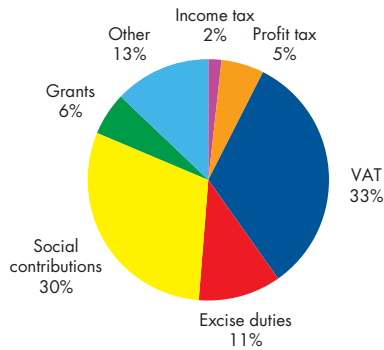


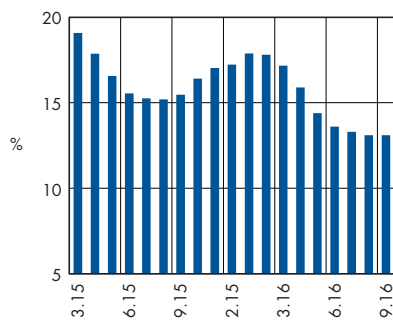
Tax Reform in Focus

Consolidated Central Government revenues* I–VIII 2016



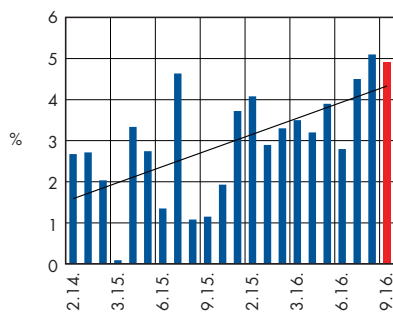
*GFS 2001 methodology
Sources: MoF, Economic RESEARCH/RBA

Registered unemployment rate



Sources: CES, Economic RESEARCH/RBA

Retail trade, real annual changes



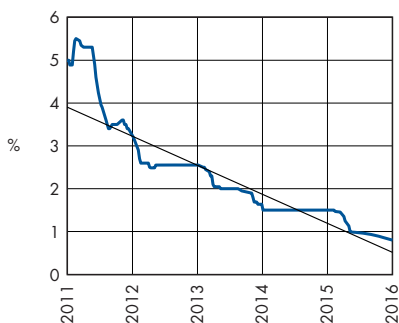
Sources: CBS, Economic RESEARCH/RBA

This week's **absolute eye-catcher** was the first session of the new Government and details of the much awaited tax reform. According to preliminary announced data, the **new tax reform** brings a reduction in the corporate income tax rate (20–18%), while the income tax rate for farmers and craftsmen with incomes of less than HRK 3 mn per year goes down to 12%. Tax redemption for reinvested profit will be repealed. The comprehensive tax reform also includes changes in the income tax system (25% reduced to 24%, and 40% to 36%), while the basic tax deduction will rise to HRK 3,800. Since the beginning of 2018 there will be only two VAT rates (24% and 12%). In the transitional period, from the beginning of 2017 the general 25% VAT rate will remain, but for certain products it will decrease to 13% (raw materials in agriculture, electricity supply, etc.). All in all, the estimated amount to be lost by the proposed changes stands between HRK 1.8 and 2 bn, which seems very attainable. We assume that the Government plans to supplant it through increased household consumption. Nevertheless, the Minister of Finance stressed that the planned general government deficit of 2% of GDP for 2017 is at no risk. The lower tax burden will definitely increase disposable income thus positively impact household consumption, which is the biggest component of GDP. On the other hand, lower corporate tax might increase competitiveness but the real positive effect might be achieved only if lower tax burden would be accompanied by the structural reforms and improvement of business climate.

In terms of **macroeconomic data**, the week behind us was reserved for labor market figures. As expected, the record high tourist season brought a positive spill-over effect on the rest of the economy, confirmed by the Sep registered unemployment rate which remained at 13.1%. Also, gross and net wages for August recorded a continued positive real growth of average wages. In the week to come industrial production and retail trade turnover data for September are to be released. Industrial production data might report continued annual growth rate for the twelfth consecutive month but at a slower pace (+0.9%yoy), partly as a result of the last year's low base effect. As raising receipts from tourism affect disposable income positively (additionally supported by deflationary environment and prolonged tourist season), we assume that real retail trade growth in Sep could report a high 4.9%yoy growth rate. Towards the end of the year the positive trends are expected to continue, supported also by the deflationary environment, which exerts a positive impact on disposable income and personal consumption, as the biggest component of GDP.

Turning our attention to the **financial markets**, for the first time since the end of August the Ministry of Finance issued 1y pure HRK 1.2bn and 1y EUR 29mn (HRK 100mn and EUR 19mn higher than planned). In spite of the historically low yields, and due to ample HRK liquidity, the increased demand for short term Government papers consequently resulted in the 1Y yields' decline to 0.80% and 0.17% respectively (–0.7pp lower if compared to the previous auction). Over the months ahead we expect that yields on T-bills could stay at the current low levels, but we do not exclude an even further slight decline in yields, strongly supported by high liquidity in the system and the lack of any attractive investments. On the

1-Y HRK T-bills yield



Sources: MoF, Economic RESEARCH/RBA

FX market the EUR/HRK saw some rather stable trading through the course of the week with the pair still staying low in seasonal terms. The latter reflects a strong fiscal performance, FCY inflows from the prolonged tourist season, demand for HRK loans and solid performance C/A outcome. However, coming closer to the end of the year, EUR/HRK should face a slight upward movement supported by import activity. Regarding **local bonds**, last week brought somewhat higher trading volumes with the investors' focus still on the pure kuna issues. Consequently, a slight price increase was recorded. A similar pattern of movement is expected to continue over the following days. As of Croatian Eurobonds, with a slight drop in prices, a more pronounced rise in the core market yields (Bund and US treasury) led to a narrowing of spreads on the EUR and USD issues as well.

Economic analyst: Elizabeta Saboek Resanović

Reporting season in focus

Trading comment

CROBEX and CROBEX10 closed the week behind with gains of 0.2% and 0.4%, respectively. The regular equity turnover was a bit higher than in the previous week and amounted to HRK 14 million daily on average. Thereof, shares of **Valamar Riviera** were the most traded with turnover of HRK 11 million in total. Among CROBEX members, shares of **Kraš** were the top performer, while CROBEXnutris was the winner among the sector indices. The regional stock indices had mostly positive performance in the previous week.

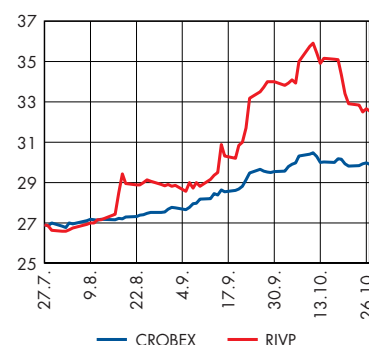
Company news

Hrvatski Telekom posted the 1–3Q 2016 sales revenues almost yoy flat thanks to growth of mobile segment of 3.3% which made up for the drop of fixed voice revenues. The profitability was improved at all levels on the back of revenues from sales of long-term assets and lower employees' expenses. **Podravka's** top line went up 23.1% yoy driven mostly by acquisition of Žito. EBITDA margin remained almost flat in the same period at 11.1% whereas the net profit margin deteriorated to 4.7%. Valamar Riviera recorded sales growth of 14.7% on the back of higher No. of units sold as well as higher ADR. Moreover, profitability was improved at all levels. **Atlantic Grupa** posted a top line decline of 4.9%, which was mainly due to drop of sales of Sports and Functional Food unit. Still, operating margin posted only minor decline, while net profit margin went up to 6.1% due to yoy lower interest expenses and FX revenues.

In this week

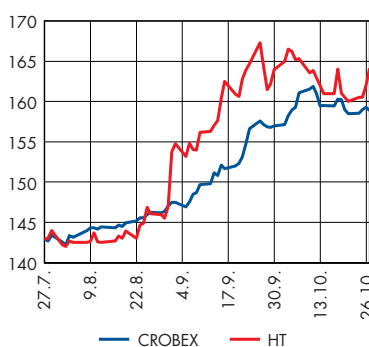
Reporting season ends in this week and therefore we reckon with somewhat calmer trading on ZSE.

Valamar Riviera (3 m)



Sources: ZSE, Economic RESEARCH/RBA

HT (3 m)



Sources: ZSE, Economic RESEARCH/RBA

Ana Turudić

Market performance

Index	1w %	ytd %	Value on*
28.10.2016			
SOFIX (BG)	3.67	14.19	526
WIG30 (PL)	2.90	0.90	2,094
SASX10 (BH)	2.25	0.93	706
MICEX (RU)	1.05	12.32	1,978
BELEX15 (RS)	0.94	5.03	677
SBITOP (SI)	0.93	7.25	747
BUX (HU)	0.51	24.26	29,723
CROBEX (HR)	0.24	16.26	1,964
ATX (AT)	0.00	3.02	2,469
BETI (RO)	0.00	-1.77	6,880
NTX (SEE,CE,EE)	0.00	-0.61	954
PX (CZ)	-0.30	-3.23	925

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

Top/Flop – CROBEX index

Share	1w %	Price on*
28.10.2016		
Kraš	3.43	538
HT	2.60	164
Zagrebačka Banka	2.00	51
Ledo	1.96	11,369
Atlantska Plov.	1.76	290
Tankerska NG	0.97	78
Arenaturist	0.95	426
Luka Rijeka	0.39	49
Imperial	0.32	808
Adris Grupa (P)	0.00	450
AD Plastik	0.00	140
Ingra	0.00	3

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

Share	1w %	Price on*
28.10.2016		
Belje	-0.12	26
Ericsson NT	-0.34	1,141
Dalekovod	-0.66	15
Atlantic Grupa	-0.70	860
OT-Optima T.	-0.74	3
Podravka	-0.81	369
Sunčani Hvar	-0.83	24
Valamar Riviera	-0.97	33
Končar EI	-1.19	675
Đuro Đaković Holding	-2.25	50
Varteks	-2.40	17

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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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"Reduce": expected negative return up to -10% over next 12 months.

"Sell": for stock with expected negative return by more than -10% u over next 12 months.

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% all IB services	0%	29%	0%	0%	0%	0%

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