

## Moody's downgraded Croatia's credit rating

### Budget proposal for 2016 and fiscal projections for 2017 – 2018

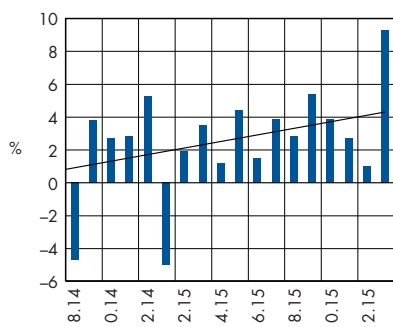
DEFICIT*	Plan 2015	2016	2017	2018
Central Gov't	-12,525	-7,485	-7,203	-6,555
% of GDP	-3.7	-2.2	-2.0	-1.8
Extrabudgetary funds	254	-1,222	32	177
% of GDP	0.1	-0.4	0.0	0.0
Local Gov't	-301	-507	123	196
% of GDP	-0.1	-0.1	0.0	0.1
Consolidated General Government	-12,572	-9,214	-7,048	-6,183
% of GDP	-3.8	-2.7	-2.0	-1.7

\*national methodology (cash principle);  
Source: Ministry of Finance

The focus of the weak was on the **government's budget proposal for 2016 and fiscal projections for 2017–2018**. The budget proposal is based on 2.0% real GDP growth in 2016 (primarily driven by higher households consumption) and strong receipts from EU funds. We see potential risks in the persistently weak conditions on the labour market and the optimistic EU-related revenues. Despite the targeted improvement in the primary balance, the rigid expenditure structure remained. Crucial structural reforms are needed (mainly in the health and pension systems) but definite plans are expected within the Convergence and National Reform Programme (scheduled for April). However, some of the measures are already announced primarily focused on two key areas – public debt stabilisation and reduction, and

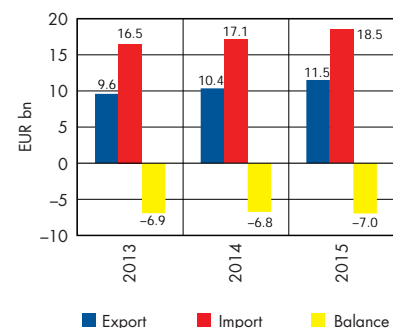
structural reforms – so as to strengthen the foundation for economic growth. The consolidated general budget deficit (in % of GDP) is set to decrease from 2.7% in 2016 to 2.0% and 1.7% in 2017–2018, respectively (in accordance with national methodology). It will be partly financed through privatisation receipts from sales of equity and shares of SOEs, set as "flat" at HRK 1.6bn over the 3-year period (should be met easily). No tax changes are predicted in 2016 (indicating a more stable business environment). All of the above obviously did not make a strong positive impression on Moody's since this credit rating agency at the very end of the week cut the Croatia's sovereign credit rating. **Moody's downgraded Croatia's long-term debt ratings** to Ba2 and maintained the negative outlook. Lowering the rating by one level Moody's has followed two other agencies (Fitch and S&P) thus put it two levels below investment grade. The key drivers for Moody's decision is the large and increasing public debt burden which is expected to reach 90% of GDP by 2018 (significantly exceeds the Ba1 peers median of around 45% of GDP) and is unlikely to reverse much before the end of decade. Beside that, Moody's stressed continuing weak medium-term economic growth prospects which derive from historically low investment and structural rigidities, including a low labor force participation rate as well as bottlenecks in the absorption of EU funds. Although the Government presented ambitious reforms plan, Moody's negative outlook reflects expectation that the new Government to face significant challenges in implementing a demanding reform agenda. Also they stressed that Croatia has had a poor track record of implementing far-reaching reforms and the current government coalition lacks significant support in parliament.

### Industrial production, annual change



Sources: CBS, Economic RESEARCH, RBA

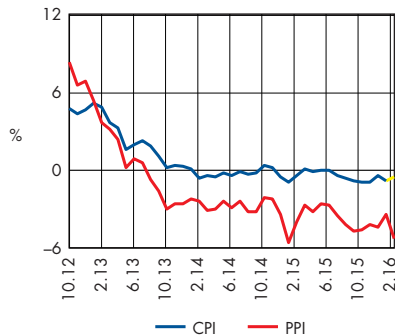
### Foreign trade



Sources: CBS, Economic RESEARCH, RBA

In terms of economic data, **industrial production figures for January positively surprised** the market. Strongly supported by low base effect the industrial production recorded a 9.3%yoy growth (according to WDA indices). Namely, in accordance with the revised data, in January 2015 industrial production declined 4.3%yoy. However, the main positive contribution to the annual growth came from manufacturing (+11.1%yoy) while a more noticeable growth was offset by a fall in the categories mining and quarrying and electricity, gas, steam and air conditioning supply. This year we expect positive annual growth rates to continue mainly influenced by external demand. Certainly, we need to further strengthen the competitiveness of the Croatian industry and exports. On the other hand, **for-**

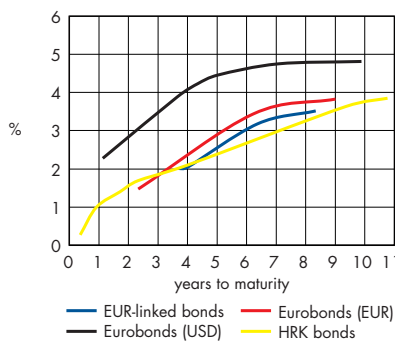
## CPI and PPI



Sources: CBS, Economic RESEARCH, RBA

**Foreign trade data for 2015** reported a deepening of deficit to EUR 7bn (2.8%yoy) with merchandise export increase by 11.2%yoy while imports grew by 7.9%yoy. Finally, **PPI** readings for February confirm that imported deflationary pressures prevailed on the domestic market with accelerated 5.3%yoy decline. In the week to come the Croatian statistical office will be announcing the retail trade for January and CPI for February. We expect favorable movements in retail trade to continue with a positive annual growth rate at around 4.2% as indicated by CNBs' consumer confidence, expectations and sentiment indices boosted also by the lack of inflationary pressures and the continued modest economic recovery. The **CPI** figures are scheduled for release on Wednesday. Imported deflationary pressures, strongly affected by the languishing oil prices, are expected to continue, impacting domestic prices significantly. So we expect the CPI in February could report an annual decline of 0.5%.

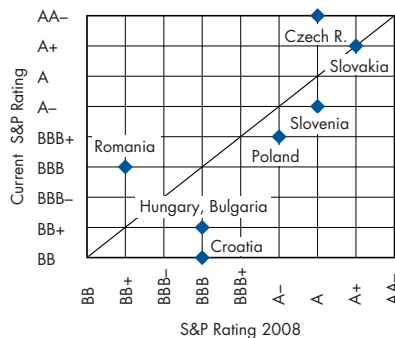
## Croatia – sovereign bonds yield curve



\* bid rate, as of March 11th 8:30 CET  
Sources: Bloomberg, Economic RESEARCH/RBA

Turning our attention to the **financial markets**, last week on the domestic bond market, compared to the previous two, passed with reduced trading volumes of total registered weekly turnover amounting at HRK 328mn, which mostly concentrated on the shorter-end of the domestic yield curve. The most traded HRK bond was the one with maturity in 2017, which offers more attractive yields compared to the 1Y HRK T-bills. Given the lower trading volume, it may be concluded that investors, especially institutional ones, took their positions ahead of the expected new Government borrowing on the capital markets. Namely, according to the domestic media announcements, the Government plans to tap the domestic market by issuing a new tranche of 2026 pure HRK bonds in the minimal amount of HRK 4bn. After the announcements of 2016 Budget Proposal and ECB decisions **Croatian Eurobonds** ended the week with slightly higher prices, with a stronger growth on the euro issues. This week the focus will be on additional news and speculation regarding the announced bond issuance.

## S&P sovereign credit rating (2008/March 2016)\*



\*end of 2008 compared to 11 March 2016  
Sources: Bloomberg, Economic RESEARCH/RBA

As of the FX market, we saw **further appreciation pressure on the domestic currency**, driven by a higher FCY supply from institutional investors and domestic banks. Therefore, EUR/HRK temporarily fell below 7.565 (the lowest level since Nov2015) but ended the week above this level. However, after somewhat more pronounced appreciation pressures on the HRK we expect a calmer week and trading in a tight range between 7.56 and 7.59 kuna per euro.

Finally, as of the money market, at the last week's T-bills auction the MoF issued pure HRK 779mn T-bills. Although the yields on 3mth and 1Y pure HRK T-bills remained unchanged (0.40% and 0.99%, respectively), 6mth pure HRK yields declined further from 0.50% to 0.45%. The next T-bills auction is scheduled for Tuesday when pure HRK 504mn matures.

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## Continuation of low turnover

### Trading comment

Low trading activity on the Zagreb Stock Exchange continues and only HRK 5.6 mn of regular turnover on average daily has been achieved. Hrvatski Telekom stock was the most traded one in regular turnover for the fourth week in a row, with HRK 6.2 mn turnover. General indices CROBEX and CROBEX10 in a contrast with the week before closed with an increase of 0.86% and 0.67% respectively. Almost all sector indices ended the week with gains, with the largest increase of 5.17% achieved by the CROBEXtransport index, while CROBEXind was the only one with a negative change (-2.51%). Among CROBEX constituents, shares of Tankerska Next Generation increased the most while shares of Petrokemija lost the most. The majority of stock indices in the region had positive performance led by Hungarian BUX index.

### Company news

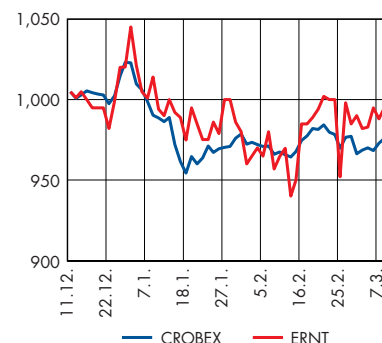
**Ericsson Nikola Tesla** and Interdnestrcom (IDC) from Moldova signed a contract worth almost HRK 56 mn for 4G/LTE network building with related services and the necessary software upgrades. **Atlanska Plovidba** sold the Hotel Lapad in Dubrovnik to an undisclosed buyer. Atlanska Plovidba has exited the hospitality business by selling the Hotel Lapad and the Hotel Imperial Hilton last year. On 7th of March **Tehnika's** business accounts were unblocked and the company continues its regular operations.

### In this week

We expect continuation of low trading activity in share turnover on the Zagreb Stock Exchange and small changes of leading stock indices.

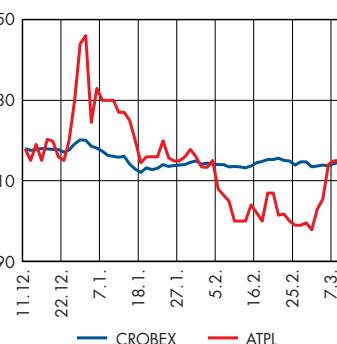
Financial analyst Damijan Sutlić (+385 1 55 75 733)

### Ericsson Nikola Tesla (3 m)



Sources: ZSE, Raiffeisen RESEARCH

### Atlanska Plovidba (3 m)



Sources: ZSE, Raiffeisen RESEARCH

### Market performance

Index	1w %	ytd %	Value on*
<b>11.3.2016</b>			
BUX (HU)	3.53	7.06	25,609
NTX (SEE,CE,EE)	2.68	-1.03	950
SBITOP (SI)	2.49	2.26	712
ATX (AT)	2.27	-4.83	2,281
PX (CZ)	2.01	-5.10	908
WIG30 (PL)	1.74	2.70	2,132
BELEX15 (RS)	1.16	-7.09	598
CROBEX (HR)	0.86	-4.51	1,613
BETI (RO)	0.77	-5.67	6,607
MICEX (RU)	-0.09	6.54	1,877
SOFIX (BG)	-0.28	-3.34	446
SASX10 (BH)	-0.46	-2.36	682.51

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

### Top/Flop – CROBEX index

Share	1w %	Price on*	Share	1w %	Price on*
<b>11.3.2016</b>					
Tankerska NG	9.40	74	Arenaturist	0.00	335
Kraš	4.23	542	AD Plastik	0.00	101
Dalekovod	3.89	12	Luka Ploče	-0.05	600
Luka Rijeka	3.70	42	Zagrebačka Banka	-0.18	39
Valamar Riviera	2.48	24	Maistra	-0.23	215
HT	1.54	143	Končar El	-0.78	635
Ingra	1.12	3	RIZ Odašiljači	-1.25	83
Podravka	0.97	309	OT-Optima T.	-1.62	2
Atlantic Grupa	0.62	810	Ina	-1.63	2,361
Ericsson NT	0.50	1,000	Đuro Đaković H.	-1.95	36
Adris Grupa (P)	0.10	354	Belje	-3.41	21
Atlanska Plov.	0.00	114	Petrokemija	-7.84	11

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

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#### Abbreviations

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

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