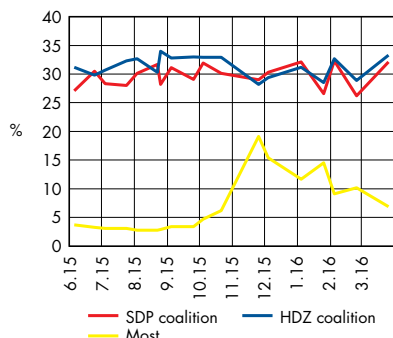


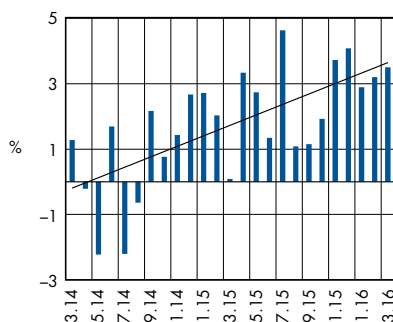
Upside Risks in Q1

Opinion polling (SDP, HDZ and Most)



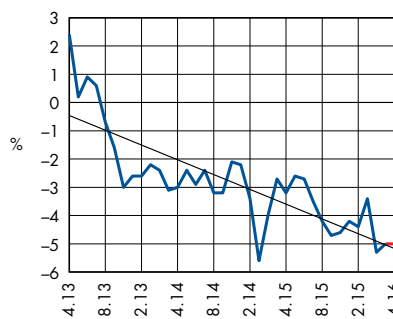
* 15-day average trend line
Sources: Promocija plus, IPSOS PULS, Economic RESEARCH/RBA

Retail trade, annual changes



Sources: CBS, Economic RESEARCH/RBA

PPI, annual changes (%)*



* on domestic market
Sources: CBS, Economic RESEARCH/RBA

In its *Spring Economic Forecast* **European Commission** has revised downward its 2016 GDP forecasts for Croatia (from 2.1 to 1.8% yoy) thus nearing our estimates (+1.5%). Compared to the EC's targets, we differ mostly on outlook for household and government consumption where we stick to a more conservative outlook. However, the high frequency indicators have continued to give us an opposite picture pointing out that economic activity has picked up again in the early months of 2016 and thus this raises risks that we will probably have to move our estimate close to 2%.

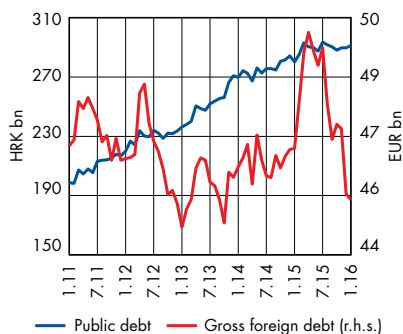
The EC stated downside risks related to the high private and public debt burden and the uncertain implementation of reforms. Although both of these are surely present, we still think that those factors will be more crucial in a mid-term period, rather than in 2016. Namely, from the current perspective and the released figures it seems more that the economic activity in 2016 will be accompanied by further deleveraging of the private sector (or at least stagnation in debt burden stock) and a very modest increase of public debt. Anyway, the first signs of possible delay or limp enforcement of reforms will be seen at the earliest in Q32016 when the **new budget** (2017) **cycle** begins*. In the meantime, the expected solid tourist season and its multiplier effects (primarily on disposable income of households) as well as investment activity (partially supported by EU funds) are supposed to be the biggest drivers of the still modest recovery. Growth sustainability is still largely questionable as we all expect to see the implementation of the presented reform plan. This sprung up into focus more due to the political disputes that arise from time to time. However, in our view and according to the opinion polls (see chart 1), none of the political parties are interested in the new elections as the outcome would be even more uncertain than in November. Therefore, we remain optimistic but very cautious.

In the meantime, the real **retail trade** upward trajectory continued in March with 3.5%yoy growth (w. d. a) due to the rising real wages, higher but usual pre-holiday consumption and earlier start of the tourist season. As in Q116 we have already seen strong industrial production growth at 6.8%yoy (w. d. a.), the confirmation of solid retail growth in Q116 (3.2%yoy) widely supports our expectation (or even poses some upside risks) to our Q1GDP estimate of 1.8% yoy real growth (the first estimate will be published at the end of May).

As for the upcoming releases the **foreign trade** data for February will be published on Monday. We anticipate that the trade deficit in the first two months could deteriorate slightly on annual basis as import growth rates intensify due to the higher elasticity of imports with regards to exports of goods and services and (in a short term) consumption. Anyway, we expect to see a slightly negative contribution of net foreign demand to the GDP figures in Q116. **PPI data** for April are set to be released in on Tuesday. Imported deflationary pressures are still the main driver of negative rates so the April PPI is expected to be delivered at -5%yoy again.

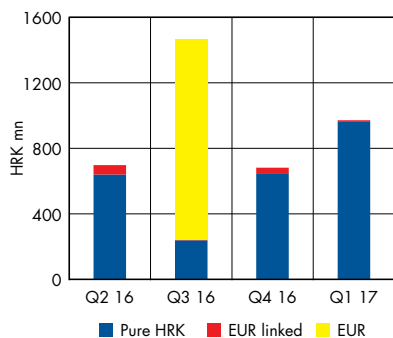
* The budgeting process begins in July with Guidelines for fiscal and economic policy in the next three-year period and ends with Budget vote in December.

Public debt and Gross foreign debt



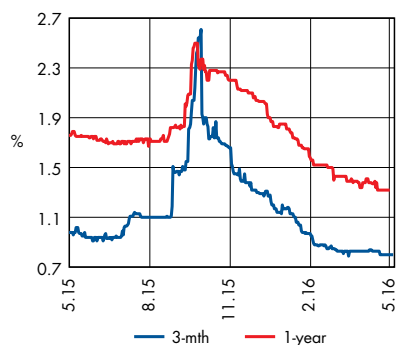
Sources: CNB, Economic RESEARCH/RBA

Outstanding T-bills



Sources: MoF, Economic RESEARCH/RBA

ZIBOR



Sources: Bloomberg, Economic RESEARCH/RBA

Meanwhile, the **EUR/HRK** upside pressure prevailed but the trading range actually remained very tight, at around 7.51 kuna per euro. With the latter likely due to profit taking as a consequence of the previous sharp EUR/HRK decline, we do not exclude that some of the FCY demand stem from the market positioning ahead of the probable **Eurobond** issuance in the second half of May. The stronger upward movement was probably mitigated by FCY inflow from corporate borrowing abroad. In the months ahead HRK will be well supported by seasonally stronger FC tourism receipts, lower fiscal risks and C/A surplus. Given the unwavering commitment of the Croatian central bank to preserve the stability of the kuna exchange rate against the euro, in case of stronger and more sudden upward pressures on the kuna we do not rule out the possibility of the CNB intervening in the FX market. At the end of summer, the kuna should depreciate slightly. However, an upward EUR /HRK trend is expected to be observed until the end of the year. Nevertheless, the average kuna exchange rate against the euro for the whole 2016 should be lower than in 2015.

The risk of such expectations materialising, that is, of the kuna depreciating more strongly, would be possible if the situation in the macroeconomic environment were to deteriorate significantly, which means if reforms were to be postponed and recession developments were to return. For the time being, such a scenario is not likely. Moreover, the movements of EUR/HRK thus far indicate that in 2016, for the first time in six years, the HRK might record an increase in value against the euro on annual level.

In addition to pressing ahead with the policy of the stable exchange rate, the monetary policy will continue to support high HRK liquidity which reached its historic highs already in the first quarter of the year. Amid these conditions, **money market interest rates** have gone down across the curve keeping yields on T-bills in their record lows (this must have also been influenced by the structural LTRO). After placing HRK565m (out of HRK3-4bn planned in this year) in February, the CNB will proceed with its **4Y structural repo operations** (probably already in May) whereas we expect to see a modest interest given the ample HRK liquidity surplus of around HRK6bn.

Eventually, at the last week auction the Ministry of Finance issued 1-year pure **T-bills** in the amount of HRK 575mn. As there are no T-bills falling due this week, the new auction is not announced.

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

New contracts for Dalekovod

Trading comment

Regular shares turnovers on ZSE were quite low with daily average at HRK 6.5 mn. The highest turnover was recorded by preferred share of **Adris**, HRK 8 mn, out of which HRK 7.4 mn refers to block transactions. Out of CROBEX constituents, the strongest performance was posted by Dalekovod while the largest drop had share of **Atlantska Plovidba**.

Company news

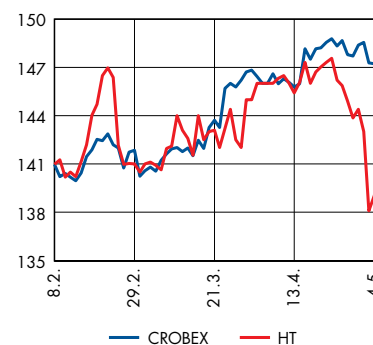
Croatian consortium consisting of DIV, Zagreb-Montaža and **Dalekovod** and the contract owner HŽ Infrastruktura signed the contract for the Dugo Selo – Križevci railway section upgrade and construction of the second track. The contract, including construction and site supervision, is worth HRK 1.3 billion. Dalekovod also informed that they are about to be awarded new contracts in Norway worth more than EUR 65 mn in total. Namely, Dalekovod's proposal was chosen as the best according to the evaluation criteria, whereas the final decision is to be made by Statnett investment committee. The share reacted on the news with a surge of 10%. **Viadukt** signed new contract worth HRK 32 mn with Hrvatske ceste related to reconstruction of a state road. **Atlantic Grupa** announced a dividend proposal of HRK 13.5 per share. The share goes ex-dividend at June 21st.

In this week

In this week we do not expect some major changes on ZSE, i. e. continuation of low turnovers and cautious trading.

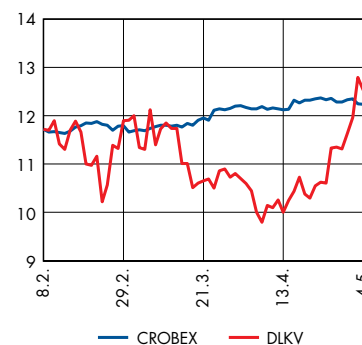
Financial analyst Ana Turudić (+385 1 61 74 401)

HT (3 m)



Sources: ZSE, Raiffeisen RESEARCH

Dalekovod (3 m)



Sources: ZSE, Raiffeisen RESEARCH

Market performance

Index	1w %	ytd %	Value on*
6.5.2016			
SBITOP (SI)	0.34	2.60	714
BETI (RO)	0.02	-7.92	6,449
BELEX15 (RS)	0.00	-5.56	608
PX (CZ)	0.00	0.00	1,540
MICEX (RU)	0.00	11.32	1,961
SOFIX (BG)	0.00	-5.40	436
CROBEX (HR)	-0.12	-0.19	1,686
SASX10 (BH)	-0.13	0.39	702
WIG30 (PL)	-2.42	-0.43	2,067
BUX (HU)	-2.60	9.42	26,173
NTX (SEE,CE,EE)	-3.65	-4.31	918
ATX (AT)	-4.00	-6.71	2,236

* as at 16:30 CET. Source: Bloomberg

Top/Flop – CROBEX index

Share	1w %	Price on*	Share	1w %	Price on*
6.5.2016					
Dalekovod	5.67	12	Arenaturist	-0.67	324
Đuro Đaković H.	5.04	45	Adris Grupa (P)	-0.76	392
Podravka	4.26	343	Ingra	-1.19	3
Maistra	4.10	225	Kraš	-1.54	510
Tankerska NG	3.35	76	Valamar Riviera	-1.88	24
Luka Rijeka	3.28	43	Ledo	-2.21	9,730
Ericsson NT	2.73	1,111	AD Plastik	-2.99	97
Ina	1.31	2,700	Varteks	-3.78	14
Končar El	0.77	650	HT	-3.90	139
Belje	0.58	19	Zagrebačka Banka	-4.19	40
Atlantic Grupa	0.00	815	Atlantska Plov.	-6.03	120
OT-Optima T.	-0.56	2			

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

Economic 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 – Aystem 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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