global stock market indices and a deeper plunge of the dollar. The Fed's Chair Yellen's Congressional Testimony did not bring bigger surprise, which came as a support to the market opinion that, currently, we may not expect the Fed's interest rate hike as early as March. The dollar ended the week trading at 1.1256 dollar to the euro, up by 0.9% wow, while the franc moderately continued to strengthen against the euro, so the EURCHF closed the week at a 0.4% lower level than 1.10059 franc to the euro.



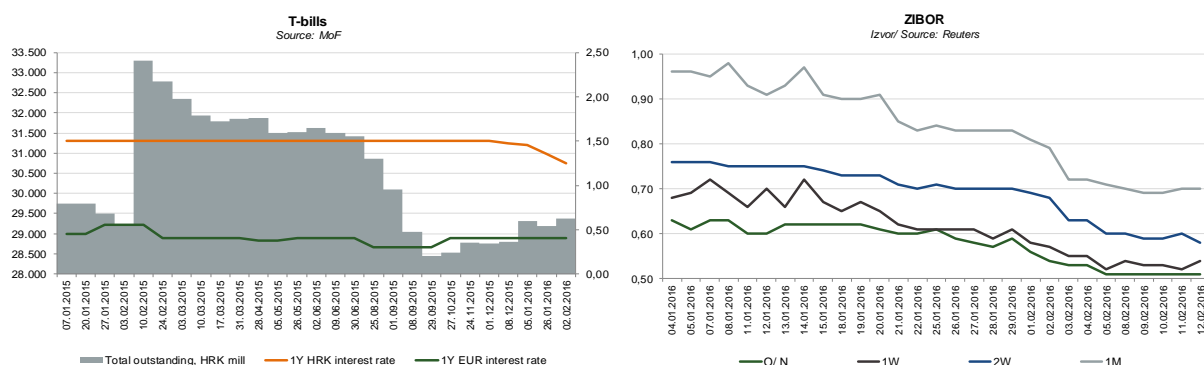
Last week, the EURHRK exchange rate began trading at a 7.645 level and ended at a 7.625 level. The interbank market saw a slightly higher selling of the euro, while a stronger drop was mildly lessened by the renewed corporate demand. The mid-exchange rate of the kuna against the euro closed on Friday at 7.6338 kuna to the euro, which is an increase of 0.3%. The kuna strengthened against the dollar, by 1.3%, to 6.7598 kuna to the dolar, while the kuna weakened by 0.5% against the Swiss franc, to 6.9417 kuna to the franc. This week, we expect the same trend and the trading in the range from 7.60 to 7.64 kuna to the euro.



First structural repo operation announced

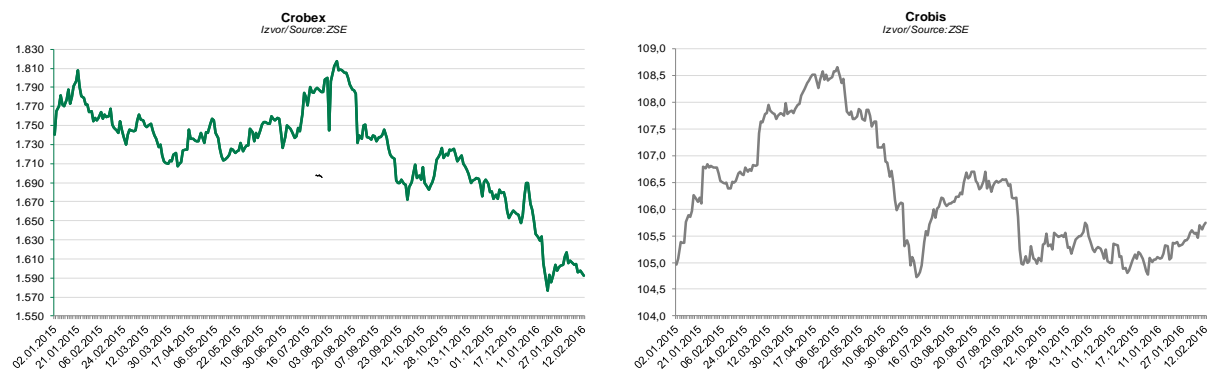
At the regular reverse repo auction held last week, all the submitted bank offers amounting to 160.5 million kuna at the fixed 0.50% repo rate were accepted and the liquidity remained generous, exceeding 11 billion kuna. However, the largest news is the announcement that this week CNB will hold the first out of four structural repo operations planned for this year, where debt securities of the Croatian issuers will be accepted as collateral. The operation will be held on 16 February with the settlement due on 18 February, at the fixed 1.8% repo rate and with the maturity on 18 February 2020, aimed at ensuring long-term kuna liquidity to banks and thus boost a stronger kuna lending activity. In such a climate, despite the beginning of a new cycle of maintaining reserve requirements, interest rate recorded only moderate changes, therefore the overnight Zibor closed the week at 0.51%, the same as the week before, 1M slightly declined by 1 b.p. to 0.70%, while 3M remained at 0.88%. The total ZSE turnover amounted to 591 million kuna, up by 4.5 wow, whereas supply and demand were more balanced than the previous week, therefore supply exceeded demand by an average of 148 million kuna per day.

There was no auction last week and, also, no maturity. There will be no maturity this week again, and the current balance of the subscribed T-bills amounts to 29.4 billion kuna.



Crobex drops below psychological threshold

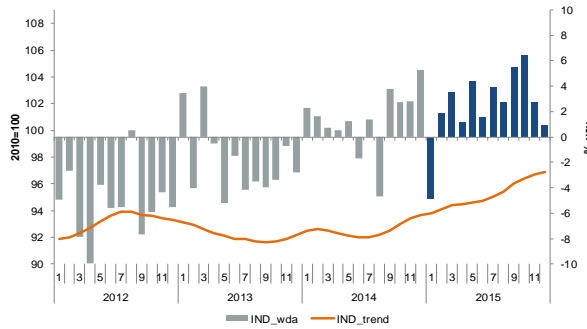
Crobex closed last week at 1,592.84 points, or losing 0.7% wow, while the Crobis closed the week at a 0.2% higher level, i.e. at 105.74 points. The total ZSE turnover was down by almost 50% wow, amounting to 626 million kuna, where the turnover in bonds was down by 46.9% to 578 million kuna, and the turnover in shares fell by 41.4% to 45 million kuna.



Statistics

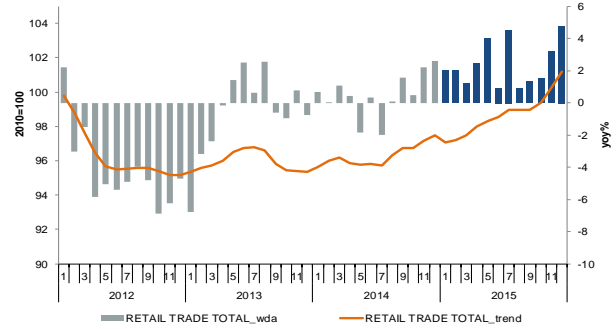
Industrial production, wda yoy % ch.

Source: Eurostat



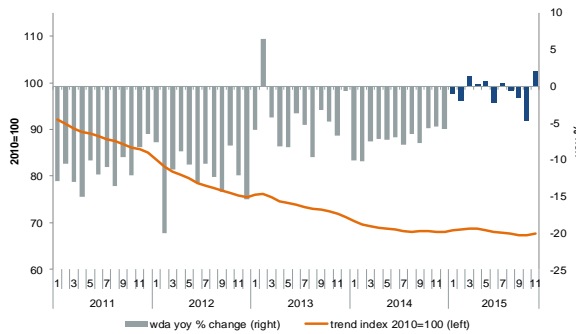
Retail trade, real, wda yoy ch.

Source: CBS



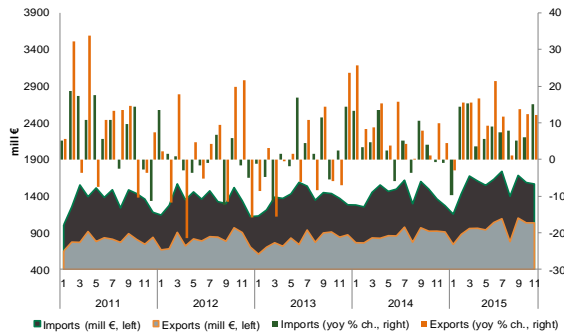
Construction works, yoy % ch. and index 2010=100

Source: CBS



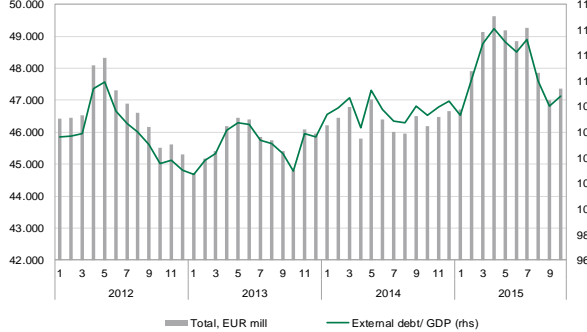
Goods exports and imports (yoy % ch. and mill €)

Source: CBS



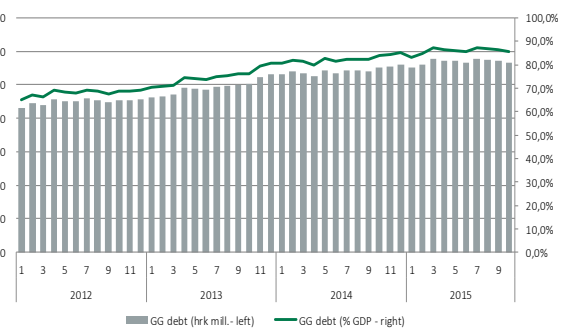
External debt, amount and share to GDP

Sources: CNB, CBS, PBZ



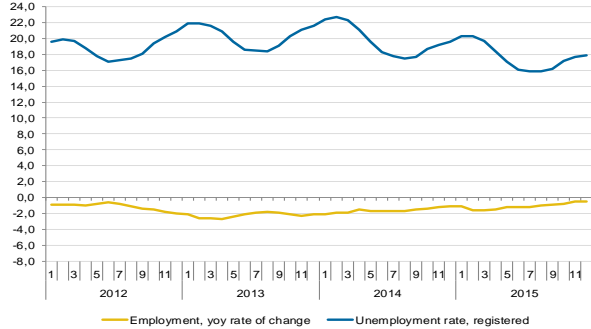
General government debt

Source: CNB



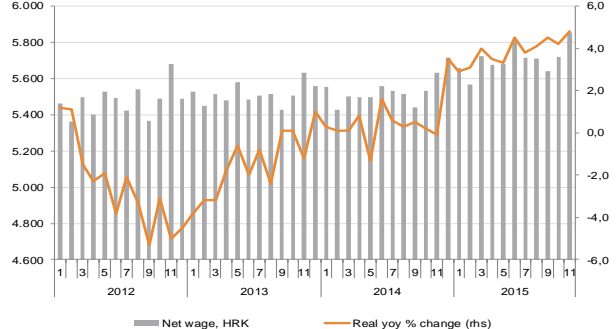
Employment, yoy rate of change and unemployment rate, %

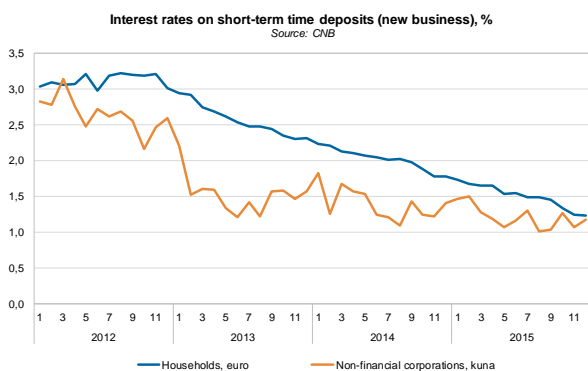
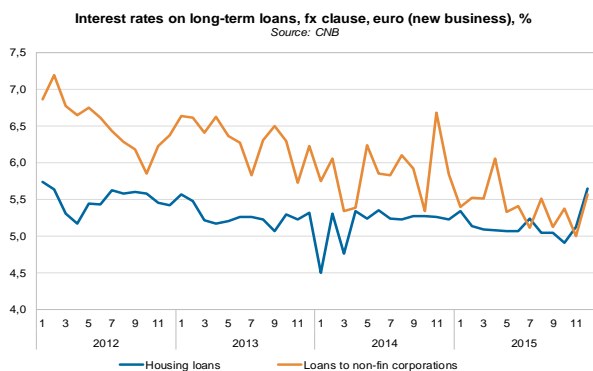
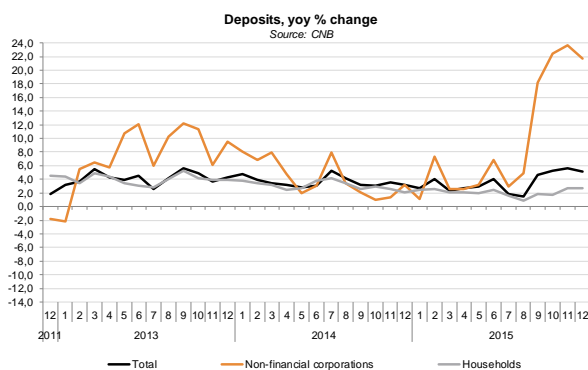
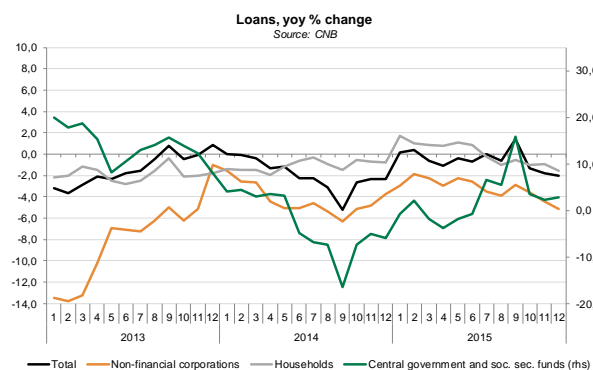
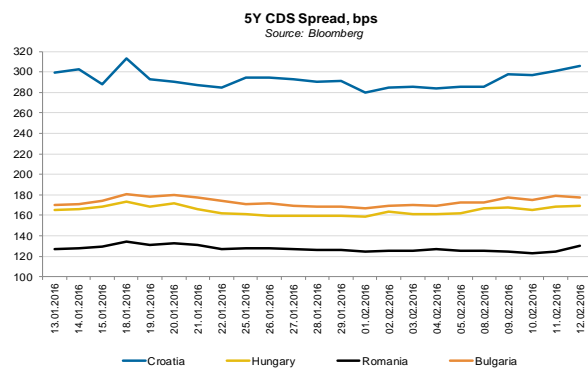
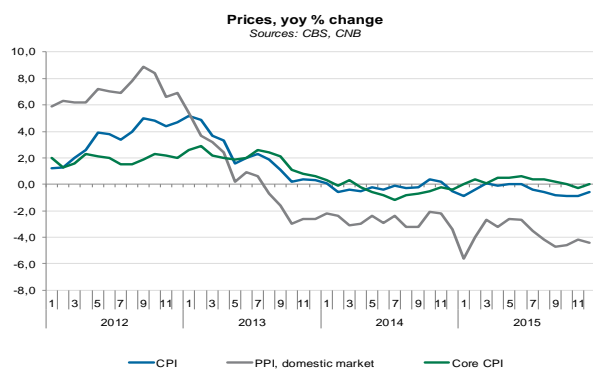
Source: CBS



Net wages: amount and real yoy rate of change

Source: CBS





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