

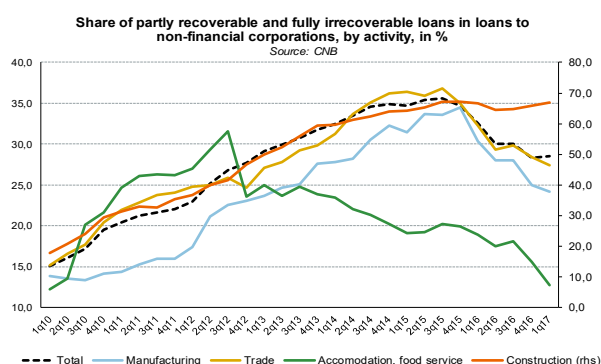
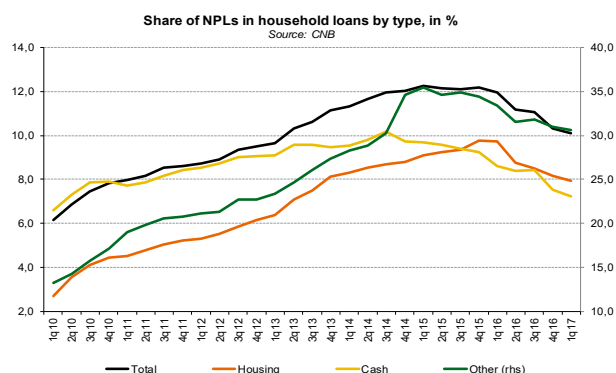
PBZ Weekly Analysis

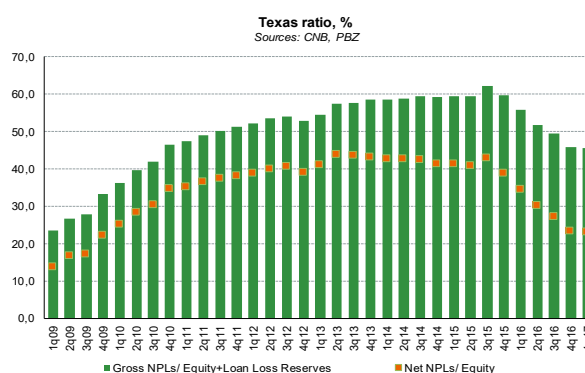
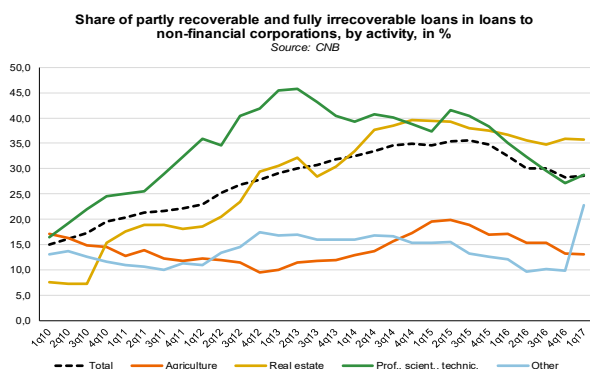
Number 567, June 12, 2017

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Weekly overview

- A positive declining trend in the share of partly recoverable and fully irrecoverable loans in total loans ended in the first quarter of this year, where the share rose by 0.1 p.p. versus the end of 2016, to 13.9% (private sector: -0.1 p.p. to 17.9%). The increase in the share is a result of a deteriorated corporate portfolio quality owing to the restructuring of Agrokor, due to which the share rose by 0.2 p.p. to 28.5%, and the growth would even be higher if the banks had not sold almost 1 billion kuna of gross claims on non-financial corporations in the first quarter. Analysed according to activities, the largest contribution came from an increase in non-performing loans in the category Other activities, where a jump from 9.9% recorded at the end of last year to 22.7% from the end of March this year was registered. For other activities, we see a positive trend (Manufacturing -0.8 p.p. to 24.2%, Trade -1.0 p.p. to 27.4%, Accommodation and food service activities -2.9 p.p. to 12.7%), except for Construction, where the amount of non-performing loans has continued to decrease, however, the share rose by 1.1 p.p. to 66.8%. As regards loans to citizens, the share of partly recoverable and fully irrecoverable loans in total loans has continued its downward trend, therefore, over the monitored period the share decreased by 0.2 p.p. to 10.1%, where housing loans dropped by 0.3 p.p. to 7.9%, overdrafts by 0.1 p.p. to 9.9%, card loans rose by 0.1 p.p. to 3.3%, cash loans decline by 0.3 p.p. to 7.2%, while other loans decreased by 0.4 p.p. to 30.6%. As regards housing loans according to currencies, the share of non-performing loans in loans indexed to the euro declined to 6.8% and in kuna loans to 4.3%. A slight asset quality deterioration was followed by a simultaneous increase in the coverage of partly recoverable and fully irrecoverable loans by value adjustments. Thus, the total coverage at the end of the first quarter reached 64.2%, up by 0.6 p.p. versus the end of 2016, where the coverage of loans to non-financial corporations rose by 0.4 p.p. to 63.4%, while the coverage of loans to citizens rose even by 1.3 p.p. to 65.9%. At the same time, the Texas ratio (net non-performing loans/ capital) moderately dropped due to a reduction in the capital, amounting to 23.1% at the end of March. Both of the mentioned ratios as well as a high total capital ratio of 23.15%, indicate a stable and highly capitalised system, while a further confirmation of the above comes from the stress tests conducted by the central bank which show that, even in the case of a disorderly restructuring of the Agrokor Group, the Common Equity Tier 1 rate remains at the satisfactory 14.4% this year. By the end of the year, we expect a continuation of the loan sale and write-offs, however, the total share might increase due to the expected deterioration in the corporate portfolio quality.





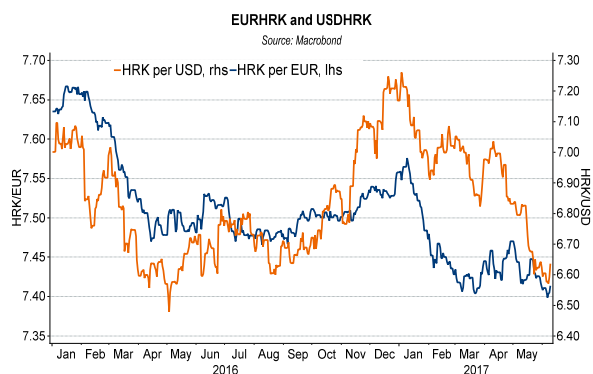
- The net profit of credit institutions in the first quarter amounted to 434 million kuna, down by 64.8% versus the same period last year, as a result of higher expenses on value adjustments (1.3 billion kuna, compared with 251 million kuna of provisioning income in the first quarter of 2016). Simultaneously, operations of credit institutions were exceptionally successful, with a 36.8% higher net operating profit. Net interest income rose by 1.7% yoy, mainly as a result of lower time deposit interest expenses (-40.9%), net income from fees and commissions jumped by 7.8% due to a 6.3% increase in income from fees and commissions, while other operating income reached 224 million kuna (in 1Q 2016, 84 million kuna of expenses related to the conversion), due to which the gross operating profit rose by 12.1%. Total operating costs fell by 2.7%, thus the cost/ income ratio dropped from 62.5% recorded in the first quarter of 2016 to 54.3% in the first quarter of 2017. The return on average assets declined to 1.4% (2016: 1.6%), and on average equity to 7.9% (2016: 9.6%). Amid increasing uncertainty over the restructuring of the Agrokor Group, and its impact on banks which is difficult to quantify at this moment, we expect that the banks will remain focused on maintaining the net interest margin, mainly through cost control, but also through a further easing in the credit standards, which will eventually strengthen market competition.

ECB unchanged, CNB intervenes twice

Last week, global FX markets focused on the expectations of the ECB meeting and this week's meeting of the Fed. The ECB meeting did not bring monetary policy changes, however, a possibility of a further interest rate cut was ruled out and the inflation forecasts for this and next year were revised downwards. In such an environment, the dollar strengthened against the euro, so trading on Friday closed at 1.1195 dollar to the euro, down by 0.7% wow.

The domestic FX market saw a dynamic last week, where the central bank made two interventions in the market. First on Tuesday, when the exchange rate decreased to 7.38-7.39 kuna to the euro, purchasing from banks 188 million euro at the average exchange rate of 7.4163, then again on Thursday, after the exchange rate decrease to 7.397-7.402, purchasing a further 186 million euro at

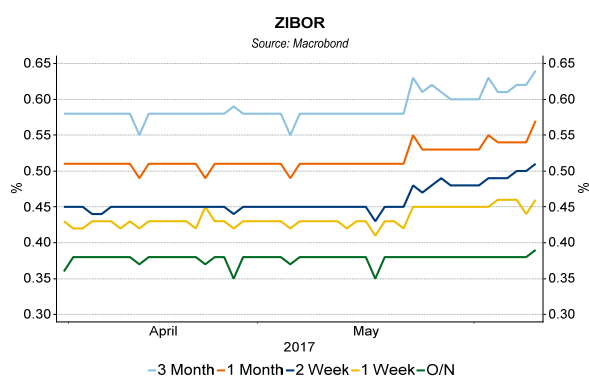
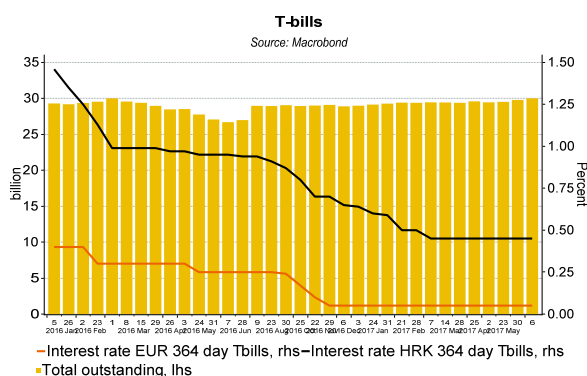
the average exchange rate of 7.4266. Finally, the kuna remained almost unchanged against the euro wow, at 7.4137 kuna to the euro, whereas the kuna against the dollar weakened by 0.5% and the exchange rate rose to 6.6360 kuna to the dollar. A satisfactory shaping up of the tourism season, the announced new issue of the domestic bond and a new loan to Agrokor will boost the kuna strengthening over the upcoming period.



Higher liquidity

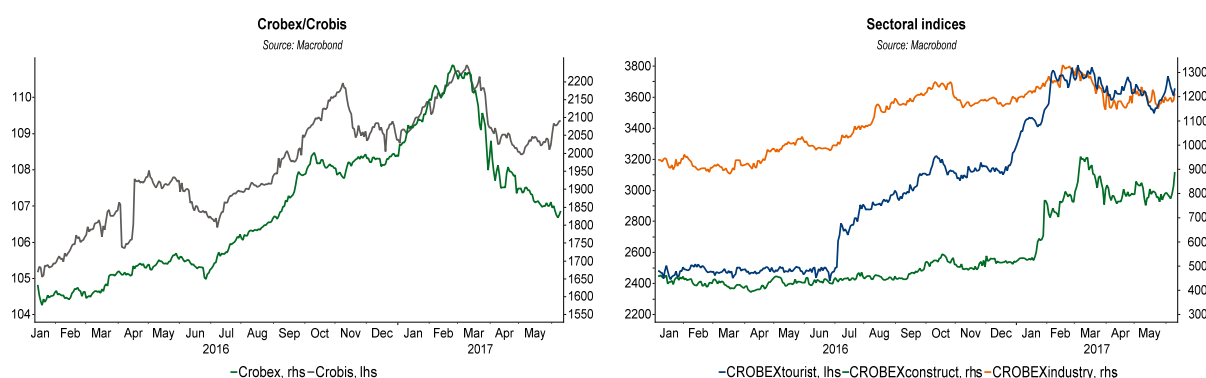
Ample liquidity further increased after last week's two interventions of the central bank in the FX market, which resulted in the kuna liquidity of almost 2.8 billion kuna. In this environment, interest rates in the interbank market recorded only minor changes wow, therefore the overnight Zibor rose by 1 b.p. to 0.39%, 1M by 2 b.p. to 0.57% and 3M Zibor by 1 b.p. to 0.64%. There was no demand for the sixth consecutive week at the regular reverse repo auction, while the ZMM turnover was more dynamic, amounting to 833 million kuna.

Last week, 402 million kuna in T-bills matured, while 643 million kuna were subscribed, due to which the government debt under T-bills rose to 30.0 billion kuna. There was a subscription of one-year kuna T-bills at the interest rate of 0.45%, unchanged versus the previous issues. There will be no maturity or auction this week.

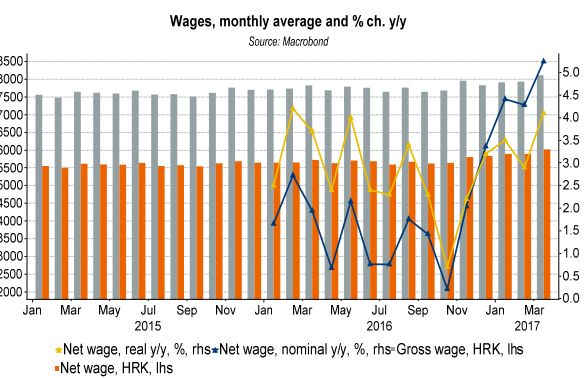
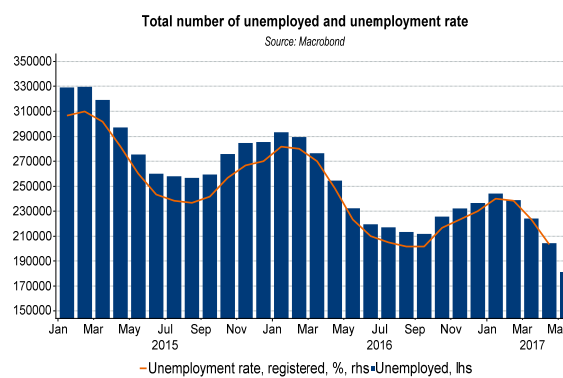
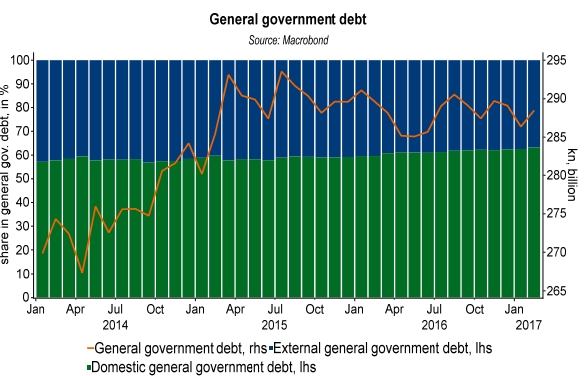
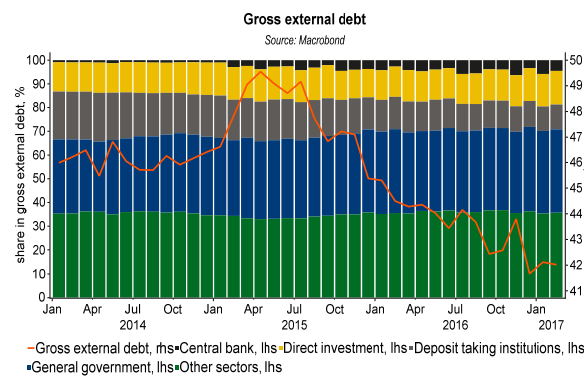
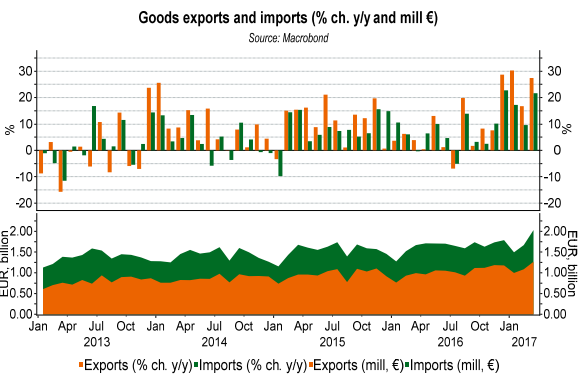
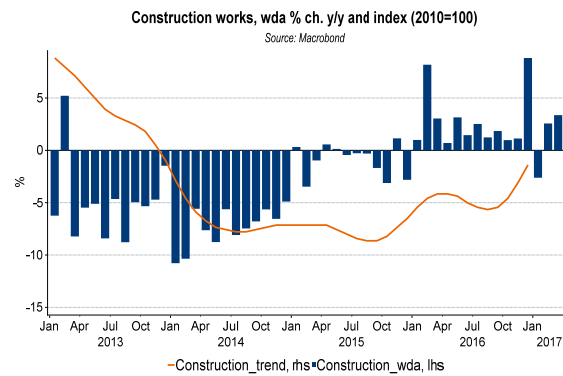
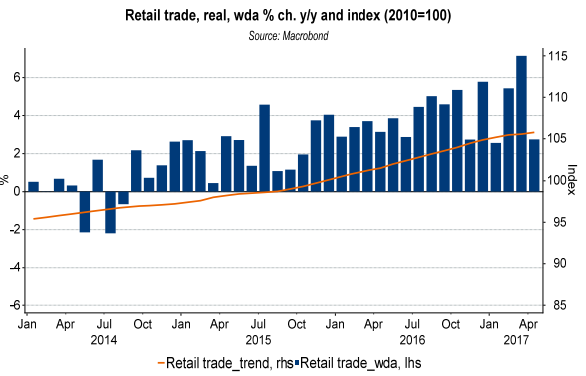
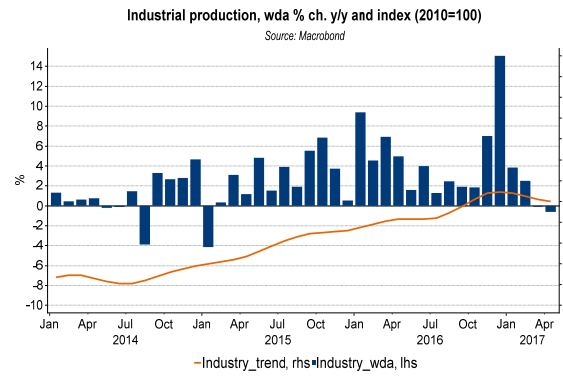


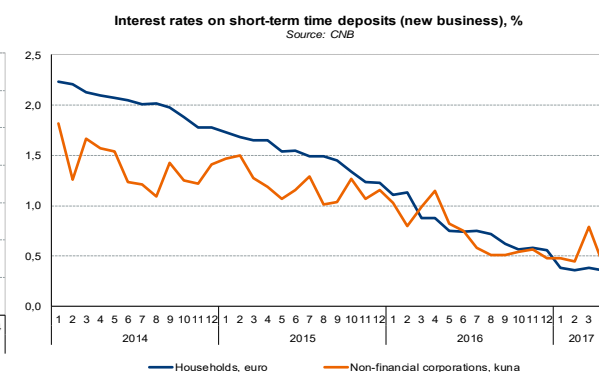
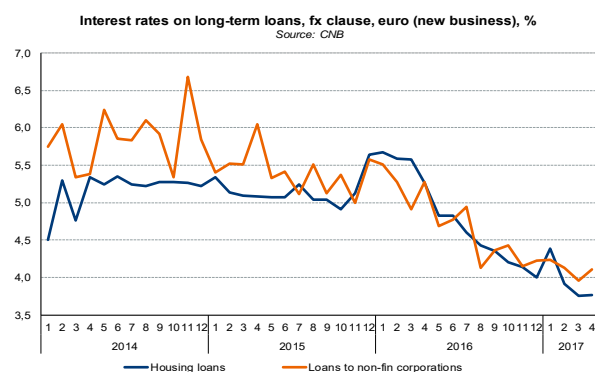
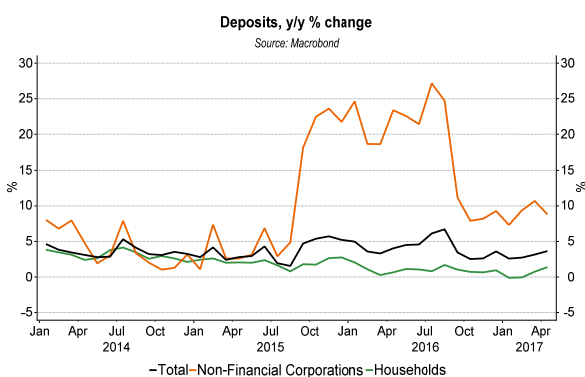
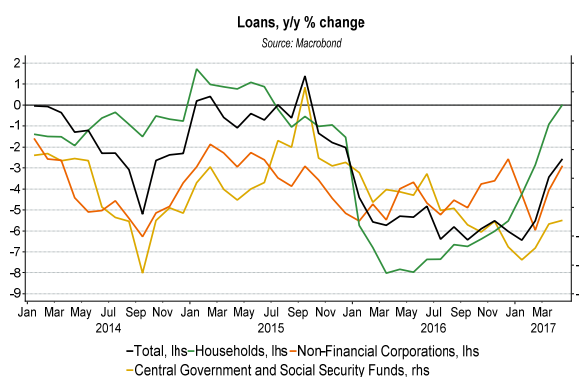
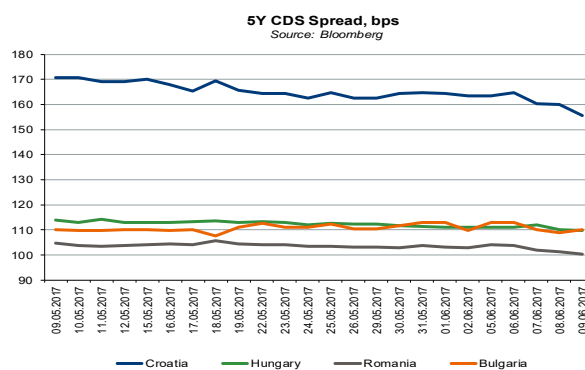
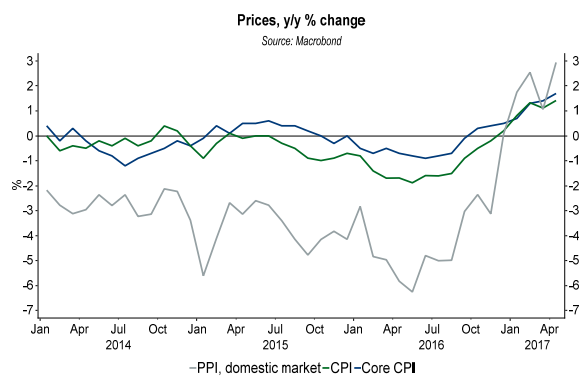
Crobex in negative territory for second consecutive week

The Crobex index closed at 1,839.81 points last Friday, down by 0.7% wow, while Crobis closed the week at 109.35 points, i.e. up by 0.1% wow. As regards sector indices, CROBEXtourist decreased by 2.1% wow, falling to 3,656.02 points, whereas CROBEXconstruct (888.45 points) and CROBEXindustry (1,212.75 points) rose by 11.7% and 2.5%, respectively. Last week, the total ZSE turnover amounted to 616.6 million kuna, i.e. up by 1.4% compared with the week before, where the turnover in shares increased 5.1 times (to 176.0 million kuna), while the turnover in bonds decreased by 23.2% (to 440.6 million kuna). At its meeting held on 7 June 2017, the Index Committee made an extraordinary revision of the Crobex index, based on which the shares of the company Viadukt d.d. are to be excluded from the Crobex index, since the mentioned company had submitted a notification on the beginning of a pre-bankruptcy procedure. The extraordinary revision of the Crobex index will be made after the close of trading on 19 June 2017.



Statistics





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