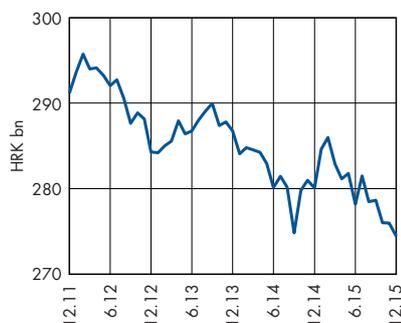


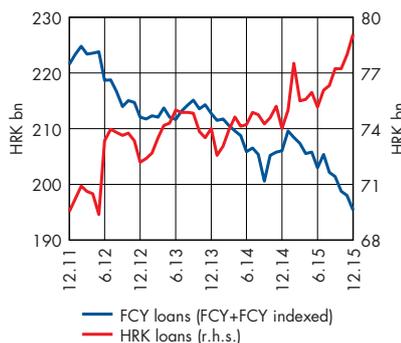
Long – term Structural Operations Start

Total loans



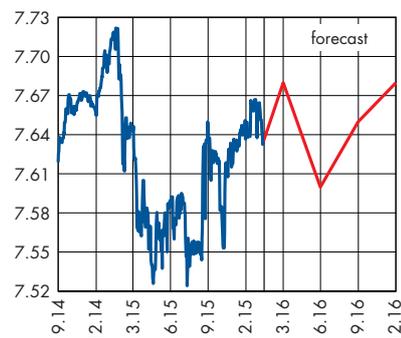
Sources: CNB, Raiffeisen RESEARCH

HRK loans and FCY loans



Sources: CNB, Raiffeisen RESEARCH

EUR/HRK



* bid rate, as of Feb 12th 16:00 CET
Sources: Bloomberg, Raiffeisen RESEARCH

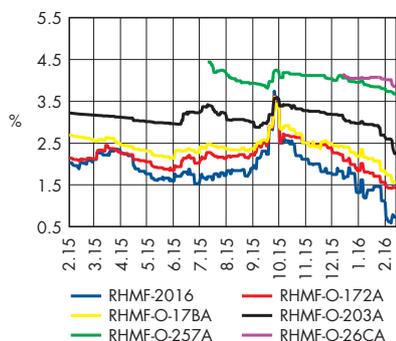
Tomorrow, on 16th Feb, the Croatian National Bank will hold the first out of four **structural (long-term) repo operations** planned for this year. With 4-year maturity at a fixed repo rate of 1.8%, the new monetary instrument aims at providing banks with long-term HRK liquidity in order to spur the lending activity (at more favorable lending conditions) and thus responding to the rising demand for pure HRK loans. As eligible collateral the CNB accepts debt securities of all Croatian issuers (in all currencies) with credit rating at least equals to the sovereign credit rating of the RoC. According to the central bank, the total effect of the structural operations planned will depend on the degree of interest that banks show in this monetary policy mechanism, the preliminary assessments being that it will approximately equal one percentage point reduction in the reserve requirement rate.

In our view the success of the LTRO will depend on the following factors: demand for HRK loans and consistency of the central bank to hold the operation on a regular basis in order to ensure stable HRK funding and banking sector confidence. The first one will largely depend on the preferences of refinancing the existing FX – linked loans to new pure HRK loans. Namely, we do not expect a significant incentive for new borrowing in the retail segment due to the relatively high leverage of households and the still weak labour market. On the other hand, the corporate sector could be more active but we should not ignore the highly competitive European market were the (large) companies manage to obtain sources of financing at more favorable terms than offered by the local banks. Although the SME segment is supported by the CBRD credit lines, simpler procedures in the banking sector as well as signs of stable recovery suggest that there could be a demand of the corporate sector for HRK loans. As for the banking sector confidence, it is crucial that the CNB ensures stable HRK funding on a regular basis.

The timing of the operations is not surprising considering the relatively favourable market and economic conditions (C/A surplus, announced fiscal consolidation, low inflationary pressures and, which is the most important, low HRK volatility). Namely, long-term repo operations do not represent a change in monetary policy instruments (from exchange rate to interest rates) and the CNB clearly stressed that it remains committed to HRK stability.

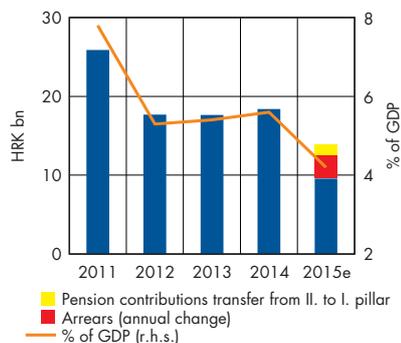
In the meantime the **FX market** remained calm but with a slight downward EUR/HRK tendency despite the present steady FCY corporate demand. HRK appreciation is probably additionally supported by the positive sentiment and lowered risk perception amid continued economic recovery, better than expected 2015 fiscal data and the announced monetary policy support. In addition, the compulsory CHF loans conversion is approaching its end but, after all, the impact on the FX market was somewhat overestimated. In a very short time (this week) we do not see any drivers that might push out the EUR/HRK trading range of 7.62 – 7.65 kuna per euro. However, we expect the domestic currency to gain strength against the euro as we approach the pre-holiday spending (Easter), which correlates with the beginning of the tourist pre-season.

Yields on HRK bonds



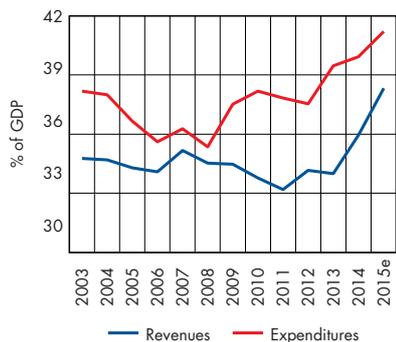
Sources: Bloomberg, Raiffeisen RESEARCH

Consolidated general Gov't deficit (ESA 2010)



Sources: MoF, CBS, Raiffeisen RESEARCH

Consolidated central Gov't (GFS 2001)



Sources: MoF, Raiffeisen RESEARCH

As for the **money market**, interest rates remained stuck at the low levels from the week before. The daily excess of HRK liquidity reached HRK11bn (historical maximum) so with the expected very low market activity we would not be surprised to see some decrease along the short-term curve. As no maturities fall due, we should wait for the oncoming week for the next T-bill auction.

Eventually, soon after the news of the LTRO, prices of the longer-dated HRK **bonds** increased. Still, we do not exclude further downside pressure to the longer end of the LCY bond yield curve. Hopefully, such movements will be an incentive for fiscal consolidation rather than just a motive for further public borrowing at lower costs.

Poor macroeconomic data calendar was in the shadow of the published data on **the consolidated central government budget for 2015** (according to the GFS 2001 methodology – cash basis). Consolidated central government deficit in 2015 amounted at HRK 9.6bn or 2.9% of GDP, which is almost HRK 3.5bn lower compared to 2014 (-26.7%yoy). Significant annual decline in the fiscal deficit is primarily a result of the solid revenue increase (+7.8%yoy) as a consequence of a splendid tourist season, which resulted in multiplicative effects on the overall economic activity last year. The better VAT collection (+6.3%yoy) reflects also the positive effects of fiscalization while revenues from excises increased by 8.4%yoy as well. On the other side, total expenditure rose by 4.3%yoy but it should be noted that the Health Fund exclusion from the single treasury account significantly undermined the fiscal transparency thus the main expenditure aggregates are not comparable on annual level at all.

Therefore, before a broader coverage on consolidated general government level (based on accrual principle in accordance with ESA 2010 methodology,) it is not appropriate to assess the degree of fiscal consolidation in 2015. However, it might happen that, according to ESA 2010, the consolidated general government deficit (corrected by the one-off transfer from the second pension pillar and estimated changes in arrears) stands at HRK 13.9bn or 4.2% of GDP, which is below our forecast. However, the high public debt (close to 90% of GDP) and interest expenses (at HRK 11.2bn; +7% yoy) warn of a possible snowball effect.

Therefore, the new Croatian Government is faced with the absolute necessity of intervening with expenditures, which should finally become the focus of the fiscal consolidation process. The 2016 Budget (which is expected to be adopted during March) will be the first indicator of how serious those intentions are. Until it is adopted we maintain all our macroeconomic and fiscal projections at current levels.

As for macroeconomic releases, the upcoming week will be in short supply so the focus will be on the success of the first long – term repo and politics.

Financial analyst: Zrinka Živković Matijević (+385 1 61 74 338), Raiffeisenbank Austria d. d., Zagreb

Calm before the publication of the results for the fourth quarter

Trading comment

In anticipation of the publication of the results for the fourth quarter on the Zagreb Stock Exchange when reaction from investors to the published results is expected, average daily stock turnover last week amounted HRK 7.2 mn. General stock indices CROBEX and CROBEX10 closed the week with a fall of 0.67% and 0.46%, respectively. Almost all sector indices recorded decline except index of tourist companies that was up by 0.50%. All equity indices in the region had losses in the last week whereas Czech PX index dropped the most. Common shares of Adris Grupa had the highest turnover of HRK 7.8 mn of regular turnover. Among CROBEX constituents, shares of Luka Ploce had the best performance while shares of Petrokemija lost the most.

Company news

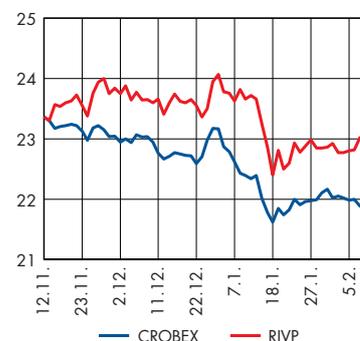
There was only a handful relevant announcements and news releases on the Zagreb Stock Exchange last week. **Valamar Riviera** reported on the conclusion of the Merger Agreement between Valamar and Hoteli Baska on 10th of February, and the Merger Agreement was submitted to the court registry. **Tehnika's** business account is blocked, and Management undertakes maximum efforts to remove the blockade as soon as possible.

In this week

A significant number of companies whose shares are listed on the Zagreb Stock Exchange will announce its unaudited results for the fourth quarter, and we expect greater activity of investors in relation to the previous week.

Financial analyst Nada Harambašić Nereau (+385 1 55 75 733), Raiffeisenbank Austria d. d. Zagreb

Valamar Riviera (3 m)



Sources: ZSE, Raiffeisen RESEARCH

Tehnika (3 m)



Sources: ZSE, Raiffeisen RESEARCH

Market performance

Index	1w %	ytd %	Value on*
12.2.2016			
SASX10 (BH)	-0.65	-4.69	666
CROBEX (HR)	-0.67	-5.73	1,593
SOFIX (BG)	-1.38	-3.70	444
WIG30 (PL)	-1.65	-4.99	1,972
SBITOP (SI)	-1.85	-4.10	668
BELEX15 (RS)	-1.97	-9.48	583
MICEX (RU)	-3.10	-2.04	1,725
NTX (SEE,CE,EE)	-3.74	-11.47	850
BUX (HU)	-4.00	-5.14	22,692
BETI (RO)	-4.90	-13.37	6,068
ATX (AT)	-5.34	-15.89	2,016
PX (CZ)	-6.51	-11.55	845.92

* as at 16:30 CET. Source: Bloomberg

Top/Flop – CROBEX index

Share	1w %	Price on*
12.2.2016		
Luka Ploče	1.61	630
Tankerska NG	1.43	71
Maistra	1.40	218
Podravka	0.81	318
Valamar Riviera	0.57	23
Zagrebačka Banka	0.26	38
Kraš	0.02	500
Adris Grupa (P)	-0.29	341
Belje	-0.53	23
Atlantic Grupa	-0.61	805
HT	-0.62	140
Ina	-0.95	2,600

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

Share	1w %	Price on*
12.2.2016		
Đuro Đaković H.	-1.19	35
Končar El	-1.24	639
AD Plastik	-1.56	95
Arenaturist	-2.01	337
Ericsson NT	-2.59	940
OT-Optima T.	-2.72	2
Dalekovod	-3.58	11
RIZ Odašiljači	-4.27	99
Luka Rijeka	-5.29	39
Ingra	-7.19	3
Atlantska Plov.	-7.41	100
Petrokemija	-17.07	10

Economic RESEARCH

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

Economic Research

Zrinka Živković Matijević, MSc, Head of Department; tel: +385 1/61 74 338, email: zrinka.zivkovic-matijevic@rba.hr
 Elizabeta Sabolek Resanović, Economic Analyst; tel: +385 1/46 95 099, e-mail: elizabeta.sabolek-resanovic@rba.hr
 Tomislava Ujević, Economic Analyst; tel: + 385 1/61 74 606, email: tomislava.ujevic@rba.hr
 Mate Rosan, Economic Analyst; tel: + 385 1/61 74 388, email: mate.rosan@rba.hr

Financial Advisory

Nada Harambašić Nereau, MSc, Financial Analyst; tel.: + 385 1/61 74 870, email nada.harambasic-nereau@rba.hr
 Damjan Sutlić, Financial Analyst; tel: +385 1/55 75 733, email: damjan.sutlic@rba.hr

Markets and Investment Banking

Robert Mamić, Executive Director; tel: +385 1/46 95 076, email: robert.mamic@rba.hr

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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Raiffeisenbank Austria d.d. Zagreb
 Petrinjska 59, 10000 Zagreb
 www.rba.hr
 tel. ++385 1/45 66 466
 fax: ++385 1/48 11 626

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