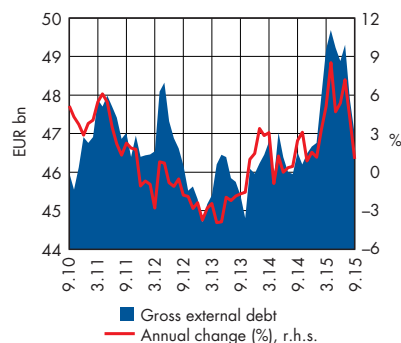


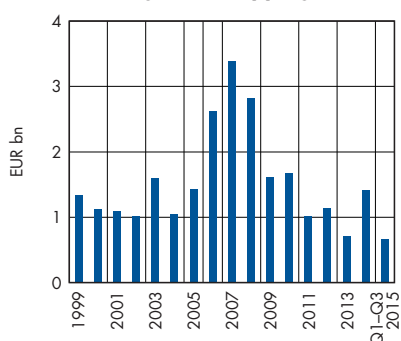
S&P Affirms Croatia's Rating

Gross external debt, annual change



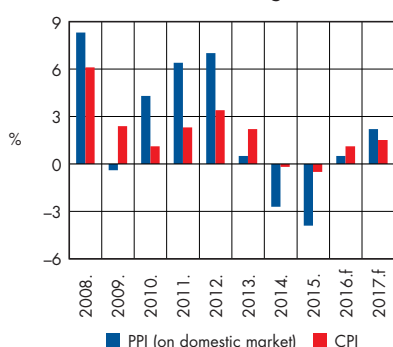
Sources: CNB, Raiffeisen RESEARCH

FDI (excluding round tripping)



Sources: CNB, Economic RESEARCH/RBA

CPI and PPI, annual change (%)



Sources: CBS, Economic RESEARCH/RBA

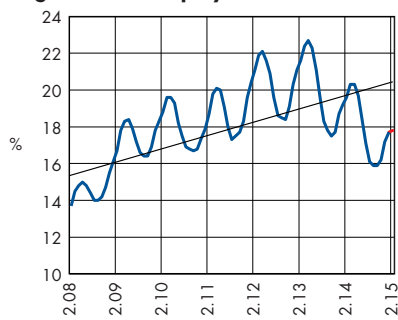
Important macroeconomic data were plentiful this week. In line with expectations, deflationary pressures continued and the latest CNB data for Q315 confirmed weak Croatian debt metrics. Namely, at the end of Q3 total **gross external debt** amounted to EUR 47bn or 107.6% of GDP (+1.0%yoy) thus continuing on the upward trend that (excluding two single months) dates back to end of 2013. Such an unfavorable trend is driven primarily by the public sector indebtedness, also reflected in deteriorated public debt data. Reaching the amount of HRK 286bn or 85.9% of GDP, the total **public debt** continued at relatively high growth rates on annual level (+5.9%yoy) warning us of weak and unsustainable fiscal metrics.

Therefore, waiting for the new Government (that will be presented under the first regular session of the new parliament on 22 January), we expect that its working plan as well as the 2016 budget will tackle the crucial structural problems which led to the weak debt indicators. At the Friday press conference the PM designate stressed that he will insist on efficiency in the public sector which is in line with the five growth generators defined: efficiency of the public sector, increase in competitiveness and in investments (through better use of EU funds), reduction of debt and deficit through privatization of state property and non-strategic businesses, and reform of the health sector.

In Q1–Q3 2015 total **FDI** amounted to EUR 666mn. Compared to the same period in 2014 (excluding the round tripping effect), FDI declined by EUR 467mn (a drop of almost 50%yoy). In the observed period most of the FDI (78%) came from equity investments in the tobacco industry, which is predominantly a result of the concluded selling of the Adris Group subsidiary, the Rovinj Tobacco Factory (TDR), to the British American Tobacco (BAT) in late September. At the same time, banks' losses caused by the forced CHF conversion led to negative retained earnings in the Q1–Q3 15 (EUR –380mn). This triggered an investments drop in the financial intermediation sector (except for insurance and pension funds), and the period Q1–Q3 2015 recorded a negative value of about EUR 600mn. Thus, the main objective of the new government should be a more energetic effort to remove the most problematic factors of doing business in Croatia (primarily the inefficient of government bureaucracy and judiciary with complexity of the legislation), which is a precondition for stronger FDI investments, particularly in the tradable sector.

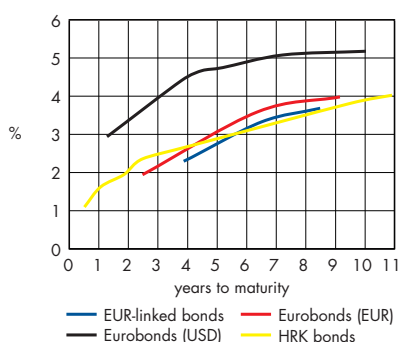
The last published producer and consumer prices for December confirmed ongoing negative annual growth rates. With a monthly drop of 1.2%mom, **PPI** decreased by 4.0%yoy, continuing at the negative annual growth rates that have been lasting since August 2013. Nearly all main industrial groups contributed to a relatively strong annual PPI decline. The strongest decline is recorded in the industrial group of Energy (–12.8%yoy). Thus, PPI excluding energy prices in the observed month recorded a significantly lower decline at 0.4%yoy. In 2015, compared to 2014, PPI declined by 3.9%yoy, for the second year in a row. The same trend is confirmed by the release on **CPI** for December (0.7% on monthly and annual basis). Imported deflationary pressures (strongly driven by lower crude oil prices) paired with the weak domestic demand supported decline of CPI in 2015

Registered unemployment rate



Sources: CBS, Economic RESEARCH/RBA

Croatia – sovereign bonds yield curve



As of 15 January, 8:30 a.m. (CET)

Sources: Bloomberg, Economic RESEARCH/RBA

Croatia 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

by 0.5%yoy. This is the second year in a row recording an average annual CPI drop. A significant negative contribution came from lower prices of transportation, which recorded a fall by 6.3%yoy (in the structure of the consumer basket makes a share of almost 13%). Excluding the volatile components (prices of energy and food), the core annual inflation in 2015 grew by 0.7%yoy. Negative growth rates are expected to continue over the forthcoming months as well, additionally supported by the weakened domestic demand paired with mild inflationary pressures from commodity markets (especially considerably lower crude oil prices). The data calendar for the next week will bring the figure on registered unemployment rate for December which is expected to move up slightly to 17.8% (+1 pp mom).

Last week's volumes on the domestic bond market were a reflection of the beginning of the year, with reduced volumes of trading. The trend of trading the short-term domestic currency bonds continued into this week, and the most traded bond was the one with maturity in 2017. Of the bonds indexed in euro, we must mention trading with maturities in 2020 and 2022. In the meantime, there are some first positive signs on the market. Last week the yield on HRK and currency clause bonds declined along the curve and 5y USD CDS showed a downward trend to below 300bp. Due to expected higher interest of investors, this week could bring increased trading volumes. In line with our expectation, **rating agency S&P** on Friday kept LT rating on BB with negative outlook. We do not expect any changes before the new Government's program is published (in our view, it may not be seen before the second half of Q1 2016).

Last week brought some depreciation pressures on the domestic **FX market**. Due to an increased FCY demand driven by institutional investors and domestic banks, HRK weakened against the euro to a level of about 7.67 kuna per euro. By the end of the week, the EUR/HRK is stabilized on the level around 7.66 kuna per euro. With the level of liquidity in the system exceeding HRK 10bn, combined with a weak HRK demand and a modest trading volume, the market interest rates (3mth and 1-year) slightly drop on weekly level. In case the central bank starts a long term repo operation (2 and more years), HRK yields might face pressures on the long end, allowing cheaper borrowing. In this week pressures caused by the compulsory CHF conversion paired with a slightly higher corporate FCY demand could result in an upward EUR/HRK movement towards a trading range 7.66 – 7.69 kuna per euro.

Financial analyst: Mate Rosan (+385 1 61 74 388), 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

Equity indices still in the red

Trading comment

Despite higher activity on the Zagreb Stock Exchange compared to the previous week, the main indices CROBEX and CROBEX10 ended the second week in a row in the red, with a sharp drop in value of 2.92% and 2.94%, respectively. The leading European stock indices also closed the week with losses due to concerns for the Chinese economic growth slowdown and oil prices falling below USD 30 per barrel. Regional indices also ended the week mostly with lower values and the largest drop was seen by Russian MICEX index. All sector indices on the ZSE saw a decline with the biggest drop recorded with construction shares index. Average regular daily turnover amounted to HRK 8.6 mn, 51.6% increase compared to the week before. Preferred shares of Adris Grupa had the highest turnover of HRK 8.5 mn of regular turnover. Among CROBEX constituents, shares of Ingra had the best performance while shares of RIZ Odašiljači lost the most.

Company news

There was only a handful relevant announcements and news releases on the Zagreb Stock Exchange last week.

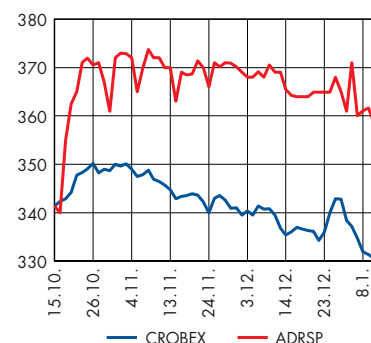
Auto Hrvatska increased its share capital by issuing new 100,000 shares with voting rights which have been subscribed by Mr Bogdan Tihava thus surpassing the 20% threshold. After this addition, Mr Tihava holds a total of 135,410 shares, which represents 22.57% of share capital.

In this week

On the Zagreb Stock Exchange in the week ahead, we expect continuation of tracking the sentiment on European and world markets and keeping an eye on the new government formation.

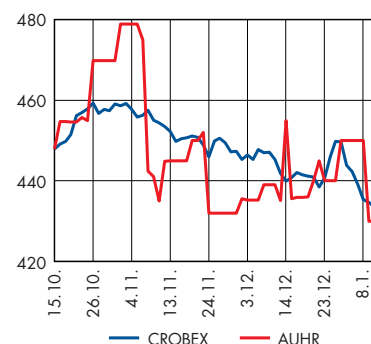
Financial analyst Damjan Sutlić (+385 1 55 75 733), Raiffeisenbank Austria d. d. Zagreb

Adris Grupa (preferred) (3 m)



Sources: ZSE, Raiffeisen RESEARCH

Auto Hrvatska (3 m)



Sources: ZSE, Raiffeisen RESEARCH

Market performance

Index	1w %	ytd %	Value on*
15.1.2016			
WIG30 (PL)	1.26	-5.61	1,959
BUX (HU)	0.07	0.22	23,974
SASX10 (BH)	-1.41	-1.90	686
SOFIX (BG)	-1.47	-2.31	450
SBITOP (SI)	-1.60	-3.74	670
CROBEX (HR)	-2.92	-6.00	1,588
NTX (SEE,CE,EE)	-2.98	-9.90	865
PX (CZ)	-4.64	-7.86	881
BELEX15 (RS)	-5.02	-6.64	601
ATX (AT)	-5.62	-12.54	2,096
BETI (RO)	-6.18	-10.14	6,294
MICEX (RU)	-7.77	-8.44	1,613

* as at 16:30 CET. Source: Bloomberg

Top/Flop – CROBEX index

Share	1w %	Price on*	Share	1w %	Price on*
15.1.2016					
Ingra	3.33	3	Zagrebačka Banka	-2.36	36
Arenaturist	3.13	327	Ericsson NT	-2.47	989
Đuro Đaković H.	2.81	30	Končar El	-3.09	630
OT-Optima T.	2.73	2	Luka Rijeka	-4.03	41
Tankerska NG	2.73	75	Valamar Riviera	-4.03	23
AD Plastik	1.82	97	Adris Grupa (P)	-5.12	343
Petrokemija	1.68	12	Podravka	-5.16	310
Genera	0.00	167	Atlantska Plov.	-7.69	120
Kraš	-0.20	499	Dalekovod	-8.22	12
HT	-1.14	139	Belje	-8.96	23
Luka Ploče	-1.77	640	Maistra	-10.26	206
Ina	-1.84	2,513	RIZ Odašiljači	-11.93	96
Atlantic Grupa	-1.97	806			

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

Economic RESEARCH

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

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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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