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Intesa Sanpaolo  
International Research  
Network

GDP growth has been revised slightly upwards on average in CEE/SEE countries in 2017. Inflation is seen to accelerate, but to remain below targets. Sharp increase in CPI is expected in Egypt after the EGP depreciation.

The business cycle dynamics in the third quarter of 2016 and the most recent high frequency economic indicators in the fourth quarter have supported a slight upward revision of previous growth forecasts for the CEE/SEE countries with ISP subsidiaries, to 3.2% on average in 2016 (from 3.1% projected in September) and to 3.1% in 2017 (from the previous 2.9%). The slight deceleration from 2016 to 2017 is due to a more moderate pace in Romania in 2017, after the exceptional performance in 2016; but growth is forecast to accelerate in all the other countries.

The recent strong PMI data for both the manufacturing and services sectors continue to support our view of an economy returning to growth in Russia in 2017, with GDP forecast seen to increase by 1%. In Egypt, higher inflation and interest rates following the shift in the currency regime and the sharp depreciation in the EGP are expected to have some negative impact on growth in the short term (GDP is expected to decelerate at 4% in the FY 2016/2017), but to improve GDP prospects in the medium and long term, with annual growth moving towards 5%.

CEE/SEE countries are forecast to turn from negative (-0.5% on average in 2016) to positive inflation rates (+1.7% in 2017), driven (externally) by oil price recovery and (internally) by generally improved labour market conditions, while remaining, however, below central bank targets. In this context and taking into account the ECB's decisions to prolong the asset purchase programme to December 2017 and to keep interest rates unchanged well beyond the APP, monetary policies among the banks of the region are forecast to stay easy next year.

Long-term rates are seen to move upwards due instead to higher inflationary expectations and contagion effects from rising yields on US Treasury Bonds in response to the looser fiscal and tighter monetary policies, anticipated once President-elect Trump takes office. Exchange rates are forecast to be quite stable against the Euro and to depreciate against a stronger USD.

In the CIS area, in Russia and Ukraine, inflation within target by year-end and still declining in 2017 should support new rate cuts in 2017. In Egypt, after the significant depreciation occurred to the EGP, inflation is forecast to increase significantly in 2017 (27% on average, with risks mostly to the upside), suggesting that the CBE will be cautious before starting to cut rates back.

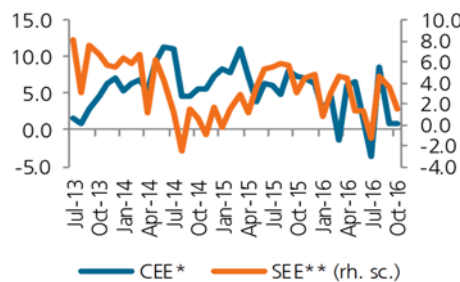
Regarding banking aggregates, lending is expected to show only weak signs of recovery in the CEE/SEE banking, supported by positive real economic improvements. In 2016 in Slovenia, Hungary and Croatia, credit growth rates are forecast to remain negative - mainly due to the ongoing process of portfolio restructuring at banks and, in the latter two countries, to the *ad hoc* measures undertaken to tackle the Swiss franc appreciation issue - before turning positive in 2017. In all the countries except Croatia (because of NPLs selloff) loan growth rates are indeed projected to move into positive territory in 2017. Deposit growth is generally expected to accelerate in all the countries and to continue to remain above the loan growth dynamics, even if partially affected, in some cases, by stronger competition by investment funds. The loans/GDP and the loans/deposits ratios are forecast to decline further, along with a rebalancing between internal vs external bank funding. In a context of prolonged low monetary rates and stronger banking competition, bank interest rate spreads are projected to narrow further.

Industrial production % y/y – CIS - Egypt



Sources: National Statistics Offices; note \* weighted average on Russia and Ukraine data

Industrial production % y/y – CEE - SEE



Sources: National Statistics Offices; note \* weighted average on Slovakia, Slovenia and Hungary data; \*\* weighted average on Bosnia, Croatia, Romania and Serbia data

The figures in this document have been updated to 12<sup>th</sup> December 2016.  
See the final page for important information.

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This note has been coordinated by Gianluca Salsecci. The names of the authors are reported in the single sections.

The note considers the countries with Intesa Sanpaolo Subsidiaries and in particular: Slovakia, Slovenia and Hungary among CEE Countries, Albania, Bosnia, Croatia, Serbia and Romania among SEE Countries, Russia and Ukraine among CSI Countries and Egypt among MENA Countries.

## Cross Country Analysis

### Recent developments

In the third quarter of 2016, the **GDP dynamic** was broadly in line with expectations in the countries with ISP subsidiaries in the **CEE/SEE region**, with some differences among the two sub-regions and among countries. In the CEE area, in Slovakia, Slovenia and Hungary, GDP still grew at significant rates (3.0% y/y, 2.7% y/y, and 2.2% y/y, respectively), though slightly below the performance in the first semester (3.6%, 2.6% and 2%, respectively). However, high frequency indicators support forecasts of re-acceleration in Q4 and in 2017. Industrial production growth in Slovakia (3.4% y/y in October) and Slovenia (7.4% y/y in September) was actually stronger with respect to the average of the previous three months. Surprisingly, it recorded a negative performance in Hungary in October (-2.1% y/y), where, however, the manufacturing PMI rose again to 56.6, moving close to the high for the year (57.2 in September). In the same month, the ESIs in Slovakia and Slovenia also improved, moving closer to the historical highs of 2016.

In the **SEE countries**, the business cycle consolidated further in 3Q, pushing GDP growth in the first nine months of 2016 above previous expectations. It accelerated in Serbia (2.6% y/y in 3Q after 1.9% in 2Q) and improved in Croatia (2.9%), while in Romania, it decelerated slightly in 3Q to 4.9%, but just in comparison with the extraordinary performance in 2Q (5.9%). For Albania and Bosnia, data on GDP are only available for 2Q (3.2% and 1.4%, respectively). The results were below previous expectations for Bosnia and Herzegovina. In almost all the SEE countries, industrial production remained on a positive trend in September/October.

In October, annual **consumer price inflation** was improving, though it was still negative in Slovakia (-0.3%), but positive in Hungary and Slovenia (1.1% and 0.7%, respectively). It was still negative in most SEE countries (-0.7% in Bosnia, -0.5% in Croatia, and -0.4% in Romania), with the exception of Albania and Serbia, with CPI at 1.5% in both cases. A rising path for inflation is now generally supported by a recovery in energy prices and better labour market conditions.

All the central banks of the CEE/SEE countries with ISP subsidiaries are maintaining easy **monetary conditions** and money market rates remain at historical lows. Long-term rates have nevertheless increased, partly reflecting higher expectations regarding inflation and partly due to contagion effects from US long-term rates, which moved upwards following the US presidential election. Exchange rates appear to be quite stable across the region and CDS have remained broadly in line with the values recorded three months ago.

In the **CIS region**, in **Russia**, real GDP contracted by 0.4% in 3Q, a slightly better performance with respect to the 0.6% fall recorded in 2Q. PMI for the manufacturing sector climbed, however, to a 68-month high in November 2016: it reached 53.6 points *vs* 52.4 points in October 2016, hitting the high last seen in March 2011. In parallel, the Services PMI index rose to 54.7 points in November 2016. November's survey data still highlighted a number of positives for service providers, including quicker expansions of new work, outstanding business and historically subdued inflationary pressures. Annual CPI inflation eased to 5.8% in November. The slowdown in inflation, together with the stronger rouble, sustained by the rise in oil prices, support the view that the RCB will resume its easing cycle next year.

In **Ukraine**, real GDP growth was again positive in 3Q (+1.8%), providing new evidence of an economy on a path of gradually accelerating growth. Annual inflation was 12.1% in November, down slightly from 12.4% in October, moving closer to its year-end target of 12%. The central bank, which has cut policy rates by 800 bps so far this year (to 14%), is expected to resume easing next year. The release of the fourth tranche of the IMF loan to Ukraine, originally scheduled for December, is now expected to be delayed to January/February of next year, as the government is struggling to carry out the reform programme sponsored by the Fund.

In **Egypt**, non-oil business forward-looking indicators contracted in November, to a 40-month low, according to the PMI. November's reading of 41.8 was the third lowest since the series

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Economic growth continued in the CEE and consolidated in the SEE area in 3Q16

In CIS countries, growth scenarios continue to improve, inflation to slow

In Egypt, inflation jumped after the EGP depreciation

began in May 2011, and was far below the 50 threshold. Among the worst performing segments were input costs, which have increased almost every month in the last year. At the beginning of November, the ECB shifted to a regime of free floating currency. This move was aimed to reverse the fall in fx reserves, to close the large gap between the official and unofficial exchange rates, and to remove the shortage of foreign currency in the market that penalised economic activity. The foreign exchange liberalisation was also one of the reforms agreed in the adjustment programme with the IMF which in November approved a 12bn USD Extended Fund Facility for Egypt. The announcement regarding the new exchange rate regime led to a sharp depreciation of the pound (EGP/USD over 18 compared to 8.9 previously) and added to inflationary pressures (the annual rate jumped to 19.4% in November and it is expected to rise further over the coming months).

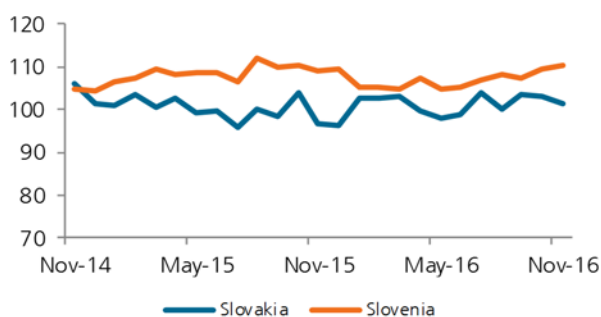
With reference to **banking aggregates**, we highlight different performances in **lending** according to the last available data (as of October, in many cases). In Serbia and Bosnia, we observed a slight deceleration in lending, while in Slovenia – where the corporate sector continues to be particularly fragile – even though the stock of loans contracted, the fall was less intense than in previous months. In Hungary and Ukraine, the improving trend reversed, showing a slight deterioration. The household sectors remain fragile in Hungary and Croatia, while corporates showed a further decline in Slovenia, Hungary, Romania and Croatia.

**Deposits** were resilient in many countries in October, particularly in Romania (+11.2% yoy) and in Serbia (+11.8% yoy), though facing, in several cases (particularly in Slovakia and Croatia), competition from alternative investment products (mainly investment funds). NPL ratios remained high, particularly in Albania and Serbia (both around 20%).

In the CIS area, positive changes in the main banking aggregates still incorporate the effects of exchange rates. In **Russia**, loans rose nominally, by 1.3%, in August, but net of fx effects (that appreciated by more than 2% yoy), they are estimated to have increased by 2%. Russian banks should still benefit from the further key interest rate cut which occurred last September (by 50bp, to 10.0%) supporting a decrease in the cost of funding and stronger demand for new loans. In **Ukraine**, where the banking sector is under stress, loans decreased by 2.5% in October, but net of the fx depreciation, they fell by 8.7%. Deposits increased by 8.1% y/y (but fell by 2.4% net of fx depreciation). Nonperforming loans reached 31% of loans in September, putting further pressures on capital adequacy.

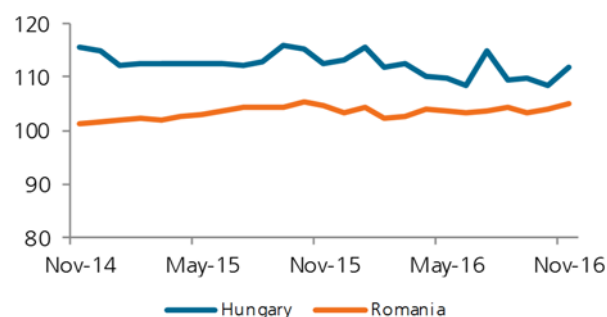
In the last month, **foreign liabilities** continued to decline significantly, both in some CEE countries (in Slovenia, -16%, and in Hungary, -10%) and in some SEE countries (in Croatia, -34%, and in Romania, -14%). Among CEE countries, foreign liabilities continued to grow instead, eg, in Slovakia (+15%), where they have been gradually increasing since February 2015. In **Russia**, they decreased nominally by 16.5%, in September (but fell by 14% y/y net of exchange rate effect). In **Ukraine**, the trend in foreign liabilities in September was negative in nominal terms by 6.5% y/y (and around -30% net of the exchange rate effect).

Economic sentiment indicator



Source: European Commission

Economic sentiment indicator



Source: European Commission

## The International Outlook Underlying the Scenario

**GDP growth and monetary policy in the main advanced countries.** The surprising victory of Donald Trump in the US presidential election is likely to lead to significant changes in economic policy in the US, even if the details on the implementation remain uncertain. Investors are discounting a shift in the US policy mix towards looser fiscal policy and tighter monetary policy, which are expected to lead to faster than previously expected growth, to an upward shift of the interest rate curve, and to a stronger US dollar. These developments are also likely to be supportive of growth in advanced economies, but they have raised some concerns for emerging economies, exacerbating fears regarding more inward-looking US trade and immigration policies.

At its mid-December meeting, the Fed lifted rates by 25 bps, as expected, indicating a path of three further 25 bps hikes next year, with risks now more on the tighter side depending on fiscal policy developments. The effects of the fiscal stimulus on growth should start to be felt starting from the second half of 2017.

The ECB has extended from March to December 2017 its Asset Purchase Programme while reducing from April onwards the monthly volume of purchases from € 80Bn to €60Bn. The decision to extend the monetary stimulus was motivated by a slow recovery of the inflation rate and by persisting uncertainty on the economic outlook. The decision to move the monthly asset purchases back to € 60Bn related instead to largely disappearing deflationary risks (a tapering option has not been discussed yet). The announced APP extension expands the ECB's safety net beyond the packed Euro Area electoral cycle of 2017, in which the Netherlands (March), France (May/June), Germany (end of September) and, perhaps, Italy will hold Parliamentary elections. In these circumstances, money market rates (Euribor 3M) are expected to remain negative in 2017 and well into 2018. The business cycle is expected to recover, but only very gradually.

**Growth and monetary policy in main emerging countries.** Emerging economies have shown a stronger than previously expected dynamic this year, but growth is still expected to stay generally below the averages of the past decade both in 2016 and 2017. Three large economies – among BRICS – have been the main drivers of these developments. In China, monetary policy easing and the fiscal boost have been feeding through, leading to a forecast of 6.7% GDP growth this year and to a decelerated 6.4% in 2017, nevertheless setting aside the fears of a hard landing that dominated the start of this year. Recession in Brazil appears to have bottomed and the economy should return to a growth path in 2017 (+0.8% vs -3.4% expected this year). In Russian, the financial situation has stabilised and the past sharp depreciation of the rouble and the recovery of oil prices have been supporting the economy. After two years of recession, GDP growth is expected to turn positive, albeit showing still-modest values next year.

On the negative side for emerging economies, the above-mentioned prospects for a further tightening in US monetary policy will be a concern for a handful of emerging economies with large current account shortfalls to fund, eg, Turkey and South Africa. At the same time, despite the oil price recovery supported by the recent historical agreement on oil production cuts between OPEC and non-OPEC countries, the economies of oil-producing countries will experience the full effects of restrictive fiscal measures next year adopted to contain public deficits in 2016.

## The Economic Outlook

### GDP growth and inflation

For the whole **CEE/SEE area with ISP subsidiaries**, following the GDP dynamics observed in the first three quarters of this year, and considering the most recent high frequency indicators, the growth forecasts have been revised slightly upwards from the 3.1% expected in September to

**Rates might rise more than previously expected in the US**

**The ECB extends its asset purchase programme amid persisting uncertainty on economic and political outlooks**

**Emerging markets may be negatively affected by tightening US monetary policy and a stronger dollar**

**GDP growth revised slightly upwards in the CEE/SEE regions in 2016. Slight slowdown projected in 2017**

3.2% for full-year 2016, and from the 2.9% expected in September to 3.1% for 2017, and then moving around 3% on average in the following years, as previously expected.

The revised CEE/SEE GDP forecast for 2017 is the result of two different profiles for the CEE and the SEE sub-regions. Among the **CEE countries**, the GDP growth rate is expected to accelerate to 3.0% (in comparison with the 2.7% projected in September) *vs* the 2.5% now expected in 2016. Growth in the CEE region is expected to benefit from the contribution of all countries in the region, thanks to some space left to be exploited in public budgets, to a recovery of private consumption supported by improved labour market conditions, and to a higher contribution with respect to 2016 from EU structural funds.

Among the **SEE countries**, GDP is, in contrast, forecast to decelerate in 2017 to 3.2% (revised nevertheless upwards from the 3.0% projected in September) with respect to the extraordinary 3.7% expected in 2016. The deceleration is expected to occur mainly due to a slowdown in Romania in 2017, after the exceptional GDP performance seen in 2016 (+4.6%), and despite the further acceleration forecast in the economic recovery of all the other countries.

In the **CIS area**, the recent strong PMI data for both the manufacturing and services sectors in **Russia** support our view of an economy returning to growth starting from next year (GDP: +1%). For **Ukraine**, after weaker than previously expected growth from January to September 2016, we trimmed our GDP growth forecast for this year to 1.1%, but we still expect GDP to expand by 2.5% in 2017.

In the MENA region, the adjustment to the new currency regime is expected to have some negative impacts on growth in the short term in **Egypt** (the GDP growth expectation for fiscal year 2016/2017 has been cut to 4%) through higher interest rates and inflation, but, at the same time, to improve growth prospects in the medium/long term, with growth accelerating towards 5%, supported by stronger investments.

**Inflation forecasts** have generally been revised upwards in 2016 for the countries with ISP subsidiaries. The average inflation rate in 2016 is expected to be below zero in Slovakia (-0.4%) and Slovenia (-0.1%) among CEE countries, and in almost all SEE countries with the exceptions of Albania and Serbia (1.3% and respectively 1.1%). In parallel with the Euro Area as a whole inflation is projected to revive in the CEE and SEE regions in 2017, in particular in Hungary and Romania, due to significant base effects, while remaining, however, in most cases still below the lower limits of the ranges set by the respective central banks.

In the CIS area, year-end 2016 inflation targets are expected to be within reach both in **Ukraine** and **Russia**. Inflation is forecast to slow further next year, reflecting, in Russia, the phasing out of past price increases due to rouble devaluation, and, in Ukraine, milder rises in utility tariffs. In **Egypt**, after the large exchange rate depreciation that occurred in November, we have revised our inflation forecasts for next year upwards significantly, with the average and annual rates now projected at 27% and 23%, respectively.

#### Monetary policy and financial markets

The expansionary **monetary policy** anticipated in previous forecasts for 2016 and 2017 is confirmed for the **CEE and SEE regions**. As remarked upon in our September Forecast Note, the forecasts are supported (directly for Slovakia and Slovenia, members of the EA, but also indirectly for the other countries) by the decisions adopted by the ECB to keep current (negative) policy rates unchanged for an extended period of time *and well past the horizon of the Net Asset Purchase* programme and to prolong the QE programme to December 2017, *or beyond if necessary* (as stated in the press release following the Governing Council Meeting of last 8 December). The monetary policy forecast, in addition, is strongly supported by current (and expected) local trends in inflation, which are forecast to accelerate but nevertheless remaining significantly below central bank targets. As a consequence of this, monetary rates are forecast to

**In CIS countries, GDP growth forecast to accelerate ...**

**In Egypt, a boost to GDP from the new currency regime shift in the M/L term ...**

**... and much higher inflation in the short term**

**Monetary policies are forecast to continue to be accommodative in the CEE/SEE regions**

stay negative in Slovakia and Slovenia and below or equal to 1% in all the other countries in 2017 (with the only exception being Serbia, where they are projected to stay around 4%).

For the **CIS area**, money market rates are expected to continue along the downward path started this year, helped by slowing inflation and further progress in financial stabilisation. In the **MENA region**, in **Egypt**, the 300 bps hike in reference rates accompanying the decision to let the exchange rate devalue sharply is expected to be only partially re-absorbed in the second half of 2017, when the inflation rate will likely have reached its peak and the foreign exchange market is showing signs of stabilisation.

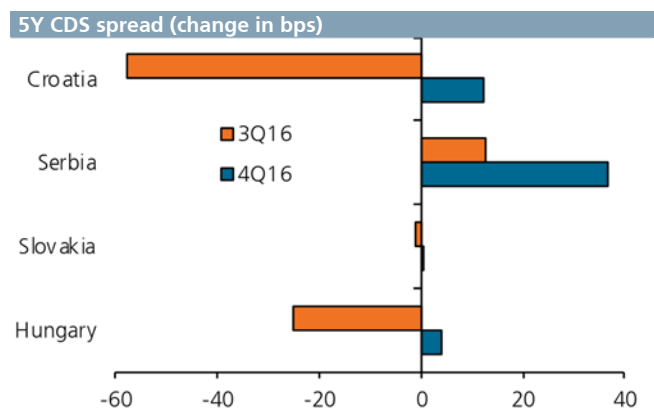
**Long-term rates** are still expected to remain generally low in 2016 in **CEE and SEE countries** – but above the September forecasts – due to some signs of reversals in international inflationary trends and the contagion effect of higher interest rates at the international level (mainly the US). Turbulence that occurred in financial markets following the Brexit referendum mainly affected equity markets (especially banking sector indices) and government bonds, but only slightly and in a transient way. A stronger impact is instead expected to result from the change in the mix of fiscal and monetary expectations following Donald Trump’s victory in the US presidential elections. In the **CIS region**, in **Russia**, an easing of inflationary pressures and further progress towards financial stabilisation should still favour a reduction in long-term yields in 2017.

**Exchange rates** are forecast to remain around current levels in 2016 in the CEE/SEE areas. As in the case of government bonds, turbulence related to the Brexit result seems to have been only transient. The depreciation of the euro against the USD, following the US presidential election, is also favouring the stability of exchange rates in CEE/SEE countries with respect to the euro.

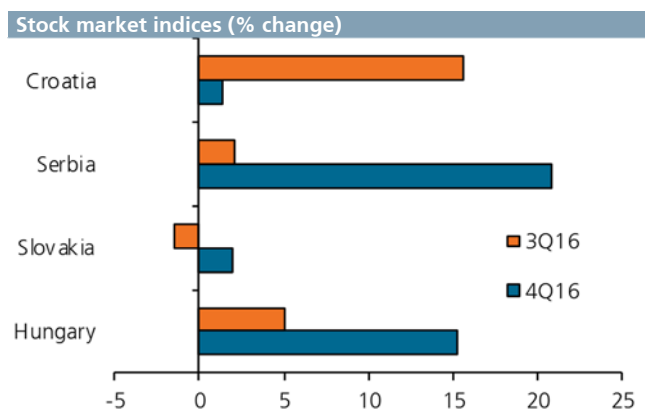
In the CIS area, although we have not changed our previous forecast of a gradual appreciation of the **Russian** currency over the forecasting period, a high degree of compliance with the agreed oil output cuts would favour higher oil prices, potentially offering a stronger boost to the rouble. We continue to expect **Ukraine’s** hryvnia to be stable in the near term, but to then follow a path of depreciation, based on a significantly higher inflationary profile than for trading partners. For **Egypt**, we expect the pound to recover some ground, ending next year around 16.5 against the USD, after the phase of high volatility that has followed the liberalisation of the currency subsidies, also supported by more favourable international conditions related to the recent agreement with the IMF. However, the currency is expected to resume a depreciating trend in the medium term to defend the country’s competitive position amid much higher inflation than for trading partners.

Long rates have been revised upwards due to some signs of reversals in international inflationary trends

Upside risk for the rouble amid higher oil price. The Egyptian pound likely to show some recovery next year, but to fall further in the M/L term



Source: Bloomberg (\*) 3Q16 up to mid-September



Source: Thomson Reuters. (\*) 3Q16 up to mid-September

### Aggregates and bank rates

The **private sector loan stock dynamics** in the CEE/SEE region are expected to improve only slightly in 2016 with respect to 2015, supported in some countries by economic recovery. Data

Loan performance expected to recover slightly

on new lending flows are not available, but according to some surveys conducted locally, there are signs of improvement. The persistently slow trend is – as stated in previous forecast notes – mainly a result of the long-lasting processes of deleveraging occurring in private sectors (from the demand side) and the selloff of bank portfolios (from the supply side). In some countries (mainly Slovenia, Hungary and Croatia), loan growth rates are still expected to remain in negative territory in 2016, due to the impact of the ongoing restructuring of banks' portfolios, and in addition (in the case of Croatia and Hungary), the *ad hoc* measures adopted by the authorities to tackle the Swiss franc appreciation issue, the effects of which are forecast to finish in the coming year.

In 2017 in all the countries, loan growth rates are projected to improve and move to positive territory (with Croatia the only exception, because of loan book cleaning operations), even if this occurs at a still generally mild pace (except for Slovakia, where a stronger pace is expected). Asset quality has been improving. Therefore, the gap between the leading countries (eg, Slovakia) and the others is expected to narrow.

In the CIS area, the pace of the loan recovery is forecast to be weak in 2016, at a rate still below inflation in Russia (until 2017), and especially in Ukraine. In 2017, the reduction of key interest rates and the recovery of growth are expected to support the demand for new loans in Russia. In Egypt, a still significant increase in loans is forecast in 2016 (+18%, as in 2015), followed by a lower +13% in 2017, which would be significantly below the nominal GDP dynamics.

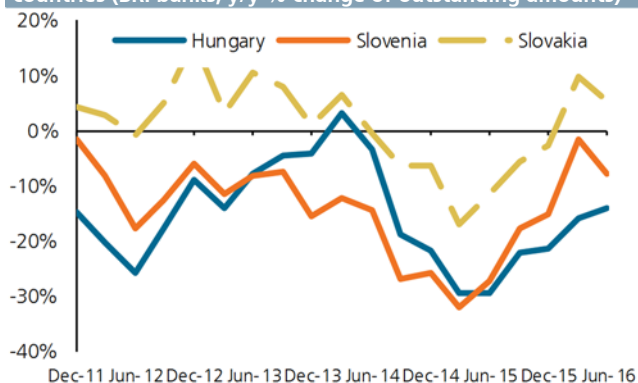
**Deposits growth rates** are forecast to be positive in 2016 (even if lower than in 2015 in many countries) and to be confirmed in 2017. In both years, however, they should stay well above the loans' dynamics, but face stronger competition from investment funds in many countries (especially in Slovakia, Slovenia, Croatia and Hungary). The loans/GDP and loans/deposits ratios are expected to decline further, together with further rebalancing between internal *vs* external bank funding.

In line with declining/low policy rates, banking interest rates are expected to decline/remain low as well in 2017, especially on the lending side, while interest rates on deposits, having already reached very low levels, are expected to be more resilient. Therefore, interest rate spreads are generally expected to shrink, squeezing the expected net interest margin in most CEE/SEE countries. Interest rates are expected to increase again in the years ahead across the board.

**Aggregates in the CIS area  
expected to remain weak**

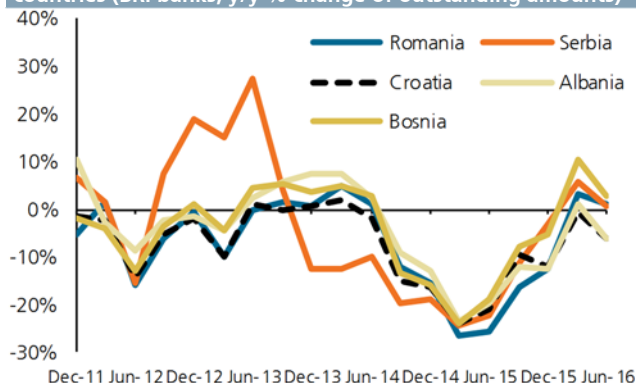
**Banking interest rate spreads  
are expected to narrow further**

Consolidated positions on counterparties resident in CEE countries (BRI banks, y/y % change of outstanding amounts)



Source: Intesa Sanpaolo processing of Bank for International Settlements data

Consolidated positions on counterparties resident in SEE countries (BRI banks, y/y % change of outstanding amounts)



Source: Intesa Sanpaolo processing of Bank for International Settlements data



## Country-Specific Analysis

### Albania

#### Real Economy

GDP is forecast to grow by 3% (with possible upside to 3.3 %) in 2016, and to further increase by 3.5% (with possible upside to 3.7%) in 2017, which compare to a growth rate of 2.6% in 2015. Economic activity is supported by investments in large FDI-financed energy-related projects, the pickup in private consumption, and higher tourism revenues. The TAP construction project is fully in process in 2016-2017, with a total investment of about 1.5% of GDP per year in each of the two years. The official unemployment rate in Albania decreased in 3Q16 to 14.7% from 15.5% in the previous quarter. On an annual basis, the official unemployment rate has decreased by 2.5%.

In November, the CPI inflation rate was 1.9%. The economic policy continues to focus on fiscal adjustment and monetary easing to support growth. Consumer prices, the main focus of the monetary policy, are returning to an upward trajectory. Inflation is expected to progressively approach the 3% target by 2018.

The authorities remain committed to gradually reducing the public debt ratio and to ensuring the feasibility of the fiscal framework. The fiscal balance was positive in the first half of the year, due to a cyclical upturn in revenues and a reduction in spending. In 2016, the public debt is expected to be 71.4% of GDP. It is projected at 69.1% in 2017. Domestic debt is currently 52% of total debt. The debt is made up of 77.4% long term and 50% in local currency. Investors have shown confidence in the currency and the economy.

#### Financial Markets

Current monetary policy provides a favourable environment for implementing structural reforms. The fall in the key interest rate to a record low of 1.25% is transmitted to all segments of the financial market, contributing to the decrease of credit costs and to investment growth. In November, the domestic currency had appreciated by more than 1% against the euro.

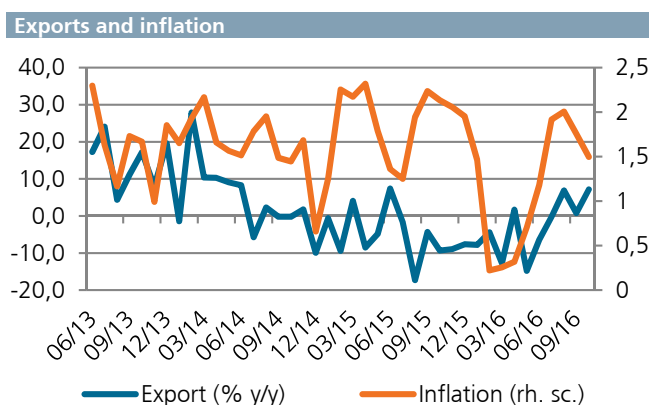
#### Banking Sector

Bank lending has gathered pace, supported mainly by domestic currency lending, though NPLs (21.4% in October) continue to be a drag on credit growth. In spite of that, the banking sector remains stable, liquid, profitable and well-capitalised, with a loan/deposit ratio to 53.3% vs 54.3% a year ago. The capital adequacy ratio is 15.6%. In 3Q16, banks' total assets increased by 2.5% compared with 3Q15.

In September, outstanding loans increased by 2.5% compared to December 2015 and 1.4% y/y. In the same period, total deposits recorded 1.8% growth. Lending was driven by households (+8.7%) while corporate loans declined by 1.2%. During the third quarter of 2016, new loans reached about Lek 57.3Bn (+3.3% y/y). The increase of NPLs and the environment of near zero interest rates have affected the profit of the banking sector. According to IFRS standards, accumulated net income recorded a 39% y/y decrease in the first nine months of 2016.

Forecasts	2015	2016F	2017F
Real GDP yoy	2.6	3.0	3.5
CPI avg	1.9	1.3	2.0
Euro exchange rate (avg)	139.8	137.7	137.8
Euro exchange rate (end of period)	137.7	136.3	139.3
Short-term rate (avg)	2.7	0.9	0.9
Short-term rate (end of period)	2.2	0.9	0.9
L/T bond yields (avg)	n.a.	n.a.	n.a.
Bank loans yoy (end of period)	-2.6	1.0	2.0
Bank deposits yoy (end of period)	1.0	1.5	2.0

Source: Intesa Sanpaolo Research Department forecasts



Source: INSTAT

## Bosnia and Herzegovina

### Real Economy

Although 3Q high frequency data indicates a rebound in consumer spending with real retail trade growth of 7.2% yoy, a slowdown in industrial production and export growth, to 2.1% and 1.8% yoy, respectively, combined with lower-than-expected 1H16 growth (1.7% yoy) is expected to drag 2016 GDP growth down to 2.1% from the previous forecast of 2.4% yoy. For 2017, we now expect mildly stronger growth of 2.5%, supported by personal consumption and exports, but still limited by slow progress in large investment projects like pan-European transport Corridor Vc. The main risk to our baseline scenario remains political instability, which could hamper the structural reforms agenda, as well as any unforeseen slowdown in BH's major trading partners.

Ivana Jovic

In the meantime, on the political front, in December, Bosnia received the EC Questionnaire on readiness to join the EU, following the submission of its application for EU membership in February and the green light from the European Council in September.

As the average 12-month CPI declined in October by 1.3% yoy, we estimate that the 2016 average inflation rate will be as low as -1.2%, representing the fourth consecutive deflationary year. In line with the expected recovery in oil prices and the announced hike in excise duties on fuel, the inflation rate is expected to return to positive territory in 2017 (0.8% yoy).

### Banking Sector

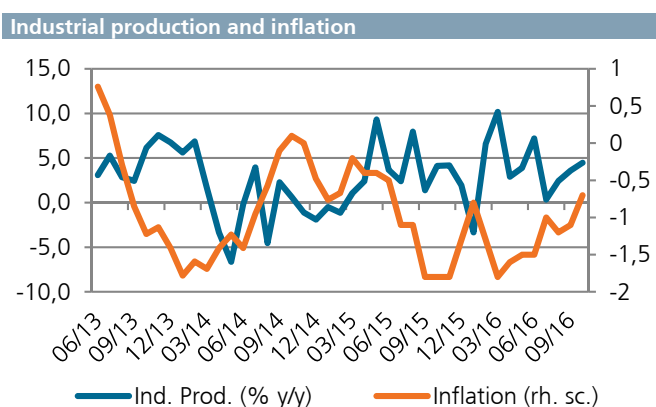
Total loans to the private sector in both September and October increased by 2.4% yoy, a tad lower than in the previous period. The loans to households kept up the +3% yoy pace, as consumer loans continued to grow at +5% yoy, whereas housing loans slipped into negative territory. Loans to non-financial corporations slowed to below +2% yoy, due to the deleveraging of public companies, while demand from privately owned companies continued to rise. In line with these latest developments, we have cut slightly our forecast for private sector loan growth in 2016 to 2.3% yoy (previously +2.5%). As regards 2017, we have maintained our view that the loan growth rate will speed up moderately, to 2.9% yoy, on account of stronger demand.

Ana Lokin

Private sector deposits in September and October grew by 6.6% and 6.1% yoy, respectively, representing a slowdown compared to August. Growth in corporate deposits decelerated (+6.5% yoy in September and +5.7% yoy in October), whereas household deposits recovered somewhat in the last two months (+6.6% and +6.3% yoy, respectively). As the latter represented over 70% of total private sector deposits, we have revised our 2016 deposit growth rate estimate slightly upward, to 5.1% yoy, while our 2017 forecast remains unchanged at 5.7% yoy.

Forecasts	2015	2016F	2017F
Real GDP yoy	3.1	2.1	2.5
CPI avg	-1.0	-1.2	0.8
Euro exchange rate (avg)	2.0	2.0	2.0
Euro exchange rate (end of period)	2.0	2.0	2.0
Short-term rate (avg)	n.a.	n.a.	n.a.
Short-term rate (end of period)	n.a.	n.a.	n.a.
L/T bond yields (avg)	n.a.	n.a.	n.a.
Bank loans yoy (end of period)	2.2	2.3	2.9
Bank deposits yoy (end of period)	7.8	5.1	5.7

Source: Intesa Sanpaolo Research Department forecasts



Source: Labour and employment agency

## Croatia

## Real Economy

Based on 3Q's strong GDP growth (2.9% yoy, 1.7% qoq) supported by strong domestic demand (3.4% yoy in personal consumption, 2.1% yoy in government consumption, 2.9% in investments) and exports (6.3% yoy, out of which services exports grew by 7.4% yoy), we upgraded 2016 our growth estimate to 2.6% (previously 2.3%). Based on better-than-expected 2016 GDP performance and the expectation that the EU will keep growing in 2017 at a similar rate than in 2016, but above all based on maintained domestic consumption growth and looser fiscal policy in the runup to spring local elections, we upgraded our 2017 growth forecast to 2.9% yoy. We expect that a hike in net wages amid a lower personal income tax burden, combined with the hike in public sector wages and improved labour market conditions, will positively affect household spending, while investment activity is expected to benefit from c.30% higher EU funds inflows. We found that risks to our baseline scenario are at the moment broadly balanced, although higher-than-expected rises in oil prices could undermine disposable income and consumption growth.

Ivana Jovic

In line with our expectations, deflationary pressures started to diminish in 4Q (October: -0.5% yoy). We thus keep our 2016 average CPI estimate at -1.2%, whereas, following the expected increase in oil prices, we foresee inflation returning to positive territory in 2017 (1.0% yoy).

## Financial Markets

For FY16, we estimate the average 3M Zibor rate at 0.9%. Looking forward, amid sustained abundant liquidity, next year, we see only marginal movements of interest rates. The EUR/HRK average in 2016 is estimated at 7.53, and the 2017 average is seen at 7.57. We have slashed our long-term kuna government bond yield forecast for 2017 substantially, to 2.9%, as we expect the spread vs the Bund to narrow based on rating upgrades, and we forecast domestic financing conditions to remain favourable.

Ana Lokin

## Banking Sector

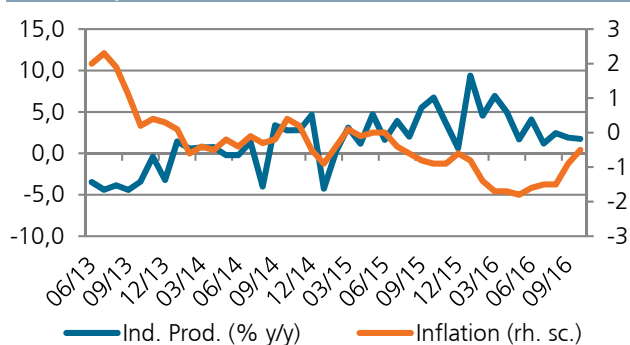
We have "upgraded" our 2016 loan forecast from -4.8% to -3.9% yoy, as some of the planned loan sales by big banks did not materialise. However, we expect these to be executed next year and some HRK 5bn in loans, mostly corporate, to be sold. Hence, we have slashed our 2017 forecast to -1.4%; however, if loan sales were excluded, the loan growth rate would amount to +1.1% yoy, in line with this year's new loan growth dynamics. The risks to our 2017 forecast are skewed to the downside due to the introduction of corporate income tax changes where write-offs are treated as tax-deductible expenses, which should push banks towards bolder balance sheet cleaning.

Our 2016 deposit growth estimate has been reduced to +1.7% yoy as the outflow of retail foreign currency time deposits from banks to investment funds has sped up. This trend is expected to last into 2017 due to declining foreign currency savings rates. Thus, we were prompted to revise downwards our 2017 forecast to +1.6% yoy.

Forecasts	2015	2016F	2017F
Real GDP yoy	1.6	2.6	2.9
CPI avg	-0.5	-1.2	1.0
Euro exchange rate (avg)	7.6	7.5	7.6
Euro exchange rate (end of period)	7.6	7.6	7.6
Short-term rate (avg)	1.2	0.9	0.9
Short-term rate (end of period)	1.2	0.9	1.0
L/T bond yields (avg)	3.7	3.6	2.9
Bank loans yoy (end of period)	-3.1	-3.9	-1.4
Bank deposits yoy (end of period)	6.4	1.7	1.6

Source: Intesa Sanpaolo Research Department forecasts

## Industrial production and inflation



Source: EC

## Egypt

### Real Economy

The real GDP growth rate was 4.3% during FY 2015/2016, compared to 4.4% a year earlier. Final consumption and investments contributed positively to growth, increasing by 4.5% and 11.2%, respectively, while trade negatively affected growth, with exports decreasing by 14.5%. GDP increased during 2Q16 by 4.5%. Key sectors that achieved positive growth rates were the construction, communications and electricity sectors, which grew by 10.2%, 10.1% and 8%, respectively, while tourism retreated by 59.7% and the extractive industries sector by 7.1%. The prolonged foreign currency shortage in the official market affected industrial production, which continued its downward trend, decreasing by 16.6% in September 2016.

Headline inflation increased in November by 19.4% yoy from 13.6% in October. Inflation is expected to increase sharply due to the combined effects of the introduction of VAT, the EGP flotation, the cut to energy subsidies. The government raised fuel prices by a range of 20%-47% after the depreciation of the EGP and tariffs on 320 non-essential goods by 40%-60%.

Higher inflation and interest rates following the sharp depreciation of the EGP are expected to have a negative impact on growth in the short term and GDP is forecast to decelerate in FY 2016/2017 to 4%, but to improve growth prospects starting in the second half of 2017, with GDP expected to grow by 4.3% in calendar year 2017.

### Financial Markets

On 3 November, the CBE announced the shift to a free-float exchange rate regime. Banks were put at liberty to price and trade the US dollar at any exchange rate according to demand and supply forces, with the dollar set to be traded at EGP 13 ± 10% as a starting point. Following the shift, the EGP has depreciated sharply in the market, exceeding EGP 18/USD 1. Further, again on 3 November, the CBE raised its key interest rates by 300 bps to contain inflationary pressures and combat dollarisation. Accordingly, a wave of rising interest rates on various saving schemes started, with the three state-owned banks offering 18-months and three-year investment certificates at 20% and 16% interest rates, respectively. Additionally, the Ministry of Finance raised yields on the five-year Suez Canal Investment Certificates, which were issued in September 2014 at 12% interest rates, to 15.5%.

In its meeting held on 17 November 2016, the CBE's Monetary Policy Committee kept overnight deposit and lending rates unchanged at 14.75% and 15.75%, respectively. The discount rate was also kept unchanged at 15.25%.

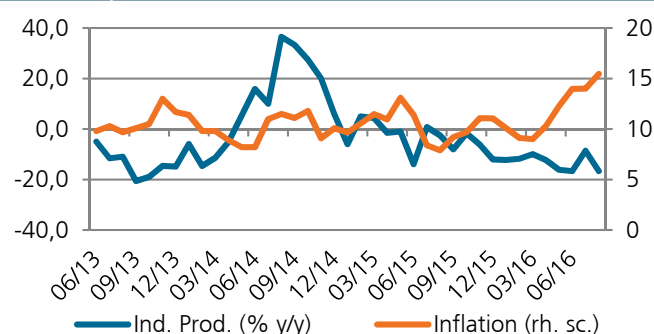
### Banking Sector

Total bank loans to customers reached EGP 951.3Bn in August 2016, up by 29.9% compared to August 2015. Private sector loans, which represented 70.1% of total loans at the end of August 2016, grew by 14.9% yoy. The banks' exposure to government bonds and T-Bills reached EGP 1.24Tn in July 2016 and is expected to grow further. Overall deposits increased by 20.1% yoy, to EGP 2.2Tn in August 2016, when private sector deposits rose by 17.8%.

Forecasts	2015	2016F	2017F
Real GDP yoy	3.6	4.0	4.3
CPI avg	10.4	13.5	27.0
USD exchange rate (avg)	7.7	10.0	16.8
USD exchange rate (end of period)	7.8	18.2	16.5
Euro exchange rate (avg)	8.5	11.1	18.5
Euro exchange rate (end of period)	8.5	19.5	18.6
Short-term rate (avg)	11.3	14.3	18.2
Short-term rate (end of period)	11.4	19.0	17.5
L/T bond yields (avg)	n.a.	n.a.	n.a.
Bank loans yoy (end of period)	18.0	18.0	13.0
Bank deposits yoy (end of period)	20.4	22.0	16.0

Source: Intesa Sanpaolo Research Department forecasts

### Industrial production and inflation



Source: Ministry of Planning, CAPMAS

## Hungary

### Real Economy

Hungary's GDP showed some deceleration in Q3 (2.2%) following an unexpectedly weak Q1 and an upward correction in Q2 (2.6%). Despite the upward revision of the Q1 and Q2 data by the Central Statistical Office, the full-year performance looks set to be lower than in 2015 (we forecast 2.1%). Industrial performance in Q2-Q3 increased concerns about the overall growth rate and failed to support overall GDP growth. The outlook has been improved, however, by fiscal easing announcements, wage growth and the related positive dynamics of domestic demand, including household consumption. The fall of EU-funded state investments still weighs on construction. Also, private investments have been slow to pick up. The contribution of exports and industry (manufacturing) decreased. Still, we see room for a better growth rate in 2017 due to further fiscal stimulus (with the deficit planned to be 0.4pp above this year's original targeted gap and 0.7pp above the amended target), the support from EU funds, and based on rising wages in the private sector fueling domestic consumption. We expect GDP growth to reach 2.7% next year. However, the stronger pace is unlikely to be sustainable for the forthcoming years, given poor investments and the lack of sufficient improvement in terms of potential GDP.

Headline inflation remained mostly in negative territory up to August and picked up in line with earlier expectations in the autumn. In October-November, CPI rates (1-1.1%) reached a three-year peak. Core inflation has remained at 1.3-1.5% recently. The lack of imported inflation still constrains the CPI, while the turn of the fuel price cycle and rising domestic demand look set to push inflation higher in 2017. Annual average inflation is projected to surge close to 2% next year from an estimated 0.4% in 2016.

### Financial Markets

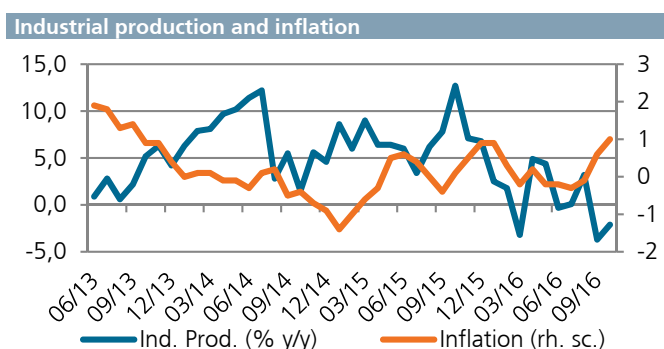
The NBH left the 3M policy rate on hold at 0.90% during the summer months, after having announced the end of rate cuts in May. Further cuts are unlikely even in 2017. Should any further room for easing emerge, the central bank is more likely to deliver unconventional monetary measures, as occurred with the announcement of limiting the main (3M) facility, effective from August and October. Recent monetary actions and global market fluctuations left the forint little changed, mostly at EUR 1/HUF 305-315, with modest potential for significant divergence in 2017. Government bond yields continued to be supported by monetary actions boosting domestic purchases.

### Banking Sector

Real economic developments lent some support to the demand side of the loan market, but the private sector remained cautious. We expect overall corporate credit market activity to continue to show modest dynamics, while retail loan development is picking up at a faster rate. Customer deposits look set to increase further next year. The activity of MARK, the central bank's vehicle to buy low-quality debt from commercial banks, showed temporary momentum in 2H6, but remained subdued overall.

Forecasts	2015	2016F	2017F
Real GDP yoy	2.9	2.1	2.7
CPI avg	-0.1	0.4	2.0
Euro exchange rate (avg)	310.0	311.4	311.2
Euro exchange rate (end of period)	312.0	311.0	311.3
Short-term rate (avg)	1.7	1.0	0.6
Short-term rate (end of period)	1.4	0.6	0.6
L/T bond yields (avg)	3.4	3.2	3.6
Bank loans yoy (end of period)	-12.3	-2.5	0.5
Bank deposits yoy (end of period)	7.5	2.3	2.5

Source: Intesa Sanpaolo Research Department forecasts



## Romania

### Real Economy

The strong real economic growth expected in 2016 in Romania among all of the EU countries (GDP growth rate of 4.7% for this year, according to Thomson Reuters) was by and large fueled by a continuous fiscal stimulus over the course of the year. As a consequence, domestic retail sales performed well, which was not reflected in the inflation data mainly due to the VAT cut at the beginning of the year, but also because of the disinflationary forces at international level (low energy prices being the most important one). Growth is expected to slow down and inflation to accelerate in 2017 since the effect of the fiscal stimulus will wear off, the budget deficit constraints will limit the room left for more fiscal stimulus, and the VAT cut effect on prices will evaporate.

Sebastian Maneran

### Financial Markets

The negative inflation in 2016 has allowed the central bank to maintain abundant liquidity conditions in the domestic money markets. Therefore, prices of local currency bonds were strongly supported and yields fell. Notwithstanding this, the pass-through effect of the lower interest rates into the real economy was asymmetric.

The strong performance of domestic retail sales gave rise to excess demand which was partially satisfied by imports. Growth in imports has acted as a deterrent to RON appreciation in a general environment characterised by negative interest rates in the EUR money market and positive RON money market rates.

Looking forward, the world's largest central bank provided strong signals that monetary policy will only become tighter from here. The US Fed just increased the interest rate to 0.75% and further increases are expected next year. The European Central Bank has trimmed the amount of liquidity it injects into the economy, but clearly stated that interest rates will remain at the current level or move lower. Thus, since RON interest rates are likely to move with EUR interest rates, monetary conditions in Romania are likely to remain loose.

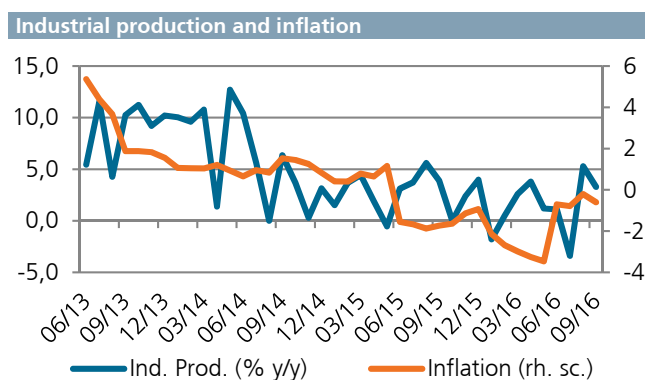
### Banking Sector

Private credit creation in 2016 is likely to be modestly positive, according to the data available (end October: +1.5% yoy). Double-digit RON credit (end October: 13.8% yoy) growth was, in part, canceled out by the FX credit contraction (end October: -11.0% ).

Looking forward, credit creation is likely to be supported by several factors: ongoing abundant liquidity conditions in the EUR markets, which will allow the Romanian central bank to maintain loose conditions in the RON markets, and a new Romanian Government which will need to be supportive for private consumption.

Forecasts	2015	2016F	2017F
Real GDP yoy	3.8	4.6	3.4
CPI avg	-0.6	-1.5	2.1
Euro Exchange rate avg	4.4	4.5	4.5
Euro Exchange rate (end of period)	4.4	4.5	4.5
Short term rate (avg.)	1.1	0.6	0.6
Short term rate (end of period)	0.8	0.6	0.6
L/T bond yields (avg.)	3.5	3.4	3.8
Bank Loans yoy (end of period)	2.7	3.0	3.5
Bank Deposits yoy (end of period)	9.1	5.0	5.5

Source: Intesa Sanpaolo Research Department forecasts



Source: NBR

## Russia

## Real Economy

The Russian economy hasn't showed the fast recovery in 2016 that was expected, but preliminary GDP estimates for 3Q16 show the smallest decline in the past seven consecutive quarters (-0.4% yoy). According to our forecasts, GDP growth will be -0.6% in 2016 and c.1.0% in 2017.

Anna Mokina

GDP growth rates will be affected by global economic growth rates, oil prices and structural restrictions on Russian economy. The decision of OPEC members and non-OPEC members (including Russia) to cut oil production in the medium term will have a positive effect on prices which could settle at the USD 55-60/bbl level. We expect the rouble to thus consolidate at around RUB 63-66/USD 1.

Stabilisation of national currency should stimulate a further slowdown in inflation and support industrial production (which has been fluctuating in a range of -2.7% and 1.7% this year). Retail sales had been declining for 22 consecutive months in October. The decrease is accounted for by the sharp decline in real income (-2.3% mom s.a.) and possibly by an increase in the savings rate. Inflation in 2016 should be 5.6-5.8% yoy. The average inflation rate is expected to be around 7.2% in 2016 and should fall to 5.7% in 2017.

## Financial Markets

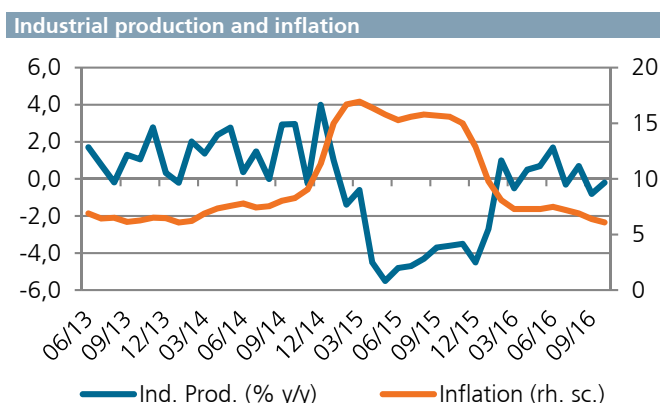
The CBR's main goal is to reduce the inflation rate to around 4% to stimulate household savings to be then channelled into investments. In order to achieve the target, the Central Bank of Russia is expected to preserve a moderately tight monetary policy, which would provide balanced level of interest rates. On 28 October, the Board of Directors of the bank kept the key rate at 10%. The Bank of Russia considers that in order to secure sustainable path towards lower inflation, it is necessary to maintain the current level of the key rate till the end of 2016, with the possibility of cuts again in the first or second quarter of 2017.

## Banking Sector

In the first three quarters of 2016, the growth rate of household deposits shrank yoy. But it is still premature to speak about a change in household savings behaviour. Cash dynamics demonstrate a growing propensity of households to save money. Growth (though weak) in lending to the private sector is maintained by a positive net growth of mortgages. In 2016, the Bank of Russia continued the process of strengthening the banking sector to protect it from crisis and systemic risk by withdrawing licences from the banks that do not comply with the requirements and by creating a system of deposits insurance. However, there is still the risk of weakening deposits growth in 2017 due to negative effects from the possible freezing of corporate funding. The deterioration of the situation with regard to funding may complicate the central bank's task of reducing key rates.

Forecasts	2015	2016F	2017F
Real GDP yoy	-3.7	-0.6	1.0
CPI avg	15.5	7.2	5.7
USD exchange rate (avg)	61.3	67.6	64.5
USD exchange rate (end of period)	72.9	65.0	64.0
Euro exchange rate (avg)	68.0	75.0	73.5
Euro exchange rate (end of period)	79.5	71.5	74.9
Short-term rate (avg)	13.5	11.3	9.4
Short-term rate (end of period)	11.8	9.8	9.0
L/T bond yields (avg)	11.4	8.9	8.2
Bank loans yoy (end of period)	8.2	3.0	5.0
Bank deposits yoy (end of period)	18.8	5.5	6.0

Source: Intesa Sanpaolo Research Department forecasts



Source: State Statistics Federal Service

## Serbia

## Real Economy

Serbia posted another quarter of solid growth with the economy expanding by 2.6% yoy (after 3.8% in 1Q16 and 1.9% in 2Q16), owing to a successful agricultural season and better performances from construction, industry and some service sectors. GDP is expected to grow by 2.7% yoy in 2016 and around 2.9% in 2017, driven by new investments and continued implementation of infrastructure projects. Rising exports and higher consumption underpinned by employment gains and private sector wages hikes should positively contribute to growth in 2017 as well.

In November 2016, yoy CPI jumped to 1.5%, the same level as recorded in October, reaching the lower bound of the new target tolerance band ( $3\pm 1.5\%$ ) that will take effect as of 2017. Inflation is expected to move within the new target band throughout 2017, driven by the low base effect from primary commodities, gradual strengthening of demand and rising inflation abroad.

## Financial Markets

The National Bank of Serbia left its key policy rate unchanged (4.0%) at its December meeting, after a cut by 0.25pp in July. In making this decision, the NBS took into consideration the inflation outlook in the period ahead, but also uncertainties regarding international financial market mostly related to the pace of the Fed's monetary policy normalisation and the continuation of the ECB's quantitative easing programme.

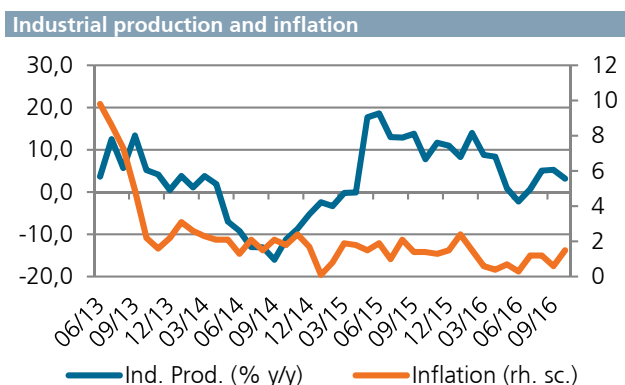
This year, the dinar has been relatively stable supported by low inflation, investments inflow and a lower current account deficit. Moreover, it was additionally controlled by timely interventions on the FX market by the National Bank of Serbia. In January-November 2016, the domestic currency depreciated against the EUR by 1.4%, while the NBS sold EUR 880M and purchased EUR 730M in order to mitigate the daily excessive fluctuations of the exchange rate. In November 2016, the NBS made its first intervention on the sale side since August (EUR 10Mn), as appreciation pressures have prevailed in the market over the last few months.

## Banking Sector

Credit activity accelerated in October 2016 (4.6% yoy) with lending rising in the household segment (10.3% yoy) but rising only slightly in the corporate sector (0.7% y/y). Further growth of lending in 2017 is expected as well mostly on the back of past monetary easing, expansion of the economy and competition among banks in the market. Deposit dinarisation is on the rise with corporate deposits at a relatively high level (52.6%). Household deposits also picked up by 2.5pp, to 13.8%, in the last two years.

Forecasts	2015	2016F	2017F
Real GDP yoy	0.8	2.7	2.9
CPI avg	1.4	1.1	2.0
Short-term rate (avg)	6.3	4.1	4.0
Short-term rate (end of period)	4.5	4.0	4.0
L/T bond yields (avg)	0.0	0.0	0.0
Bank loans yoy (end of period)	3.0	3.0	3.2
Bank deposits yoy (end of period)	7.1	7.0	5.0

Source: Intesa Sanpaolo Research Department forecasts



Source: Statistical Office, National Bank of Serbia



## Slovakia

## Real Economy

Real economic activity in Slovakia in the summer was quite volatile, but the trend was visibly decreasing. Overall, GDP decelerated from 3.8% yoy in 2Q to 3.0% in 3Q. On a seasonally adjusted basis, the deceleration was less steep, moving from 0.9% qoq in 2Q to 0.7% in 3Q.

The outlook is rather encouraging. Confidence indicators point to activity reaccelerating in 4Q. Full-year GDP in 2016 remains on track for 3.3% growth. In 2017, we expect 3.5% growth, based on both domestic and foreign demand. Foreign demand is expected to grow in line with the ongoing recovery in the Euro Area economy. On domestic front, the labour market experienced significant progress in the past years supporting private consumption. Public consumption and investments will again benefit from a further postponement of a balanced budget. Private investments should still be driven primarily by the automotive sector and overall manufacturing as capacity utilisation hovers above the long-term average.

Similar to in the Euro Area, inflation is increasing in Slovakia, though from a much lower base (from an all-time low of -0.9% yoy in July to -0.2% in October). While global drivers of recently increasing inflation were thus far energy prices, in Slovakia, domestic demand factors also increased in the past months. Nevertheless, in 2016, inflation will likely have remained in negative territory for the third consecutive year. Deflation, though, should cease in 2017. Growth should be driven primarily by base effects, as previous drops in oil prices will fade. In January 2017, moreover, the effect of lower VAT on basic food will drop out of the year-on-year inflation reading. In 2017, however, headline inflation will be affected by further drops in prices of gas (-2.6%) and electricity (-4.3%).

Andrej Arady

## Financial Markets

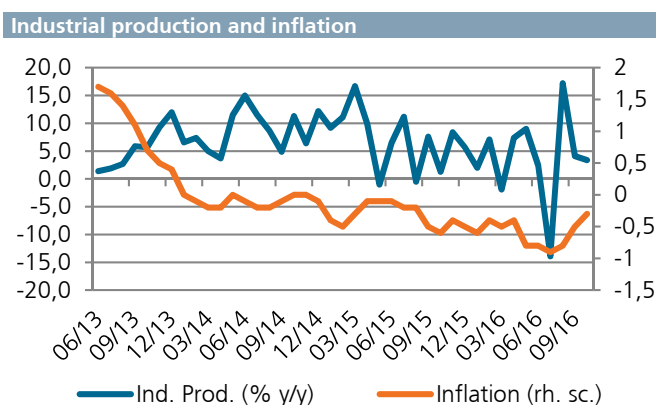
In the past weeks, yields have risen on a shift in global inflation expectation, pushing up the Slovak yield curve as well. Furthermore, on the spreads on 10-year government bonds increased over the past month by 30bps to above 70bps vs German *Bunds*. We expect spreads to normalise to their levels prior to the ECB starting its Asset Purchase Programme, ie, at 70bps above German *Bunds*.

## Banking Sector

In the banking sector, both deposits and loans continued to show good growth. The retail sector grew especially fast, at 13.6% yoy in 3Q. But nonfinancials also saw their stock of bank loans grow, by 6.2% yoy. The local macroprudential authority was already concerned about such buoyant growth of household debt, and in response it is preparing measures to tighten LTV and debt regulations. Growth is thus probably already close to its peak. Interest rates no longer appear to be declining for new housing loans, but the repricing of the existing stock of loans will negatively affect banks in 2017.

Forecasts	2015	2016F	2017F
Real GDP yoy	3.8	3.3	3.5
CPI avg	-0.3	-0.4	0.8
Short-term rate (avg)	0.0	-0.3	-0.3
Short-term rate (end of period)	-0.1	-0.3	-0.3
L/T bond yields (avg)	0.9	0.6	1.2
Bank loans yoy (end of period)	8.7	8.8	6.4
Bank deposits yoy (end of period)	9.9	6.0	4.8

Source: Intesa Sanpaolo Research Department forecasts



Source: Statistical Office of Slovak Republic

## Slovenia

## Real Economy

Growth continued to be solid in 3Q16 (+2.7%). Exports as well as household and government consumption contributed to this, while investment contracted. The latter was caused by a large fall in public investment (due to the end of the period of EU funding) which was only partially compensated for by solid private investment growth. GDP is expected to grow by 2.4%. Growth in 2017 and 2018 is expected to be broad-based with a further shift from external to domestic demand.

The mild recovery in oil prices this year after last year's slump implies that inflation is likely to remain around zero in 2016. As oil prices are expected to rise further in 2017 and 2018, and wages are also set to increase, inflation is expected to start rising again, although it should not exceed 2.0% until the end of the forecast horizon.

## Financial Markets

In the last period, the slight downward trend of short-term interest rates continued, reflecting the ECB's accommodative monetary policy stance till March 2017. The three-month Euribor rate is currently moving around -0.31% and it is expected to remain in negative territory for an extended period of time, but the downtrend should stabilise after the ECB's December meeting. The council decided that from April 2017 until the end of December 2017 or longer, the net asset purchases will continue at a monthly pace of EUR 60Bn (current monthly pace of EUR 80Bn).

The yield on Slovenia's benchmark 10-year government bond increased sharply in the last month, following the movements in the Eurozone bond market (mostly related to the ECB's December meeting, the election of Donald Trump as US president). Currently, the 10-year cost for borrowing has increased to 0.95 approximately. The yield on the Slovenian benchmark 10-year government bond is expected to rise further. It could rise to 1.60% (on average) in 2017 and to 2.10% (on average) in 2018.

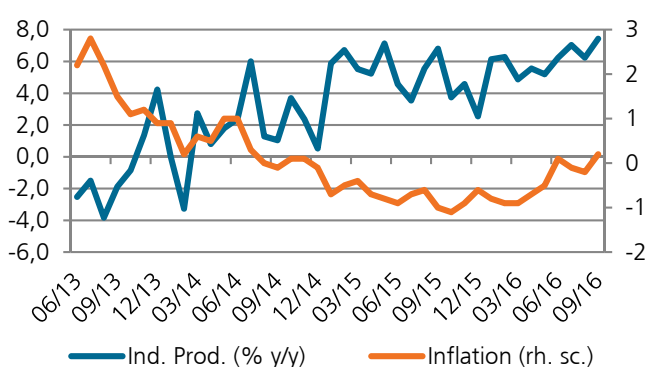
## Banking Sector

The negative effect of falling corporate loans volumes will only be partially mitigated by rising household loans: the growth of consumer loans in the first 10 months of the year reached 5.2% and even outpaced the growth of mortgages (3.2%). With the stabilisation of the banking system, the conditions for an increase in loans are improving. Nevertheless, significant growth is not expected. It is assumed that non-banking and internal sources of funding will play an increasingly important role in financing the economy. With better access to funding on capital markets, the amount of debt securities issued by non-financial corporations is rising. Moreover, internal resources of enterprises are an increasingly important source of finance. An increase in deposit volumes continued in the last quarter and growth is expected to continue.

Forecasts	2015	2016F	2017F
Real GDP yoy	2.3	2.4	2.7
CPI avg	-0.8	-0.1	0.9
Short-term rate (avg)	0.0	-0.3	-0.3
Short-term rate (end of period)	-0.1	-0.3	-0.3
L/T bond yields (avg)	1.7	1.3	1.6
Bank loans yoy (end of period)	-5.2	-6.0	1.0
Bank deposits yoy (end of period)	5.8	6.0	4.8

Source: Intesa Sanpaolo Research Department forecasts

## Industrial production and inflation



Source: Statistical Office of the Republic of Slovenia

## Ukraine

## Real Economy

Real GDP growth accelerated to 1.8% yoy in the third quarter from 1.4% in 2Q. The main boost came from civil construction and agriculture, reflecting a buoyant wheat crop. From January to September 2016, real GDP rose by 1.1% compared to the same period in 2015. From the demand side, the main support was provided by investment. Net trade continued to negatively affect growth, due to weak exports dragged down by trade constraints with Russia and output cuts related to security concerns in some exporting industries, particularly metal forming and chemicals, located in the eastern regions of the country. Domestic demand, including household consumption, sustained by higher wages and falling inflation, is expected to boost growth next year as well, while exports are likely to remain a drag. Real GDP growth is forecast to accelerate to 2.5% next year, from 1.1% expected this year.

Giancarlo Frigoli

## Financial Markets

Annual inflation is expected to end 2016 at close to the 12% official target. The notable slowdown in inflation seen this year (the annual rate was over 40% at end-2015) and the relatively stable currency (the UAH/USD exchange rate has hovered around 26 for most of the year) have opened up the possibility for large rate cuts (the official rate fell to 14% in December 2016 from 22% at the beginning of this year). Additional monetary easing is likely in 2017 in the wake of weakening inflationary pressures and the new fiscal stabilisation measures included in the economic adjustment programme sponsored by the IMF.

## Banking Sector

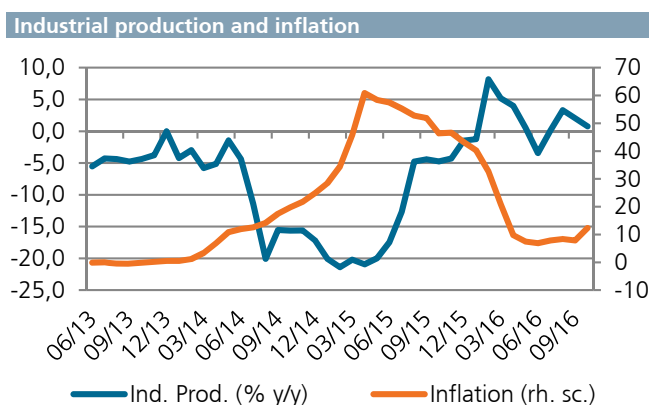
Banking aggregates remain weak because of persistently high credit risk, the weak solvency of households and high leverage of corporations. The better nominal performance of corporate loan portfolios (-0.8% yoy in October, but +7.5% yoy in local currency) was offset by shrinking retail lending (-9.3% yoy). Nominal loans to the private sector decreased by 2.5% yoy in October (from +0.7% in September); net of the FX depreciation, loans showed a decline of 8.7%. According to the last Lending survey, in 3Q16, major growth drivers included lower interest rates, a need for debt restructuring, and borrowers' needs for working capital. The highest growth in demand was for short-term and hryvnia loans. Household demand increased for both consumer loans and mortgages due to lower interest rates and stronger consumer confidence. NPLs reported by banks increased further, to 31% as of September.

Davidia Zucchelli

Deposits also showed a nominal increase (8.1% yoy in October, +2.4% net of FX depreciation). Deposits in local currency continued to increase strongly (+7.8% yoy in October), both in the household and in the corporate sector. Recent adjustments in limitations on daily withdrawals from households' hryvnia accounts and a significant increase in limits on daily withdrawals from FX deposits had no negative impact on the dynamics of deposits. The growth in household deposits points to growing public confidence in the banking sector.

Forecasts	2015	2016F	2017F
Real GDP yoy	-10.0	1.1	2.5
CPI avg	48.0	15.0	11.0
USD exchange rate (avg)	22.0	25.6	26.8
Euro exchange rate (avg)	24.4	28.5	29.4
Short-term rate (avg)	25.9	21.4	17.0
L/T bond yields (avg)	0.0	0.0	0.0
Bank lending	-3.8	2.0	3.0
Bank deposits	1.5	5.0	4.0

Source: Intesa Sanpaolo Research Department forecasts



Source: State Statistics Service of Ukraine

## Country Data: Economy, Markets and Banks - the economic cycle

Economy																		
	GDP chg yoy			Ind. Prod* . ch.yoy			Export nom. ch yoy			Inflation chg yoy				FX reserves chg**			CA bal ance***	
	3Q16	2Q16	2015	Last	mth	3Q16	Last	mth	3Q16	Last	mth	3Q16	2015	3Q16	2Q16	2015	3Q16	2Q16
<b>CEE</b>																		
Slovakia	3.0	3.8	3.8	3.4	Oct	2.5	0.0	Oct	1.9	-0.3	Oct	-0.7	-0.3	n.s.	n.s.	n.s.	n.a	-41
Slovenia	2.7	2.8	2.3	7.4	Sep	6.9	5.2	Sep	4.1	0.7	Nov	0.0	-0.8	n.s.	n.s.	n.s.	743	757
Hungary	2.2	2.8	3.1	-2.1	Oct	-0.1	-1.1	Oct	3.5	1.1	Nov	0.1	-0.1	n.a	-3727	-4256	n.a	1767
<b>SEE</b>																		
Albania	n.a.	3.2	2.6	n.a.	n.a.	n.a.	0.7	Sep	2.4	1.5	Oct	1.9	1.8	n.a.	n.a.	n.a.	n.a	-354
Bosnia H.	n.a.	1.4	3.1	4.5	Oct	2.1	2.7	Oct	1.7	-0.7	Oct	-1.1	-1.0	n.a	92	399	n.a	-253
Croatia	2.9	2.8	1.6	1.7	Oct	1.8	-0.6	Sep	1.5	-0.5	Oct	-1.3	-0.5	102	-262	1019	n.a	152
Romania	4.6	5.9	3.7	3.3	Sep	1.7	6.7	Sep	5.2	-0.4	Oct	-0.5	-0.6	n.a	n.a	-3990	-3	-2507
Serbia	2.6	1.9	0.8	3.2	Oct	3.7	9.2	Oct	10.1	1.5	Oct	1.0	1.4	167	-121	171	-240	-271
<b>CIS MENA</b>																		
Russia	-0.4	-0.6	-3.7	-0.2	Oct	-0.1	-3.0	Sep	-9.2	5.8	Nov	6.8	15.8	3005	484	-18340	n.a.	12248
Ukraine	1.8	1.4	-9.9	0.8	Oct	1.8	-8.0	Sep	-8.7	12.1	Nov	8.1	48.5	525	-525	5741	-1698	615
Egypt	n.a.	4.5	3.5	-11.7	Sep	-12.6	12.0	Aug	7.7	19.4	Nov	14.5	10.4	2046	985	1112	n.a.	-4190
<b>m.i. E. A.</b>	1.6	1.6	2.0	1.2	Sep	1.0	2.0	Sep	0.3	0.6	Nov	0.3	0.0					

Source: Datastream, Reuters, Bloomberg; \*Wda data for Slovakia, Slovenia; Bosnia, Croatia, Egypt; \*\*USD for Russia, Egypt, Ukraine, Romania; \*\*\*USD for Russia, Egypt, Ukraine

Markets and Ratings														
	S/T rates*			L/T rates**			Foreign exchanges***			Stock markets		CDS spread		Rating
	12/12	chg bp	3M	12/12	chg bp	3M	12/12	3M chg%	1Y chg%	3M chg%	1Y chg%	12/12	12/09	S&P
<b>CEE</b>														
<b>Vs Euro</b>														
Slovakia	-0.3	0.0		1.2	0.8		Euro	Euro	Euro	-2.2	6.1	38.4	39.1	A+
Slovenia	-0.3	0.0		1.0	0.2		Euro	Euro	Euro	-3.9	2.7	94.4	92.2	A
Hungary	0.4	-0.5		3.5	0.6		314.1	1.1	-0.8	8.7	30.4	117.6	120.2	BBB-
<b>SEE</b>														
Albania	0.9	0.0		n.a.	n.a.		135.5	-1.2	-1.8	n.a.	n.a.	n.a.	n.a.	B+
Bosnia H.	n.a.	n.a.		n.a.	n.a.		1.96	Board	Board	n.a.	n.a.	n.a.	n.a.	B
Croatia	0.9	0.1		3.1	-0.4		7.5	0.7	-1.3	7.2	18.7	206.8	196.9	BB
Romania	0.6	0.1		3.6	0.5		4.5	1.3	0.1	0.6	-1.0	100.3	99.4	BBB-
Serbia	4.0	0.0		n.a.	n.a.		123.5	0.2	1.0	19.4	17.0	208.8	201.9	BB-
<b>CIS MENA</b>														
<b>Vs USD</b>														
Russia	10.6	0.0		8.5	0.4		63.3	-1.3	-8.5	12.0	29.3	177.6	189.7	BB+
Ukraine	18.0	-1.0		9.7	0.0		26.1	-1.9	10.9	3.9	27.9	663.7	13957.0	B-
Egypt	18.2	4.2		16.7	-0.9		18.3	105.6	133.1	39.9	95.2	444.7	477.8	B-
<b>m.i.A.E.</b>	-0.3	0.0		0.3	0.0		1.06	5,5	2.0	7.1	0.9	14,1	10.6	

Source: Datastream, Reuters, and Bloomberg; \* The data for Albania refers to October \*\*For Ukraine, the long-term rate refers to a government issue in dollars; \*\*\* The (-) sign indicates appreciation. Sources: Thomson Reuters-Datastream, Bloomberg

Aggregates and bank rates for the private sector																							
	Loans		NPL/Loans		Foreign Liab.		Deposits		Loans rate <sup>1</sup> -NewB*			DepositsRate <sup>1</sup> -NewB*			Loans/Dep								
	Chg yoy %	Last Mth	%	Last mth	Chg yoy %	Last mth	Chg yoy %	Last Mth	Last	mth	2015	%	Last	mth	2015	%	Last	mth					
<b>CEE</b>																							
Slovakia	9.6	Sep	8.7	4.9	Sep	5.1	14.7	Sep	1.1	7.6	Sep	9.9	2.66	Sep	2.83	C <sup>2</sup>	0.55	Sep	0.75	H <sup>2</sup>	93.3	Sep	90.0
Slovenia	-6.0	Oct	-5.2	6.4	Sep	9.9	-15.9	Oct	-20.7	7.6	Oct	5.8	3.03	Oct	3.45	C <sup>2</sup>	0.2	Oct	0.28	H <sup>2</sup>	80.9	Oct	89.2
Hungary	-6.0	Oct	-12.3	0.1	Sep	0.1	-9.9	Oct	-8.1	5.9	Oct	7.5	3.57	Oct	4.1	C	0.45	Oct	1.0	A	89.3	Oct	90.8
<b>SEE</b>																							
Albania	0.0	Aug	-2.6	21.3	Sep	18.2	-11.0	Sep	-14.4	2.2	Sep	1.0	11.04	Aug	8.35	A	0.54	Aug	1.27	H	54.1	Aug	54.2
Bosnia H.	2.4	Oct	2.2	12.1	Sep	13.7	-13.3	Oct	-11.7	6.1	Oct	7.8	5.37	Oct	4.99	C	0.58	Oct	1.06	H	111.8	Oct	114.4
Croatia	-5.3	Oct	-3.1	14.7	Sep	16.6	-34.2	Oct	-25.1	2.3	Oct	6.4	4.44	Oct	5.08	C	1.33	Oct	2.15	H	81.6	Oct	86.5
Romania	1.5	Oct	2.7	10.0	Sep	13.5	-14.3	Sep	-10.2	11.2	Oct	9.1	3.51	Sep	4.32	C	0.94	Sep	1.48	H	82.9	Sep	85.4
Serbia	4.6	Oct	3.0	19.5	Sep	21.6	-15.6	Oct	-6.3	11.8	Oct	7.1	6.21	Oct	6.24	C	3.04	Oct	4.17	H	105.8	Oct	111.4
<b>CIS MENA</b>																							
Russia	1.3	Aug	8.2	9.6	Sep	8.3	-1.4	Jun	-0.8	4.6	Aug	18.8	12.19	Aug	13.8	C	6.77	Aug	8.43	H	109.9	Aug	108.1
Ukraine	-2.5	Oct	-3.8	31.0	Sep	28.0	-6.5	Sep	6.3	8.1	Oct	1.5	23.43	Oct	26.09	R <sup>3</sup>	16.42	Oct	20.06	R <sup>3</sup>	140.1	Oct	146.3
Egypt	14.9	Aug	18.0	5.9	Jun	6.8	105.7	Aug	91.6	17.8	Aug	20.4	13.9	Sep	11.8	C	8.1	Sep	6.8	H	38.6	Aug	38.8
<b>m.i. E. A.</b>	0.7	Sep	0.6	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	2.4	Sep	3.1	1.3	Sep	1.6	C	0.5	Sep	0.6	H	82.4	Sep	83.1

Source: Central Banks, IMF, Moody's ; <sup>1</sup>monthly average; <sup>2</sup>lending rate on current account overdraft; on deposits up to 1 year; <sup>3</sup>does not include banks

\*Sector A=All, C=Corporates, H=Household, PS=Private Sector, R=Residents.

## Country Outlook

The economy											
	2013	2014	2015	2016F	2017F		2013	2014	2015	2016F	2017F
<b>GDP (% yoy)</b>						<b>Inflation (average)</b>					
<b>CEE</b>						<b>CEE</b>					
Slovakia	1.4	2.5	3.8	3.3	3.5	Slovakia	1.5	-0.1	-0.3	-0.4	0.8
Slovenia	-1.1	3.1	2.3	2.4	2.7	Slovenia	1.9	0.4	-0.8	-0.1	0.9
Hungary	2.1	4.0	2.9	2.1	2.7	Hungary	1.7	-0.2	-0.1	0.4	2.0
<i>Average</i>	1.4	3.4	3.1	2.5	3.0						
<b>SEE</b>						<b>SEE</b>					
Albania	1.1	2.0	2.6	3.0	3.5	Albania	1.9	1.6	1.9	1.3	2.0
Bosnia Herzegovina	2.4	1.1	3.1	2.1	2.5	Bosnia Herzegovina	0.0	-0.9	-1.0	-1.2	0.8
Croatia	-1.1	-0.5	1.6	2.6	2.9	Croatia	2.2	-0.2	-0.5	-1.2	1.0
Romania	3.5	3.0	3.8	4.6	3.4	Romania	4.0	1.1	-0.6	-1.5	2.1
Serbia	2.6	-1.8	0.8	2.7	2.9	Serbia	7.9	2.1	1.4	1.1	2.0
<i>Average</i>	2.5	1.5	2.8	3.7	3.2						
<b>CIS</b>						<b>CIS</b>					
Russia	1.3	0.7	-3.7	-0.6	1.0	Russia	6.8	7.8	15.5	7.1	5.5
Ukraine	0.0	-6.8	-10.0	1.1	2.5	Ukraine	-0.3	12.2	48.0	15.0	11.0
<i>Average</i>	1.1	-0.3	-4.5	-0.4	1.2						
<b>MENA</b>						<b>MENA</b>					
Egypt	1.5	4.3	3.6	4.0	4.3	Egypt	9.5	10.1	10.4	13.5	27.0
<b>Average ISP Subsidiaries</b>	1.4	0.8	-2.0	0.9	2.0						

Market											
	2013	2014	2015	2016F	2017F		2013	2014	2015	2016F	2017F
<b>Exchange rate (average)</b>						<b>Interest rate (average)</b>					
<b>CEE</b>						<b>CEE</b>					
Slovakia						Slovakia	0.2	0.2	0.0	-0.3	-0.3
Slovenia						Slovenia	0.2	0.2	0.0	-0.3	-0.3
Hungary	297.0	308.6	310.0	311.4	311.2	Hungary	4.3	2.4	1.7	1.0	0.6
<b>SEE</b>						<b>SEE</b>					
Albania	140.0	140.4	139.8	137.7	137.8	Albania	4.3	3.0	2.7	0.9	0.9
Bosnia Herzegovina	2.0	2.0	2.0	2.0	2.0	Bosnia Herzegovina	0.0	0.0	0.0	0.0	0.0
Croatia	7.6	7.6	7.6	7.5	7.6	Croatia	1.3	0.7	1.2	0.9	0.9
Romania	4.4	4.4	4.4	4.5	4.5	Romania	4.0	2.3	1.1	0.6	0.6
Serbia	113.1	117.3	120.8	123.1	124.5	Serbia	11.1	8.8	6.3	4.1	4.0
<b>CSI MENA</b>						<b>CSI MENA</b>					
Russia (USD)	31.8	38.6	61.3	67.6	64.5	Russia	7.0	10.6	13.5	11.2	9.8
Ukraine (USD)	8.2	12.0	22.0	25.6	26.8	Ukraine	11.4	17.9	25.9	21.4	17.0
Egypt (USD)	6.9	7.1	7.7	10.0	16.8	Egypt	12.3	11.2	11.3	14.3	18.3

Bank											
	2013	2014	2015	2016F	2017F		2013	2014	2015	2016F	2017F
<b>Loans to private sector (% change yoy)</b>						<b>Deposit by private sector (% change yoy)</b>					
<b>CEE</b>						<b>CEE</b>					
Slovakia	5.7	6.4	8.7	8.8	6.4	Slovakia	4.3	3.8	9.9	6.0	4.8
Slovenia	-17.4	-13.4	-5.2	-6.0	1.0	Slovenia	0.0	6.6	5.8	6.0	4.8
Hungary	-4.4	-0.3	-12.3	-2.5	0.5	Hungary	-1.0	1.3	7.5	2.3	2.5
<b>SEE</b>						<b>SEE</b>					
Albania	-1.2	2.2	-2.6	1.0	2.0	Albania	2.1	2.9	1.0	1.5	2.0
Bosnia Herzegovina	2.6	1.9	2.2	2.3	2.9	Bosnia Herzegovina	8.9	6.4	7.8	5.1	5.7
Croatia	-1.5	-2.0	-3.1	-3.9	-1.4	Croatia	4.9	2.3	6.4	1.7	1.6
Romania	-3.4	-3.7	2.7	3.0	3.5	Romania	9.3	8.9	9.1	5.0	5.5
Serbia	-4.9	4.4	3.0	3.0	3.2	Serbia	3.3	9.7	7.1	7.0	5.0
<b>CIS</b>						<b>CIS</b>					
Russia	17.4	25.4	8.2	4.5	5.0	Russia	16.4	27.9	18.8	3.0	4.5
Ukraine	13.5	10.9	-3.8	2.0	3.0	Ukraine	18.5	-1.8	1.5	5.0	4.0
<b>MENA</b>						<b>MENA</b>					
Egypt	7.1	12.7	18.0	18.0	13.0	Egypt	18.3	16.6	20.4	22.0	16.0

Source: Intesa Sanpaolo Research Department forecasts

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