

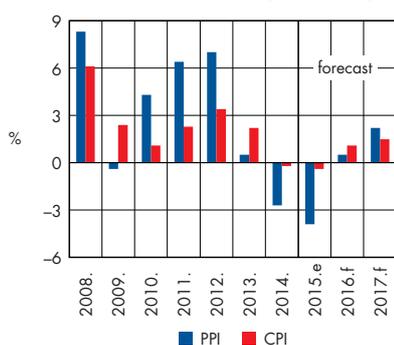
## Focus on Politics

### Croatia – sovereign credit rating

	Long Term (LT) Rating			
	Foreign Currency		Domestic Currency	
	LT Rating	Out-look	LT Rating	Out-look
Fitch Ratings	BB	Negative	BB+	Negative
Moody's	Ba1	Negative	Ba1	Negative
Standard & Poor's	BB	Negative	BB	Negative

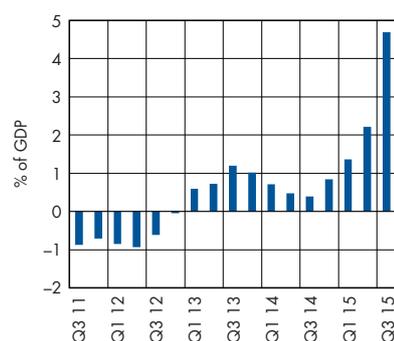
Sources: CBS, Economic RESEARCH/RBA

### CPI and PPI annual change, average



Sources: CBS, Economic RESEARCH/RBA

### C/A balance as % of GDP



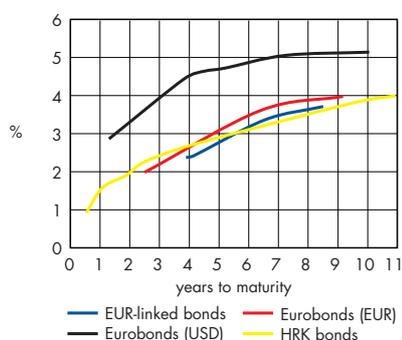
Sources: CNB, Economic RESEARCH/RBA

The **process of government formation** is in progress but expected to be completed within two weeks. The distribution of ministries between the political parties is still unknown, at least for now. The proposed candidates for ministers are to be confirmed by the PM designate and finally confirmed by the Parliament that has been constituted on 28 December. The intention is to make the government more focused on crucial reforms. According to the public announcement, the first measures of the new government could be directed to the reduction and rationalization of the public administration and the reform of the healthcare system (both suffer from relatively high inefficiency). Although it could be said that the political deadlock has come to an end, Croatia will continue to experience a politically challenging period ahead as lots of uncertainties remain. Namely, the Croatian political system has no experience with non-partisan PM's, with no political authority and experience. It should not be forgotten that the HDZ-led coalition, with the support of MOST and a few minor parties has for now 78 seats in the Parliament which is only 2 seats above the parliamentary majority. The latter suggest a harder political environment to implement reforms, potentially more tensions and instabilities. Eventually, in such an environment the functioning of the public administration will certainly be weakened in 2016. However, for the first time the public sentiment and politicians are focused on reforms and this could bring some positive changes crucial for the sustainable recovery and weak fiscal metrics.

Besides focusing on politics the week ahead will bring the **inflation data releases**, CPI and PPI. Both will confirm negative inflation rates that have been lasting for a relatively long time, mostly due to the fall of energy prices. We expect to see **CPI** at  $-0.4\%$  yoy level, while the **PPI** will report a negative rate for the 29th month in a row. As long as we do not see some recovery of the global commodity prices (especially oil) and a shift in the weak domestic demand, the inflation will remain subdued. Nevertheless, a slow upward trend could be seen during 2016, more pronounced in the second half of the year.

In the meantime the latest **retail trade** and **industrial production** data for November confirmed that recovery gained momentum (retail rose by  $3.2\%$  yoy (w.d.a) while industry increased by  $2.7\%$  yoy). Although it did not bring any surprises, the **current account** for Q3 2015 is worth mentioning. Namely, in the respective quarter the C/A reported a surplus in the amount of EUR 3.9 bn, which is EUR 1 bn or  $38.9\%$  higher on annual level. On a rolling basis the C/A balance surplus in Q3 2015 increased to  $4.7\%$  of GDP from  $2.2\%$  of GDP in Q2 15 (the highest historical value). The main positive contributions in Q3 15 came from the primary account that, for the first time ever, reported a surplus as a result of the banks' losses caused by the forced CHF-indexed loans conversion. Furthermore, in line with the first tourism indicators, the service account surplus bridged EUR 5 bn, suggesting that the total 2015 FCY inflow from tourism will reach EUR 8 bn. Ahead of the release for the whole year 2015, the C/A surplus is expected to remain at relatively high levels (over  $4.5\%$  of GDP), widely supported by tourism and a one-off spike caused by the said bank losses. Positive developments (in the service and goods account) are expected to continue in 2016, thus being supportive for HRK.

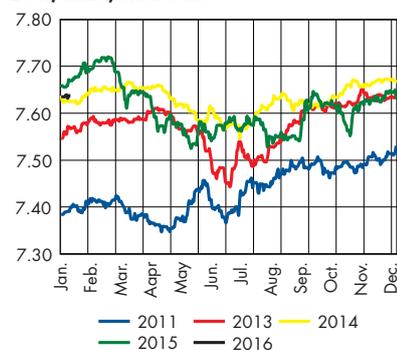
## Croatia – sovereign bonds yield curve



As of 8 January, 8:30 a.m. (CET)

Sources: Bloomberg, Economic RESEARCH/RBA

## EUR/HRK, mid rate



Sources: CNB, Economic RESEARCH/RBA

As for financial markets, we will see another calm week of low **money market** interest rates supported by ample HRK liquidity and absence of T-bill auctions given the fact that no maturities fell due. The accommodative stance of the monetary policy is expected to be confirmed by additional central bank measures, a long term repo operation (2 and more years) focused on ensuring longer HRK funds. Although the aim is to spur the domestic lending activity in the local currency, such market environment will be supportive for the sovereign securities. Therefore, HRK yields might face pressures on the long end, allowing cheaper borrowing. Hopefully, the possible implementation of long-term open market operations will be an incentive for fiscal consolidation, rather than just a motive for further public borrowing. In the next week local **bond market** might stay well bid, being the most expensive on the HRK curve. We see value in the Eurobond market as good entry point (if the positive sentiment connected to the formation of reform – oriented Government materializes).

The very end of the year as well as the beginning of the New Year did not bring any surprises on the domestic **FX market**. EUR/ HRK hovered between 7.63-7.66. The usual weakening of HRK at the end of the year was broadly mitigated by an increased HRK demand ahead of the holidays. Consequently, the middle exchange rate closed the year at 7.635 or 0.34% yoy lower. In the following weeks, we expect to see a stable EUR/HRK rate, as the trading range should stay unchanged at 7.63 to 7.66. However, FX movements over the year might be determined by the final political outcome as this might influence further economic growth and fiscal metrics in the mid-term. The reform oriented government will definitely be HRK-supportive, while renewed tensions and instabilities might cause depreciation pressures on EUR/HRK since in that case the FCY inflows will be definitely lower (threatening recovery as well).

According to the rating calendar, the **S&P rating agency** may announce a renewed assessment on Croatia at the very end of the week. Nevertheless, we do not expect any changes until the new Government presents its working plan and the 2016 budget. The latter, in our view, could not be seen before the second half of the Q116.

Financial analyst: Zrinka Zivkovic Matijevic (+385 1 61 74 338), Raiffeisenbank Austria d.d., Zagreb

## Key economic figures and forecast

	2014	2015e	2016f	2017f
Real GDP (% yoy)	-0.4	1.5	1.0	1.5
Industrial production, % yoy	1.2	2.7	2.5	3.4
Consumer prices (avg, % yoy)	-0.2	-0.4	1.1	1.5
Unemployment rate (ILO, avg)	17.3	16.2	16.0	15.8
Budget deficit, % of GDP, ESA 2010	-5.7	-5.0	-4.5	-4.1
Public debt, % GDP	85.1	89.9	93.1	94.9
C/A Balance, % of GDP	0.8	4.7	1.5	1.5
FX reserves, (eop, EUR bn)	12.7	13.0	13.1	12.9
EUR/HRK (avg)	7.63	7.62	7.65	7.66

Sources: CNB, MoF, CBS, Raiffeisen RESEARCH

## The strong decrease of stock indices

### Trading comment

With a much lower activity of investors in the first week of 2016 compared to the previous week, the CROBEX and CROBEX10 indices achieved a sharp drop in value. The strong fall in US and European stock markets prompted with a concern over a slowdown in Chinese economic growth, spilled over to the Zagreb Stock Exchange, and both CROBEX and CROBEX10 recorded minuses of 3.2% and 3.5% respectively. All sector indices also recorded a drop on the weekly basis with CROBEXtransport leading with a drop of 6.54%. Average daily regular turnover was 61% lower than in the week before, at HRK 5.6 mn daily and the shares of Hrvatski Telekom were the most traded with HRK 4.8 mn of regular turnover. Among CROBEX constituents, shares of Đuro Đaković Holding had the best performance while shares of Petrokemija lost the most. Regional indices ended the week mostly with lower values and the largest drop was seen by Polish WIG30 index.

### Company news

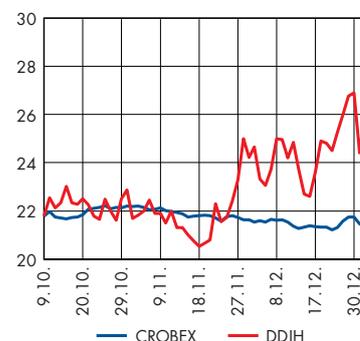
**Đuro Đaković Holding** signed a contract with Jadranski Naftovod in amount of HRK 164 mn, to build two storage tanks for oil products at the Omisalj terminal. **Jadranski Naftovod** signed the contract with the Naftna industrija Srbije a.d. and Optima Grupa d.o.o. for the transport of 3.1 million tons of crude oil during 2016, and a contract for the storage of oil products at the Janaf's terminal in Omisalj with companies Vitol s.a. and Glencore Energy UK Ltd for the year 2016. **Atlanska Plovidba** took over new vessel from Chinese shipyard; it is a Handysize vessel with a total capacity of 38,700 tons dwt, length of 180 meters and width of 32 meters.

### In this week

In the week ahead, we expect slightly higher activity on the Zagreb Stock Exchange with the stagnation of the main stock indices.

Financial analyst Damjan Sutlić (+385 1 55 75 733), Raiffeisenbank Austria d.d. Zagreb

### Đuro Đaković Holding (3 m)



Sources: ZSE, Raiffeisen RESEARCH

### Atlanska Plovidba (3 m)



Sources: ZSE, Raiffeisen RESEARCH

### Market performance

Index	1w %	ytd %	Value on*
<b>8.1.2016</b>			
BUX (HU)	0.08	43.93	23,941
SASX10 (BH)	-0.50	-2.69	696
MICEX (RU)	-0.73	25.20	1,749
SOFIX (BG)	-0.85	-12.47	457
BELEX15 (RS)	-1.70	-5.08	633
SBITOP (SI)	-2.17	-13.15	681
CROBEX (HR)	-3.18	-6.27	1,636
PX (CZ)	-3.38	-2.39	924
BETI (RO)	-4.25	-5.31	6,707
ATX (AT)	-6.49	3.77	2,241
NTX (SEE,CE,EE)	-6.81	-9.06	894
WIG30 (PL)	-6.88	-22.31	1,932.64

\* as at 16:30 CET. Source: Bloomberg

### Top/Flop – CROBEX index

Share	1w %	Price on*	Share	1w %	Price on*
<b>8.1.2016</b>					
Đuro Đaković H.	8.48	29	Tankerska NG	-2.67	73
Kraš	1.01	500	Končar EI	-2.68	650
Belje	0.93	25	Ericsson NT	-2.97	1.014
Genera	0.00	167	AD Plastik	-3.51	95
Maistra	0.00	230	Luka Rijeka	-4.54	42
Dalekovod	-0.44	14	Arenaturist	-6.76	317
RIZ Odašiljači	-0.92	109	Luka Ploče	-6.92	652
Valamar Riviera	-1.04	24	Ingra	-9.70	3
Adris Grupa (P)	-1.09	361	OT-Optima T.	-9.85	2
Atlantic Grupa	-1.28	822	Atlanska Plov.	-10.96	130
Zagrebačka Banka	-1.30	37	Ina	-13.26	2.560
Podravka	-2.07	327	Petrokemija	-14.32	11
HT	-2.63	141			

\* as at 16:30 CET. Source: ZSE, Raiffeisen RESEARCH

## Economic RESEARCH

### Raiffeisenbank Austria d.d. Zagreb (abbreviated as "RBA")

#### Economic Research

Zrinka Živković Matijević, MSc, Head of Department; tel: +385 1/61 74 338, email: zrinka.zivkovic-matijevic@rba.hr  
Tomislava Ujević, Economic Analyst; tel: + 385 1/46 95 099, email: tomlava.ujevic@rba.hr  
Mate Rosan, Economic Analyst; tel: + 385 1/61 74 388, email: mate.rosan@rba.hr

#### Financial Advisory

Nada Harambašić Nereau, MSc, Financial Analyst; tel.: + 385 1/61 74 870, email nada.harambasic-nereau@rba.hr  
Damjan Sutlić, Financial Analyst; tel: +385 1/55 75 733, email: damjan.sutlic@rba.hr

#### Markets and Investment Banking

Ivan Žižić, Executive Director; tel: +385 1/46 95 076, email: ivan.zizic@rba.hr

#### Abbreviations

avg – average	FED – Federal Reserve System	ON – overnight
bp – basis points	FI – financial institutions	MM – money market
C/A – current account	FY – full year	MFEA – Ministry of Foreign and European Affairs
CBS – Croatian Bureau of Statistics	GDP – Gross Domestic Product	qoq – quarter over quarter
CES – Croatian Employment Service	GFCF – Gross fixed capital formation	RBA – Raiffeisenbank Austria d.d.
CNB – Croatian National Bank	ILO – International Labour Organisation	RoC – Republic of Croatia
DPS – dividend per share	IMF – International Monetary Fund	SMP – Securities markets programme
EC – European Commission	kn, HRK – Kuna	SNA – System of national accounts
ECB – European Central Bank	LSE – London Stock Exchange	USD – Dollar
EDP – Excessive Deficit Procedure	MIP – Macroeconomic imbalance procedure	w.d.a – working day adjusted
EM – Emerging Markets	MoF – Ministry of Finance	yoy – year over year
eop – end of period	mom – month over month	
EUR – Euro		
FCY – foreign currency		

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Raiffeisenbank Austria d.d. Zagreb  
Petrijnska 59, 10000 Zagreb  
www.rba.hr  
tel. ++385 1/45 66 466  
fax: ++385 1/48 11 626

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