

PBZ Weekly Analysis

Number 507, March 7, 2016

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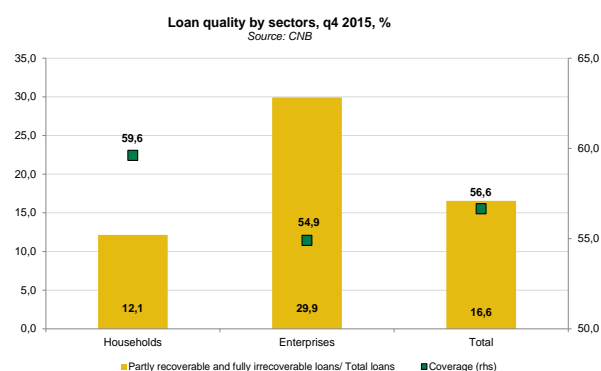
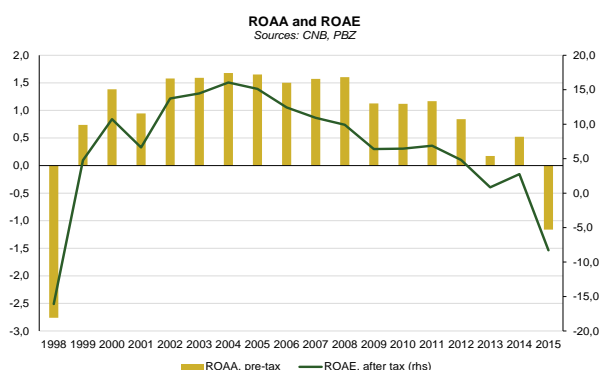
Weekly overview

- Net interest income of credit institutions in 2015 amounted to 10.7 billion kuna, which is an increase of 2.7% yoy, while net fee income moderately decreased by 2.0% to 3.1 billion kuna. Along with 24.2% lower other income amounting to 1.9 billion kuna (20.0% lower profit from currency trading and exchange rate differences), gross operating profit

reached 15.6 billion kuna, which is a fall of 2.4% yoy. Operating costs increased by 3.4% to 8.6 billion kuna, with a consequential increase in the cost to operating income ratio to 55% (2014: 52%) and a decline in net operating profit by 8.7% to 7.0 billion kuna. Costs of value adjustments and provisions reached 11.7 billion kuna, because of costs of the conversion of loans indexed to the franc (item "other provisions" grew to 6.8 billion kuna), due to which the impairment costs to net operating profit ratio jumped to 167%, which resulted in negative gross profit amounting to 4.7 billion kuna, or 4.3 million kuna loss after taxes. Therefore, last year, returns on assets and equity became negative for the first time since 1998, amounting to -1.2%, and -8.3%, respectively (we must say that, according to the Financial Stability Report No.16, returns for 2015, without conversion costs, were higher than the previous year). Six large banks (with a market share which accounts for more than 1% of the system assets) together have suffered gross losses of 4.9 billion kuna, which, given their high capitalisation level, does not threaten the stability of the system.

- The share of partly recoverable and fully irrecoverable loans in total loans was reduced last year to 16.6%, which is a decrease of 0.5 p.p. qoq, and this positive trend is a result of a lower share in loans to non –financial corporations over the last quarter by 1.2 p.p. to 29.9%. As in previous periods, the described movements are mainly a

result of the sale of non-performing loans, due to which the share of bad loans at the total portfolio level declined by around 3 p.p. (FS 16). The share of non-performing loans in loans to households has remained at 12.1% since the second quarter of last year; according to types, the share in housing loans rose by 0.4 p.p. to 9.7% qoq, in cash loans it declined by 0.2 p.p. to 9.2%, while the share in other loans fell solidly by 0.6 p.p. to 34.3% (mostly because of reduced amounts of other loans indexed to the franc). The data according to currency show that the last quarter saw a drop in the share of bad loans in kuna and euro loans by 0.7, or -0.6 p.p. to 17.6 and 15.3%, respectively, while the share in loans indexed to



the franc grew by 1.9 p.p. to 21.6%. However, the latter is not a consequence of a deteriorated quality of loans in francs; on the contrary, the amounts of partly recoverable and fully irrecoverable loans are lower, but, owing to the conversion, the decrease in the franc portfolio was faster, which resulted in a higher share. The overall coverage of non-performing loans with value adjustments continued to grow, reaching 56.6% at the end of the year (corporations 54.9%, households 59.6%), thus exceeding the highest level recorded at the end of 2007 (54.4%).

- The total number of employed persons in January 2016 decreased by 1% from December 2015, reaching 1,293,354 persons. The number of persons in paid employment in legal entities also dropped by 1% (to 1,092,291), in crafts and trades and free lances by 1.3% (to 180,813), while the number of private farmers fell by 2.7% (to 20,250). The largest relative decline in employed persons mom was recorded in *Accommodation and food service activities* (-6.9%), while the number of employed persons rose in only three categories: *Education*, *Health care* and *Arts, entertainment and recreation* (+0.2% each). The total number of employed persons in January decreased by 0.5%yoy, where the number of persons in paid employment in legal entities was lower by 0.3%, in crafts and trades and free lances by 0.8%, and agriculture by 7%. The largest relative drop yoy was recorded by *Real estate activities* (-8%), while the largest relative growth was recorded in the category *Other service activities* (+3.4%).
- The total number of unemployed persons in January increased by 2.7% from the previous month, amounting to 293,236 persons, while the registered unemployment rate rose from 17.9% to 18.5%. The number of unemployed persons yoy fell by 35,994 persons, which led to a decline in the registered unemployment rate by 1.8 p.p. As Easter holidays fall quite early this year (at the end of March), we expect that the February data will show a decline in the number of unemployed persons due to early seasonal employment, which is also seen from the number of registered job openings in January which were higher by almost 70%, showing 7600 more job openings from December.
- The average monthly net earnings per person in employment in legal entities in December of 2015 amounted to 5,772 kuna, which is a nominal decrease of 1.4% and a real-term decrease of 0.8% mom. Thus, the highest average net earnings were paid off in the category *Air transport* (10,715 kuna), while the lowest average monthly net earnings were paid off in the category *Manufacture of leather and related products* (3,060 kuna). At the annual level, the average monthly net earnings paid off in December were higher by 1% in nominal terms and 1.6% in real terms (lower rates are expected due to the base equalisation). In 2015, the average monthly net earnings per person in employment in legal entities amounted to 5,711 kuna, which is a nominal increase of 3.2%, or a real-term increase of 3.7%, compared with 2014. Thereby, the highest average net earnings were recorded in the categories *Air transport* (10,426 kuna), *Advertising and market research* (9,161 kuna), *Extraction of crude petroleum and natural gas* (8,973 kuna), *Telecommunications* (8,945 kuna) and *Computer programming, consultancy and related activities*, (8,932 kuna). On the contrary, the lowest net earnings of legal entities were paid off in the categories *Manufacture of wearing apparel*

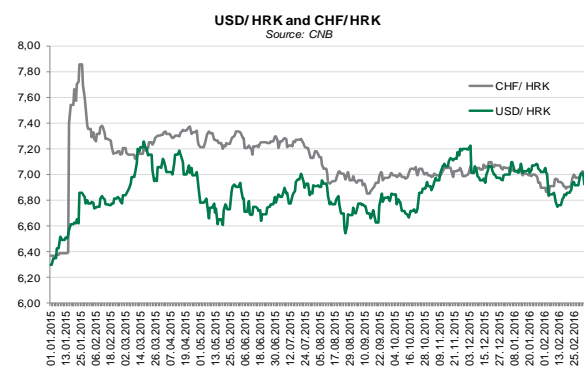
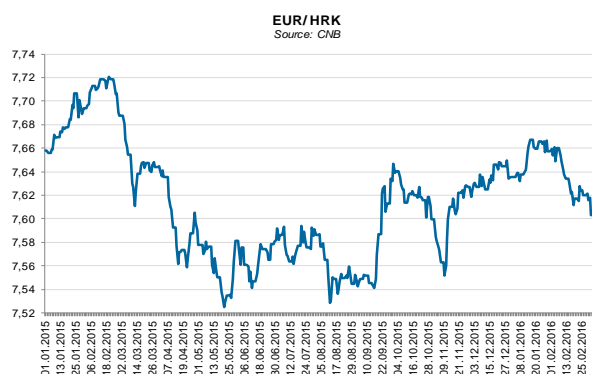
(3,087 kuna), *Security and investigation activities* (3,159 kuna), *Manufacture of leather and related products* (3.182 kn), *Services to buildings and landscape activities* (3,360 kuna) and *Manufacture of wood and of products of wood and cork, except furniture; manufacture of articles of straw and plaiting materials* (3,496 kuna). The upcoming trends in real net earnings will be mainly influenced by a negative inflation rate, as no changes in the tax system which would significantly influence the nominal earnings level, as in 2015, are planned for this year. However, depending on the outcome of negotiations between the Government and the unions, an increase in the governments and public sector wages is possible, but, according to the current situation, probably rather due to a correction of past service than as a result of a 6% rise in the wage base consistent with the GDP growth.

EUR/USD corrected, kuna stronger

Last week, positive trends in the USA and the anticipation of the new monetary ECB stimulus created an environment where the euro slipped downwards and the EUR/USD fell below 1.09. However, the end of the week saw a technical correction due to the expectations of the US employment data, so the trading on Friday closed at 1.1005 dollar to the euro, up by 0.6% wow. The franc weakened by 0.3% against the euro, closing the week at 1.09315 franc to the euro.



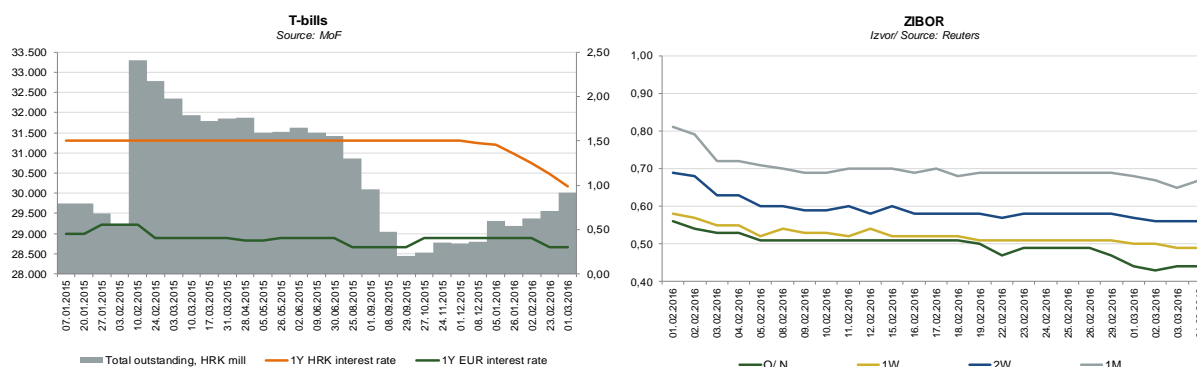
The domestic currency trading was within the expected range up to the end of the week when, forced by the sale of the euro on the interbank market, the exchange rate broke above the level of 7.60 and dropped to 7.5920. The mid-exchange rate of the kuna against the euro ended on Friday at 7.6028 kuna to the euro, down by 0.2% from the previous Friday. The kuna slightly weakened against the dollar and the franc respectively by 0.1%, to 6.9230 kuna to the dollar and 6.9853 kuna to the franc. This week, we expect the trading in the range from 7.585 to 7.625 kuna to the euro.



Decrease in money market interest rates

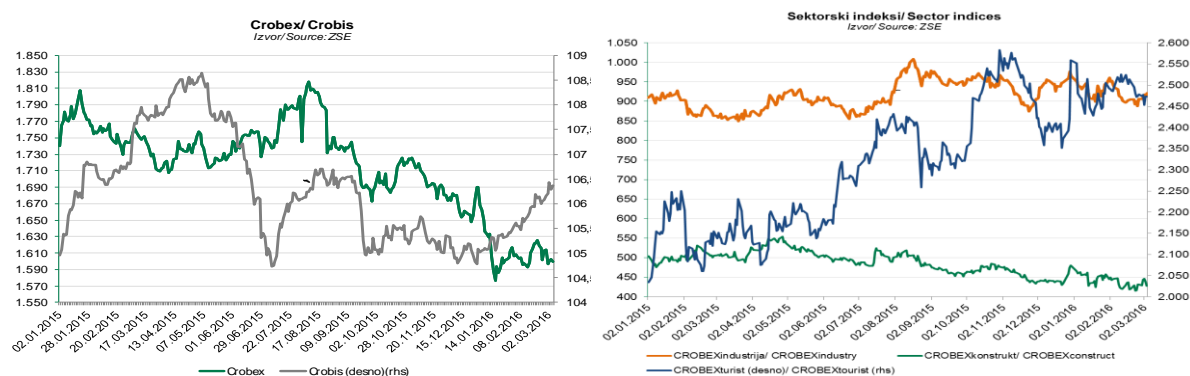
At the last week's regular reverse repo auction all the submitted bank offers amounting to 106 million kuna at the fixed 0.5% repo rate were accepted as usual. The total ZMM turnover amounted barely to 89 million kuna, while supply exceeded demand by an average of 212 million kuna per day. Due to ample liquidity and low trading volume, the interbank market interest rates moderately decreased, therefore the overnight Zibor closed the week at 0.44% (-5 b.p. wow), while 1M and 3M at 0.67 and 0.83%, respectively (both -2 b.p.).

The MF T-bill auction saw a subscription of 5 million kuna in three-month T-bills with an unchanged yield of 0.40%, 20 million kuna in six-month T-bills, also with an unchanged yield of 0.50% and 1.5 billion kuna in one-year T-bills with 0.99% interest rate (-14 b.p.). As 1.1 billion kuna in T-bills matured and 1.5 billion kuna were subscribed, the government debt under T-bills rose to 30.0 billion kuna. A total of 1.2 billion kuna will mature this week, and the auction amounting to 1.0 billion kuna has been announced for Tuesday.



Crobex below psychological threshold

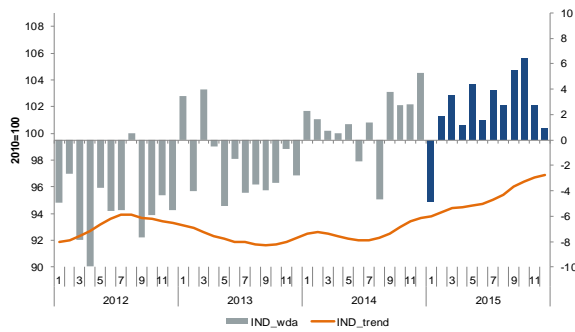
The Crobex index declined by 0.8% wow, closing the week below the psychological threshold, at 1,599.71 points, whereas the Crobis rose by 0.3% wow, closing the week at 106.36 points. According to the ZSE statement, after the close of trading on 18 March 2016, the shares of RIZ-Odašiljači, Luka Ploče and Petrokemija will be excluded from the Crobex index, while Ledo and Varteks will be included in the Crobex index. With regard to sector indices, CROBEXindustry closed the week at 921.08 points (+1.6% wow), CROBEXtourist at 2,472.61 points (-0.2% wow), while CROBEXconstruct dropped by 0.9% wow, closing the week at 427.75 points. The total ZSE turnover declined by 50.5% from the previous week, amounting to 1.270 billion kuna, due to a reduced bond turnover of 54% wow (to 1.155 billion kuna), however, the share turnover reached 114 million kuna (+91.5% wow).



Statistics

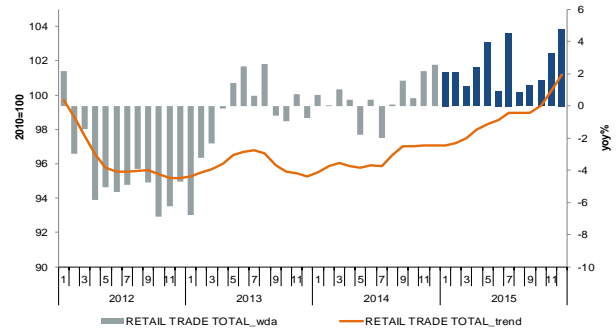
Industrial production, wda yoy % ch.

Source: Eurostat



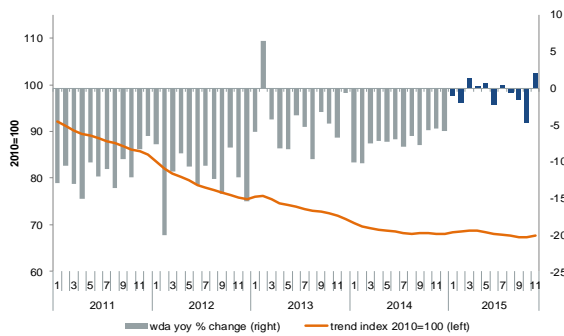
Retail trade, real, wda yoy ch.

Source: CBS



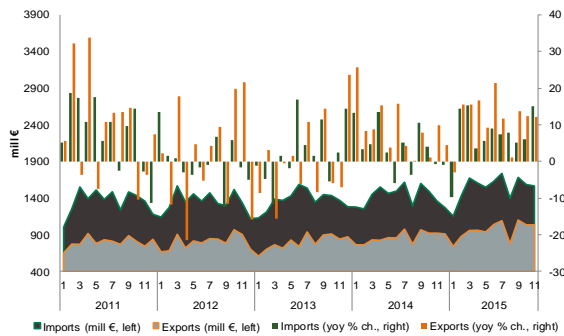
Construction works, yoy % ch. and index 2010=100

Source: CBS



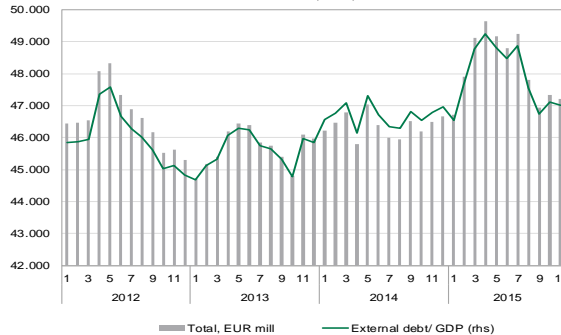
Goods exports and imports (yoy % ch. and mill €)

Source: CBS



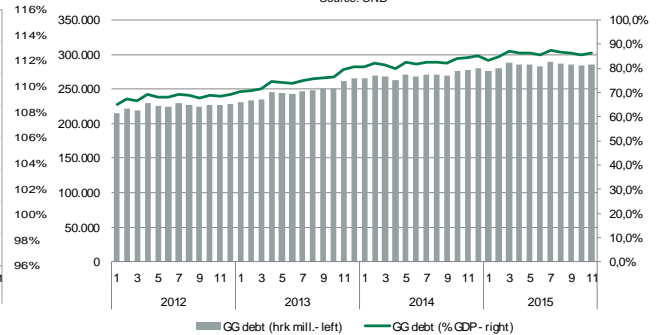
External debt, amount and share to GDP

Sources: CNB, CBS, PBZ



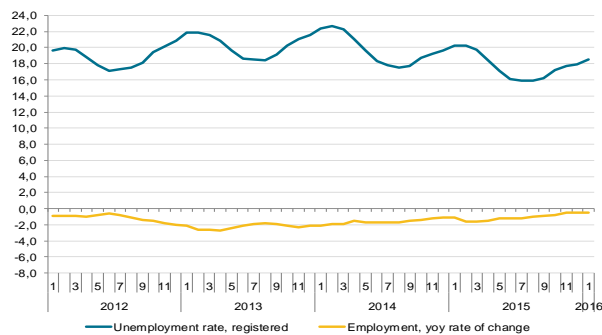
General government debt

Source: CNB



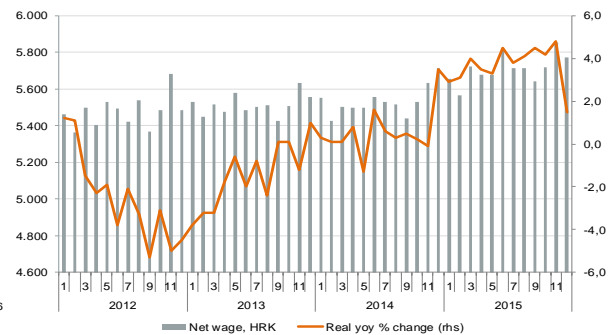
Employment, yoy rate of change and unemployment rate, %

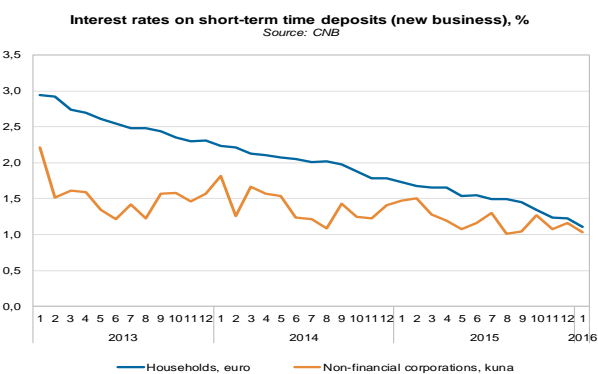
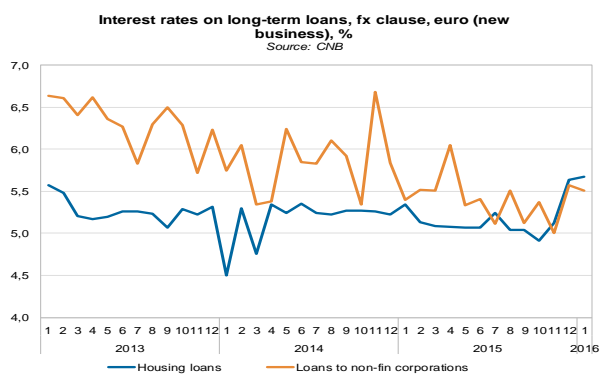
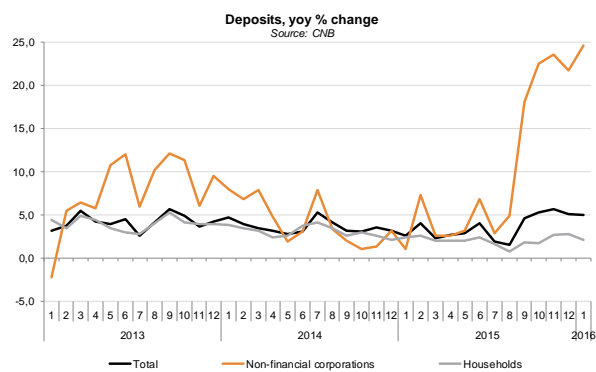
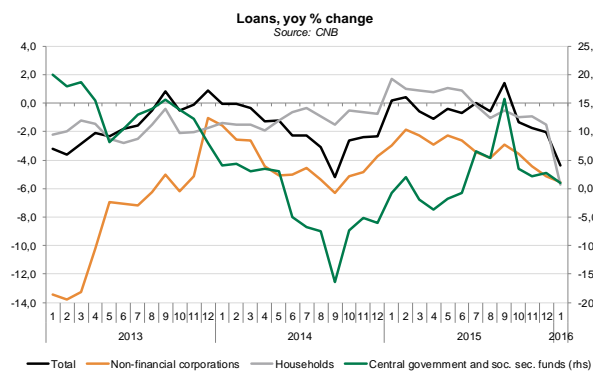
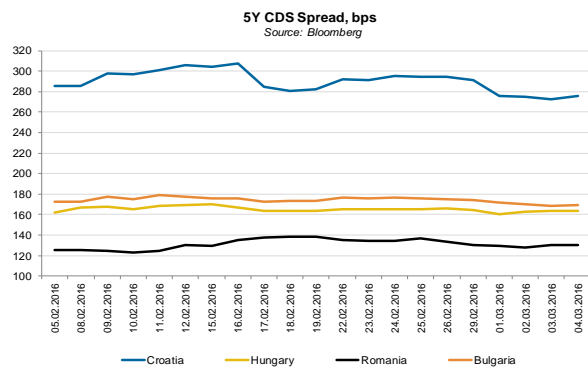
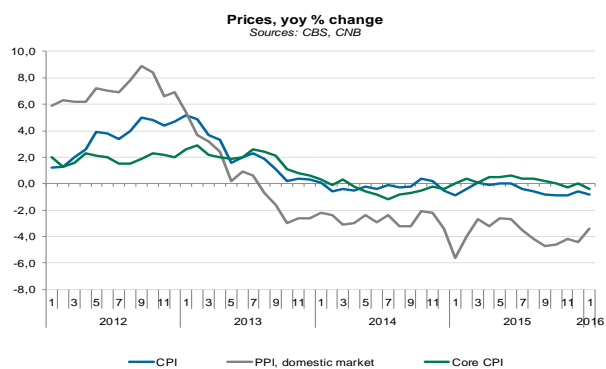
Source: CBS



Net wages: amount and real yoy rate of change

Source: CBS





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