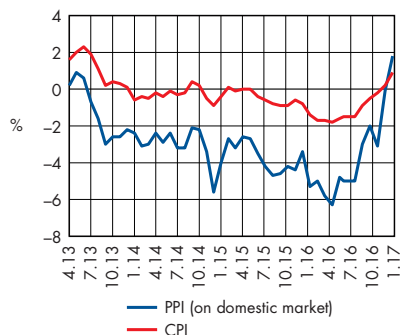


GDP data in focus, HRK continues to strengthen

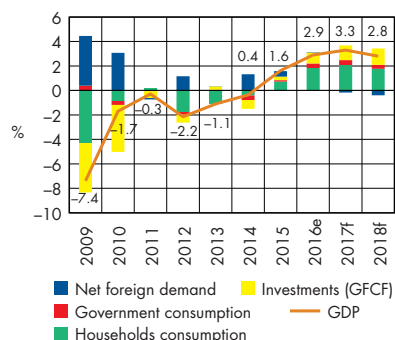
CPI and PPI annual changes



Sources: CBS, Economic RESEARCH/RBA

Inflation data (CPI and PPI), published at the very end of last week, were among the first ones referring to the current year statistics. In line with the expectation, inflation dynamics accelerated. Despite the 0.1% mom decline, the average consumer price index in January increased by 0.9% yoy which represents the highest rate since September 2013. Detailed review confirms the effect of imported inflation. Namely, the higher crude oil prices have impacted Transport that rose at the annual rate of 5.9% yoy. Furthermore, growth in the category of Food is particularly related to the non-processed food products (+ 5.9% yoy on average), which can be linked to the deterioration of climate conditions and spillover from global commodity markets. Obviously the three-year disinflation period is behind us, and the average 2017 CPI, in our view, might reach 1.9% yoy. As for PPI similar trends with similar causes were recorded that resulted in a rise by 0.7% mom and 1.8% yoy, respectively.

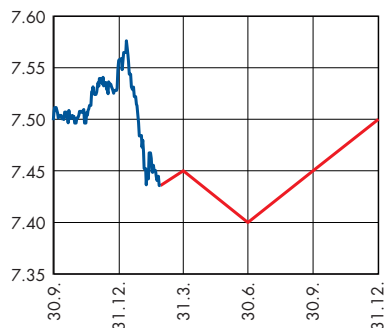
GDP and components contribution



Sources: CBS, Economic RESEARCH/RBA

The focus of the week is on the first **GDP** estimate for **Q4 2016**. Given that economic growth in Croatia during 2016 exceeded even the most optimistic expectations, we project real growth will accelerate to over 3% (3.4% yoy). The high frequency indicators point to growth in all components of domestic demand. The largest contribution to growth is expected from private consumption, which has been encouraged by the announced changes in the tax system aimed at lowering tax burdens. Although the tax reform started at the beginning of 2017, the mere announcement of the tax relief has obviously stimulated consumption. Additionally, consumer confidence and expectation indicators are on positive trends. On the other hand, the return of political stability and the Government's cut of administrative barriers have definitely encouraged investments. Investments are also supported by better utilisation of EU funds. Although high import dependence mitigates the positive effect of goods' and services' exports, we expect to see a slightly positive contribution from net exports, especially considering the excellent tourism results. In view of the previous quarters, when real GDP grew on an annual basis by 2.7%, 2.8% and 2.9% respectively, we expect the GDP growth rate to reach at least 2.9% for 2016 as a whole.

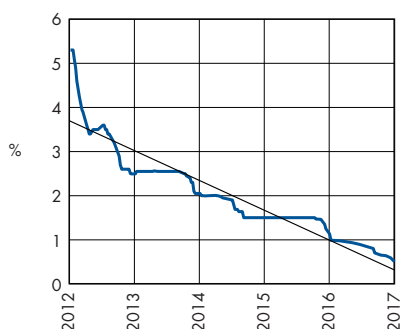
EUR/HRK middle rate



Sources: CNB, Economic RESEARCH/RBA

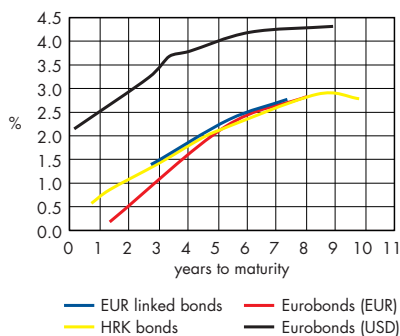
The strong **growth momentum** gathered in the second half of 2016 is expected to carry over to **2017**. Moreover, growth is projected to strengthen in 2017 driven by robust domestic demand. The positive effect of tax relief might be higher than initially expected, which together with the last hike of public wage, pension and minimum wage give a more optimistic view on households' consumption outlook. Moreover, tourist seasons could be longer and once again better on annual level. Therefore, we are inclined to revise upward real GDP growth to 3.3% yoy from 2.8%, mainly due to the stronger private consumption outlook. In addition, economic growth will receive extra impetus from the government's expansionary fiscal stance. Amid the start of a positive business cycle and enhanced cost competitiveness, investments have gained momentum also from the improved utilisation of EU funds. We anticipate the trend might be accelerated from both, private and public sector.

1- year T-bill yield



Sources: MoF, Economic RESEARCH/RBA

Croatia – sovereign bond curve*



* bid, as of 24Feb 9:00 CET

Sources: Bloomberg, Economic RESEARCH/RBA

Croatia – main figures and forecasts

	2016e	2017f	2018f
Real GDP (% yoy)	2.9	3.3	2.8
Industrial Production, % yoy	5.3	4.5	4.0
Consumer prices (avg, % yoy)	-1.1	1.9	1.6
ILO unemployment rate (avg, %)	13.6	12.5	11.2
General budget balance (% of GDP)	-2.0	-2.4	-2.5
Public debt (% of GDP)	84.2	82.6	80.6
CA (% of GDP)	3.1	2.5	2.2
Official FX reserves (EUR bn)	13.5	13.5	13.6
Gross foreign debt (EUR bn)	42.9	41.7	43.0
EUR/LCY (eop)	7.6	7.5	7.5

Source: CNB, CBS, Economic RESEARCH/RBA

As for 2018, we stick to our old forecast, i.e. economic growth is expected to moderate to 2.8% yoy. Nevertheless, GDP figures for 2017 and even 2018 are above GDP potential rate so we have to be cautious especially in mid to long run. In order to achieve long-term sustainability and stability, as well as an increase in the potential growth rate, it is necessary to implement the widely known measures aimed at improving the investment climate, reform public systems, strengthen the rule of law, and increase the efficiency of the public administration. This is especially important considering the still high indebtedness of both private and public sector. In its latest **MIP report** from last week the **European Commission** warned of exactly these weaknesses.

Turning our attention to the financial market, the most interesting developments were once again delivered by the FX market. **HRK** continued to appreciate mainly as a result of strong FCY supply, especially from the banking sector. The average EUR/HRK mid-rate reached the levels last time seen in Q3 2012. It seems that market sentiment could maintain the achieved level, at below 7.45 kuna per euro. In case of a stronger HRK appreciation pressure, we do not exclude a possibility of a CNB FX intervention.

Although the recovery of economic activity is usually accompanied by strengthening of HRK, recent market development seems to be somewhat stronger than we expected. Therefore, we revised our forecast of EUR/HRK downward. HRK will continue to find support in increased FCY inflows spurred by tourism and rising investments, solid C/A surplus, improved fiscal outcome, positive net foreign assets of banks, and, after all, increased HRK lending.

On the **money market** ample liquidity has persisted with daily HRK excess liquidity at a record high thus keeping the interest rates at their historical lows. As long as inflation remains subdued and EUR/HRK stable (without depreciation), the central bank may continue with its accommodative stance thus pushing pressure even on the longer end of sovereign curve.

Finally, the Ministry of Finance issued HRK1.5 bn in **1-year T-bills**, thus surpassing the plan and overall maturity (both at HRK1.3bn), which resulted with HRK223mn higher stock of short-term HRK debt. Furthermore, in line with our expectations, the 1-year yield fell further by 9bps to 0.5% amid bid-to-cover ratio of 1.3x and ample liquidity in the system. On the upcoming Tuesday auction the Ministry of Finance plans to issue another HRK 1.4 bn of 1Y T-bills. Further correction of yield is not excluded.

Zrinka Živković Matijević

Mostly growth of earnings in the last quarter, so far

Trading comment

In a very dynamic trading week behind us on the Zagreb Stock Exchange the average daily stock turnover surged by over 60% w/w and stock indices CROBEX and CROBEX10 added 2.3% and 2.8%, respectively. The regular stock turnover amounted to HRK 25 mn on average. Shares of **Jamnica** were again the most traded with total turnover of near HRK 26 mn. Among CROBEX constituents shares of **Belje** and **Ericsson NT** were the top performers while shares of **Arenaturist** lost the most. Regional equity indices had a mixed performance on the weekly level.

Company news

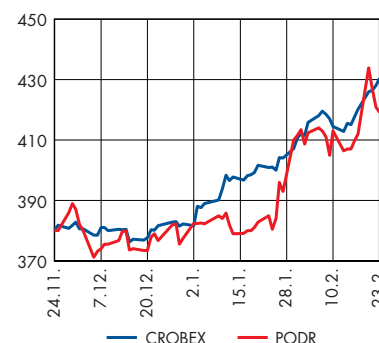
Ericsson Nikola Tesla reported 15.3% higher sales in Q4 2016 and an increase of all profit margins yoy. In the last quarter of 2016 **Podravka** posted slightly lower sales but a handsome growth of earnings on all levels yoy. The General Assembly of Podravka elected four new members of the Supervisory Board which now count nine members and also, the SB nominated new Management Board headed by Mr Marin Pucar. **Hrvatski Telekom** reported in Q4 2016 growth of sales by 3.2% and growth of EBITDA before exceptional items of 3.8% yoy thus bringing the 2016 indicators even slightly above the guidance. The dividend proposed for 2016 amounts to HRK 6 per share (54% payout). **AD Plastik** announced new deals in Russia worth EUR 2.2 mn in the four-years period related to production of parts for Nissan. **Tehnika** informed about new contract for construction of residential and commercial building in Središće in Zagreb.

In this week

We expect continuation of dynamic trading with stocks on the ZSE during the remaining two days of reporting but also in the rest of the week as an aftermath to the readings.

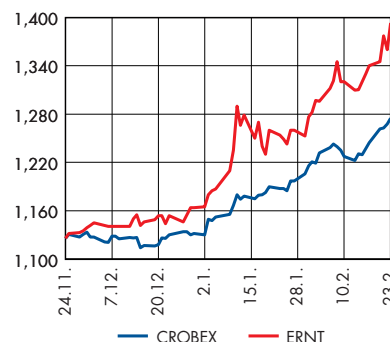
Nada Harambašić Nereau

Podravka (3 m)



Sources: ZSE, Economic RESEARCH/RBA

Ericsson NT (3 m)



Sources: ZSE, Economic RESEARCH/RBA

Market performance

Index	1w %	ytd %	Value on*
24.2.2017			
BETI (RO)	2.38	11.92	7,930
CROBEX (HR)	2.31	12.46	2,243
SOFIX (BG)	1.74	3.57	607
SBITOP (SI)	1.56	7.93	775
WIG30 (PL)	1.27	14.33	2,565
BELEX15 (RS)	0.83	-0.22	716
NTX (SEE,CE,EE)	-0.35	10.06	1,114
PX (CZ)	-1.05	4.14	960
ATX (AT)	-1.64	5.12	2,752
MICEX (RU)	-1.76	-6.36	2,091
SASX10 (BH)	-2.28	-7.36	640
BUX (HU)	-2.93	2.61	32,839

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

Top/Flop – CROBEX index

Share	1w %	Price on*	Share	1w %	Price on*
24.2.2017					
Belje	6.69	23	Adris Grupa (P)	1.61	508
Ericsson NT	6.64	1,429	Luka Ploče	1.04	566
Dalekovod	5.75	21	Luka Rijeka	0.64	47
Atlantic Grupa	5.71	1,000	OT–Optima T.	0.25	4
HT	5.54	190	Imperial	0.00	815
Končar El	5.26	860	Valamar Riviera	-0.05	42
Zagrebačka Banka	4.84	65	Varteks	-2.72	18
Đuro Đaković Grupa	2.65	47	Ledo	-3.02	9,600
Podravka	2.40	422	Uljanik Plovidba	-3.57	167
Tankerska NG	2.32	80	Ingra	-4.59	5
AD Plastik	2.08	156	Atlantska Plov.	-5.11	313
Kraš	1.63	560	Arenaturist	-7.14	520

* as at 16:30 CET. Source: 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	

Design

SIBI; OIB: 62606715155; I.B. Mažuranić 70, 10090 Zagreb

Publisher

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Magazinska cesta 69, 10000 Zagreb
www.rba.hr
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Publication finished on February 24, 2017

Publication approved by editor on February 27, 2017 at 08:05

First release scheduled for February 27, 2017 at 08:17

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% of all recommendations	0%	86%	14%	0%	0%	0%
Investment banking services	0	1	0	0	0	0
% all IB services	0%	29%	0%	0%	0%	0%

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EU REGULATION NO 833/2014 CONCERNING RESTRICTIVE MEASURES IN VIEW OF RUSSIA'S ACTIONS DESTABILISING THE SITUATION IN UKRAINE

Please note that research is done and recommendations are given only in respect of financial instruments which are not affected by the sanctions 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, i. e. financial instruments which have been issued before 1 August 2014.

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.