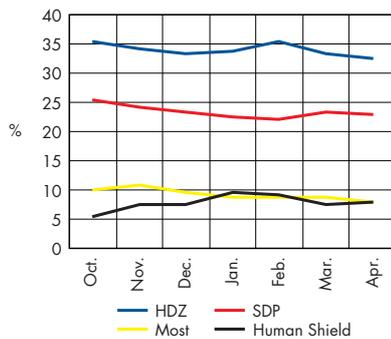


Politics Again: Government Reshuffle or Snap Elections?

Opinion polling for the next Croatian parliamentary election

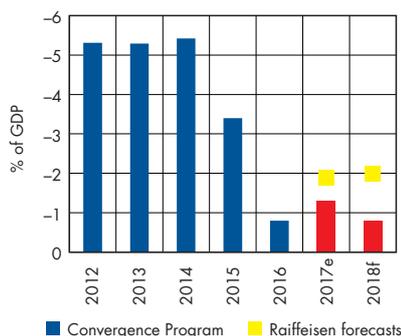


Sources: Ipsos Puls, Economic RESEARCH/RBA

The week behind us was everything but boring, in terms of data and especially in terms of politics. Moreover, although the "Agrokor issue" actually triggered the political turmoil, the newsflow regarding Agrokor was put aside.

At the last Government session the Prime Minister dismissed the (MOST's) ministers for justice, the interior and the environment as they refused to support the finance minister, Zdravko Maric, in a no-confidence vote. The speculation about the stability of the Government increased and the snap election is not an excluded option. To become effective, the no-confidence vote against the Minister of Finance (scheduled for Wednesday) has to pass the Parliament with majority votes. Also, the replacement of four ministers that come from the junior partner party Most, requires the Parliament adoption.

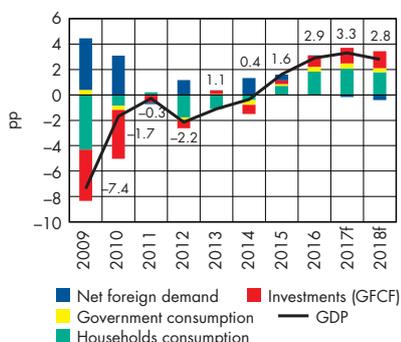
General Budget Balance*



* ESA 2010 methodology
Sources: MoF, Economic RESEARCH/RBA

Taking into account the breakdown within the ruling coalition (between HDZ and MOST), it is likely that both claims will pass the parliamentary procedure but it remains questionable whether the PM will succeed in forming the new majority required for smooth Government functioning. Although the PM expressed his confidence about the sufficient majority in the Parliament, we think it will be very tight and fragile, and therefore, he leaves an open door for snap elections. In our view, the changes for both options are very balanced (50:50). Currently, opinion polling for the next Croatian parliamentary election provides a relatively good rating of HDZ (above 32%), which has a solid advantage ahead the main opposition party SDP (close to 23%). Namely, despite their falling popularity due to the Agrokor case, HDZ is well supported by strong economic growth, fiscal easing and better than expected fiscal metrics. As for MOST, their rating hovers between 7% and 10%. Of course, in the case of snap elections, once again, we may miss the clear winner. Therefore, the situation is very tense but we assume that the political deadlock, i.e. negotiating the new majority in the Parliament or deciding on snap elections, will be resolved relatively soon, especially considering the fact that local elections have been scheduled already – for 21 May.

GDP contributions



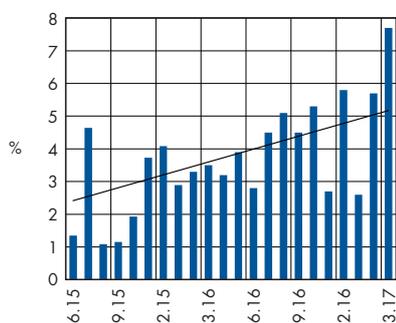
Sources: CBS, Economic RESEARCH/RBA

In the light of the new **political uncertainties**, the local bond market did not report any significant changes, while on the FX market EUR/HRK was temporarily pushed up close to 7.49 kuna per euro, thus causing more than 250 pips of HRK depreciation. Of course, part of the FCY demand came from dividend payouts. We find the latest EUR/HRK upward movement unsustainable, as HRK still finds support in a number of positive domestic factors (C/A surplus, tourism, exports growth, improved fiscal metrics, stronger demand for HRK loans).

Looking back at the Government session, the **National Reform Programme** as well as the **Convergence Programme** for 2017 – 2020 were adopted.

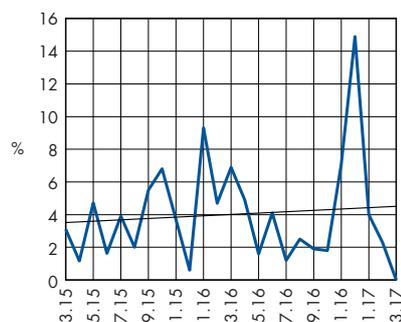
The National Reform Programme focuses on three key areas: competitiveness, education system and public finance. It delivers 53 reform measures in 12 areas aimed at solving structural problems that hamper the functioning of market economy and lower the potential economic growth. As for competitiveness, public asset management and para-fiscal levies are in focus once again. Besides privatisa-

Retail trade, real changes, yoy



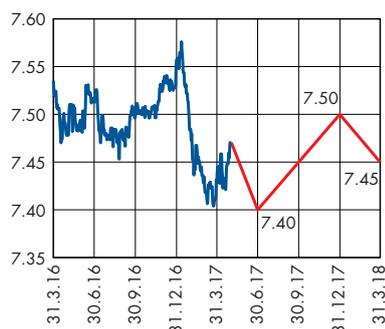
Sources: CBS, Economic RESEARCH/RBA

Industrial production, yoy



Sources: CBS, Economic RESEARCH/RBA

EUR/HRK mid rate



Sources: CNB, Economic RESEARCH/RBA

tion, public asset management includes restructuring and raising efficiency in the state-owned enterprises while para-fiscal burden is to be reduced by at least 20% in next couple of years. One of the key reforms laid down in the National Reform Programme is in the healthcare system that generates a relatively high debt (and arrears each year). In its Convergence Programme, the Government plans a public deficit of 1.3% of GDP, while the medium-term fiscal framework foresees a fall from 2018 onward, from deficit of 0.8% in 2018 to surplus at 0.5% of GDP. Owing to the shrinking budget shortage, privatization and economic growth, public debt should fall mid-term by declining in the share of GDP. The basic macroeconomic projections were not changed. Although the fiscal assumption in the Convergence Programme seems optimistic, the figures are probably encouraged by the latest EDP notification. Namely, **consolidated general government deficit** in 2016 decreased to HRK 2.8 bn or 0.8% of GDP (-2.6 pp yoy). The historical low fiscal deficit was driven by better-than-expected tax receipts, which brought the biggest positive contribution to last year's fiscal improvement (VAT increased by 7.1% yoy). The latter is mostly a result of improved macroeconomic trends, strongly supported by the record high tourist season. A positive impact also came from decreased interest expenses (-6.4% yoy), thus resulting in a significant improvement in the primary balance, which recorded a surplus for two consecutive years. The primary surplus in 2016 exceeded HRK 8.4 bn or 2.4% of GDP (+2.3 pp yoy). Lower fiscal deficit (also supported by last year's discontinuity on the political scene) consequently resulted in lower needs for government borrowing. Therefore, as expected, the EDP report confirmed that total **public debt** at the end of 2016 stood at HRK 289,1 bn or 84.2% of GDP. First time after eight consecutive years total public debt share in GDP (-2.5 pp yoy) fell. The expected positive economic trend in the current year could provide support to further fiscal outcome. If state budget expenditures meet values planned for 2017, we see a rising possibility to exit from the EDP procedure. However, although we expect fiscal deficit to deepen in 2017, it could stay at levels below 2% of GDP and primary balance might be positive for the third year in a row.

At the very end of the week CBS published **industrial output** and **retail trade** for March. March real retail trade reported the strongest (and above expected) growth at 7.7% yoy, which is the strongest since the summer of 2007. In Q117 real retail trade rose by 5.3% yoy suggesting the strong contribution of households' consumption to the GDP growth. The positive effect of tax relief, increases in minimum wages and pensions paired with the planned gradual increase of public sector wages obviously boosted household consumption further. Moreover, seasonal employment started in March thus contributing to the positive sentiment. Obviously there was no negative impact on retail sales from the Agrokor's issue, and a possible negative spillover in Q217 will be offset definitely by strong tourism indicators. Contrary to retail data, industry surprised on the downside. Following sharp declines over the last two months, it increased 1.5% mom thus reporting stagnation on annual level. The rounded figures for the first quarter confirmed a slowdown on quarterly measurement basis but also a 2% yoy annual growth.

The first week of May does not have much to offer in terms of economic data but it is certainly to be reserved for the **political developments** in the country.

Zrinka Živković Matijević

CROBEX decline after crisis in Government

Trading comment

Equity indices of Zagreb Stock Exchange posted a decline after the unexpected turbulences in Government and CROBEX lost 2.4% wow. The turnovers were lower than in the week before, on average HRK 11 mn daily. **Atlantic Grupa** was the most traded share with total turnover of HRK 10 mn. Among CROBEX constituents **Viadukt** lost as much as 26%, while the best performer was **Đuro Đaković Grupa**. Among sector indices the strongest drop was posted by CROBEXnutris, while industrial shares' index performed the best. Regional equity indices had mainly positive performance on the weekly level.

Company news

Most companies have announced the financial reports for 1Q 2017. Atlantic Grupa managed to mitigate the negative impact of the disturbance in supply of Agrokor's retail chains by higher sales through other chains while the profit margins posted yoy improvement. **Kraš** recorded a top line growth of 1.6% as well as profitability growth. **Adris** realized stable top line accompanied by EBITDA margin improvement, while the bottom line of HRK 8.9 mn was much better than the loss of HRK 90 mn in 1Q 2016. **ĐĐ Grupa** recorded 52% yoy growth of sales revenues, positive EBITDA and net profit of HRK 7 mn, which is the best company's quarterly result in recent years. **Uljanik plovidba** posted yoy flat sales and significant operating profit growth as well as positive bottom line of HRK 1 mn. **Ericsson NT**'s sales went up 9%, while gross margin and operating profit remained stable. On the other hand, the net profit dropped 29% due to FX loss and yoy higher calculated income tax. Furthermore, the company informed about new contract with BH Telecom worth HRK 11 mn. Agrokor's companies announced that AlixPartners was appointed as the restructuring advisor whereas the trading of those shares was suspended as they will not be able to present the audited reports for 2016 until the April 30th.

In this week

The movements on ZSE are likely to be influenced by news related to crisis in ruling coalition.

Ana Turudić

Market performance

Index	1w %	ytd %	Value on*
28.4.2017			
ATX (AT)	5.40	14.78	3,005
WIG30 (PL)	4.74	21.21	2,719
NTX (SEE,CE,EE)	4.53	17.33	1,187
MICEX (RU)	3.65	-9.72	2,016
PX (CZ)	3.14	9.43	1,009
SBITOP (SI)	1.15	9.02	782
SASX10 (BH)	0.50	-10.16	620
BUX (HU)	-0.03	2.99	32,958
SOFIX (BG)	-0.10	12.08	657
BETI (RO)	-0.13	16.05	8,222
BELEX15 (RS)	-1.81	0.46	721
CROBEX (HR)	-2.43	-4.66	1,902

* as at 16:30 CET.

Source: Bloomberg, Economic RESEARCH/RBA

Top/Flop – CROBEX index

Share	1w %	Price on*
28.4.2017		
Đuro Đaković Grupa	19.69	42
Petrokemija	10.74	15
Zagrebačka burza	4.16	17
Ingra	4.13	4
AD Plastik	3.55	165
Končar El	3.49	800
HT	2.40	179
Ericsson NT	-0.08	1,340
Valamar Riviera	-0.94	42
Adris Grupa (P)	-1.04	458
Atlantska Plov.	-1.17	434
Maistra	-1.33	296
Kraš	-1.42	450

* as at 16:30 CET.

Source: ZSE, Economic RESEARCH/RBA

Atlantic Grupa (P) (3 m)



Sources: ZSE, Economic RESEARCH/RBA

ĐĐ grupa (3 m)



Sources: ZSE, Economic RESEARCH/RBA

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Abbreviations

bp – basis points	HBOR – Croatian Bank for Reconstruction and Development	pp – percentage points
CERP – Restructuring and Sale Center		Q1, Q2, Q3, Q4 – quarters
DZS – Croatian Bureau of Statistics		RBA – Raiffeisenbank Austria d.d.
ECB – European Central Bank	HNB – Croatian National Bank	USD – Dollar
EUR – Euro	IMF – International Monetary Fund	yoy – year-on-year
FED – Federal Reserve System	kn, HRK – Kuna	
GDP – Gross Domestic Product	MF – Ministry of Finance	

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Investment banking services	0	0	0	0	0	0
% all IB services	0%	0%	0%	0%	0%	0%

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We wish to call to your attention that the acquisition of financial instruments with a term exceeding 30 days issued after 31 July 2014 is prohibited under EU regulation no 833/2014 concerning restrictive measures in view of Russia's actions destabilising the situation in Ukraine, as amended from time to time. No opinion is given with respect to such prohibited financial instruments.

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If any term of this Disclaimer is found to be illegal, invalid or unenforceable under any applicable law, such term shall, insofar as it is severable from the remaining terms, be deemed omitted from this Disclaimer. It shall in no way affect the legality, validity or enforceability of the remaining terms.