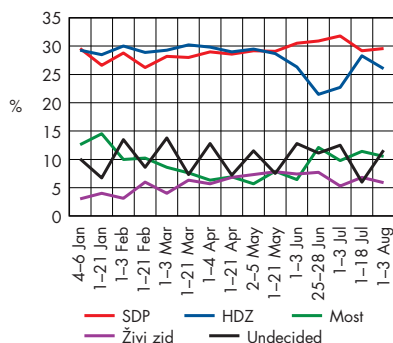


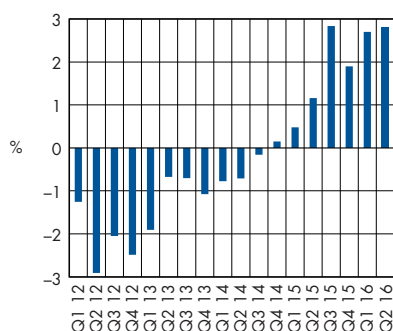
Snap Elections in Focus

Party standings



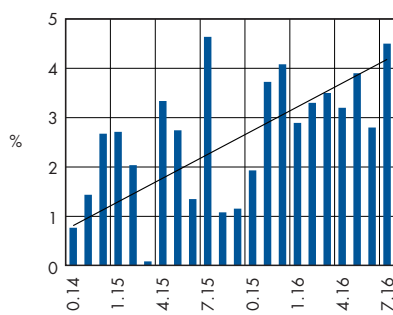
Sources: Promocija plus, IPSOS PULS, Economic RESEARCH/RBA

GDP, real annual changes



Sources: CBS, Economic RESEARCH/RBA

Retail trade, real annual changes



Sources: CBS, Economic RESEARCH/RBA

Sound macroeconomic data released over the last week will be quickly overshadowed by politics as we are entering the final election campaign. **Early elections** will take place this Sunday (11th September). Still the outcome remains quite uncertain as most probably neither of the main parties will secure majority. Therefore once again the period of Government formation could take some time (as in November 2015).

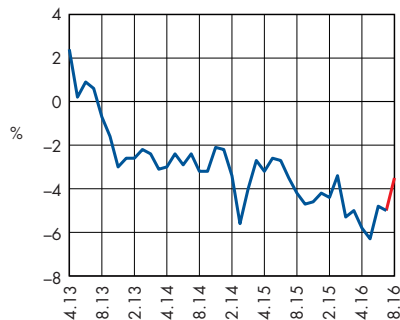
The latest opinion polls suggest that the SDP and their "People's coalition" might win a higher numbers of votes than the HDZ, but they will fall short of the absolute majority needed. Therefore, MOST could once again act as a kingmaker. At this moment there is a higher probability of negotiation between the HDZ – MOST than between the SDP – MOST. In fact the latter probability is really small. On the other hand, MOST proved to be a tough negotiator and a political partner who does not back off when faced with demands of the leading parties commanding stronger electoral support. Furthermore, the negotiations could take much less time as we assume that MOST is now more prepared with a much clear economic program and aim. However, the number of undecided voters (around 20%) is relatively high and there are also lots of votes scattered among the smaller parties. Moreover, we should not be surprised if a relatively new or unknown party pops up on the political stage.

Looking at the economic programs and the election campaign of the main political parties, all focused on taxes, particularly tax relief as an awareness of high tax burden came to the fore. While this is undoubtedly true, the election campaign (at least that of the HDZ and SDP) gives us less about reforms, exports, competitiveness, efficiency of the legal system, etc. And these factors, besides the cutback of tax burden (both labour and capital), are definitely the key for a sustainable growth.

Political programs mostly aim at relieving income (partly due to populist intentions) and a gradual VAT decrease. Furthermore, unlike the SDP, the HDZ and some smaller parties announced a reduction of corporate income tax and continuation of the pension reform. Debate regarding the expenditure side is largely missing, and both major parties (at least publicly) do not talk about the consequences of tax cuts for the budget deficit and debt. In this regard, for both of them GDP growth per se will solve the poor and fragile fiscal metrics.

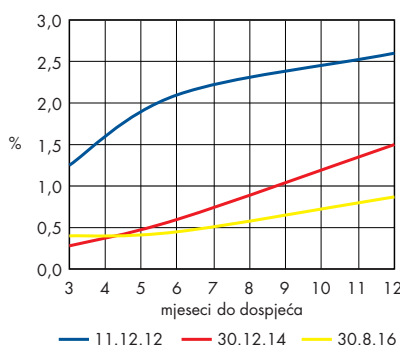
The data for Q4 2015 and H1 2016 confirm that political uncertainty dominated government spending, especially in relation to the material costs item and capital investments. This, amid the economic growth and cyclical inflow to the state budget, leads to deficit reduction and a "natural" fiscal consolidation. Paired with lower deficit, primary surplus and continued privatisation of the remaining government portfolio, public debt growth slows down or even stabilises. However, although fiscal metrics improves under such conditions, deeply rooted structural problems remain (health-care, education, pension system, public administration, etc.) and the creation of the conditions for a stable and stronger recovery is postponed. Therefore, the sustainability of quotes on lower taxes and

PPI on domestic market, annual changes



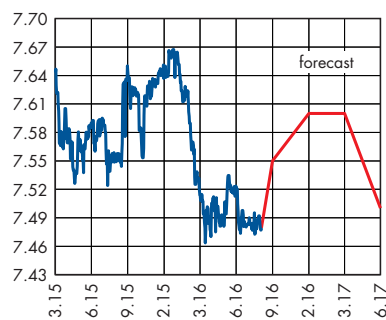
Sources: CBS, Raiffeisen RESEARCH/RBA

1Y HRK T-bills yield



Sources: MoF, Economic RESEARCH/RBA

EUR/HRK



Sources: Bloomberg, Economic RESEARCH/RBA

GDP growth based on household consumption (spurred primarily by tourism) widely comes under a question mark.

Turning our attention to the latest macroeconomic releases, the week behind us was highlighted by the first GDP figures for the second quarter. Croatian **real GDP** grew by 2.8%yoy in Q2, and thus confirmed the continuation of economic recovery and exceeded analysts' expectations. As anticipated, positive contribution came from the domestic demand where the largest GDP component, household consumption, continued with solid real annual changes (+3%yoy), while the net-foreign demand brought a negative contribution thus warning of the still high import dependence. However, over the upcoming quarter we expect confirmation of economic growth, led by household consumption and investments, while the positive contribution of foreign demand could be offset by continued growth in imports. At the level of the whole 2016 we expect real GDP growth could accelerate to 2.3%yoy.

Moreover, favourable economic trends, supported primarily by another extraordinarily good tourist season, were also confirmed by the latest retail data and industrial production outcome. Namely, at the very end of the week the CBS reported first **retail trade** results for July (+4.5%yoy in real terms), while in the same observed month **industrial production** growth slowed down to 1.2%yoy. Over the months ahead we expect the encouraging trends in foreign demand to continue thus resulting in a positive contribution to the GDP growth. The latter could be also supported by the upcoming **tourism data**, which will be published on Thursday together with the **PPI figures** for August (we reckon negative growth rates on annual level at 3.5%).

On the **financial market** the Ministry of Finance issued HRK406mn and EUR 20mn in 1Y T-bills thus exceeding the planned amounts. With bid-to-cover ratio of 2x the 1Y HRK T-bill decreased by 4bp to 0.87% while the 1Y EUR T-Bill yield fell by 1bp to 0.24%. The new auction was not announced for this week due to the fact that the next significant amounts of the T-bills mature at the very end of October (HRK 1.3bn and EUR 8.8mn).

As investors returned from holidays, we saw increased trading volumes on the local **bond market**, as usual at the beginning of September. This week further pressures on the pure HRK bonds in terms of higher demand, and trading volumes are expected to continue. However, by the end of the current year we do not exclude a new Government bond issuance.

Regarding the **FX market**, last week brought a stable EUR/HRK trading so during the days ahead it could continue to oscillate below the level of 7.50 kuna per euro. The end of peak tourist season could bring usual HRK depreciation pressures but the whole 2016 is expected to record average EUR/HRK at the level of 7.56 kuna per euro. Lower exchange rate on an annual level is supported by continuation of economic growth and improved fiscal metrics.

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Strong performance of Optima Telekom and HT

Trading comment

Equity indices CROBEX and CROBEX10 posted wow advance, with **Optima Telekom** and **HT** posting the strongest growth, while the biggest decline was recorded by **Đuro Đaković Holding**. Among sector indices, the F&B sector index was the best performer, while construction sector index had the strongest decline. Regional indices closed the week mainly in green, with PX posting the highest return. The regular shares' turnovers were considerably higher wow, at HRK 8.5 mn daily on average, whereas the highest turnover had HT.

Company news

The Croatian Government gave its consent to **Petrokemija** to seek a loan of HRK 200 mn from the Croatian Bank for Reconstruction and Development for the implementation of restructuring and financial consolidation of the company and approved a state collateral for the loan. **Croatia Osiguranje** informed that they had received the resolution of the Slovenian Competition Agency that permits the company to acquire the share in the reinsurance company Pozavarovalnica Sava that is equal to or higher than the qualified share and below the 20% threshold.

In this week

According to the dividend calendar of the Zagreb Stock Exchange, shares of **Ledo** go ex-dividend on Tuesday, 5th September (DPS of HRK 425.01).

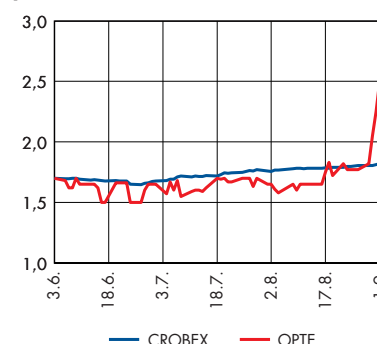
Financial analyst Ana Turudić

Hrvatski Telekom (3 m)



Sources: ZSE, Economic RESEARCH/RBA

Optima Telekom (3 m)



Sources: ZSE, Economic RESEARCH/RBA

Market performance

Index	1w %	ytd %	Value on*
2.9.2016			
PX (CZ)	2.37	-8.67	873
ATX (AT)	1.69	-1.93	2,351
BELEX15 (RS)	1.39	-2.09	631
BUX (HU)	1.35	17.51	28,109
CROBEX (HR)	0.84	7.93	1,824
NTX (SEE,CE,EE)	0.40	-3.36	927
MICEX (RU)	0.39	13.61	2,001
BETI (RO)	0.13	-0.15	6,994
SBITOP (SI)	-0.10	5.38	734
WIG30 (PL)	-0.13	-2.28	2,028
SASX10 (BH)	-0.14	-1.40	689
SOFIX (BG)	-0.40	2.38	472

* as at 16:30 CET. Source: Bloomberg, Economic RESEARCH/RBA

Top/Flop – CROBEX index

Share	1w %	Price on*
2.9.2016		
OT–Optima T.	29.38	2
HT	5.92	155
Ericsson NT	5.43	1,096
AD Plastik	4.54	124
Belje	4.45	23
Tankerska NG	2.83	72
Ina	2.37	3,025
Kraš	1.92	525
Končar El	0.75	675
Atlantic Grupa	0.72	822
Dalekovod	0.62	13
Adris Grupa (P)	0.47	406

* as at 16:30 CET. Source: ZSE, Economic RESEARCH/RBA

Share	1w %	Price on*
2.9.2016		
Ledo	-0.47	10,650
Valamar Riviera	-0.69	29
Maistra	-0.99	232
Podravka	-1.92	358
Zagrebačka Banka	-2.14	41
Ingra	-3.19	2
Luka Rijeka	-3.68	47
Arenaturist	-3.87	392
Atlantska Plov.	-4.24	174
Varteks	-4.95	17
Đuro Đaković Holding	-8.32	49

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Abbreviations

bp – basis points	GDP – Gross Domestic Product	kn, HRK – Kuna
CERP – Restructuring and Sale Center	HBOR – Croatian Bank for	MF – Ministry of Finance
DZS – Croatian Bureau of Statistics	Reconstruction and	RBA – Raiffeisenbank Austria d.d.
ECB – European Central Bank	Development	USD – Dollar
EUR – Euro	HNB – Croatian National Bank	
FED – Federal Reserve System	IMF – International Monetary Fund	

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Investment banking services	0	2	0	0	0	0
% all IB services	0%	29%	0%	0%	0%	0%

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