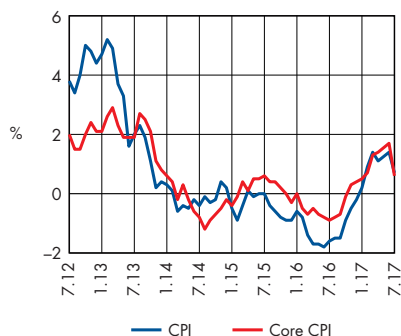


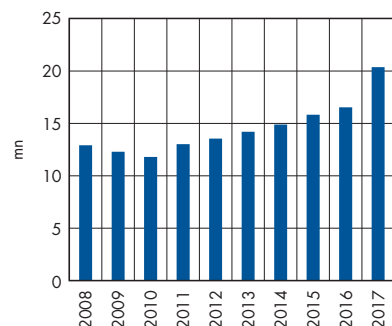
Low July inflation, high Tourism and consistent CNB

CPI, annual changes



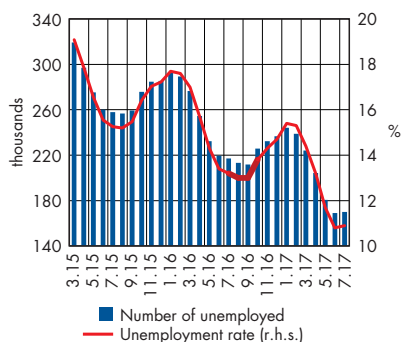
Sources: CBS, CNB, Economic RESEARCH/RBA

Tourist nights in the first half of the year



Sources: CBS, Economic RESEARCH/RBA

Registered unemployment



Sources: CBS, Economic RESEARCH/RBA

In line with the expectation, the **July CPI** reading brought the rate below 1% yoy (-0.7% mom, 0.8% yoy), thus confirming the slowdown of inflationary pressures and suggesting a potential revision of the initial forecast for the whole year, currently standing at the average of 1.5% yoy. The shortfall in expectations is achieved in the prices of energy and utility services primarily, partly because of the decline of administrative set prices and partly due to developments in the global commodity markets (primarily oil). Nevertheless, consumer inflation remains in a positive territory, mainly driven by food prices, while energy has been moving in the downward direction (VAT on electricity has decreased to 13% from 25% since the beginning of this year).

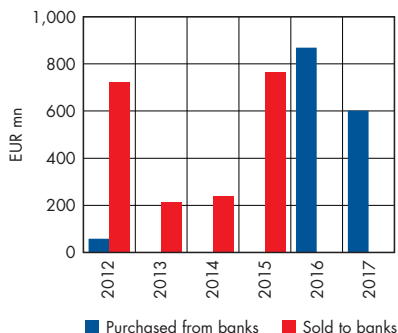
In the January – July period the average inflation rate, measured by the CPI totalled 1.0%. Despite the slowdown in growth dynamics, it is at significantly higher levels than in the same period last year, when prices fell by 1.5% yoy. The inflation returning to positive values is primarily a consequence of the growth in the prices of food, beverages, transport and prices in restaurants and hotels. In addition to the higher VAT on services in hospitality industry, some of the growth in the latter category is surely accounted for by a growing demand in tourism.

Again this year **tourism** will remain the main driver of healthy economic results, generating additional investments directed at increasing both capacities and quality. Although part of the increase in tourist arrivals/nights should be attributed to the instability in the competitive Mediterranean markets (Turkey and North Africa), the fact remains that Croatia is constantly improving its competitiveness in tourism¹. According to H1 preliminary results, both the number of arrivals and the number of overnight stays rose by double-digit rates (23% yoy both) and similar dynamics (more than 10% yoy) continued in July. As a result, we estimate that 2017 might exceed even the most optimistic forecasts and have a multiplicative effect on the rest of the economy, holding the rate of economic growth at around 3 percent. Furthermore, as a labor-intensive industry, a consistent performance of tourism is crucial for the Croatian economy as the relatively high employment connected to tourism and the high share of private accommodation (on avg 30% but even close to 70% in the high season) have a direct impact on disposable income of households. In addition, the robust performance of travel services mitigates deficits on goods account thus supporting a current account surplus and decreasing external vulnerability.

In the second half of the year we expect inflation rates measured by the CPI to remain in the positive territory, but still below the relatively modest 1%. It seems that even the relatively high wage increase has but a limited impact on inflation dynamics. Since February nominal net wages have risen more than 5% yoy and a similar trend may be expected in the upcoming months. It is precisely for the **June wages** and the **July unemployment rate** that the upcoming week is reserved. Besides a solid growth in wages (widely supported by tax relief since the beginning of the year), we expect to see a slightly higher unemployment rate in

¹ The Travel & Tourism Competitiveness Report 2017, published by the World Economic Forum

Open market operations – CNB's FX interventions



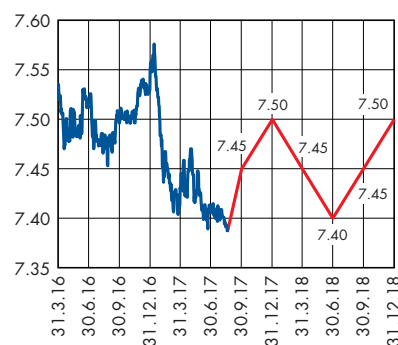
*until 18.8.2017

Sources: CNB, Economic RESEARCH/RBA

comparison to June but the expected rate of 10.9% would represent a significant annual improvement (-2.3bp).

No sooner had we thought that the local **financial market** would operate in a relatively quiet mood, small appreciation pressures (market rate fell shortly to 7.39 kuna per euro) motivated the central bank to intervene on the FX market. The CNB purchased EUR 126 mn from banks at average rate 7.408032 kuna per euro thus creating additional 0.9 bn HRK liquidity. This was the fourth FX intervention in 2017 by which the monetary authority showed its commitment to the stability of HRK clearly. All in all, the summer on the FX market was very calm. The EUR/HRK rate kept a stable footprint, mostly around the 7.40 level. HRK has been supported by FCY inflows from tourism, while the awareness of the CNB commitment to FX stability does not allow any stronger appreciation pressures. Similar FX movements might be expected over the next weeks.

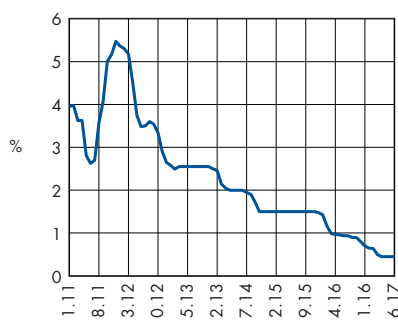
EUR/HRK mid rate



Sources: CNB, Economic RESEARCH/RBA

As the tourist season ends and the end of the year approaches, EUR/HRK should trend slightly upwards. However, compared with 2016, the average as well as the end of the year figure should reach lower levels. FCY inflows from exports, stronger investments and increasing demand for HRK loans, together with reduced fiscal risks are some of the factors that will support HRK in the upcoming months. On the other hand, the central bank has no intention to change its FX policy, and FCY demand is likely to increase due to the relatively high import dependence (that usually grows stronger amid recovery in domestic demand and tourism). In addition, the possible sovereign issuance (indexed to the euro) just before the maturing of a HRK bond in November might mitigate the HRK depreciation pressures. In case of a pure HRK issue, no FX market reaction is expected.

1-year T-Bill yield



Sources: CNB, Economic RESEARCH/RBA

After more than a month, finally the Ministry of Finance has announced a new **T-bill auction** for the upcoming Tuesday. It plans to issue HRK 1 bn of 1Y T-bills and 100 mn of 182-day short term securities. We do not expect any changes in yields and the maturing amount (HRK 1.15 bn) will be covered definitely.

Finally, the **local bond market** as well as the Croatian Eurobonds will move in line with the regional peers but will also benefit from the improved fiscal metrics, solid growth and still extremely accommodative monetary policy.

Zrinka Živković Matijević

New contract for Đuro Đaković Grupa

Trading comment

The regular equity turnover on the Zagreb Stock Exchange last week amounted to only HRK 4 mn daily on average. Thereof, the most traded were shares of **Valamar Riviera** and **Hrvatski Telekom**. Stock index CROBEX advanced by 0.5% with shares of **Uljanik Plovidba** as the best performers among member companies. Accordingly, CROBEXtransport was the winner among sector indices, while industrial sector index lost the most. Majority of equity indices in the region saw gains last week.

Company news

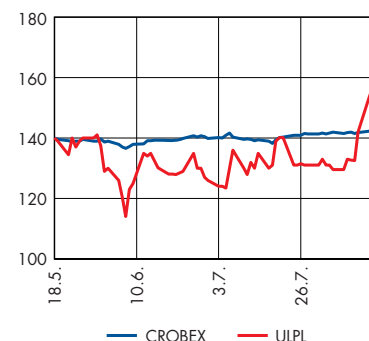
Đuro Đaković Specijalna Vozila, the member company of **Đuro Đaković Grupa** contracted with German customer delivery of freight wagons for transportation of sheet metal rolls. Value of the contract is HRK 62 mn. Đuro Đaković Grupa also informed that HRK 51.1 mn of new capital (2.6 mn new shares) was subscribed, which means the success threshold for the New Share Issue has been reached. Restructuring and Sale Centre (CERP) announced the invitation for submission of binding offers for the purchase of 1,584,124 shares of **Luka Rijeka** (11.75% of the founding equity) owned by Republic of Croatia. The offered price per share must be at least HRK 49 while the deadline for submitting binding offers is August 28, 2017 until 12.00.

In this week

In this week we expect similar trading dynamics on the Zagreb Stock Exchange.

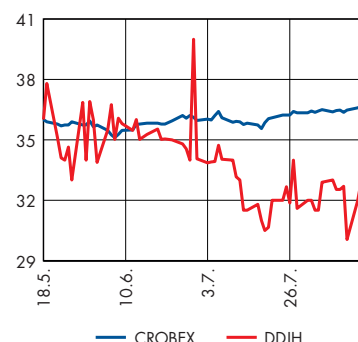
Ana Turudić

Uljanik Plovidba (3 m)



Sources: ZSE, Economic RESEARCH/RBA

Đuro Đaković Grupa (3 m)



Sources: ZSE, Economic RESEARCH/RBA

Market performance

Index	1w %	ytd %	Value on*
18.8.2017			
PX (CZ)	1.13	12.04	1,033
SBITOP (SI)	0.86	12.91	810
ATX (AT)	0.61	21.51	3,182
BUX (HU)	0.61	15.73	37,036
CROBEX (HR)	0.49	-4.70	1,901
SASX10 (BH)	0.41	-10.25	620
BETI (RO)	0.18	17.61	8,332
NTX (SEE,CE,EE)	0.12	20.58	1,220
SOFIX (BG)	-0.38	23.24	723
BELEX15 (RS)	-0.46	0.51	721
WIG30 (PL)	-0.51	21.99	2,737
MICEX (RU)	-1.05	-13.81	1,924

* as at 16:30 CET.

Source: Bloomberg, Economic RESEARCH/RBA

Top/Flop – CROBEX index

Share	1w %	Price on*
18.8.2017		
Uljanik Plovidba	18.35	168
Končar El	4.31	750
Atlantska Plov.	3.30	438
Ingra	2.45	5
Valamar Riviera	2.09	45
AD Plastik	1.05	169
OT–Optima T.	0.98	3
Podravka	0.92	318
Zagrebačka Banka	0.76	55
Luka Ploče	0.23	521
Arenaturist	0.20	490

* as at 16:30 CET.

Source: ZSE, Economic RESEARCH/RBA

Share	1w %	Price on*
18.8.2017		
Đuro Đaković Grupa	-0.17	30
Adris Grupa (P)	-0.22	452
Dalekovod	-0.62	22
HT	-0.76	179
Atlantic Grupa	-0.96	815
Petrokemija	-1.33	15
Maistra	-1.56	315
Kraš	-3.16	460
Ericsson NT	-3.52	1,205
Zagrebačka burza	-3.86	14
Viadukt	-10.00	36

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Abbreviations

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

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% 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.

INFORMATION REGARDING THE PRINCIPALITY OF LIECHTENSTEIN: COMMISSION DIRECTIVE 2003/125/EC of 22 December 2003 implementing Directive 2003/6/EC of the European Parliament and of the Council as regards the fair presentation of investment recommendations and the disclosure of conflicts of interest has been incorporated into national law in the Principality of Liechtenstein by the Finanzanalyse-Marktmisbrauchs-Verordnung.

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.