Raiffeisen Research Report

Number 66
July 2017

Although slower, growth continues

- Growth propelled by exports and households consumption
- Croatia exits the Excessive Deficit Procedure
- All eyes on the peak season
- Corporate earnings in 2017 could be affected by crisis in Agrokor

Raiffeisen RESEARCH

www.rba.hr

Contents

Selected macroeconomic indicators

	2010	2011	2012	2013	2014	2015	2016	2017e	2018f
GDP & Production									
Gross Domestic Product, % (constant prices)	–1.7	–0.3	–2.2	–1.1	–0.5	2.2	3.0	2.9	2.3
GDP at current prices (EUR millions)	45,022	44,744	43,965	43,495	42,981	44,072	45,817	47,900	49,800
GDP per capita at current prices (EUR)	10,495	10,452	10,301	10,220	10,147	10,404	10,899	11,520	12,014
Retail trade, % real annual changes	–2.1	0.6	–4.1	–0.6	0.4	2.4	4.0	4.5	3.0
Industrial production, % annual changes	–1.4	–1.2	–5.5	–1.8	1.2	2.7	5.3	2.0	2.5
Prices, Employment and Budget									
Consumer Prices, %, end of period	1.8	2.1	4.7	0.3	–0.5	–0.6	0.2	1.4	2.0
%, average	1.1	2.3	3.4	2.2	–0.2	–0.5	–1.1	1.5	1.7
Producer Prices[1], %, end of period	5.7	5.8	6.9	–2.6	–3.4	–4.4	–0.1	1.5	2.5
%, average	4.3	6.4	7.0	0.5	–2.7	–3.9	–4.1	2.6	2.4
Unemployment rate (official rate, avg)	17.4	17.8	18.9	20.2	19.6	17.0	14.8	13.6	12.7
Unemployment rate (ILO, avg)	11.6	13.7	15.9	17.4	17.3	16.3	13.1	12.2	11.2
Average net wage, in Kuna	5,343	5,441	5,478	5,515	5,534	5,594	5,685	5,827	5,932
General Government Balance, % of GDP, ESA 2010	–6.2	–7.8	–5.3	–5.3	–5.4	–3.4	–0.8	–1.9	–2.0
Public Debt, HRK bn, ESA 2010	191.3	216.7	233.6	270.8	284.2	289.6	289.1	295.8	302.0
% of GDP, ESA 2010	58.3	65.2	70.7	82.2	86.6	86.3	83.7	82.9	81.3
Balance of Payment and External Debt									
Good's and Services Exports, EUR million	17,007	18,126	18,336	18,771	19,691	21,512	22,801	24,308	25,530
% change	9.2	6.6	1.2	2.4	4.9	9.3	6.0	6.6	5.0
Good's and Services Imports, EUR million	17,158	18,302	18,116	18,573	18,843	20,414	21,366	22,567	23,820
% change	–0.5	6.7	–1.0	2.5	1.4	8.3	4.7	5.6	5.6
Current Account Balance, % of GDP[2]	–1.1	–0.7	–0.1	1.0	2.1	4.8	2.6	3.7	2.2
Official International Reserves, EUR millon, eop	10,660	11,195	11,236	12,908	12,688	13,707	13,514	13,700	14,000
Official International Reserves, in terms of months of imports of goods and services, eop[1]	7.5	7.3	7.4	8.3	8.1	8.1	7.6	7.3	7.1
Foreign Direct Investment, EUR million[3]	1,066	1,017	1,150	737	2,292	192	1,706	1,600	1,800
Tourism – nightstays, % change	2.6	7.0	4.0	3.3	2.6	7.7	9.0	5.0	3.5
External debt, EUR billion	46.9	46.4	45.3	45.8	46.4	45.4	41.7	41.5	42.4
External debt, as % of GDP[2]	104.2	103.7	103.0	105.3	107.9	103.0	90.9	86.6	85.1
External debt, as % export of goods and services[2]	275.8	256.0	247.0	244.0	235.7	211.0	182.7	170.7	166.1
Monetary and Financial Data									
Exchange rate, eop, USD / HRK	5.57	5.82	5.73	5.55	6.30	6.99	7.17	7.01	6.52
avg, USD / HRK	5.50	5.34	5.85	5.71	5.75	6.86	6.80	6.90	6.72
Exchange rate, eop, EUR / HRK	7.39	7.53	7.55	7.64	7.66	7.64	7.56	7.50	7.50
avg, EUR / HRK	7.29	7.43	7.52	7.57	7.63	7.61	7.53	7.45	7.46
Money (M1), Kuna billion, eop	48.0	51.5	51.9	57.9	63.4	70.7	83.5	86.8	90.5
% change	1.7	7.3	0.9	11.5	9.6	11.4	18.1	4.0	4.3
Broadest money (M4), Kuna billion, eop	232.8	246.0	254.7	264.9	273.3	287.4	300.9	312.3	320.5
% change	1.9	5.6	3.6	4.0	3.2	5.1	4.7	3.8	2.6
Credits, Kuna billion	245.6	257.4	242.1	240.8	237.0	230.0	221.5	218.2	221.5
% change	4.7	4.8	–5.9	–0.5	–1.6	–2.9	–3.7	–1.5	1.5
ZIBOR 3m, %, avg	2.4	3.2	3.4	1.5	1.0	1.2	0.9	0.6	0.8
Treasury bills rate 12m, %, avg	4.0	3.9	3.9	2.5	1.9	1.4	0.9	1.1	2.0

[1] on domestic market; [2] in euro terms; [3] including round tripping
e – estimate; f – forecast; eop – end of period; avg – period average
Forecasts: Economic Research/RBA
Sources: CNB, MoF, CBS

Real GDP (% yoy)

	2015	2016	2017e	2018f
Poland	3.8	2.7	3.8	3.1
Hungary	3.1	2.0	3.8	3.6
Czech Rep.	4.6	2.3	2.7	2.5
Slovakia	3.8	3.3	3.3	4.0
Slovenia	2.3	2.5	4.6	3.3
CE	**3.8**	**2.6**	**3.6**	**3.1**
Croatia	**2.2**	**3.0**	**2.9**	**2.3**
Bulgaria	3.6	3.4	3.7	3.7
Romania	3.9	4.8	4.9	3.8
Serbia	0.7	2.8	3.0	3.0
BiH	3.0	2.5	2.5	3.0
Albania	2.2	3.5	4.0	4.0
SEE	**3.2**	**4.0**	**4.1**	**3.5**
Russia	–2.8	–0.2	1.0	1.5
Ukraine	–9.8	2.3	1.5	3.0
Belarus	–3.8	–2.6	0.5	1.5
EE	**–3.3**	**–0.1**	**1.0**	**1.6**
CEE	**0.0**	**1.3**	**2.3**	**2.4**
Austria	1.0	1.5	2.2	1.7
Germany	1.5	1.8	1.7	1.5
Euro area	2.0	1.8	2.1	1.7
USA	**2.6**	**1.6**	**2.4**	**2.2**

Source: Raiffeisen RESEARCH/RBI

Consumer prices (avg, % yoy)

	2015	2016	2017e	2018f
Poland	–0.9	–0.6	2.2	2.4
Hungary	0.0	0.2	2.6	3.3
Czech Rep.	0.3	0.7	2.3	2.1
Slovakia	–0.3	–0.5	1.1	2.0
Slovenia	–0.8	–0.2	1.8	2.2
CE	**–0.5**	**–0.2**	**2.1**	**2.4**
Croatia	**–0.5**	**–1.1**	**1.5**	**1.7**
Bulgaria	–0.1	–0.8	1.9	2.6
Romania	–0.6	–1.5	0.9	2.9
Serbia	1.4	1.2	4.0	2.9
BiH	–1.0	–1.1	2.0	2.0
Albania	1.8	1.3	2.5	2.7
SEE	**–0.2**	**–0.9**	**1.6**	**2.6**
Russia	15.6	7.1	4.0	4.5
Ukraine	48.7	13.9	12.0	7.4
Belarus	13.5	12.0	10.0	9.0
EE	**17.7**	**7.7**	**4.7**	**4.8**
CEE	**9.1**	**3.9**	**3.4**	**3.7**
Austria	0.8	1.0	2.0	2.1
Germany	0.1	0.4	1.9	2.2
Euro area*	0.0	0.2	1.6	1.5
USA	**0.1**	**1.2**	**2.2**	**2.5**

Source: Raiffeisen RESEARCH/RBI

Fixed capital formation (% yoy)

	2015	2016	2017e	2018f
Poland	6.1	–5.5	5.5	5.4
Hungary	1.9	–15.5	9.0	8.0
Czech Rep.	9.1	–3.6	4.0	3.1
Slovakia	16.9	–9.3	4.0	4.0
Slovenia	1.0	–3.1	n.v.	n.v.
CE	**7.0**	**–6.7**	**5.2**	**4.9**
Croatia	**1.6**	**4.6**	**4.5**	**6.0**
Bulgaria	2.7	–4.0	2.3	4.5
Romania	8.3	–3.3	6.5	7.0
Serbia	n.v.	n.v.	n.v.	n.v.
BiH	3.0	3.5	4.0	7.0
Albania	4.0	7.1	n.v.	n.v.
SEE	**5.3**	**–1.1**	**4.5**	**5.4**
Russia	–9.4	–1.4	3.0	4.0
Ukraine	–9.2	20.1	15.0	7.0
Belarus	–15.9	n.v.	n.v.	n.v.
EE	**–9.6**	**0.1**	**3.7**	**4.1**
CEE	**–2.0**	**–2.4**	**4.3**	**4.5**
Austria	**0.7**	**3.4**	**2.2**	**2.5**
Germany	1.1	2.0	2.1	n.v.
Euro area	2.2	3.0	5.9	3.3
USA	**4.0**	**0.7**	**n.v.**	**n.v.**

Source: Raiffeisen RESEARCH/RBI

Current account balance (% of GDP)

	2015	2016	2017e	2018f
Poland	–0.6	–0.5	–0.2	–0.9
Hungary	3.4	5.4	3.2	2.9
Czech Rep.	0.2	1.1	1.1	1.2
Slovakia	0.2	–0.6	–0.4	0.6
Slovenia	5.2	6.8	6.6	6.2
CE	**0.2**	**0.6**	**0.5**	**0.2**
Croatia	**4.8**	**2.6**	**3.7**	**2.2**
Bulgaria	0.4	3.8	3.4	0.9
Romania	–1.2	–2.4	–3.6	–3.8
Serbia	–4.6	–3.9	–3.7	–3.5
BiH	–5.5	–4.4	–6.0	–6.2
Albania	–10.8	–9.1	–9.2	–9.5
SEE	**–1.1**	**–1.4**	**–2.0**	**–2.7**
Russia	5.1	1.7	4.7	5.5
Ukraine	–0.2	–4.1	–4.1	–3.6
Belarus	–3.8	–3.6	–3.5	–3.4
EE	**4.4**	**1.2**	**3.9**	**4.6**
CEE	**2.3**	**0.6**	**2.1**	**2.2**
Austria	1.9	1.7	2.1	2.3
Germany	8.3	8.3	8.0	8.0
Euro area	3.0	3.3	3.0	3.0
USA	**–2.6**	**–2.4**	**–3.5**	**–3.5**

Source: Raiffeisen RESEARCH/RBI

General budget balance (% of GDP)

	2015	2016	2017e	2018f
Poland	–2.6	–2.6	–2.8	–3.0
Hungary	–2.0	–2.0	–2.5	–3.0
Czech Rep.	–0.6	0.6	–0.2	0.0
Slovakia	–2.7	–1.7	–1.5	–1.5
Slovenia	–2.9	–1.8	–1.5	–1.3
CE	**–2.1**	**–1.8**	**–2.0**	**–2.1**
Croatia	**–3.4**	**–0.8**	**–1.9**	**–2.0**
Bulgaria	–2.8	1.6	–0.5	–1.0
Romania	–0.8	–3.0	–3.6	–3.8
Serbia	–3.7	–1.3	–1.8	–1.8
BiH	0.7	–1.5	–1.0	–1.0
Albania	–4.0	–2.5	–2.0	–1.0
SEE	**–1.8**	**–1.9**	**–2.5**	**–2.7**
Russia	–3.6	–3.7	–2.5	–2.0
Ukraine	–2.3	–2.9	–3.2	–2.7
Belarus	1.8	1.5	1.0	1.0
EE	**–3.3**	**–3.5**	**–2.4**	**–1.9**
CEE	**n.v.**	**n.v.**	**n.v.**	**n.v.**
Austria	–1.1	–1.6	–1.0	–1.1
Germany	0.7	0.8	0.5	0.3
Euro area	–2.1	–1.5	–1.4	–1.4
USA	**–2.4**	**–3.2**	**–3.5**	**–2.6**

Source: Raiffeisen RESEARCH/RBI

Public debt (% of GDP)

	2015	2016	2017e	2018f
Poland	51.1	52.8	54.0	54.1
Hungary	75.2	73.9	73.2	72.4
Czech Rep.	40.3	37.9	36.8	35.8
Slovakia	52.5	51.9	52.0	50.9
Slovenia	83.1	79.7	77.0	74.7
CE	**53.8**	**53.7**	**53.9**	**53.4**
Croatia	**86.3**	**83.7**	**82.9**	**81.3**
Bulgaria	25.6	29.1	27.5	28.0
Romania	38.0	37.6	38.4	39.7
Serbia	74.7	71.6	68.8	66.4
BiH	42.8	42.5	42.8	42.5
Albania	72.7	71.0	69.0	65.0
SEE	**47.7**	**47.3**	**47.0**	**47.2**
Russia	12.7	13.5	14.0	14.5
Ukraine	72.3	76.1	78.4	73.0
Belarus	36.5	39.0	38.7	36.5
EE	**17.4**	**18.4**	**19.0**	**19.1**
CEE	**n.v.**	**n.v.**	**n.v.**	**n.v.**
Austria	85.5	84.6	80.7	79.2
Germany	71.2	68.3	65.8	63.3
Euro area	90.3	89.2	88.2	87.0
USA	**101.9**	**105.5**	**105.6**	**104.9**

Source: Raiffeisen RESEARCH/RBI

Gross foreign debt (% of GDP)

	2015	2016	2017e	2018f
Poland	70.3	74.4	72.4	71.3
Hungary	106.2	98.3	88.3	81.8
Czech Rep.	69.4	73.2	76.3	74.0
Slovakia	85.4	88.8	87.2	84.0
Slovenia	116.6	108.8	103.5	102.0
CE	**64.9**	**66.6**	**65.1**	**63.4**
Croatia	**103.0**	**90.9**	**86.7**	**85.2**
Bulgaria	75.3	73.3	68.9	65.7
Romania	56.5	54.6	53.0	52.3
Serbia	81.6	74.2	70.5	66.6
BiH	53.4	54.7	55.1	54.3
Albania	73.2	71.7	67.9	65.6
SEE	**68.4**	**64.6**	**50.2**	**49.0**
Russia	37.9	39.0	29.5	25.8
Ukraine	130.9	121.7	114.5	108.8
Belarus	70.2	79.3	69.4	69.7
EE	**44.7**	**45.8**	**35.8**	**32.3**
CEE	**n.v.**	**n.v.**	**n.v.**	**n.v.**
Austria	n.v.	n.v.	n.v.	n.v.
Germany	n.v.	n.v.	n.v.	n.v.
Euro area	126.2	126.2	n.v.	n.v.
USA	**n.v.**	**n.v.**	**n.v.**	**n.v.**

Source: Raiffeisen RESEARCH/RBI

EUR/LCY (avg)

	2015	2016	2017e	2018f
Poland	4.18	4.36	4.21	4.09
Hungary	309.93	311.47	309.53	311.88
Czech R.	27.28	27.03	26.53	25.53
Slovakia	Euro	Euro	Euro	Euro
Slovenia	Euro	Euro	Euro	Euro
CE				
Croatia	**7.61**	**7.53**	**7.45**	**7.46**
Bulgaria	1.96	1.96	1.96	1.96
Romania	4.45	4.49	4.54	4.51
Serbia	120.73	123.13	123.57	124.88
BiH	1.96	1.96	1.96	1.96
Albania	139.72	137.33	135.15	136.50
SEE				
Russia	68.01	74.14	62.83	67.71
Ukraine	24.33	28.27	29.05	31.29
Belarus	1.77	2.20	2.08	2.40
Austria	Euro	Euro	Euro	Euro
Germany	Euro	Euro	Euro	Euro
Euro area	**Euro**	**Euro**	**Euro**	**Euro**
USA	**1.11**	**1.11**	**1.08**	**1.11**

Source: Raiffeisen RESEARCH/RBI

Ratings

	S&P	Moody`s	Fitch
Poland	BBB+	A2	A–
Hungary	BBB–	Baa3	BBB–
Czech Rep.	AA–	A1	A+
Slovakia	A+	A2	A+
Slovenia	A+	Baa3	A–
Croatia	**BB**	**Ba2**	**BB**
Bulgaria	BB+	Baa2	BBB–
Romania	BBB–	Baa3	BBB–
Serbia	BB–	Ba3	BB–
BiH	B	B3	NR
Albania	B+	B1	NR
Russia	BB+	Ba1	BBB–
Ukraine	B–	Caa3	B–
Belarus	B–	Caa1	B–
Austria	AA+	Aa1	AA+
Germany	AAA	Aaa	AAA
Euro area			
USA	**AA+**	**Aaa**	**AAA**

for FCY, long-term debt
Source: Raiffeisen RESEARCH/RBI

Healthy growth continues despite a correction

The first half of the year in Croatia was interesting in every sense. The country's largest privately-owned company turned into the greatest systemic risk for its economy, a solution of the situation not yet being in sight. The issue of Agrokor caused a temporary but a quite serious political uncertainty. The Government of PM Plenković ultimately managed to survive but with a changed team. After the end of local elections and rearrangement of political positions we are likely to head for a less turbulent period although the majority in Parliament remains weak. Croatia thus joined many European countries, especially over the last few years that are marked by political volatility. Experience has shown that this usually does not pose much of a problem if the institutional environment and the rule of law are strong and efficient. Otherwise, negative risk stemming from political uncertainty rises. Now the Government is expected to take concrete measures in improving the economy. Reforms and measures for their implementation have been laid down in the National Programme of Reforms. The assessment of their implementation is ahead of us. We hold crucial the measures directed at the reform of public administration, whose employees (general government) together with public enterprises account for over 20% of the work force. Under such conditions, the still high tax burden remains difficult to be alleviated.

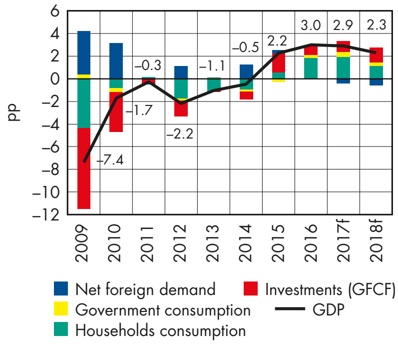
Overshadowed by Agrokor and political turmoil, Croatia continued to recover at an unchanged pace. The growth in the exports of goods and investments is encouraging. However, positive effects of both foreign and domestic demand are diminished by still high import dependence, which indicates low competitiveness and the need to strengthen the exports sector and the share in the global market. On the supply side, growth will be driven by sectors linked to the hospitality industry (tourism). Despite a slowdown, we expect growth in manufacturing to continue and healthy recovery in construction. This is an activity that is still far below the levels seen in the pre-crisis period. It is expected to gain some momentum through EU funds.

Economic growth projections were slightly corrected (cumulatively in two years by 1 percentage point). However, the projected two-year period is still marked by solid and, in the long term, above-average potential growth rates. According to our expectations, 2017 might come in only slightly below the last year's 3%. However, 2018 might prove to be a challenge. The uncertainty surrounding the manner and pace of Agrokor's restructuring, secondary and indirect effects and the global environment, including the possibility of slow tightening of monetary policies, are key and sizeable challenges. The period of negative interest must end sometime so the time available must be used to get the country's public finances in order. A small and open economy, like Croatia's, with the risk profile of non-investment rating is especially vulnerable to the possible growth in interest rates and/or financial instabilities.

Favourable market conditions in this year and the next should be provided by the domestic financial market given that moderate inflation rates and the stable exchange rate do not require a turn in the monetary policy. An attempt to give more weight to the kuna and less to the euro in the financial system has yielded only partial results because although the propensity to lend in kuna increases, bank sources of funds (long-term deposits) remain predominantly in euros.

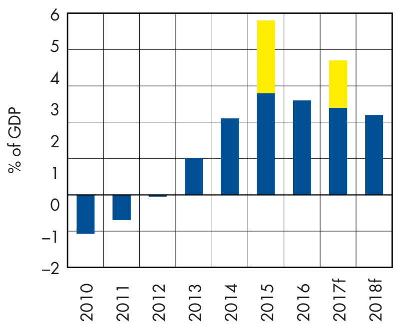
Zrinka Živković Matijević

GDP contributions



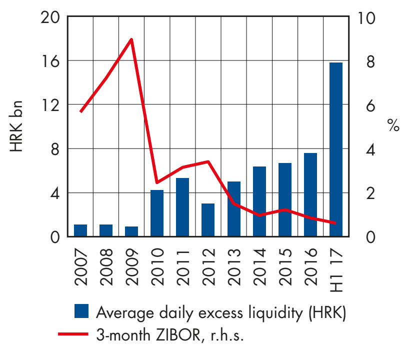
Sources: CBS, Economic RESEARCH/RBA

C/A balance



** yellow implies impact of mandatory CHF conversion in 2015 and AGTR impact in 2017*
Sources: CNB, Economic RESEARCH/RBA

HRK liquidity and MM intrest rates

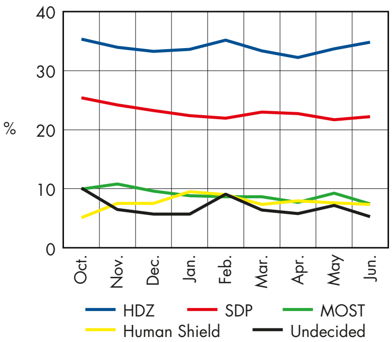


Sources: CNB, Economic RESEARCH/RBA

Growth slows down slightly, 2018 poses a bigger challenge

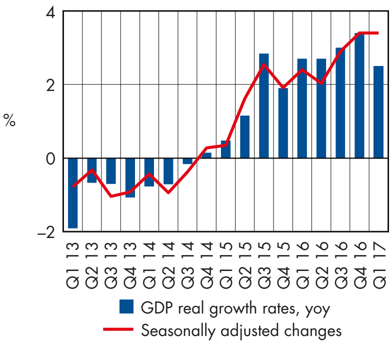
- High imports reduce positive effects of exports
- Growth propelled by domestic demand

Public opinion poll on party preferences



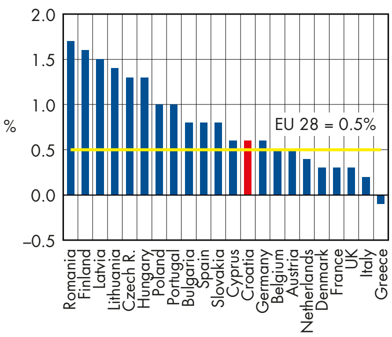
Sources: Ipsos Puls, Economic RESEARCH/RBA

Real GDP growth (% yoy)



Sources: CBS, Economic RESEARCH/RBA

Real GDP growth*, qoq



**seasonally adjusted changes*
Sources: CBS, Eurostat, Economic RESEARCH/RBA

Economic growth continued in Q1 although at a slightly slower pace (2.5% pursuant to the original data). On the other side, seasonally adjusted data reflect that the annual GDP growth in the period under concern held at 3.4%, while the qoq growth remained at 0.6%. The greatest contribution came from the exports of goods. Still the foreign demand contribution was negative (1.3 pps). This is a consequence of the relatively strong imports that grew as domestic demand and the exports of services grew due to high dependence on imports. High rates of growth in the exports of goods confirmed the positive effects of the entry in the single European market, as well as the fact that more and more Croatian companies (especially SMEs) are turning towards the foreign market. Increased income from exports on their balance sheets reduces dependence on the relatively small Croatian market, spurs faster transfer of new knowledge and technologies and diminishes the vulnerability of the economy, not to mention enables the opening of new jobs. Expectations that EU economies and the economies of Croatia's other more important foreign trade partners will continue to register stronger demand in the upcoming part of the year will consequently lead to the growth in Croatia's exports in goods, while on the other side, the exports of services (tourism) as well as the strengthening of domestic demand will generate imports. Foreign trade data as at the beginning of Q2 confirm high rates of growth in both exports and imports. The exports of services, where tourism accounts for almost two thirds, after moderate growth in Q1 will gain momentum in Q2 as additionally supported by the fact that this year's Easter holidays were in April. Although data on the tourist season should confirm healthy growth in the number of over-night stays and tourist arrivals, or perhaps even exceed expectations, one should bear in mind the base period effect and the fact that the unified tourist registration system e-Visitor is fully applied as of 1 January 2016. It undoubtedly contributed to better statistics and probably to a decline in gray economy surrounding tourist accommodation in Croatia. Again this year tourism will remain the main generator of healthy economic results, spurring additional investments directed at increasing capacity and quality. The reputation of a safe and accessible tourist destination paired with nature's beauties contributes to Croatia's attractiveness but a share of the arrivals should be attributed to the instability in the competitive markets of the Mediterranean (Turkey and North Africa). According to preliminary results for the first 5 months, despite the shortfall in May, the number of tourist arrivals and overnight stays registers two-digit growth rates.

Domestic demand contributed a relatively high 3.8 percentage points to growth, primarily thanks to households consumption, although investments also registered healthy growth. The annual growth of personal consumption held at 3.5% probably encouraged by the alleviation of the tax burden, slow growth of employment and positive expectations. The escalation of the Agrokor crisis deteriorated consumer perception of the economic and financial situation already in April, which was reflected in the slowdown of the growth in retail trade. However, slight recovery was visible already in May which gives us reason to expect that a potential effect on households consumption will have a certain time lag and only in case of more sizeable layoffs in the restructuring process. Namely, the labour market boasted a continued decline in unemployment, slow growth of employment and a growth in wages. Although the 2017 fall in unemployment started already in February, reaching its lowest levels of the past 20 odd years in April, fact remains that the majority of the outflow from the unemployment register is a consequence of the so-called removal from the register due to non-adherence to statutory provisions and to a smaller extent due to new employment. In addition, new jobs are mostly seasonal jobs and/or jobs based on fixed-time employment contracts (mostly in trade and the hospitality industry), while industry accounted for a smaller share of the employment growth. This means that the labour market remains fragile and burdened by serious structural problems of disbalance between supply and demand, long-term unemployment and fall of working-age population.

In addition, Croatia as many other European countries, is plagued by the demographic ageing process, and there are no signs of the emigration of the most productive share of working-age population slacking. This is a result of easier movement of persons in the common EU market amid sluggish and inadequate speed of new jobs creation in the country. Facing and addressing the problem of the loss of one of the most valuable growth resources – labour remains a huge challenge to be faced by economic policy creators both in the short and in the long run.

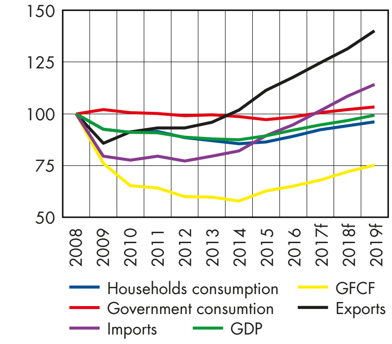
Although investments in Q1 went up at a relatively high growth rate of 5.4% we assume that this GDP constituent will be hit the most by uncertainties and problems surrounding the crisis at Agrokor. Therefore, the majority of corrections in the growth projections for 2017 and 2018 (by 0.4 and 0.5 percentage points respectively) are based on lower investment activity. Nevertheless, investments have slowly been gaining momentum as a result of EU funds. In addition, the period before the local elections must have, as usually, been marked by investment activity in the public sector. The view that investments are recovering is supported by relatively favourable financing conditions, as well as by exceptionally low base (due to strong fall during the crisis) so we see some potential in both the private and the public sector.

In short, addressing Agrokor's liquidity issues has, in the short run, provided the entire economy with some room to breathe in, most likely without more significantly affecting households consumption but causing postponement of certain investments. However, the Agrokor case reopened the issue of long-standing weaknesses of the country's economy by underlying the problem of inability to collect payments. This problem was stress over numerous years by all market participants as one of the main hurdles to successful operation and competitiveness. Finally, we expect moderate but positive growth of real government spending to continue in all quarters.

On the supply side, we expect growth to continue, especially in activities closely linked with tourism, trade and IT industry. Construction will also register a moderately positive recovery. The recovery in manufacturing, as one of the most important economic activities (accounting for a share of some 13%), will slow down. After the real annual growth of gross value added in manufacturing registered 2.8% in Q12017, its growth rate over the upcoming quarters should hold at some 2%.

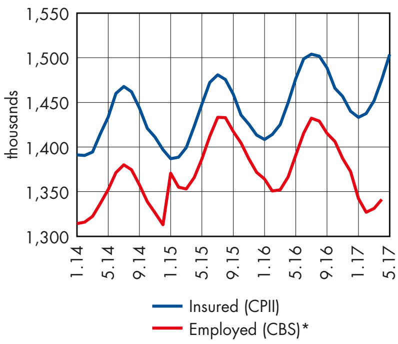
Zrinka Živković Matijević

Real GDP and components (2008 = 100)



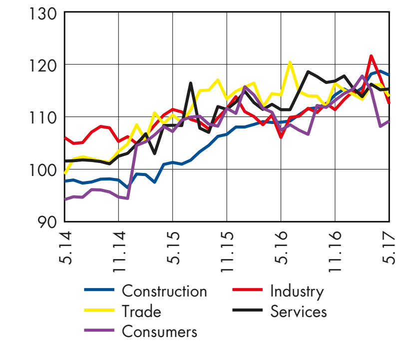
Sources: Eurostat, Raiffeisen RESEARCH/RBI

Employment and persons ensured



**New methodology as of Jan 2015 (series broken)*
Sources: CBS, CPII, Economic RESEARCH/RBA

Confidence indicators

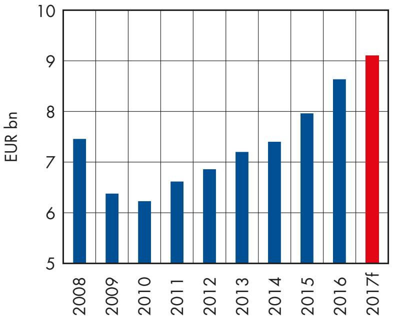


**Standardized values, seasonally adjusted index*
Sources: CNB, Economic RESEARCH/RBA

Deleveraging continues in corporate segment

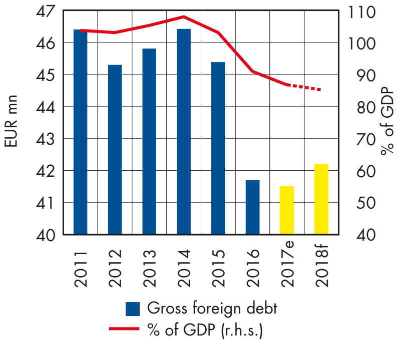
- **Healthy surplus in the current and capital accounts**
- **Gross external debt likely to continue to fall**

Travel receipts (tourism)



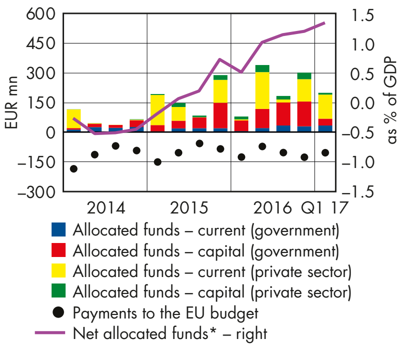
Sources: CNB, Economic RESEARCH/RBA

Gross foreign debt



Sources: CNB, Economic RESEARCH/RBA

Transactions with the EU budget



Sources: CNB, Economic RESEARCH/RBA

At the end of Q1, gross external debt amounted to EUR 43.8bn or 94.5% of GDP. Statistics for the period from January to March indicate a relatively strong growth of external debt compared to the end of 2015 (5.1%), which is mainly the result of the Eurobond issuance in March. We expect that already the data for April will reflect a decline in the external debt due to the maturity of USD 1.5 bn Eurobond issued in 2007. Furthermore, data for the end of March confirm the deleveraging of domestic corporate toward foreign creditors. Compared with the end of March 2016 total external debt recorded 1.1%yoy decline. The greatest contribution to the decline in external debt, in annual terms, came from continued deleveraging of the financial sector, or rather, banks, due to relatively cheaper domestic deposits, high liquidity and still modest demand for loans. We think that bank deleveraging neared its end, which means that the level of banking sector indebtedness is expected to remain at the current level. On the other hand, we do not exclude the possibility that the corporate segment will continue to refinance a share of their external liabilities in the domestic market due to more favourable and more competitive financing conditions. Despite a slight revision of this year's economic growth, the share of gross external debt in GDP could continue to fall again this year, which confirms that Croatia's external vulnerability reduced. Renewed inflation and the strengthening of the kuna against the euro are additional factors expected to contribute to the reduction in the ratio of public debt to GDP, which might drop below 90% this year.

In Q1 continued healthy surplus in the current and capital accounts of the balance of payments (3.8% of GDP) was maintained. The latest available statistics for the period from January to March confirmed the traditional deficit in the C/A balance of payments in Q1. As expected, the negative contribution came from the annual deterioration in the goods account, but also in the services account, as a direct consequence of Easter holidays coming later this year and hence of the tourist (low) season starting later. The stronger growth in income from travel (tourism) will positively contribute to the overall result in the balance of payments current account for this year's third quarter. On the other side, the deficit in the C/A was positively affected by developments in the primary and secondary income account. Stronger growth of bank provisions linked to the situation in Agrokor contributed to weaker operating results of non-residents thus reducing expenditures in the primary account, while on the other side income rose due to equity investments of residents abroad. Surplus in the secondary income account rose mostly thanks to the increased use of EU funds. Cumulatively, over the last four quarters, the surplus balance in the current account stood at 2.7% of GDP. On the 2017 level, we expect the current account surplus to reach 3.7% of GDP. Nevertheless, it is noteworthy that this projection includes the influence of bank provisions (1.3 percentage points) which increase the surplus. Positive developments in the balance of payments will be a consequence of improvements in the services accounts (good tourist season), better utilisation of EU funds, lower costs of (re)financing of external debt and more favourable developments in Croatia's foreign trade.

Elizabeta Sabolek Resanović

Liquidity high, interest rates low, exchange rate stable

- **Stable exchange rate with slight but persistent HRK strengthening**
- **Moderate inflation**

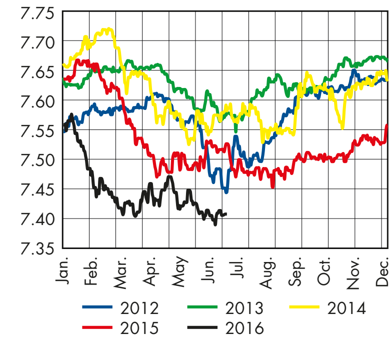
The expansionary character of the monetary policy and further growth of the HRK and FCY liquidity marked this year's Q2. The average daily HRK liquidity surplus in H1 doubled in comparison with 2016, largely contributing to interest rates holding steady at low levels. Amid moderate inflation rates and stable EUR/HRK the central bank is not expected to change the course of its policy. Moreover, its expansionary policy is likely to continue throughout the beginning of 2018, aided by the stability of the EUR/HRK rate, which is the nominal anchor of the monetary policy in pursuing its objective (price stability). Market interest rates will consequently hold at their current low levels, possibly trending only slightly downwards but without any potential for growth until the end of the year.

The average inflation rate, measured by the CPI, is estimated at 1.2% in H12017. The inflation returning to positive values is a consequence primarily 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 the hospitality industry, a share of the growth in the latter category is surely accounted for by growing demand in tourism. On the other side, the growth of the prices of transport (almost entirely) and the annual growth in the category of food products were surely aided by developments in the world's commodities markets. We expect energy prices to recover in the second part of the year (partly also due to the expiration of the effect of administrative cuts in the prices of natural gas as of 1 April) and prices to fall in some other categories, such as telecommunications services. In short, by the end of the year inflation is expected to range at around some 1.5%.

As expected, EUR/HRK trended slowly downwards during Q2 without significant volatility. However, the CNB intervened twice in the FX market by purchasing euros, once again clearly showing determination in consequently pursuing its policy of a stable exchange rate. The average EUR/HRK, as well as the exchange rate at the end of the H1 reached lower values because the economy continued to grow and enjoy a steady inflow of foreign currency from the exports of goods and services (primarily to tourists). Furthermore, stronger investments and demand for HRK loans together with the reduced fiscal risks were supportive for local currency. The same factors, especially good results relating to the FCY inflow from tourism will support HRK in the upcoming months. On the other side, there will be no stronger HRK appreciation pressures due to the central bank's consequent adherence to the policy of stable exchange rate but also due to the demand for foreign currency which arises from the relatively high imports and usually grows stronger amid recovery in domestic demand and tourism. As the tourist season ends and the end of the year approaches, EUR/HRK should trend slightly upwards. However, compared with 2016, the end of the year should be reached at slightly lower levels. 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 FX market reaction is not expected.

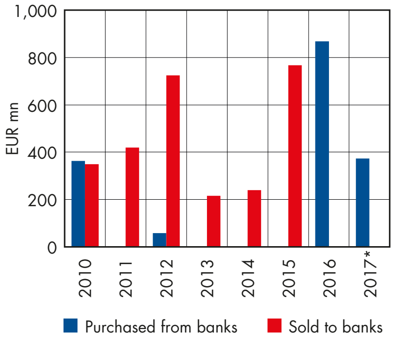
Zrinka Živković Matijević

Mid EUR/HRK



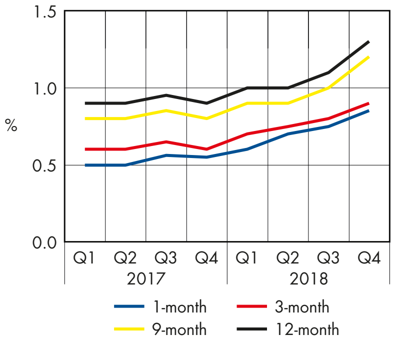
Sources: CNB, Economic RESEARCH/RBA

Open market operations – CNB`s FX interventions



** Until July 5th; Sources: CNB, Economic RESEARCH/RBA*

ZIBOR, eop



Sources: Bloomberg, Economic RESEARCH/RBA

Middle exchange rate of the CNB

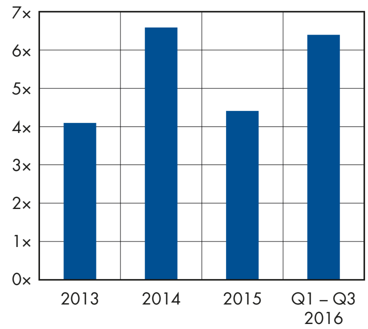
Currency	Middle exch. r. 30.6.17	Change compared to: 31.12.2016 Exch. rate	Movements	%
EUR	7.4066	7.5578	↓	–2.00
USD	6.4902	7.1685	↓	–9.46
CHF	8.4147	8.8158	↓	–4.55
GBP	6.7758	7.0357	↓	–3.69

Sources: CNB, Raiffeisen RESEARCH

Agrokor – the story of a debt-fuelled growth

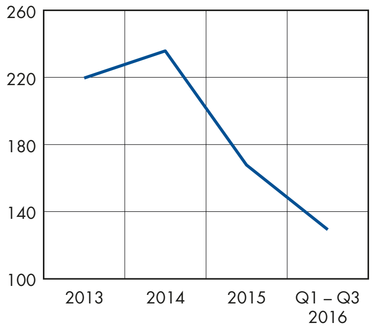
- **Mercator and non-core companies most likely to be sold in the short term**
- **Crisis at Agrokor might influence operating results of exposed companies in 2017**

Net debt/EBITDA



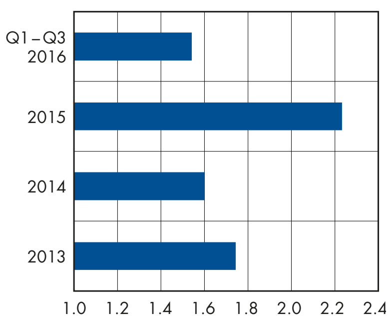
Sources: Agrokor, Economic RESEARCH/RBA

Average days payables



Sources: Agrokor, Economic RESEARCH/RBA

Interest coverage ratio



Sources: Agrokor, Economic RESEARCH/RBA

Surprisingly, the crisis at Agrokor peaked at the time of increased expectations after the economy finally registered the long-sought positive developments and when consumer optimism grew. In February, Moody's downgraded the outlook for Agrokor's credit rating from stable to negative for several reasons: inability to refinance its debt at acceptable conditions at the time when its operations and indebtedness needed stabilisation due to growing competition in the retail market and when PIK bond neared its maturity. Afterwards, Agrokor's rating was additionally downgraded several times to the current Ca with a negative outlook, following the default on coupon on EUR 300mn bond issue maturing in May 2019. Thus, from the once largest private company Agrokor became the greatest burden for Croatia's and, to an extent, the regional economy. Namely, Agrokor employs 60 000 people, of which 49% in Croatia and the remaining 51% in the Adria region. Furthermore, countries from the region accounted for 53% of the company's income in 2015. For some years now Agrokor financed its operations predominantly through external sources at very high interest and it seems that the acquisition of the (also overly-indebted) Mercator proved to be too big a bite to swallow. At the time of the takeover in 2014, Mercator's debt totalled HRK 6.5bn so Agrokor's consolidated financial debt at the end of 2014 grew to HRK 23.7bn and the ratio of its net debt to EBITDA to 6.6x (4.1x at the end of 2013). According to the latest available data, Agrokor's total debt at the end of Q3 2016 stood at HRK 25.6bn. However, doubts as regards the credibility of these reports will make us wait for the real picture until the end of August when the newly appointed auditor is expected to make the 2016 audited reports publicly available.

A very risky growth model was paired with the decline of the market share of the corporation's retail chain Konzum due to rising competition, primarily the strengthening of Lidl's position, whose share of Croatia's market in 2015 reached some 10%-20%. In addition, we believe the main issue was poor management at top level combined with low transparency. Very long DPO to Agrokor's suppliers (some 130 days on average, in the first 9 months of 2016, while the law allows 60 days) were one of the illiquidity generators in the economy for quite some time. Things got additionally complicated by the fact that Agrokor issued promissory notes with recourse to its suppliers. These notes are specific because the factoring company that purchased the claim from the supplier may, if collection from the debtor (in this case Agrokor) is impossible, require payment from suppliers. This is what occurred in Q1 this year, which additionally aggravated the position of suppliers. Some suppliers published their data on exposure to Agrokor already in Q1, and some set aside provisions, including for contingent liabilities arising from promissory notes with recourse rights. Some of the largest suppliers are big enough and can, in our opinion, sustain greater write-offs of their receivables. However, at some companies Agrokor accounted for as much as 50% of their sales income. In these cases, write-offs of 50% or more could prove to be a considerable problem. All in all, the crisis at Agrokor might greatly affect the operating results of exposed companies in 2017. This was visible already in Q1 due to the temporary interruption of delivery to Agrokor's retail network. Nevertheless, we expect some of the suppliers to strengthen their positions in some other retail chains and thus compensate for the decline in income from Agrokor.

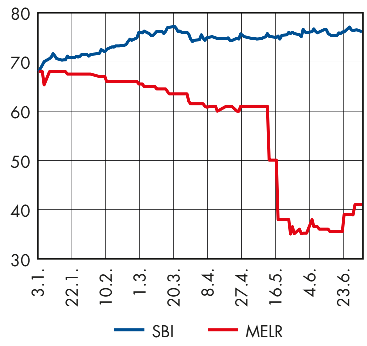
Initial speculations on likely write-offs of creditor receivables went up to some 50%. However, figures mentioned now when spoken about the likelihood of receivables collection are some 30% of less. The fact that each new loan granted under the extraordinary administration supersedes old ones in the process of collection additionally weakens their position. Although new data on market shares of retail chains are not available, Konzum's position is likely to have additionally weakened lately. According to the data issued by the Croatian Competition Agency, Konzum's market share totalled some 20%-30% in 2015. Currently it is likely to be closer to 20%. At the same time, Lidl's share grew. According to our estimates it might be close to 20%, with an additional threat coming from Lidl's entry into the Serbian market, planned for the beginning of 2018. All this, in our opinion, jeopardises the synergic effect and the reason for the corporation's existence in its current form given that the retail segment was the main cash generator for the group and the main distributor for production companies in the group. As a result, we think that the more likely strategy will be to sell some of the companies from the group aiming to rationalise operations and reduce the corporation's indebtedness.

When discussing the sale of some of the group's members, Ledo and Jamnica were always mentioned as the most likely targets. However, they are both burdened by joint guarantees for Agrokor's debt in the overall amount exceeding HRK 20bn. Accordingly, if Agrokor is unable to pay, creditors have the right to seek payment from these companies. As the amount of guarantees issued likely exceeds the market capitalisation of these companies, their future will be determined by the settlement with creditors which should be achieved in mid 2018 when the extraordinary administration is over. Since Mercator, the only one among the larger members of the group, is not burdened by guarantees, we think it is the most likely candidate to be sold in the short run. The market capitalisation of Agrokor's share in Mercator as at 3 July 2017 was EUR 173.7 mn or 5% of Agrokor's financial debt. For the time being, the company announced only its intention to sell non-core companies, i.e. companies that do not belong any of the strategic business branches of the corporation (retail, food production and agriculture).

Companies of the Agrokor group, whose shares were listed on the ZSE, lost some 65% of their market capitalisation since end of February till 27 April when trading in these shares was temporarily suspended until the audited financial statements for 2016 come in. During the same period the index of companies from the food and beverages sector, the CROBEXnutris, whose constituents include the shares of Agorkor's suppliers, lost 43%, while the CROBEX lost 16% of its value. Although Ledo and Jamnica shares were not at the top by liquidity prior to 2017, after the culmination of problems at Agrokor they found themselves in the focus of investors with the average daily turnover of HRK 2.1m and HRK 3.2m, respectively in Q1 2017. The temporary suspension of trading in these shares practically halved equity turnovers on the Zagreb Stock Exchange. Given the decline in the expected profit of companies and losses sustained by institutional investors, we expect low turnover on the ZSE to continue and be paired with possible growth of risk aversion due to the Agrokor situation and its implications for the economy as a whole.

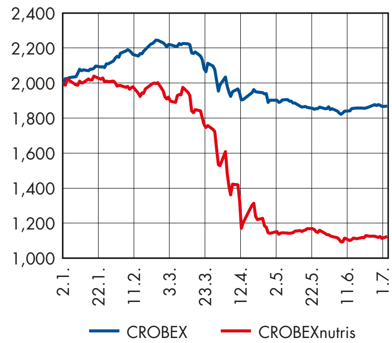
Ana Turudić

Mercator (ytd)



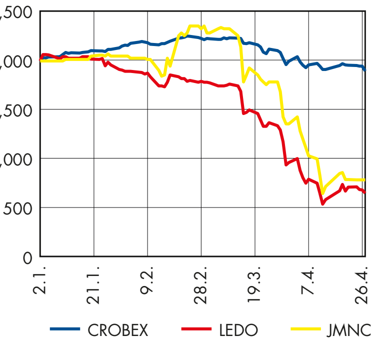
Sources: Ljubljana Stock Exchange, Economic RESEARCH/RBA

CROBEX vs CROBEXnutris



Sources: Zagreb Stock Exchange, Economic RESEARCH/RBA

Ledo and Jamnica

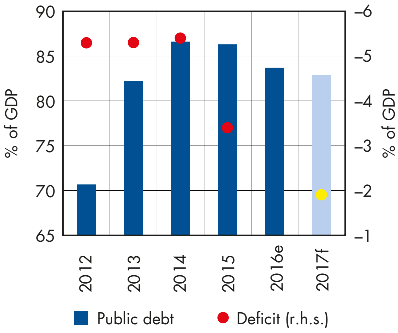


Sources: Zagreb Stock Exchange, Economic RESEARCH/RBA

Fundamentals set, public sector reforms as an imperative

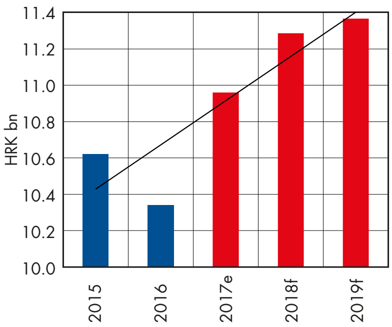
- **Croatia exits the EDP**
- **High liquidity supports low yields**

Consolidated General Government (ESA 2010)



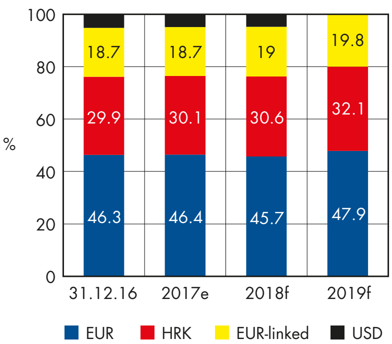
Sources: Eurostat, CBS, Economic RESEARCH/RBA

Expenses on interests



Sources: MoF, Economic RESEARCH/RBA

Currency composition of budgetary debt



Sources: MoF, Economic RESEARCH/RBA

After the April EDP notification, the EU Council's confirmation of the Commission's recommendation of Croatia's exit from the Excessive Deficit Procedure at the end of May was not a surprise. However, although the budget deficit was substantially reduced last year, paired with both nominal and relative decrease of the public debt, thus implying significant improvements in public finances, in its latest forecasts the European Commission warned that this year it expects the balance sheet structure to deteriorate which might continue in 2018. Thus, stressing the importance of public finances, the story of the need for continued public sector reform was repeated once again (covering the segment of education, administration, health care system, etc.). Croatia's exit from the Excessive Deficit Procedure obliges it to adhere to the rules under the preventive arm of the Stability and Growth Pact. This means that by 2020 Croatia needs to achieve a balanced budget, i.e. a surplus of 0.5% of GDP.

The Ministry of Finance published its Q1 fiscal statistics for the consolidated general government. Although preliminary data indicate a mild deterioration on annual level, they do not give reason for concern given the fact that reduced government spending in Q1 2016 was conditioned by temporary financing followed by a period during which the technical Government had to adhere to statutory limitations in terms of size and structure of budgetary expenditures. According to the data for the period from January to March (pursuant to the national methodology, based on the so-called cash principle) the consolidated general government deficit widened to 2.7% (from 2.0% at the same time last year). A stronger growth of revenues, by 2.4% on annual level, was predominantly a result of the increase in revenues from VAT, which accounts for almost 28% in the structure of overall revenues. In addition, revenues from profit tax went up by 5.4% on annual level which is the result of more profitable operations of Croatian companies which is the result of more profitable op. A stronger growth in the revenues of the consolidated general government was halted by the decline in revenues from income tax, which was a consequence of the tax reform applied since 1 January this year. On the expenditure side, the time frame under review registered an annual growth of 3.9%. A contribution to the growth of fiscal deficit came from the increase in expenditures on employee benefits which (accounting for 25.5% of total expenditures) grew by 1.9% on an annual level. A sizeable growth was registered in the subsidies category, which rose from 789.2 thousand in Q1 2016 to HRK 2.1bn in Q1 2017. Such developments are the result of agreed salary increase in public services, while the growth in the subsidies category is caused by different payments dynamics (compared to previous year). A positive contribution on the expenditure side came from lower interest expenses, totalling HRK 3.4bn. Their decline of 5.7% on an annual level consequently led to the improvement in the primary balance, which again boasted a surplus. Thus, primary surplus in Q1 2017 totalled HRK 1.2bn or 1.5% of GDP.

Continued positive economic indicators suggest that revenues should at least be in line with planned figures. The Government should put special emphasis on strict control of budgetary spending and use all surplus revenues to further reduce budget deficit. This would contribute to the strengthening of the stability of public finances which is crucial for the overall economic stability. As for this year's fiscal expectations, we remain cautious and expect the fiscal deficit to widen predominantly due to the increase on the expenditure side. However, it should remain below the 2% of GDP with a surplus in the primary balance for the third year in a row.

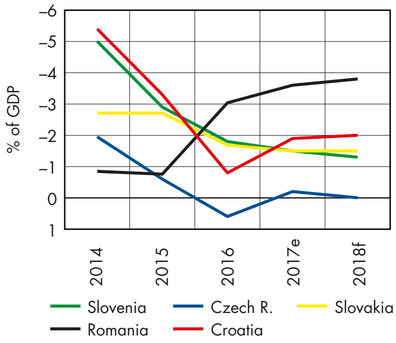
Regardless of the relatively favourable developments in public debt (resulting in the reduction of external vulnerability and improvements in maturity, interest and currency structure) high costs of debt servicing in the upcoming period will continue to pressure Croatia's public finances. Amid such conditions, a narrow room for productive investments will depend on improvements to the efficiency of public administration based on structural reforms.

In addition, public debt of some 85% of GDP remains the main hurdle to Croatia's negotiations regarding its joining the European Monetary Union. In order to be able to start negotiations, Croatia needs to cut its debt by 1/20 of the difference above 60% of GDP per year. If the political situation allows, we expect that the proposed 2018 budget will show further cuts to the debt. Therefore, despite temporary growth in public debt in Q1, which was a direct consequence of government borrowing in the domestic and foreign capital markets (local issue in February and Eurobond issue in March), public debt as a share of GDP is expected to continue to decline this year.

Amid exceptional liquidity and significantly improved economic and fiscal indicators, the Government used the favourable market environment and at the beginning of July decided to offer investors in the primary market a new bond issue denominated in kuna and indexed to the exchange rate of the kuna against the euro. The issue, worth HRK 3bn, of new indexed bonds met with exceptional investor interest, its yield to maturity totalling 3.30% (3.25% coupon). With a 15-year maturity of the new issue the yield curve of the currency clause was thus extended until 2032. One more government issue in the local market should not affect the growth of public debt more significantly since a 2010 kuna bond worth HRK 4bn is maturing in November. We expect the Government to issue a long-term bond in the primary market in this year's final quarter totalling some HRK 5.5bn. This will cover this year's (re)financing needs. As usually, domestic pension funds and insurance companies will pick up most issues in the primary markets, thus satisfying their appetite for new issues even at relatively high yields. Namely, despite the fall in the government's risk premium, it still remains above that of comparable countries which clearly reflects Croatia's rating two notches below the investment level.

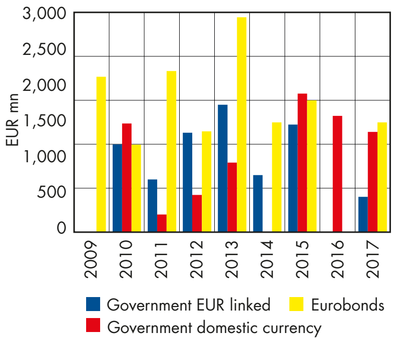
After the end of this year's Q1 was largely marked by the situation surrounding the fate of Croatia's largest private company to which together with the rise in uncertainty domestic government bonds reacted with increased volatility and the growth in yields amid ample market liquidity, the prices of domestic issues gradually recovered already in the middle of April. A quiet period with a slightly more pronounced investor interest for the longer end of the yield curve marked the rest of the quarter. In the remainder of the year, high surplus liquidity in the system will continue to support current yield levels. We do not exclude the possibility of a slight growth in yields towards the end of the year, which will largely depend

Consolidated General Gov't balance, as % of GDP



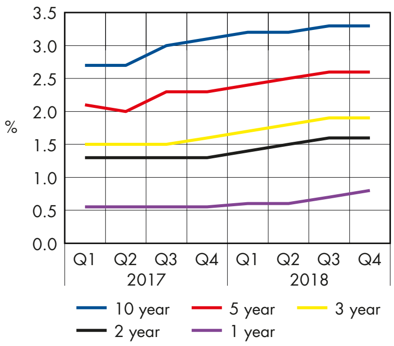
Sources: Raiffeisen RESEARCH/RBI, Economic RESEARCH/RBA

New government bond issues



Includes T-bills with maturity longer than 1y
Sources: MoF, Economic RESEARCH/RBA

Domestic bonds, eop



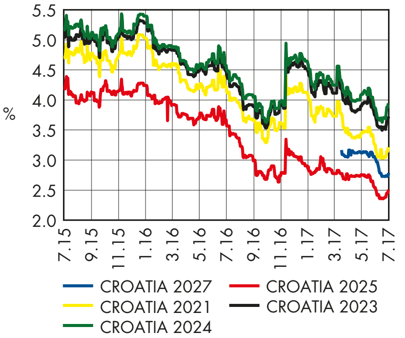
Sources: Bloomberg, Economic RESEARCH/RBA on the new local issue. Institutional investors, primarily pension funds, will remain the main demand generators at the longer end of the domestic yield curve.

Yields in the market for short-term debt issues continued moving at record low levels. The yield on a one-year kuna T-bill remained at 0.45%. Such developments pushed some of market participants towards kuna securities with shorter maturities which in comparison with yields on T-bills with similar maturity offer higher returns. By the end of the year, amid exceptionally high liquidity in the system and modest alternative investment opportunities, we expect the yield curve of short-term debt securities to remain low, additionally supported by the continued expansionary monetary policy of the CNB. Pursuant to this year's T-bill issuance calendar, the Government intends to roll-over all issues at maturity.

As for Croatian eurobonds and their movements in the secondary market, Q2 was relatively uneventful with the absence of more serious price changes. Regional developments and CEE market sentiment will continue to determine the developments of Croatia's foreign issues in the remainder of the year. The expansive character of the European Central Bank's monetary policy paired with historically low yields will continue to positively affect CEE bonds which will again be reflected in the trends of Croatian issues. A possible narrowing of the spreads will primarily depend on macroeconomic and fiscal developments. Improved fiscal metrics, implementation of reforms and continued economic growth would surely have a positive reflection on the country's credit rating and consequently its risk premium expressed in the spread against the benchmark foreign issues. According to their calendar, Moody's and Fitch will rate Croatia in the middle of July. We expect the country's credit rating and outlook to remain at current levels.

Elizabeta Sabolek Resanović

Croatian Eurobonds*



** bid ytm*
Sources: MoF, Economic RESEARCH/RBA

Croatia's ratings

Agency	Rating	Outlook	Last revision
Moody's	Ba2	Stabile	10.3.2017
Fitch	BB	Stabile	27.1.2017
S & P	BB	Stabile	16.12.2016

** LT debt in FCY*
Sources: Eurostat, Economic RESEARCH/RBA

Government bonds in domestic market

Bond	Currency	Volume (mn)	Maturity	Coupon (%)	YtM (ask, %) 4.7.17	Spread to Bund 4.7.17	Spread to EUROSWAP 4.7.17	YtM (ask, %) 31.12.16	YtM (ask, %) 30.6.16	YtM (ask, %) 31.12.15
RHMF-O-19BA	EUR*	1.000	29.11.19	5.375	0.70	175	127	1.05	1.63	2.44
RHMF-O-203E	EUR*	1.000	5.3.20	6.500	0.91	176	127	1.18	1.63	2.49
RHMF-O-227E	EUR*	1.000	22.7.22	6.500	1.73	211	165	2.41	3.22	3.49
RHMF-O-247E	EUR*	1.400	10.7.24	5.750	2.47	258	127	2.73	3.37	3.81
RHMF-O-17BA	HRK	4.000	25.11.17	6.250	0.10	–	–	0.86	1.19	1.97
RHMF-O-187A	HRK	6.000	10.7.18	5.250	0.18	–	–	1.01	1.64	2.23
RHMF-O-203A	HRK	5.000	5.3.20	6.750	1.05	–	–	1.57	2.13	2.73
RHMF-O-217A	HRK	6.000	8.7.21	2.750	1.72	–	–	2.00	–	–
RHMF-O-222-A	HRK	3.000	7.2.22	2.250	1.94	–	–	–	–	–
RHMF-O-257A	HRK	6.000	9.7.25	4.500	2.56	–	–	2.91	3.53	3.87
RHMF-O-26CA	HRK	10.000	14.12.26	4.250	2.73	–	–	2.91	3.74	3.99
RHMF-O-282-A	HRK	5.500	7.2.28	2.875	2.96	–	–	–	–	–

** indexed to euro; secondary trading, interest and principal payment mid rate of CNB on trading day or maturity day*
Sources: MoF, ZSE, Bloomberg, Economic RESEARCH/RBA

Temporary divergence from positive trends

- **Agrokor crisis negatively affects banks' Q1 operating results**
- **Slight growth in the ratio of non-performing loans declines after 6 quarters**
- **Change in the loan demand structure increases banks' balance sheet imbalances**

The debt crisis in Agrokor halted all positive developments in the financial sector in Q1. Pursuant to the special Act on the Procedure of Extraordinary Administration for Companies of Systemic Importance for the Republic of Croatia, on 10 April the management of Agrokor, the largest privately owned company facing bankruptcy due to insolvency, was surrendered to an extraordinary commissioner. The suspension of claims to be collected from all companies in the Agrokor group for a period of 15 months provided this systemically important debtor a chance to consolidate its operations. As for their creditors, the increased uncertainty regarding the collection of their receivables caused them to set aside loss provisions. This consequently resulted in reduced banking sector profit for Q1, which went down by two thirds from the same period a year ago. Until the end of the year we do not expect a sizeable increase in banks' loss provisions related to their claims on Agrokor. However, the losses from the beginning of the year will negatively affect the projected 2017 banking system profitability rate. Problems in Agrokor negatively affected trends regarding NPLs. After declining by 3.5 pps in the past 6 successive quarters, in Q1 the NPL ratio for all loans increased slightly to 13.9%, while in the corporate segment the same ratio reached a high 28.5%. As the year goes on, the NPL ratio should be positively influenced by the sale of irrecoverable and partly recoverable placements, while negative influences are expected to come from the deterioration in the assessed collectability of claims from Agrokor and commercially affiliated enterprises.

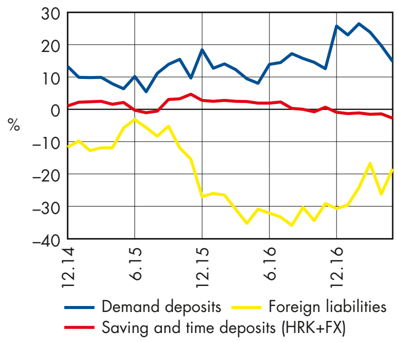
Positive developments in the households segment continued. The growth of consumer optimism, spurred by a general declining trend in interest rates increased demand for loans. The NPLs ratio in the households segment should fall below 10% by the end of this year.

Changes in the preferences of loan users have resulted in rising imbalances in banks' balance sheets. New loans are granted predominantly in HRK, while sources of finance are dominated by FCY deposits (in euros). In contrast to time deposits, dominated by euros, sight deposits are mostly held in HRK. Therefore the rise in the share of sight deposits increases the share of HRK deposits in total deposits thus contributing to the mitigation of banks' balance sheet currency imbalance. At the same time, however, the maturity structure of the balance sheet deteriorated, with sight deposits used to finance long-term loans.

Amid lower interest rates in the market, loan supply adapted. Due to atypical prices of capital in the market, the price of variable interest rates on loans offered by banks does not much differ from fixed interest rates for the medium term. As a result, consumers are faced with attractive long-term loans with fixed interest rates in the medium term followed by a period variable interest rate thereafter. This considerably increases induced credit risk if it comes to a rise in market interest rates. The bank regulator, concerned about these developments, announced the possibility of introducing special measures aimed at reducing the risk on banks' portfolios.

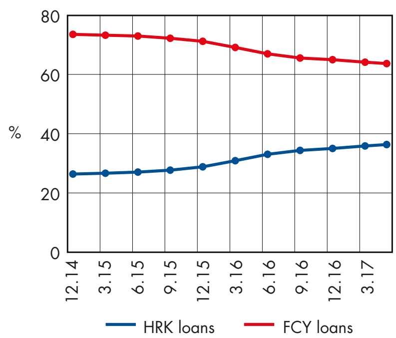
Anton Starčević

Foreign Liabilities and Deposits growth, annual level



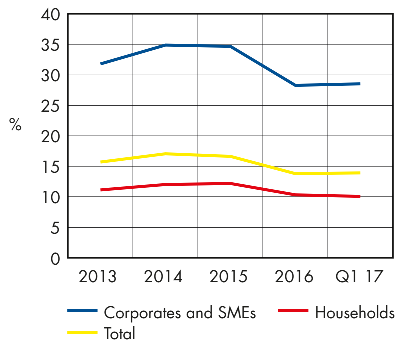
Sources: CNB, Economic RESEARCH/RBA

Loans – currency structure



Sources: CNB, Economic RESEARCH/RBA

NPLs ratio, eop

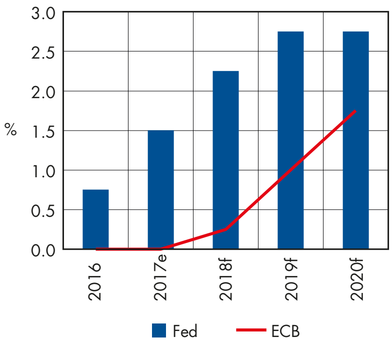


Sources: CNB, Economic RESEARCH/RBA

Divergence of monetary policies continues

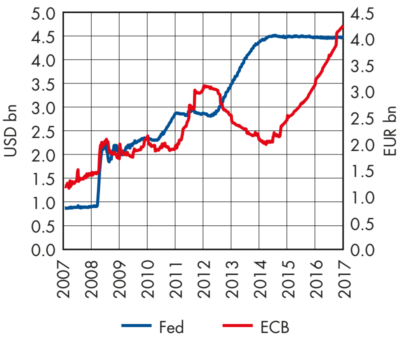
- Fed continues raising its interest rates, balance sheet reduction in sight
- Euro area still waiting for inflation

Key interest rates, eop



Sources: Raiffeisen RESEARCH/RBI, Economic RESEARCH/RBA

Central bank balance sheets



Sources: Bloomberg, RBI/Raiffeisen RESEARCH

US economic indicators and forecasts

	2015	2016	2017f	2018f
Real GDP (% yoy)	2.6	1.6	2.4	2.2
CPI (% yoy)	0.1	1.2	2.2	2.5
CPI core rate (% yoy)	1.8	2.2	2.0	2.4
Unemployment rate (%)	5.3	4.8	4.4	4.0
Employment growth (% yoy)	2.0	1.7	1.5	1.2
Current account balance[1]	–2.6	–2.6	–3.5	–3.5
EUR/USD exchange rate, avg	1.11	1.11	1.08	1.11

1 % of GDP
Sources: Thomson Reuters, Raiffeisen RESEARCH/RBI

As announced at its mid-June meeting, the Fed raised the target range of its key interest rates by 25 basis points to between 1% and 1.25%. At the same meeting the Fed announced one more time it plans to raise its benchmark rate once more by the end of the year. Three new hikes are planned for 2018, each totalling 25 basis points. Since the beginning of the financial crisis, Fed's total assets grew approximately five times. Therefore, in addition to raising interest rates, Fed will start the balance sheet reduction programme. It stopped expanding its balance sheet in October 2014, which was done via an unconventional monetary policy measure of quantitative easing (QE). Briefly, quantitative easing means the purchase of securities (predominantly US government bonds and mortgage-backed securities) with a goal of putting new liquidity in the system in order to spur the economic growth. After the Fed stopped purchasing new bonds, the size of its balance sheet was kept at the same level until today. One of the greatest challenges faced by Fed in the upcoming period will be how to raise interest rates and reduce its balance sheet without creating major turbulences in financial markets. As for the future projections, we think that Fed's policy is, for the most part, transparent and that it is reasonable to rely and act in accordance with its announcements. It is in the Fed's best interest to make public expectations coincide with their objectives because this makes the implementation of monetary policy much easier. As a result, the best way to asses the future course of the US monetary policy is to rely on what has been clearly and explicitly communicated by the Fed itself. The same is true for the ECB.

The euro area monetary policy in Q2 registered fewer changes. At the ECB forum at the end of June, Mario Draghi stressed that the normalisation of the monetary policy, that is, the gradual reduction of the quantitative easing programme, depends on productivity and investments which are paramount for the sustainability of GDP growth rates. Investments leading to the increase in productivity would help create a long and sustainable growth, and the euro area economies would no longer be so dependent on the monetary stimulus currently provided by the ECB. As for the medium-run challenges, Draghi expressed his concerns regarding the slowdown in productivity growth rates and lower investment levels which in turn contribute to the reduction of the already low growth of productivity. The ECB currently faces an unusual situation. Namely, the euro area has undoubtedly recovered from the crisis, as confirmed by growth rates and employment. However, inflation failed to keep pace with the growth and remained at unusually low levels. Accordingly, the reduction in the volume of bond purchases and the increase in interest rates will begin when inflation is at a satisfactory level, bearing in mind that the ECB's main target is "below, but close to, 2% over the medium term". Mario Draghi repeatedly stated that the ECB's monetary policy will take a slow and controlled turn, based exclusively on economic indicators, primarily inflationary developments in the euro area. Tightening of the monetary policy was announced for the first half of 2018 and will take the form of bond purchase reduction. The first increase in the key interest rates can be expected in the last quarter of 2018.

Viktor Viljevac

Focus on inventory drawdown*

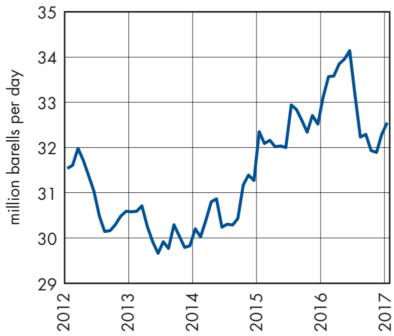
- **OPEC agrees to extend the production cuts by another nine months until the end of March 2018**
- **Oil market should remain undersupplied throughout the second half of 2017**
- **We forecast an increase in the oil price towards USD 60 per barrel of Brent in the third quarter**

At the end of May, the OPEC Member States met in Vienna, to decide on their strategy in relation to the production cap which was decided on at the end of 2016. Ultimately, this meeting did not produce any major surprises. As previously announced, the OPEC members and eleven non-OPEC countries were able to agree on extending the production cuts which had been decided on at the end of 2016 by another nine months until the end of March 2018. The main goal is to reduce the still very well filled global oil storage facilities to the average of the past few years. Since the announcement on extension, the oil price has weakened somewhat. On the one hand, market participants had been hoping that an even higher production cut would be put in place, and on the other hand US shale oil production is growing faster than most people had forecast. We consider the extension of the agreement a reasonable measure from the oil-producing countries' point of view. Assuming that the implementation discipline amounts to at least 90% in the second half of the year, the global oil oversupply ought to decrease by approximately 1 million barrels per day over this period. While the goal of the inventory reduction is unlikely to be completed by the end of the year, the countries involved nevertheless ought to be able to remove the major part of the supply glut. The main underlying unknowns of this scenario are the uncertain extent of US shale oil production growth, the production discipline of OPEC, and the very erratic production development in Libya and Nigeria – the only two countries exempt from the agreement.

In view of the expected reduction of global oil inventories and that the OPEC agreement has been extended, we still expect an oil price increase in the course of the year. From today's perspective, we expect the oil price to be in the range of USD 54 to USD 62 per barrel of Brent for most of the second half of 2017. Furthermore, the extension of the deal beyond the end of 2017 until March 2018 ought to guarantee that no inventory build-up will occur right away in the first quarter when demand is traditionally weak due to seasonal factors. From the current perspective, we expect no further extension of the OPEC agreement beyond March 2018. When it comes to 2018, we forecast the weakest oil price phase for the first two quarters because disappointments could occur in the oil market as early as in the first quarter when we expect the OPEC discipline to deteriorate. For the second quarter of 2018, we anticipate a moderate excess supply – on the one hand, oil demand will likely be approximately 500k barrels per day (bpd) higher than in the previous quarter, but on the other hand, OPEC production will be higher and US shale oil production will very likely enjoy sustained growth. From today's point of view, however, the second half of the year suggests a slight undersupply, which means that the oil price should already be relatively well supported in the first half of 2018 at approximately USD 55 per barrel of Brent. For the second half of the year, we consider a price increase to at least USD 60 per barrel to be realistic.

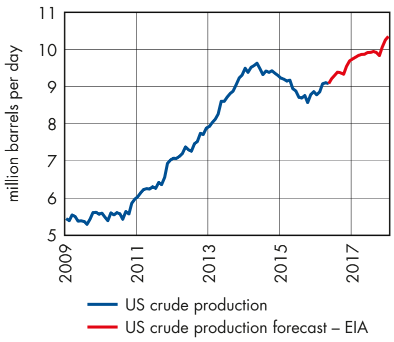
Hannes Loacker, RBI Vienna

OPEC crude production



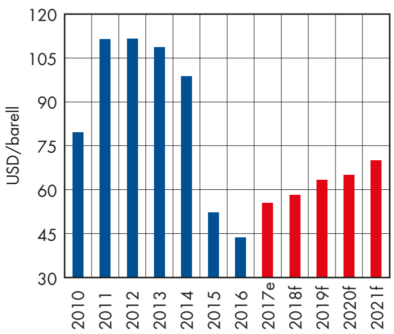
Sources: Bloomberg, RBI/Raiffeisen RESEARCH

US oil production



Sources: Energy Information Administration, RBI/ Raiffeisen RESEARCH

Oil price forecast – Brent*



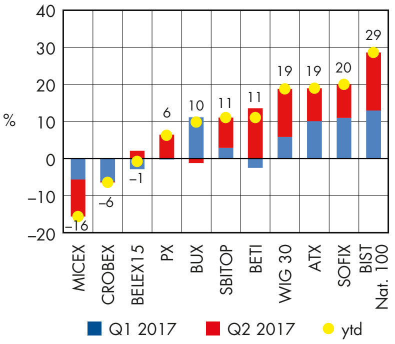
** Year average*
Sources: Thomson Reuters, RBI/Raiffeisen research

* from publication http://www.rbinternational.com/eBusiness/services/resources/media/829189266947841370-829189181316930732-1253070885932646742-1-2-EN.pdf

Provisions expected to affect earnings and dividends in 2017

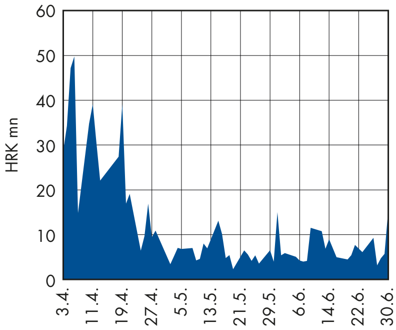
- Majority of CEE indices posted two-digit gains ytd
- Agrokor restructuring slashed both CROBEX and turnover on the ZSE
- Provisions related to Agrokor expected to impair 2017 earnings as well as dividends for companies with an exposure

CEE indices – returns*



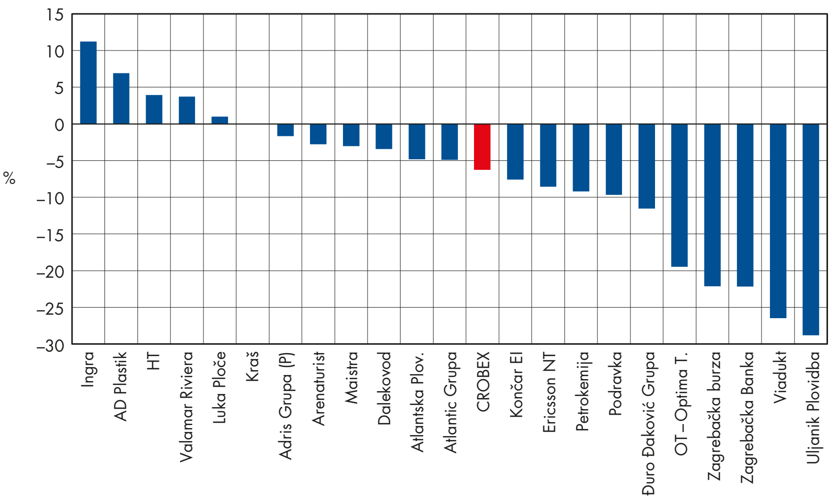
* In local currency, value on 30.6.2017 (6:30 PM)
Sources: Bloomberg, Economic RESEARCH/RBA

Equity turnover



Sources: ZSE, Economic RESEARCH/RBA

Return of CROBEX constituents in Q2 2017 (dividends not included)*



* Return calculated as on 30.6.2017 (6:30 PM)
Sources: ZSE, Economic RESEARCH/RBA

For the most part, CEE indices headed by the Turkish BIST Nat. 100 grew more than the leading European and US equity indices in the past quarter. Corporate earnings have been on the rise globally, while the growth of economic indicators might initiate discussions regarding the beginning of a turnaround in the policy of the European monetary authorities[1]. As for the development in the political arena, it is not expected to significantly affect the regional capital markets since no significant changes are expected over the upcoming elections in Germany and Austria. However, despite these stimulating factors, trading over the summer, when indices in the region traditionally yield poor returns, is expected to be cautious.

Similar influences on the capital market were registered in Croatia as well: earnings growth, nice economic indicators and lively political arena. However, the Agrokor problem, apart from burdening share prices of companies with an exposure, led to the sinking of regular turnover after the suspension of trading with Ledo and Jamnica shares. This triggered CROBEX to drop by 6.2% in Q2 and sank regular turnover to average of merely HRK 6.6m per day after shares of Ledo and Jamnica were suspended.

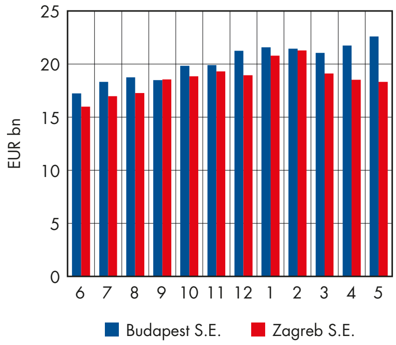
Triggered by further shrinking of equity turnover on the ZSE, we compiled a short comparative analysis with the trading on the Budapest Stock Exchange (BSE) which greatly resembles the ZSE by the equity market capitalisation as well as the implemented pension reform but has twice as high turnover. Around 90% of the turnover is accounted for by three shares: OTP, MOL and Gedeon Richter, which account for some 86% of the total equity market capitalisation on the BSE. This means that the shares of the three largest companies are the most traded. The distribution on the ZSE is greater, so that nine largest companies account for 73% of the total equity market capitalisation which participate by mere 38% in the total equity turnover because most of the largest companies have majority owners and small free-float (INA, Zagrebačka Banka and Privredna Banka Zagreb). Furthermore, even the shares with the greatest turnover turn only 3% to 6.6% of their market capitalisation over the year, while the three leading Hungarian stocks boast the same range but on a monthly level. This leads us to conclude that turnover on the ZSE is attributed to shares of smaller companies traded on a less frequent basis since the stocks are mostly unknown to international investors in comparison with trading on the BSE.

The dividends of most liquid stocks announced so far rose by 16% yoy in aggregate terms which we link to the growth in earnings. The analysis of 2016 results of 114.483 companies, carried out by FINA[2], showed that consolidated net profit grew by 38% yoy. Our analysis of the largest companies whose shares are traded on the ZSE (excluding banks and companies from Agrokor group) indicates that more than 50% of companies achieved a growth of net profit in 2016 yoy and a similar trend continued in Q1 2017.

Although the tourism season has not reached its peak yet, current booking and visitor stats give rise to optimism already in Q2. Given that all eyes are on the results of the peak season, not only because of tourism companies but also because of the sales in Agrokor's retail network on which many claims collections are dependant, the results of a sizeable number of companies in 2017 will be closely related to the success of the tourism season. Although the largest creditors and suppliers have published their exposures to Agrokor, only few made provisions so far. Therefore, we expect that provisions could impair corporate earnings in 2017 while we reckon some provisioning could be deferred to 2018 when the settlement is to be completed. Apart from these one-off provisions, F&B companies might register lower margins due to promotional sales to other retail chains and higher costs of expansion to new markets. In addition, the shortage of seasonal workers might be reflected in the results of tourism companies as pressure on the operating margin. On the other side, upgraded accommodation capacities and new products offered could result in higher revenues and profitability. The same applies to construction companies, engaged on many tourism related sites that are short of workers. Valamar Riviera published its investments plan until 2020, worth HRK 2bn, while Adris Group plans to invest the same amount in tourism operations by 2021. This implies that the investment cycle is still in a full swing. Following the consolidation of telecoms, synergies could boost profitability. Whether the F&B sector will undergo a consolidation after potential Agrokor's restructuring it remains to be seen.

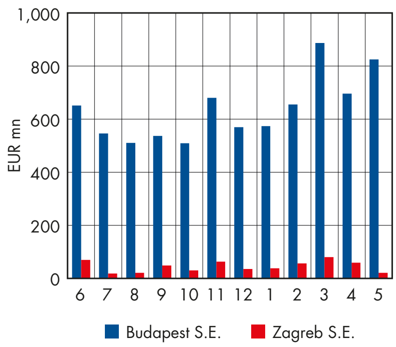
Nada Harambašić Nereau

Market capitalisation of equities



Sources: BSE, ZSE, Economic RESEARCH/RBA

Equity turnover



Sources: BSE, ZSE, Economic RESEARCH/RBA

Companies' results and dividends

In HRK	Net income/loss per share		Dividend per share	
	2015	2016	2015	2016
Ad Plastik	10.6	11.9	12.0	8.5
Adris Grupa	122.6	27.2	15.0	17.0
Arena H.G.	3.7	–22.3	–	–
Atlantic Grupa	72.7	48.8	13.5	13.5
Atlantska Plovidba	–168.4	–67.9	–	–
Croatia Osiguranje	250.4	409.2	–	–
Dalekovod	1.1	1.5	–	–
Đuro Đaković Grupa	–7.9	–4.5	–	–
Ericsson N.T.	68.7	83.2	100.0	90
Hrvatski Telekom	11.3	11.3	6.0	6.0
Hup–Zagreb	132.3	182.1	15.0	16.0

In HRK	Net income/loss per share		Dividend per share	
	2015	2016	2015	2016
Ina	–141.8	10.1	–	15.2
Ingra	5.2	0.1	–	–
Institut IGH	–116.5	–94.6	–	–
Jadranski Naftovod	201.8	288.8	132.2	165.0
Jadroplov	–96.9	–59.5	–	–
Končar–El	48.8	55.7	12.0	12.0
Kraš	11.1	19.5	–	8.0
Liburnia R.H.	0.3	42.6	–	–
Luka Ploče	74.7	–42.6	–	–
Luka Rijeka	0.2	0.5	–	–
Maistra	10.0	12.8	–	–

In HRK	Net income/loss per share		Dividend per share	
	2015	2016	2015	2016
Petrokemija	–7.3	–6.8	–	–
Plava Laguna	220.0	325.0	1.0	–
Podravka	57.3	26.2	7.0	7.0
Tankerska N.G.	4.0	4.6	4.0	1.6
Tehnika	3.0	4.9	–	–
Uljanik Plovidba	–857.6	–80.2	–	–
Valamar Riviera	0.8	2.8	0.6	0.8
Viadukt	6.5	–806.8	–	–
Viro T.Š.	3.4	41.5	–	–
Optima Telekom	0.2	0.2	–	–
Granolio	5.9	1.3	0.5	–

Sources: ZSE, Economic RESEARCH/RBA

1 http://www.rbinternational.com/eBusiness/services/resources/media/829189266947841370-829189181316930732-1253070885932646742-1-2-EN.pdf
2 Source: www.poslovni.hr (http://www.poslovni.hr/hrvatska/hrvatskim-poduzetnicima-dobit-rasla-cak-38-posto-328308).

Raiffeisenbank Austria d.d. Zagreb

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, email: elizabeta.sabole-resanovic@rba.hr
Viktor Viljevac; tel: +385 1/61 74 873, email: viktor.viljevac@rba.hr

Financial Advisory
Nada Harambašić Nereau, MSc, Financial Analyst; tel: + 385 1/61 74 870, email: nada.harambasic-nereau@rba.hr
Ana Turudić, Financial Analyst; tel: +385 1/61 74 401, email: ana.turudic@rba.hr

Anton Starčević, MSc, CEO Advisor; tel: +385 1/61 74 338, email: anton.starcevic@rba.hr

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

Editor
Zrinka Živković Matijević, MSc, Head of Economic Research

Abbreviations

avg – period average
bn – billion
BSE – Budapest Stock Exchange
C/A – current account
CBS – Croatian Bureau of Statistics
CE – Central Europe
CEE – Central and Eastern Europe
CHF – Swiss Franc
CNB – Croatian National Bank
CPI – Consumer Price Index
CPII – Croatian Pension Insurance Institute
e – estimate
EBITDA – Earnings before interest, taxes, depreciation and amortization
EC – European Commission
ECB – European Central Bank
EDP – Excessive Deficit Procedure
EE – Eastern Europe
EIA – Energy Information Administration
eop – end of period
ESA – European System of Accounts
EU – European Union
EUR – Euro
Eurostat – Statistical Office of the European Union
f – forecast
FCY – Foreign Currency
Fed – Federal Reserve System
FX – foreign exchange
GBP – British Pound
GDP – gross domestic product
GFCF – Gross fixed capital formation
H – half
HRK – Croatian Kuna
ILO – International Labour Organization
LCY – Local Currency
M, m – month
mm – money market
mn – million
MoF – Ministry of Finance
NPL – non-performing loan
OPEC – Organization of the Petroleum Exporting Countries
PM – Prime minister
pp – percent point
Q – quarter
QE – quantitative easing
r.h.s. – right hand scale
RBA – Raiffeisen bank
RBI – Raiffeisen Bank International
SEE – Southern and Eastern Europe
SMEs – Small and medium-sized enterprises
USA – United States of America
USD – US Dollar
VAT – value added tax
y – year
yoy – year on year
Ytd – yield to date
YtM – yield to maturity
ZIBOR – Zagreb Interbank Offered Rate
ZSE – Zagreb Stock Exchange

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

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

Publication finished on July 5, 2017
Publication approved by editor on July 13, 2017 at 09:00
First release scheduled for July 13, 2017 at 10:15

Disclaimer

Published by Raiffeisenbank Austria d.d. Magazinska cesta 69, 10000 Zagreb, Hrvatska ("RBA"). RBA is a credit institution and is has been incorporated in keeping with the Credit Institutions Act.

Economic Research and *Financial Advisory* are organizational units of RBA.

Supervisory Authority: Hrvatska agencija za nadzor financijskih usluga, Miramarska 24b, 10 000 Zagreb (Croatian Financial Services Supervisory Agency) and Hrvatska narodna banka, Trg hrvatskih velikana 3, 10 002 Zagreb (Croatian National Bank).

This publication is for information purposes only and may not be reproduced, translated, distributed or made available to other persons other than intended users, in whole or in part, without obtaining prior written permission of RBA on a case to case basis. This document does not constitute any kind of investment advice or a personal recommendation to buy, hold or sell financial instruments and it is neither an offer nor a solicitation of an offer. This document is not a substitute for any form of a legal document which is required pursuant to regulations of any state, including the Republic of Croatia, for a primary issue or secondary trading in financial instruments, regardless of whether investors are classified as retail or professional investors and regardless of whether they are entities or residents of the Republic of Croatia or of any other jurisdiction.

This publication is fundamentally based on generally available information, which we consider to be reliable, but we do not make any representation, warranty or assurance as to accuracy, completeness or correctness of such information. All analyses contained in this publication are based solely on generally available information and on assumption that the information is complete, true and accurate, which may not necessarily be the case, and, for the user, they involve risks related to issuer, capital market, general economic and political environment and prospects. The estimates, projections, recommendations or forecasts of future events and opinions expressed in this publication constitute independent judgement made by analysts as at the date of publication, unless explicitly otherwise stated. The following sources were material for the preparation of this publication: the Croatian Bureau of Statistics, the Croatian National Bank, the Government of the Republic of Croatia, the Croatian Employment Service, the Croatian Pension Insurance Institute, the Ministry of Finance, the Croatian Financial Services Supervisory Agency, the Zagreb Stock Exchange, the Institute of Economics, Bloomberg, Eurostat, the Vienna Institute for International Economic Studies and other sources which are expressly stated in the analysis.

RBA is under no obligation to keep current the contents of this publication and reserves the right to withdraw or suspend them in whole. The publication of an up-to-date revised analysis, if any, shall be made at the discretion of analysts and RBA. In case of any modification or suspension of the contents of this publication, RBA shall publish the notice of modification or suspension, and information regarding the circumstances which lead to the modification or suspension of this publication, in the same manner as this publication, with a clear reference to the fact that the modification or suspension apply to this publication.

This publication does not purport to be and does not constitute a basis for making any investment decision and all users are advised to seek additional expert advice and information to the extent they deem necessary, before making any investment decision.

The prices of financial instruments mentioned in this publication are the closing prices available at 16:30 CET on the day which precedes the date of this publication, unless stated otherwise in the publication.

Investment options discussed in this publication may not be appropriate for certain investors, depending on their specific investment objectives and investment time horizon, and taking into account their overall financial situation. Investments which are the subject of this publication may vary in price and value. Investors may generate returns which are below their initial capital investment. Exchange rate changes may adversely affect the investment value. Besides, past performance is not indicative of future results whatsoever. Risks arising from investment in financial instruments, financial products or investment instruments which are the subject of this publication are not explained in whole or in full detail. Information is provided "as is" without giving warranties of any kind and may not be deemed to substitute any investment advice. Investors have to make independent decision regarding the appropriateness of investment in any instruments discussed or mentioned in this document, based on risks and benefits resulting from such instruments, and on their investment strategy and legal, fiscal and financial position. As this publication is not personal recommendation for investment, neither it and nor any of its components, forms a basis for conclusion of any kind of deal, contract or commitment whatsoever, nor should it be relied upon or used as an incentive for or in connection with such actions. Investors are advised to seek specific detailed information and advice from competent certified investment advisors.

RBA, Raiffeisen Bank International AG ("RBI"), and any other company connected with them, including their directors, authorized representatives or employees, and any other party, do not accept any responsibility of liability arising in any way (whether due to negligence or otherwise) for any damages or losses whatsoever which result from the use of this publication or its contents or which may otherwise be caused in connection with this publication.

This publication is disseminated to investors who are expected to make independent investment decision and estimates of investment risks, including issuer risk, capital market risk and risks related to economic and political circumstances and prospects, without placing undue reliance on this publication, and this publication shall not be distributed, reproduced or published in whole or in part for any purpose, without RBA's permission.

RBA publishes financial instrument valuation and analyses independently or as part of publications which are created and distributed by RBI and Raiffeisen Centrobank, Austria ("RCB") under the name Raiffeisen ISTRAŽIVANJA. The analyses may relate to one or more issuers, and to financial instruments issued by them.

Unique criteria for issuance of stock market recommendation (rating) and risk classification are defined as follows:

"Buy": for stocks which have an expected total return at least 10% (15% for stocks with high volatility risk) and represent the most attractive stocks among all stocks we analyze and valuate over next 12 months

"Hold": for stocks for which we expect a positive return up to 10% (up to 15% for stocks with high volatility risk) over next 12 months.

"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.

Target prices are based on calculated fair value which is derived by applying relative valuation tools (peer group analysis) or discounted cash flow DCF method. Detailed information on specific valuation methods applied is available at: https://www.rcb.at/en/the-bank/business-segments/cr/concept-and-methods/

When publishing the analyses, ratings are determined by applying above mentioned ranges. Temporary deviations from the aforementioned ranges will not automatically result in the alteration of a recommendation, and the respective recommendation will be placed under review instead.

Opinions concerning Croatian money market rates and price fluctuations of government bonds issued in the Republic of Croatia are based on the analysis of market ratio movements.

This publication is not an offer or a personal recommendation to buy or sell a financial instrument. Information presented here does not constitute a comprehensive analysis of all material facts related to issuer, industry or financial instrument. This publication may contain expectations and forward-looking representations, which involves risks and uncertainties, however, they are not a warranty or indication of future results whatsoever and are therefore subject to change. Therefore, no warranty or representation, whether express or implied is made and no reliance should be placed on the fairness, accuracy, completeness or truth of information and views provided in this publication.

RBA analysts are involved in production of recommendations published and distributed by RCB, regarding the companies listed below along with the date of initial recommendation:

Adris Grupa d.d. (21.01.2005.), Atlantic Grupa d.d. (8.6.2015.), Ericsson Nikola Tesla d.d. (18.01.2005.), Hrvatski Telekom d.d. (11.12.2007.), Ledo d.d. (13.10.2015.), Podravka d.d. (3.3.2003.) i Valamar Riviera d.d. (17.12.2015.).

Overview of Raiffeisen recommendations:

	Buy	Hold	Reduce	Sell	Suspended	Under review
No. of recommendations	1	4	1	0	1	0
% of all recommendations	14%	58%	14%	0%	14%	0%
Investment banking services	0	0	0	0	0	0
% all IB services	0%	0%	0%	0%	0%	0%

A list of all historic recommendations for stock coverage, local money market rates in the Republic of Croatia, Croatian government bonds issued in the local markets and other recommendations is available at: http://www.rba.hr/istrazivanja/povijest-preporuka

Please note that RBA, its related companies, employees, executives and other persons who participated in the preparation of this publication, and their related persons, may hold or trade in financial instruments in excess of 0.5% of the issuer's equity stake or deal with entities from the industries discussed in this publication. However, by applying confidentiality protection and conflict of interest prevention measures RBA has ensured to a reasonable extent that this circumstance has not in any way affected anything that is mentioned in this publication.

RBA is part of RBI Group. RBI is a business investment bank domiciled in Austria. For 25 years RBI has been active in Central and Eastern Europe (CEE region) where it operates a network of subsidiary banks, leasing companies and numerous other companies which provide financial services in 17 markets. As a result of its position in Austria and CEE, RBI has established relationship, or expanded them in some cases, with companies in the following industries: oil & gas, technology, energy, real estate, telecommunications, financial services, core materials, cyclical and non-cyclical consumer goods, healthcare and industry. RBI and/or its related companies executed transactions related to products and services (including, but not being limited to, investment banking services) with the issuer mentioned in the analysis during the past 12 months. RBI and related companies have set up organizational measures which are required from the legal and supervisory point of view, and the implementation of the measures is monitored by the Compliance. Conflicts of interest are subject to application of legal, physical and other restrictions (referred to collectively as the Chinese Walls), the purpose of which is to contain the flow of information between business lines/organizational units within RBI, RBA, RCB and other group members. So for instance, Investment Banking, which comprises corporate funding activities through capital markets is separated by physical and other barriers from the front office and from research and analysis units.

Potential conflicts of interest listed below will apply to financial instruments discussed in the analysis if their respective numbers are indicated at the end of the chapter:

1. RBA or any related company or any private individual involved in the publication of this document owns a net long or short position exceeding the threshold of 0,5% of the total issued share capital of the issuer.
2. Holdings of the issuer in the total issued share capital of the RBA or any related company exceed 5%.
3. RBA or any related company or any individuals involved in the publication of this document hold significant financial interests in relation to the issuer.
4. RBA or any related company act as market maker or liquidity provider in the financial instruments of the issuer, where applicable.
5. RBA or any related company has been lead manager or co-lead manager over the previous 12 months of any publicly disclosed offer of financial instruments of the issuer, in terms of underwriting the offer or sale of financial instruments of the issuer with or without repurchase, where applicable.
6. RBA or any related company is party to any other agreement with the issuer relating to the provision of investment banking services, provided that this would not entail the disclosure of any confidential commercial information and that the agreement has been in effect over the previous 12 months or has given rise during the same period to the payment of a compensation or to the promise to get a compensation paid, where applicable.
7. RBA or any related company or any individuals involved in the publication of this document is party to an agreement with the issuer relating to the production of the recommendation, where applicable.
8. Analysts or any individuals involved in the publication of this document hold the financial instruments of the issuer which he or she has analyzed.
9. Analysts or any individuals involved in the publication of this document sit on the Supervisory Board/Board of Directors of the issuer analyzed by him or her.
10. Analyst or any individuals involved in the publication of this document have received or acquired the financial instrument of the issuer prior to the public offering of the issue. In this case the transaction has to be pre-approved at a disclosed date and buy or sell price.
11. The remuneration of analysts or any individual involved in the publication of this document is tied to the provision of investment banking service by RBA or any related company.

Applicable notes: Note 3, 4 and 5.

Portfolios of analysts and other individuals who participated in the creation of this analysis are available at: http://www.rba.hr/istrazivanja/portfelj-rba-analiticara

Analyst statement: Remuneration of the analyst is and shall not be tied, directly or directly, to the recommendations or views presented in this publication, nor shall it depend on executed transactions.

RBA employee who has not been involved in the preparation of this publication, but had access to it, prior to its distribution, has no significant financial interest in one or more financial instruments of the issuers discussed in the publication. RBA employee who has not been involved in the preparation of this publication, but had access to it, prior to its distribution, is not deemed to be in the conflict of interest in relation to the issuer discussed in the publication.

RBA has received license from the Croatian Financial Services Supervisory Agency ("HANFA") for performance of all activities governed by the relevant Capital Markets Act and other applicable rules and regulations. However, RBA is only authorized to perform these activities on the territory of the Republic of Croatia and not elsewhere. In case this publication or any part of it should become available in any jurisdiction other than the Republic of Croatia, it should be deemed to be nonexistent.

SPECIAL REGULATIONS FOR THE UNITED KINGDOM OF GREAT BRITAIN AND NORTHERN IRELAND (UK): This document does not constitute either a public offer in the meaning of the Austrian Capital Market Act (Kapitalmarktgesetz; hereinafter "KMG") nor a prospectus in the meaning of the KMG or of the Austrian Stock Exchange Act (Börsegesetz). Furthermore, this document does not intend to recommend the purchase or the sale of securities or investments in the meaning of the Austrian Supervision of Securities Act (Wertpapieraufsichtsgesetz). This document shall not replace the necessary advice concerning the purchase or the sale of securities or investments. For any advice concerning the purchase or the sale of securities of investments kindly contact your RAIFFEISENBANK. This publication has been either approved or issued by RBI in order to promote its investment business. Raiffeisen Bank International AG ("RBI"), London Branch is authorised by the Austrian Financial Market Authority and subject to limited regulation by the Financial Conduct Authority ("FCA"). Details about the extent of its regulation by the FCA are available on request. This publication is not intended for investors who are Retail Customers within the meaning of the FCA rules and shall therefore not be distributed to them. Neither the information nor the opinions expressed herein constitute or are to be construed as an offer or solicitation of an offer to buy (or sell) investments. RBI may have affected an Own Account Transaction within the meaning of FCA rules in any investment mentioned herein or related investments and/or may have a position or holding in such investments as a result. RBI may have been, or might be, acting as a manager or co-manager of a public offering of any securities mentioned in this report or in any related security.

SPECIFIC RESTRICTIONS FOR THE UNITED STATES OF AMERICA AND CANADA: This document may not be transmitted to, or distributed within, the United States of America or Canada or their respective territories or possessions, nor may it be distributed to any U.S. person or any person resident in Canada, unless it is provided directly through RB International Markets (USA) LLC ("RBIM"), a U.S. registered broker-dealer, and subject to the terms set forth below.

SPECIFIC INFORMATION FOR THE UNITED STATES OF AMERICA AND CANADA: This research document is intended only for institutional investors and is not subject to all of the independence and disclosure standards that may be applicable to research documents prepared for retail investors. This report was provided to you by RB International Markets (USA) LLC (RBIM), a U.S. registered broker-dealer, but was prepared by our non-U.S. affiliate Raiffeisen Bank International AG (RBI). Any order for the purchase or sale of securities covered by this report must be placed with RBIM. You can reach RBIM at 1133, Avenue of the Americas, 16th floor, New York, NY 10036, phone +1 212–600–2588. This document was prepared outside the United States by one or more analysts who may not have been subject to rules regarding the preparation of reports and the independence of research analysts comparable to those in effect in the United States. The analyst or analysts who prepared this research (i) are not registered or qualified as research analysts with the Financial Industry Regulatory Authority ("FINRA") in the United States, and (ii) are not allowed to be associated persons of RBIM and are therefore not subject to FINRA regulations, including regulations related to the conduct or independence of research analysts.

The opinions, estimates and projections contained in this report are those of RBI only as of the date of this report and are subject to change without notice. The information contained in this report has been compiled from sources believed to be reliable by RBI, but no representation or warranty, express or implied, is made by RBI or its affiliated companies or any other person as to the report's accuracy, completeness or correctness. Securities which are not registered in the United States may not be offered or sold, directly or indirectly, within the United States or to U.S. persons (within the meaning of Regulation S under the Securities Act of 1933 ["the Securities Act"]), except pursuant to an exemption under the Securities Act. This report does not constitute an offer with respect to the purchase or sale of any security within the meaning of Section 5 of the Securities Act and neither shall this report nor anything contained herein form the basis of, or be relied upon in connection with, any contract or commitment whatsoever. This report provides general information only. In Canada it may only be distributed to persons who are resident in Canada and who, by virtue of their exemption from the prospectus requirements of the applicable provincial or territorial securities laws, are entitled to conduct trades in the securities described herein.

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-Marktmissbrauchs-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.