South-Eastern Europe Economic Review

January 2015

2015 Outlook

Below trend growth and low inflation: SEE & Egypt follows in the footsteps of the European core.

For yet another year we look into our crystal ball and (with the help of data and statistics) we formulate our outlook for the region of South-Eastern Europe and Egypt. On many occasions in the past we argued for the ability of the EU periphery to decouple from the core European economies and proceed with the project of convergence to the European average. Well, not this year. Despite the fact that we remain positive about all the economies we cover (with the exception of Ukraine, which faces a unique set of challenges), we find it very difficult to envisage a scenario where the region escapes a situation of positive but below-par growth. Low growth does not fulfil people's aspirations for a quick improvement in their standard of living, but has some positive aspects too. Below-par growth, in conjunction with the global deflationary environment and substantial declines in commodity prices, has led to a significant deceleration in local inflation rates, even in countries with perennially high inflation such as Serbia. In turn, low inflation has allowed central banks to implement aggressive loosening of monetary policy, thus supporting economic growth and easing debt servicing costs. Finally, fiscal policy will remain contractionary in Bulgaria and Cyprus, where deficits will continue to decline, but in all other countries expanding fiscal deficits will continue to support local economic activity.

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Table of Macroeconomic Forecasts

Table of Economic Forecasts								
	Real GDP (% YoY)		Inflation		Fiscal Balance (% GDP)		Current Account Balance (% GDP)	
	2014f	2015f	2014	2015f	2014f	2015f	2014f	2015f
Albania	1.9	2.5	1.6	2.5	-3.4	-4.0	-11.0	-11.5
Bulgaria	1.5	1.9	-1.4	-0.3	-3.5	-2.9	0.9	1.9
Cyprus	-2.2	0.5	-1.5	-0.5	-2.0	-1.0	-9.0	-5.0
Romania	2.7	2.9	1.1	1.5	-1.3	-1.9	-1.5	-1.9
Serbia	-0.8	0.5	2.1	3.0	-6.5	-6.5	-5.3	-5.0
Egypt	2.2	3.8	10.1	12.0	-12.8	-10.8	-0.8	-1.5
Ukraine	-6.0	-3.0	12.1	19.5	-6.0	-10.0	-3.5	-2.0

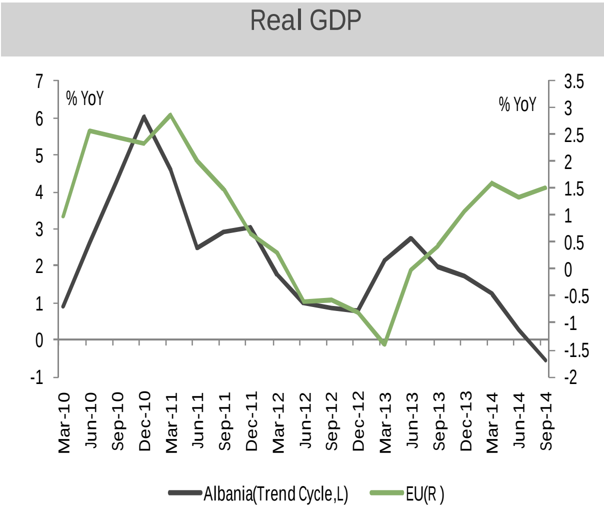
Source: Piraeus Bank Research

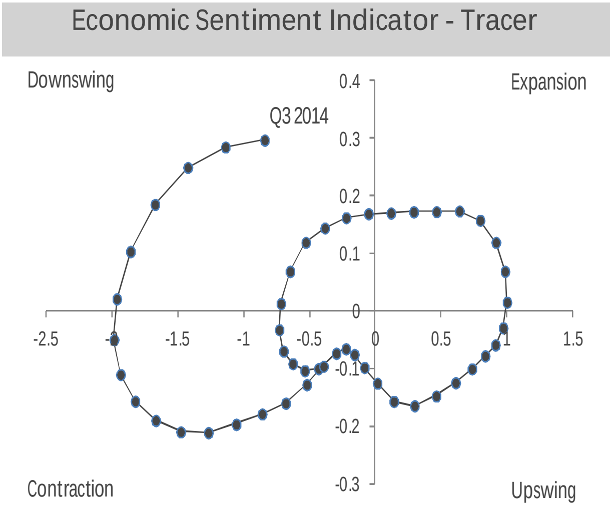
1. Albania

Things turning out well.

Exports and domestic consumption are the key growth drivers for 2015, as real GDP has already been affected by the repayment of government arrears. For 2014, we keep our forecast unchanged at 1.9% YoY for real GDP, while we anticipate a further increase in 2015 to 2.5% as production activity is expected to recover significantly, investments will be boosted and domestic demand will add a few points to economic activity. This can be seen also from the Tracer of the Economic Sentiment Indicator, which is shifting into more positive territory. However, the ongoing credit tightening is expected to keep real GDP below the anticipated level. For the first nine months of 2014, real GDP increased 1.4% YoY from 1.2%, while for 2014Q3 alone economic activity increased by 3.3% from a contraction of 0.4% in 2014Q2 and -2.0% in 2013Q3 due to the positive contribution of the agriculture, construction and services.

Prices in Albania follow the region's trend, as inflationary pressures have slowed, keeping inflation below the Bank of Albania's (BoA) lower bound. For 2015, we expect inflation to pick up marginally but remain within the lower band of the BoA target of 2.5% as food prices are anticipated to increase and domestic demand to recover. We must note however that the BoA has followed an impressive easing since 2013, by cutting the key policy rate by 150 bps to the historically low level of 2.0%.



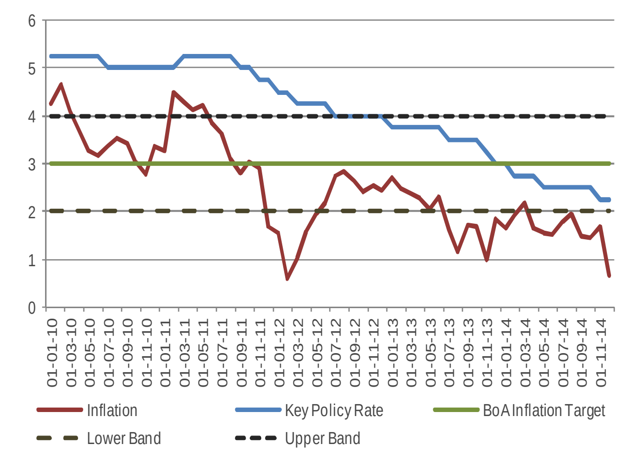


Source: Piraeus Bank Research, National Sources

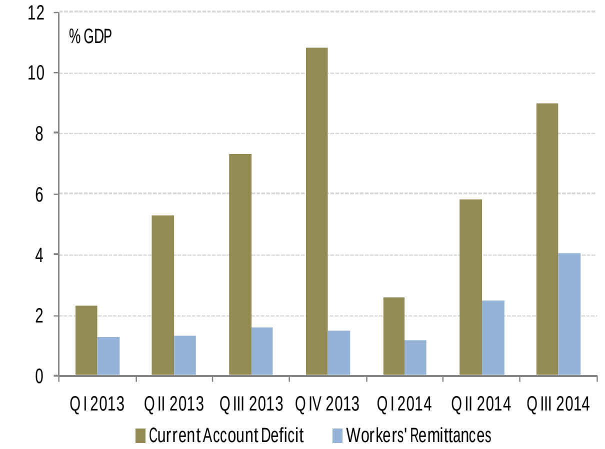
The fiscal sector has shown considerable improvement since the beginning of last year, as the government has made significant progress on the repayment of its arrears. The SBA loan from the International Monetary Fund (IMF) of EUR 330.9mn has strengthened the fiscal sector, ensuring the sustainability of public debt and placing the economy on a stable growth path over the medium term. We therefore revise our forecast for the fiscal deficit in 2014 to 3.4% and expect a deficit of 4.0% as fiscal consolidation continues. A risk to the upside is, however, energy spending, as electricity reforms have not yet been introduced. However, it is worth noting that Albania's public debt in 2015 is expected to decline for the first time in five years.

The pick-up in economic activity is expected to marginally widen the current account deficit; however, the expected improvement in exports and low domestic savings will counterbalance this. We keep our 2014 forecast unchanged for the current account deficit at 11.0% of GDP, while a widening is expected in 2015 to 11.5%. We anticipate, though, a significant recovery in investments and especially in the extractive industry, allowing the comfortable financing of the current account balance.

Inflation



Current Account Deficit & Remittances



Source: Piraeus Bank Research, National Sources

Albania Economic Indicators								
	2011	2012	2013	Q1 2014	Q2 2014	Q3 2014	2014f	2015f
% YoY								
Real GDP	3.2	1.0	1.5	1.4	-0.4	3.3	1.9	2.5
Unemployment Rate (avg)	--	13.8	16.4	18.6	17.7	17.4	--	--
Inflation (avg)	3.5	2.0	1.9	1.9	1.6	1.7	1.6	2.5
Monetary Policy Rate (eop)	4.75	4.0	3.0	2.75	2.5	2.5	2.25	--
EUR/ALL (avg)	140.4	139.0	140.3	140.4	140.1	139.7	140.0	--
% GDP								
Fiscal Balance	-3.6	-3.5	-5.0	-0.1	-1.6	-2.2	-3.4	-4.0
Current Account Balance	-13.4	-10.3	-10.8	-2.6	-5.8	-9.0	-11.0	-11.5

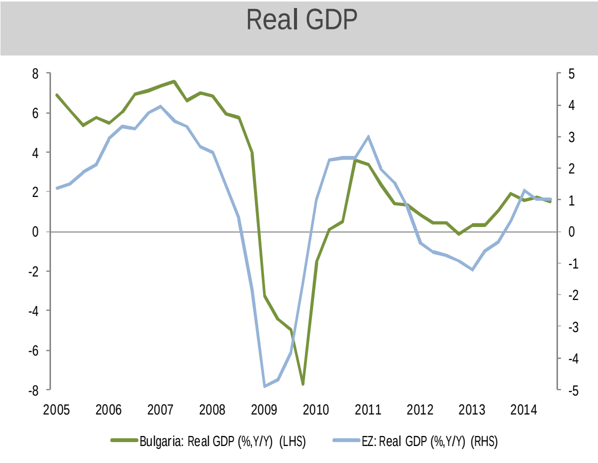
Source: Piraeus Bank Research, National Sources

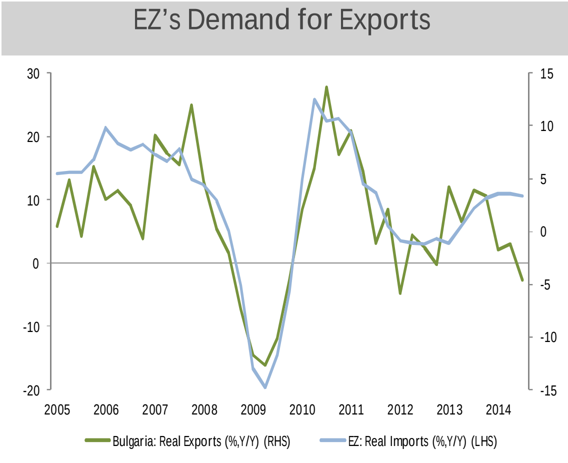
2. Bulgaria

Recovery but too Modest

In 2014, the average growth rate of real GDP is estimated to be 1.5%, as domestic demand counterbalanced the negative net export effect. In 2015, we expect a slight acceleration in the average growth rate of real GDP (to 1.9%), as domestic demand will remain a growth driver, but its contribution to growth is expected to diminish. Additionally, the net export effect is anticipated to become positive in 2015, as our basic scenario for the Eurozone economy (real GDP growth rate will increase from 0.8% in 2014 to 1.2% in 2015) indicates that the demand side conditions for Bulgarian exports will improve in 2015.

Low global oil prices, persistantly subdued inflation in the Eurozone economy and tepid wages growth are expected to maintain the negative inflation rate throughout most of 2015. However, the average inflation rate in 2015 is estimated to be less negative (-0.3%) than in 2014 (-1.4%). Tentative labour market improvement seen in 2014 will continue into 2015. However, the pace of the unemployment rate reduction is expected to be slower, due to the planned job cuts in the public sector (as part of the fiscal consolidation and structural reform efforts) and lower investment growth. Therefore, the average level of unemployment in 2015 will fall to 11.3% (from 11.6% in 2014).





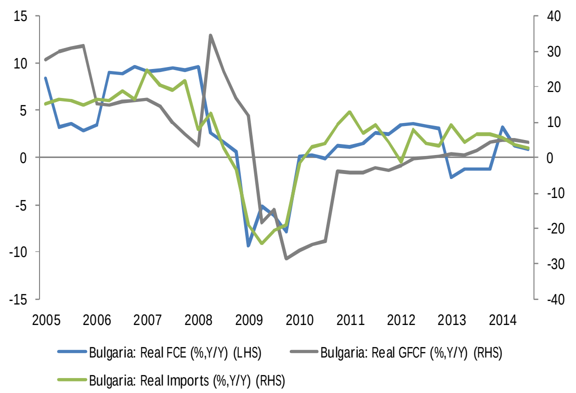
Source: Piraeus Bank Research, National Sources

Bulgaria's banking sector was shaken by substantial deposit withdrawals during 2014. However, we believe that the actions taken (the release of depositors' assets of the collapsed Corporate Commercial Bank and the extension of First Investment Bank's credit line) will lead to the gradual stabilization of the banking sector. Moreover, the banking sector has continued to deleverage and increase liquidity, leading to the avoidance of the systemic perspective of the 2014's deposit withdrawal events.

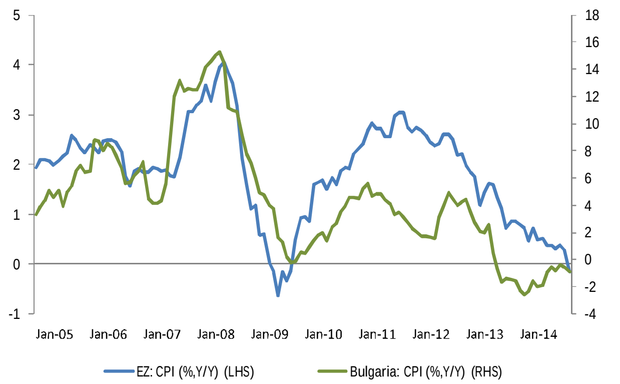
Due to the currency board arrangement, the BNB can only provide liquidity support to the banking sector to the extent that its reserves exceed its monetary base. Then, support can only exist under certain conditions and at short maturity against liquid collateral. Moreover, the currency board arrangement and high degree of euroization (in loans) limit the BNB's ability to act as a lender of last resort.

Due to the high degree of dependency on energy imports, lower global oil prices are expected to narrow the trade deficit by almost 1% of GDP, which will help the Current Account surplus to widen in 2015. Additionally, the difference in the annual growth rate between total exports and total imports is expected to shrink. Moreover, during 2015, net outflows from the financial system are also expected to be smaller than in 2014.

Domestic Demand & Imports



Inflation Rate



Source: Piraeus Bank Research, National Sources

The fiscal deficit widened to 3.5% of GDP in 2014 (from 1.8% in 2013), significantly more than initially anticipated in the original 2014 budget, due to the necessary banking sector support and the caretaker programme provided by the government. The government will not pursue aggressive fiscal consolidation within a deflationary environment with elevated unemployment rate.

Policy makers will try to reduce the deficit in the way which will be least harmful for growth and will not hinder improvement in employment. We estimate that the government will try to reduce the fiscal deficit (marginally) to below 3.0% in 2015, in order to avoid the launch of the Excessive Deficit Procedure. More analytically, we expect that the size of the state support for the banking sector will be less in 2015 and the government will try to make a small expansion of the tax base.

Bulgaria Economic Indicators

	2011	2012	2013	Q1 2014	Q2 2014	Q3 2014	2014	2015
% YoY								
GDP	2.2	0.4	0.9	1.6	1.8	1.5	1.5	1.9
Final Consumption	1.9	3.3	-1.5	3.3	1.2	0.8	1.5	1.9
Investment	-3.7	-0.5	1.9	4.8	5.1	4.4	4.6	2.5
Exports of G&S	11.7	0.5	10.1	2.2	3.1	-2.8	-0.1	1.5
Imports of G&S	8.4	3.4	6.6	5.5	3.7	2.7	3.3	1.5
Industrial Production	7.1	2.4	7.0	9.7	9.0	4.9	--	--
Retail Sales	-0.9	4.1	0.6	8.4	8.5	5.7	--	--
Inflation (avg)	4.2	2.9	0.9	-2.4	-1.8	-0.8	-1.4	-0.3
% of GDP								
Current Account Balance	0.1	-0.6	2.1	-0.7	-0.9	1.3	0.9	1.9
Fiscal Balance	-2.1	-0.5	-1.8	-1.1	-1.3	-1.9	-3.5	-2.9

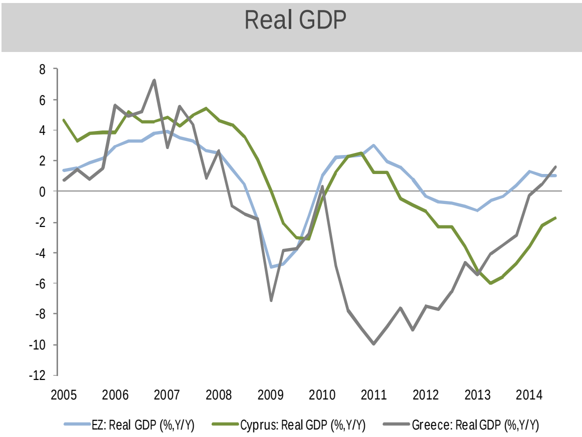
Source: Piraeus Bank Research, National Sources

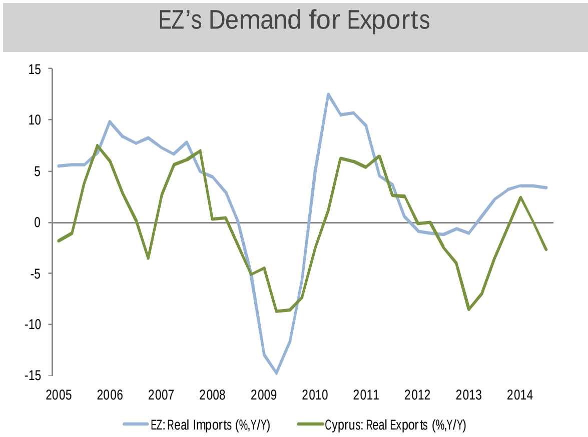
3. Cyprus

The Year of Growth?

In 2014, the average decline rate of real GDP is estimated to be 2.2%, significantly milder than initially projected, as almost all demand components performed better than initial expectations. Specifically, there was a sharp improvement in investment due to transport equipment and inventory building. In 2015, we expect a small average growth rate of 0.5% in real GDP, as the economy will try to gradually regain its momentum.

More analytically, consumption is expected to remain subdued (from -1.9% in 2014 to -0.9% in 2015), due to the very weak wage growth and continuous deleveraging from indebted households. Improved competitiveness in professional business services and gradual increase in European demand are expected to help exports to recover (from -5% in 2013 and -1% in 2014 to 1% in 2015). However, the net export contribution is expected to be almost zero, as the growth rate in exports is expected to be close to the growth rate of imports.



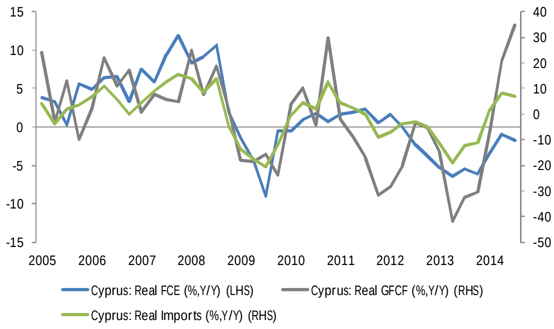


Source: Piraeus Bank Research, National Sources

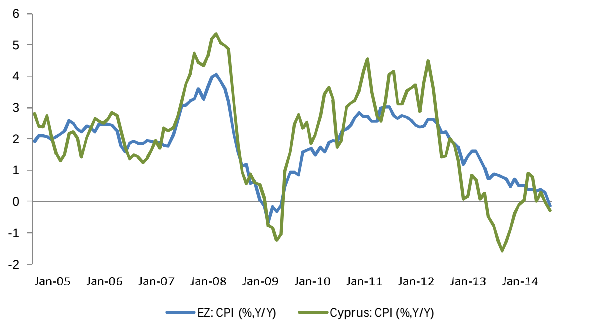
Significant downside risks still persist. The prolonged period of tight credit conditions and deleveraging hinders the sustainable recovery in domestic demand. Less leveraged sectors and households will initially lead the recovery in domestic demand. On the foreign front, sanctions against Russia could harm growth more than expected, through sizeable disruption in the flow of tourists and vast Russian rouble depreciation.

Low global oil prices, persistantly subdued inflation in the Eurozone economy and very weak wages growth are expected to maintain the negative inflation rate throughout most of 2015. However, the average inflation rate in 2015 is estimated to be less negative (-0.5%) than in 2014 (-1.5%). Tepid real GDP growth rate in 2015 will not be sufficient to lead to a reduction in the unemployment rate. We estimate that the average level of unemployment in 2015 will be marginally higher than in 2014 (16.3%).

Domestic Demand & Imports



Inflation Rate



Source: Piraeus Bank Research, National Sources

Notably, the primary fiscal balance recorded a surplus in 2014 due to the tight budget execution and the fiscal measures taken in 2013 (such as the increase in the corporate tax rate from 10.0% to 12.5%). Additionally, the total fiscal deficit shrank remarkably to 2.0% of GDP (from 4.7% in 2013), despite the third consecutive year in a recessionary environment.

In 2015, the expected return to real GDP growth will help the fiscal deficit to shrink further, as budget revenues will increase. On the other hand, expenditures will continue to follow a diminishing pathway, as the public sector wage bill is expected to fall and early retirement is also expected to wane, under the economic adjustment program.

If the government is not required to provide further capital to the banking sector and real GDP growth accelerates to around 2.0% in 2016 and thereafter, we estimate that the Debt to GDP ratio will peak in 2015 and start falling gradually from 2016. Under the adverse scenario of enduring tepid growth, the Debt to GDP ratio will probably peak in 2017.

Moreover, the effort to strengthen the banking sector's regulatory and supervisory framework must be continued by the Cypriot authorities. The large banks should continue repairing their balance sheets and recovering from high NPL ratios. As a consequence, the vulnerability to shocks from the banking sector will continue to decrease.

Cyprus Economic Indicators

	2011	2012	2013	Q1 2014	Q2 2014	Q3 2014	2014	2015
% YoY								
GDP	0.3	-2.4	-5.4	-3.6	-2.2	-1.8	-2.2	0.5
Final Consumption	1.6	-1.1	-5.8	-3.5	-0.9	-1.8	-1.9	-0.9
Investment	-14.8	-15.6	-30.0	-6.6	21.0	34.6	15.0	5.0
Exports of G&S	4.2	-1.7	-5.0	2.4	0.0	-2.6	-1.0	1.0
Imports of G&S	-0.6	-4.6	-13.6	1.7	8.0	6.7	5.0	1.0
Industrial Production	-7.6	-9.7	-12.3	-2.5	0.0	0.8	--	--
Retail Sales	-0.5	-3.7	-7.0	1.1	5.6	2.1	--	--
Inflation (avg)	3.3	2.4	-0.4	-2.6	-1.4	-0.7	-1.5	-0.5
% of GDP								
Current Account Balance	--	--	-3.1	-5.6	-5.3	-7.4	-9.0	-5.0
Fiscal Balance	-6.1	-4.9	-4.7	-0.1	0.0	1.2	-2.0	-1.0

Source: Piraeus Bank Research, National Sources

Box: Cyprus Debt Sustainability Analysis

Cyprus' public debt was low for many years, making it sustainable for the foreseeable future. However, as the global financial crisis unfolded and the Greek economic and debt crisis evolved in recent years, the actions of other markets took a toll on Cypriot public debt, as the country lost access to international debt markets. The latter combined with the government's short-term lending policy as well as the overexposed and large banking sector, left the country with unsustainable public debt in just a few years. Several measures have been taken in order to minimize the spike in public finances. Such measures include the change in terms and maturity of the Russian loan that the country received in 2012 and the rollover of debt issued for the financial support of one of the largest banks in Cyprus, Laiki Bank.

In an attempt to define the factors forming and affecting public debt, we use the following formulas, which break down the changes in debt (as a % of GDP) into each individual determinant. The first equation represents the debt at the end of year t, in terms of the debt at the end of the previous year Dt-1, the general government surplus in year t and the debt stock flow adjustments SFt.

$$D_t = D_{t-1} - NB_t + SF_t$$

Where, Dt = Public Debt
NBt = General Government Surplus
SFt = Stock-Flow Adjustments

Which lead us then to the following equation:

$$\Delta d_t = -pb_t + d_{t-1} \times (i_t - y_t) + sf_t$$

Where, Yt = nominal growth rate
Pbt = primary surplus
Dt = debt as % of GDP
It = weighetd average public dent interest rate at t-1
Sft = stock flow adjustment as % of GDP

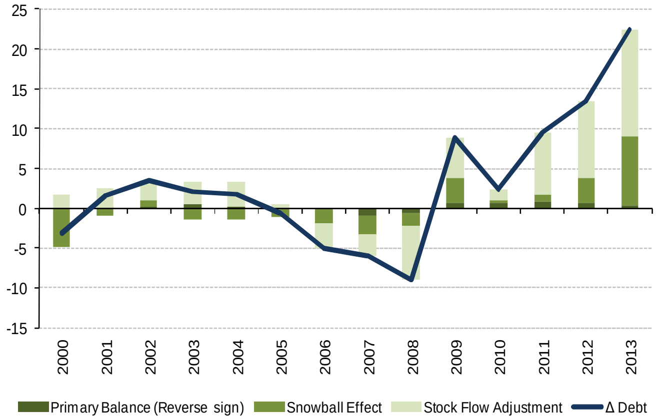
Hence, we observe that public debt dynamics (as % of GDP) are defined by:

1. The primary fiscal balance (surplus or deficit)
2. The relationship between the weighted average interest rate of public debt and the nominal GDP growth rate. The fact that the debt is expressed as a percentage of GDP creates an interaction between the nominal GDP growth rate and the cost of servicing existing debt. If the nominal GDP growth rate is higher than the nominal interest rate on public debt, the debt to GDP ratio will be lower. This phenomenon has come to be referred to as a "snowball effect" and, theoretically at least, can lead to a reduction of the debt as a percentage of GDP, despite the existence of primary deficits.
3. The stock flow adjustments, which reflect the magnitude of the change of debt that is not accounted for as deficit.

By changing one or more of the above factors as a scenario, we estimate the long-term course of the debt as a % of GDP.

Since 2012, the evolution of the debt to GDP ratio has mainly been defined by the snowball effect and the stock-flow adjustments.

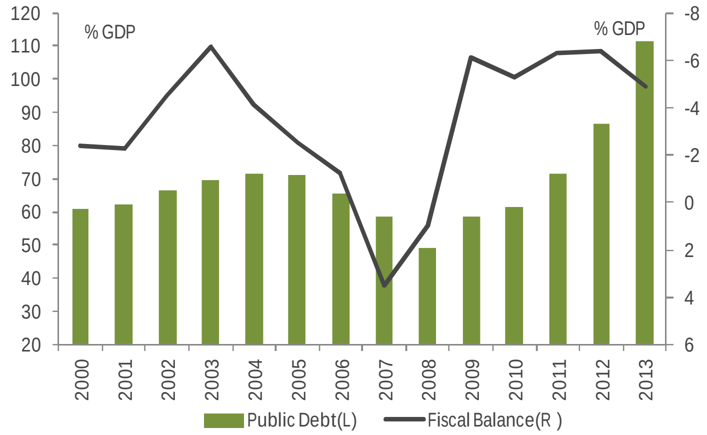
Evolution of Public Debt: 2000-2013



Source: Piraeus Bank Research, IMF – Staff Report for the Article IV Consultation (October 2014), AMECO

The Economic Program the country adopted in April 2013, following March's banking frenzy, has had impressive results, not only with regards to fiscal consolidation, but also with regards to the return of investor confidence and a rapid economic recovery. Indicative of this correction is the return of the fiscal balance to a surplus just one year after the Economic Program began. As the fiscal balance remains in positive territory, its financing does not burden the public debt, creating more favourable conditions for the future evolution of public finances.

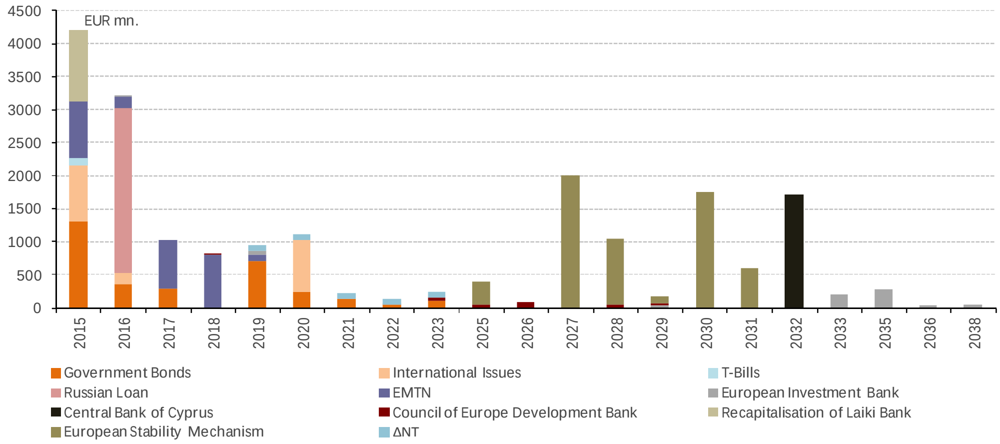
Fiscal Balance (Reverse Sign) & Debt



Source: Piraeus Bank Research, IMF

Also, by looking at the debt maturities over time, we can identify those years in which the government will have to refinance debt maturities. Debt maturities are the main financing needs and are illustrated below. The possible shift of maturities in the future as well as any other intervention would have a direct impact on the annual financing needs.

Debt Maturities



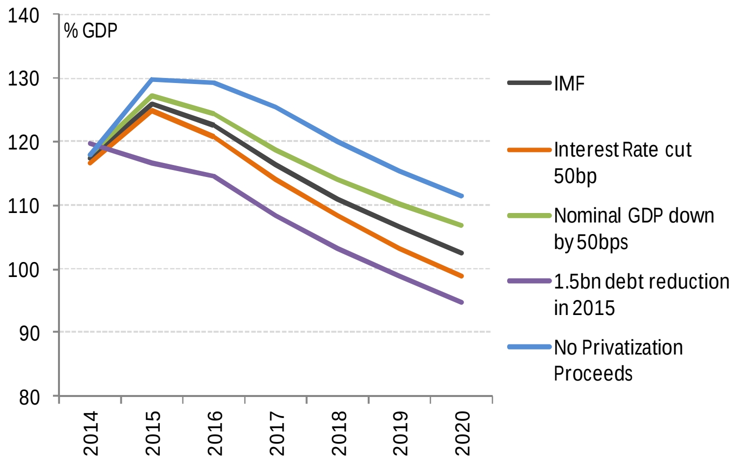
Source: Piraeus Bank Research, Ministry of Finance

In the context of the Economic Program, the IMF conducted a Debt Sustainability analysis. It expects that, should the government fully implement the Program, Cyprus' debt will remain on a sustainable course. What happens however, if some of the prerequisites are not met, or there is downward or upward realization of the forecasts?

Our basic assumptions of four different scenarios are the following:

1. A 50bp cut in the interest rate under the baseline scenario
2. A decline by 50bp of the nominal GDP forecast under the baseline scenario
3. A EUR 1.5bn debt reduction in 2015
4. No privatization proceeds

Debt Evolution under different Scenarios

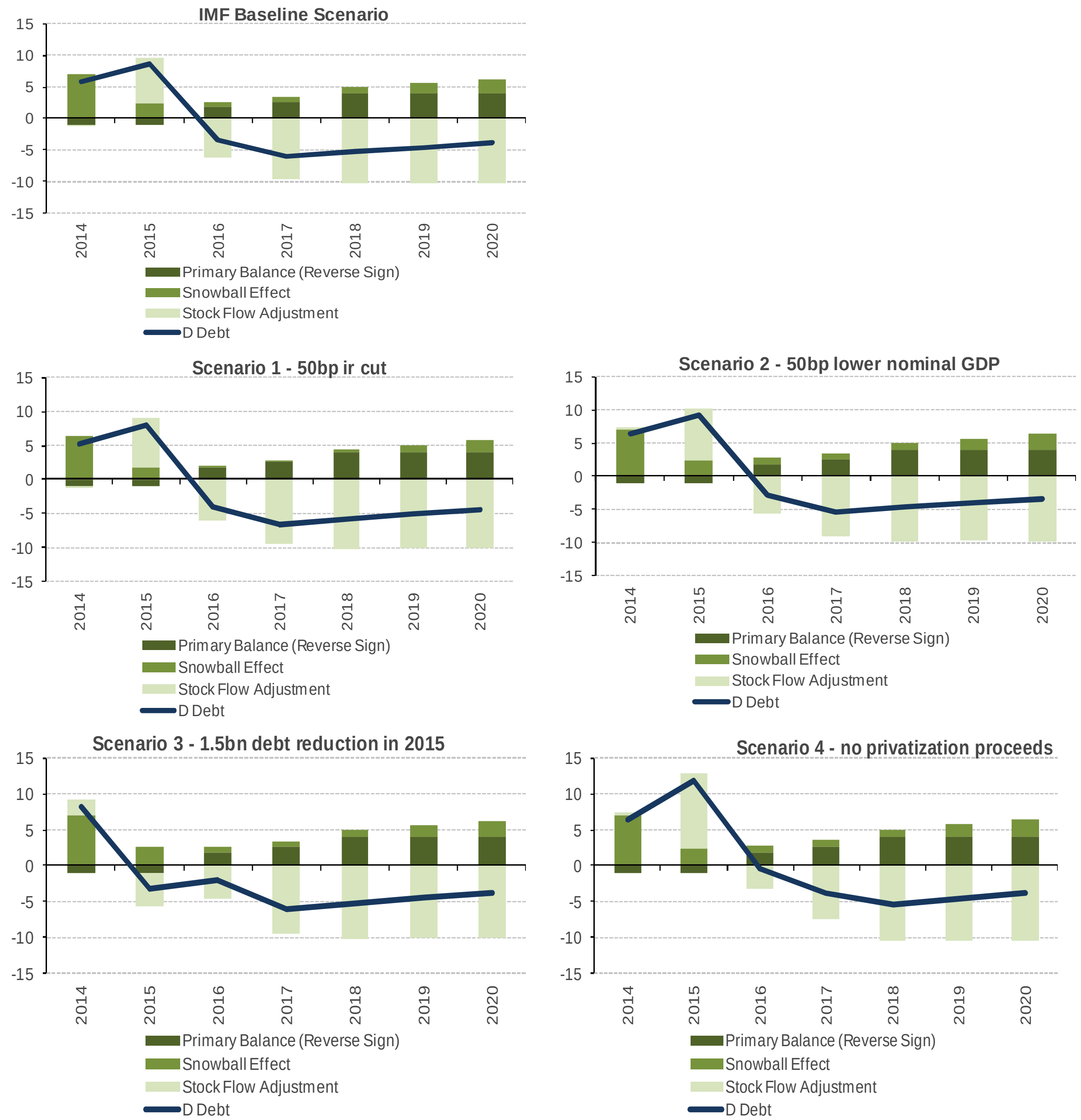


Source: Piraeus Bank Research, IMF – Staff Report for the Article IV Consultation (October 2014), AMECO

We observe that public debt under the 2 adverse scenarios (lower nominal GDP and no privatization proceeds) worsens by an average of 4.5%, while under the 2 positive scenarios public debt is lower than the baseline scenario by an average of 4.4%

In the following graphs, we depict the different decomposition of the debt determinants under the Baseline Scenario by the IMF and our four scenarios. We see that the most significant change of debt is under Scenario 3 (EUR 1.5bn. debt reduction in 2015) and the most significant change in the stock-flow adjustments is under Scenario 4 (no privatizations).

Snowball Effect under the different Scenarios



Source: Piraeus Bank Research, IMF – Staff Report for the Article IV Consultation (October 2014), AMECO

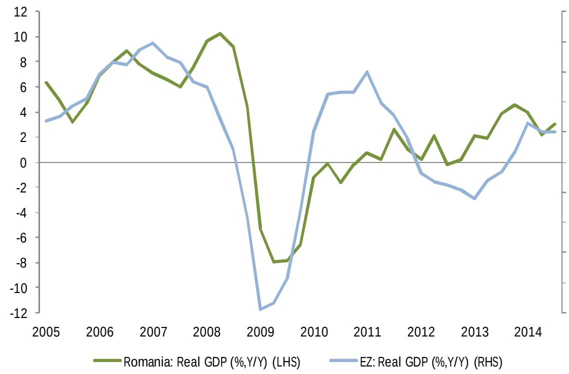
4. Romania

More than a few Green Shoots

In 2014, the average growth rate of real GDP is estimated to be 2.7%, as strong consumption (3.7%) and net exports counterbalanced a significant contraction in investment (-5.5%). In 2015, we expect slight acceleration in the average growth rate of real GDP (to 2.9%), as the recovery in investment (3.5%) is estimated to be enough to counterbalance the deceleration in consumption (2.7%) and the milder net export effect.

More analytically, consumption is anticipated to post resilient behaviour, as real disposable income will continue its ascending pathway, due to dynamic wage growth, tepid inflation and declining interest rates. Poor investment performance in 2014 and the continuation of successful EU fund absorption in 2015 are expected to result in the restoration of investment. EU fund inflows exceeded €3.5bn during 2014, and a larger inflow amount is possible in 2015, as Romania will receive the last part of the EU funds from the 2007 – 2013 program period. Therefore, the unemployment rate will benefit from the upturn in investment and consequently fall to an average level of 6.6% in 2015 (from 6.9% in 2014).

Real GDP



EZ's Demand for Exports

Source: Piraeus Bank Research, National Sources, Datastream

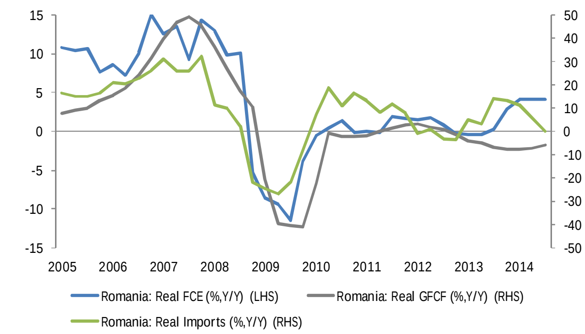
Apart from the better than expected absorption of EU funds, upside risks comprise looser monetary policy, eased credit conditions and low global oil prices. On the other hand, downside risks include higher geo-political risk, faster deleveraging from the private sector and an uncertain political landscape before the general elections in autumn 2016, resulting in little progress in the reforms needed for more effective tax collection and smaller losses at state-owned enterprises.

Low global oil prices, persistantly subdued inflation in the Eurozone economy, stability in the EUR/RON exchange rate and prospects for good agricultural production are expected to lead to a small acceleration in the average inflation rate (from 1.1%

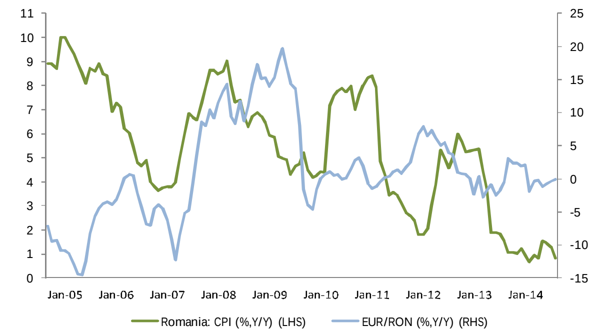
in 2014 to 1.5% in 2015). Hence, the inflation rate will be lower than the NBR's target level (2.5%) and even lower than its lower bound (1.5%) for some months of 2015.

Therefore, we expect that the NBR will reduce its policy rate by 50 bps (in two different stages of 25 bps each), from 2.75% to 2.25%, during the first half of 2015. If the inflation rate seems to remain lower than 2.5% during the second half of 2015, we would not rule out a further reduction (of 25 bps) to 2.00%. Moreover, the NBR will probably reduce its RON minimum reserve requirement ratio. Lower interest rates will ease credit conditions and consequently increase RON lending, offsetting (partly) the decline in FX loans and resulting in a stimulating credit impulse to domestic demand.

Domestic Demand & Imports



Inflation & RON's stability



Source: Piraeus Bank Research, National Sources, Datastream

The IMF team reached a broad understanding with the RON authorities on the 2015 budget, in line with the targets of the program supported by the IMF Stand-by Arrangement and EC Balance of Payments Assistance. The draft budget includes a deficit target of 1.8% of GDP in cash terms and 1.2% of GDP in ESA terms, being consistent with reaching the medium-term budgetary objective of 1.0% of GDP deficit in structural terms (ESA base) in 2015. We estimate that the budget deficit will be almost 2% of GDP (in ESA terms) in 2015, as the cut in social security contributions, reduction in the rate of property tax on specific constructions and in other excise rates will probably lower tax receipts, while public expenditures will probably remain stable. The budget will probably be vulnerable to fiscal slippage, due to the uncertain political landscape before the general elections in autumn 2016.

We expect the Current Account deficit to post a small widening (from 1.5% of GDP in 2014 to 1.9% of GDP in 2015), as the banks will continue to lose sizeable capital (until foreign liabilities fall to regional levels as a proportion of bank financing), counterbalancing the lower capital repatriation from multinational companies. Additionally, the difference in the annual growth rate between total exports and total imports is expected to shrink.

Romania Economic Indicators								
	2011	2012	2013	Q1 2014	Q2 2014	Q3 2014	2014	2015
% YoY								
GDP	1.2	0.6	3.1	4.0	2.2	3.0	2.7	2.9
Final Consumption	0.9	1.0	0.6	4.1	4.2	4.1	3.7	2.7
Investment	0.6	1.1	-5.9	-7.5	-7.5	-6.0	-5.5	3.5
Exports of G&S	11.8	1.9	21.4	14.3	8.5	-0.3	6.5	4.5
Imports of G&S	10.2	-1.7	8.8	11.4	6.0	-0.1	4.5	3.5
Industrial Production	7.1	2.4	7.0	9.7	9.0	4.9	--	--
Retail Sales	-0.9	4.1	0.6	8.4	8.5	5.7	--	--
Inflation (avg)	5.8	3.3	4.0	1.1	0.9	1.1	1.1	1.5
Monetary Policy Rate (eop)	6.0	5.25	4.0	3.50	3.50	3.00	2.75	2.25
% of GDP								
Current Account Balance	-4.7	-4.5	-0.8	-0.1	-0.5	-0.4	-1.5	-1.9
Fiscal Balance	-4.3	-2.5	-2.5	-0.1	-0.5	0.1	-1.3	-1.9

Source: Piraeus Bank Research, National Sources

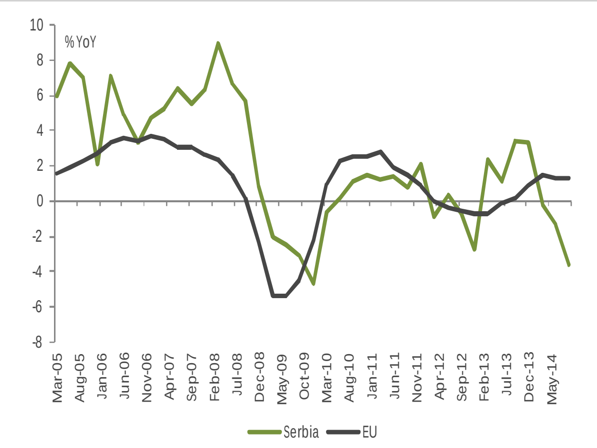
5. Serbia

Not exactly what was planned?

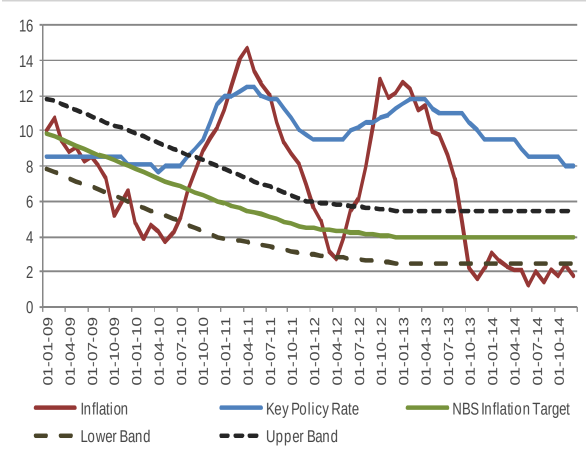
The economic prospects for Serbia remain challenging, as the country entered another round of recession in May due to floods that interrupted the production line of the country, put a halt to exports and left many households with losses. This in turn led to a contraction in real GDP in the first nine months of 2014 of 1.7% YoY from an increase of 2.3% in 9m2013. For 2015, we expect the recovery of international trade, low commodity prices, the recovery in domestic demand, the base effect from 2014 as well as the deprecating RSD to increase real GDP moderately to 0.5% YoY. The recently agreed program of the government with the IMF will lead to a significant fiscal consolidation and austerity measures that will negatively counterbalance this increase in real GDP.

Inflation has been a long-term problem for the Serbian economy, but the situation has somewhat reversed in 2014, as the extremely low levels of inflation are a source of worry. Inflation recorded record low values in 2014, as food and housing prices hit rock bottom. We expect that this trend will continue as weakened economic activity, reduced household spending due to the floods and the loosened monetary policy will keep inflation at low levels, but within the NBS's target lower bound in 2015. Any pass-through effects of the exchange rate to inflation are only expected to stabilize prices. We therefore expect average inflation in 2015 to increase to 3.0% from 2.1% in 2014, while we estimate that the NBS will cut the key monetary policy rate by year end, as the low levels of inflation allow plenty of space to attempt to boost domestic economic activity.

Real GDP



Inflation



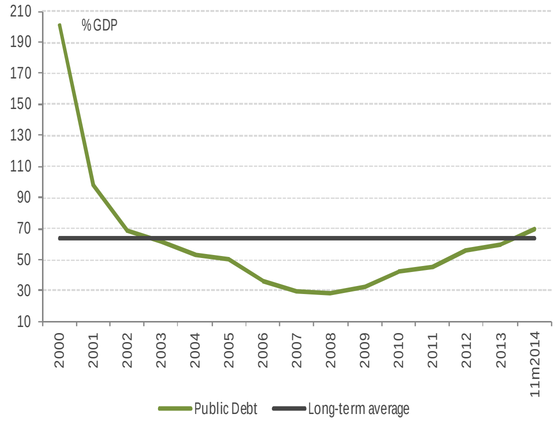
Source: Piraeus Bank Research, National Sources

In our November issue we argued that Serbia's Achilles heel is its fiscal sector and this is a fact that will be evident in 2015 as well. The widening fiscal deficit and overshooting public debt keep the balances volatile at both a macro and fiscal level, although the consolidation of public finances is starting to bear fruit. The government will have to finance a deficit that was burdened in 2014 with the support for the flood-related catastrophes.

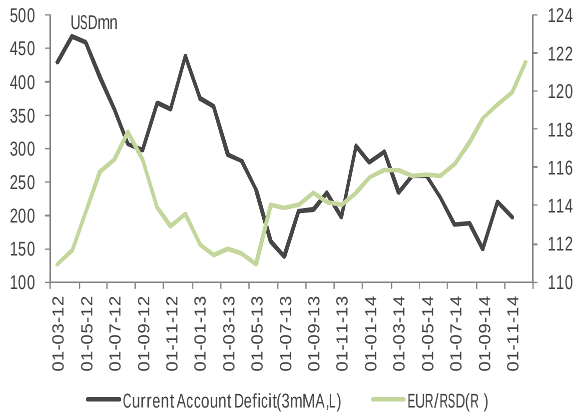
However, the newly established economic program that the country agreed with the IMF is expected to act as a much-needed fiscal buffer. We therefore expect the fiscal deficit to reach 6.5% of GDP in 2015.

External imbalances continue to be limited, as the current account deficit is almost half what it was in previous years, due to the boost in export activity, the weakening of the local currency against the EUR (especially in the last three months of 2014) and the fall in economic activity. For 2014 we expect the current account deficit to contract to 5.3% of GDP, while for 2015 we anticipate a further reduction to 5.0% of GDP as global exports and imports are expected to improve.

Real GDP



Current Account Deficit & EUR/RSD



Source: Piraeus Bank Research, National Sources, Datastream

Serbia Economic Indicators	2011	2012	2013	Q1 2014	Q2 2014	Q3 2014	2014f	2015f
				% YoY				
Real GDP	1.4	-1.0	2.6	-0.2	-1.3	-3.6	-0.8	0.5
Unemployment Rate (avg)	23.0	24.0	22.1	20.8	20.3	17.6	--	--
Inflation (avg)	11.2	7.3	7.9	2.7	1.8	1.9	2.1	3.0
Monetary Policy Rate (eop)	9.75	11.25	9.50	9.5	8.5	8.5	8.0	--
EUR/RSD (avg)	102.0	113.2	112.9	115.6	115.5	116.8	116.9	--
				% GDP				
Fiscal Balance	-3.9	-5.4	-4.9	--	--	--	-6.5	-6.5
Public Debt	45.4	56.2	59.6	--	--	69.2	--	--
Current Account Balance	--	-12.4	-6.8	-1.6	-3.2	-4.3	-5.3	-5.0

Source: Piraeus Bank Research, National Sources

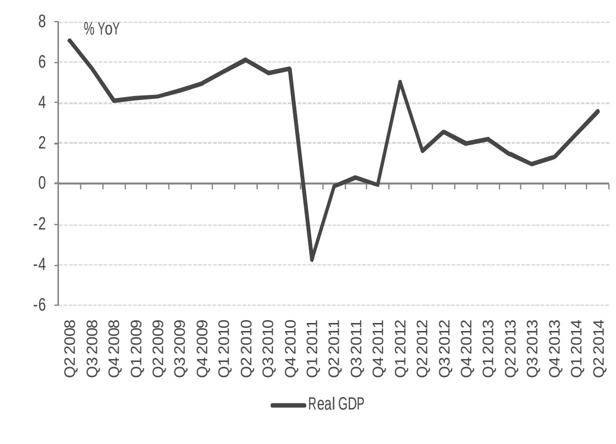
6. Egypt

It's Donor Time

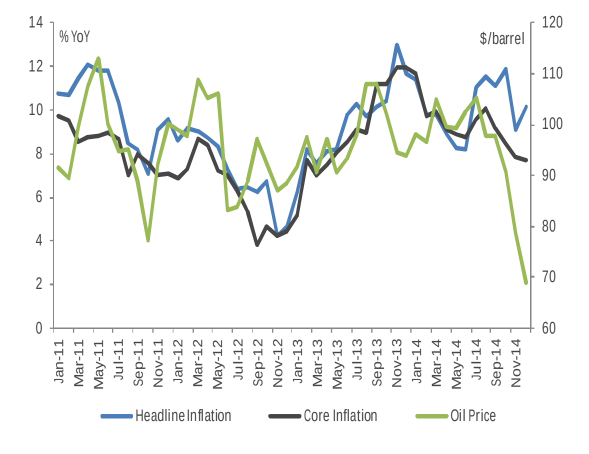
Egypt has come a long way since the socio-political turmoil that shook the country's economy. The 2013 coup d'etat not only created fewer than expected shocks but instead the Al-Sisi government sealed the GCC countries' financial support last year, ensuring much needed stability. The government has now embarked on a very generous and ambitious structural reform path aiming to restore the social and economic injustices that have worsened in the last three years. The boost in economic activity, the support of the local currency and the attempt to disengage from energy and food subsidies are the main priorities of the agenda. These actions are backed by the Arab world as they continue funding and financing the country through either subsidies or loans. Another positive factor is the recent lift of the visa and travel restrictions Europe had imposed on Egypt due to the increasing geopolitical risk in the country and the "neighbourhood". Finally, the recently announced parliamentary elections complete the country's political roadmap, adding to the stability and improvement in economic activity. For the FY 2014/15 we expect real GDP to increase to 3.8%, from 2.2% in the previous FY, as the expected additional USD 9bn. petroleum products funding by the UAE, the structural reforms introduced, the estimated recovery in the tourism sector in the following months as well as the planned improvement of the Suez Canal in order to double its capacity will add some points to GDP. Risks to the downside, however, entail the increasing and high unemployment levels and the challenging long-term average of tourist arrivals.

Real GDP in FY 2013/14 increased by 2.2% YoY from 2.1% in the FY 2012/13 with final consumption and to a lesser extent investments contributing positively to economic activity. However, net exports placed a negative drag on economic activity, due to the fact that the government was forced to cut petroleum exports in order to use them domestically. Egypt is facing one of its worst energy crises, resulting in decelerating economic activity. Hence, the recent agreement between Greece, Cyprus and Egypt on energy reserves is an attempt to secure the future supply of gas in the country.

Real GDP



Inflation



Source: Piraeus Bank Research, National Sources, Datastream

Inflation pressures increased significantly following the marginal pick-up in economic activity, easing monetary policy and an increase in fruit and vegetable prices, as headline inflation in FY 2013/14 increased to 10.1% from 6.9% in FY 2012/13. For the FY 2014/15, we expect inflation to increase further to 12.0% as the EGP continues to depreciate against the USD and the prices of regulated items has almost doubled in the first half of the current fiscal year. On the other hand, what we expect will counterbalance the inflationary pressures is the lower level of core inflation, the lower global commodity prices and an increase in the Central Bank of Egypt (CBE) overnight deposit and lending rates. What could bring the prices up further, though, could be a planned increase in the current levels of VAT to 14% from 10%.

What is truly worth noting regarding the fiscal sector is the government's attempts to actually introduce a plan in order to reduce fuel subsidies, something that has been burdening the budget for decades. Fuel subsidies were supposed to be just a quick fix, but instead this situation has persisted over the years. The fiscal deficit contracted in FY 2013/14 to 12.8% of GDP from 14.1% in FY 2012/13, as the financial aid from the Arab world to the country in 2013 allowed the government to finance the fiscal deficit. For the FY 2014/15 the government aims to undertake structural reforms, allowing a better distribution of budget funds and an increase in revenues. Additionally, the lower oil prices in the second half of the previous year are expected to limit the fuel subsidies cost and hence reduce to some degree the fiscal deficit. Therefore, we expect the fiscal balance to further moderate in FY 2014/15 to 10.8% of GDP.

In the external sector, the current account deficit narrowed in FY 2013/14 to 0.8% of GDP from 2.4% in FY 2012/13, while the country faced significant challenges with regards to its financing and declining foreign exchange reserves. This has stabilized however as foreign direct investments have been hampered by the decline in tourism activity. We expect the current account balance to remain at a deficit of 1.5% of GDP.

Egypt Economic Indicators				
	2011/12	2012/13	2013/14	2014/15f
% YoY				
Real GDP	2.2	2.1	2.2	3.8
Inflation (avg)	8.7	6.9	10.1	12.0
Discount Rate (eop)	9.50	10.25	8.75	--
% GDP				
Fiscal Balance	-10.5	-14.1	-12.8	-10.8
Current Account Balance	-3.9	-2.4	-0.8	-1.5
EUR/EGP (avg.)	6.00	6.45	6.97	--

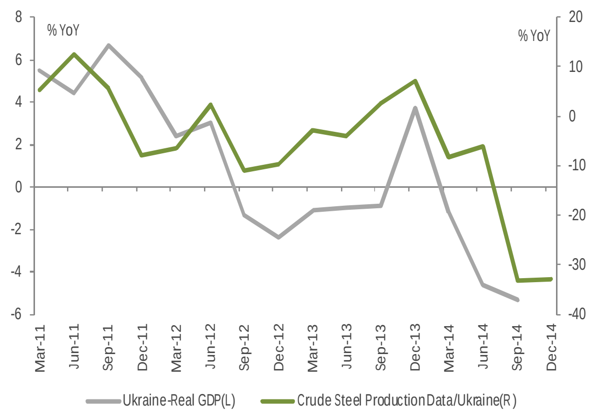
Source: Piraeus Bank Research, National Sources

7. Ukraine

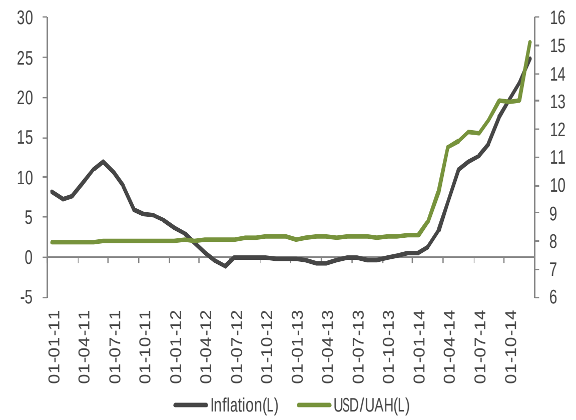
A Cemented Instability and an Unbalanced Economy

As the socio-political instability continues, we feel that if this situation drags on then the local economy will be hit even harder than it has been already. The continuous battles at the newly established "border" between Ukraine and Russia and the loss of part of Ukraine's geographic area are the first cornerstones of a very risky situation for the country and the periphery. Already real GPD (9m in 2014) has deteriorated by 3.7% YoY, as the country is faced with a vicious circle of instability and is expected to shrink further. We anticipate that in 2014 real GDP will decrease by 6.0% from 0% growth in the previous year, as domestic demand, investments and consumption have been severely hit. Another factor that we believe will negatively contribute to economic activity is the current situation in the Donetsk and Lugansk Region, where almost 75% of Ukraine's steel production originates. It is indicative that the levels of steel production in Ukraine in the last few months have fallen to 2008 crisis levels. For 2015, we expect real GDP to recover modestly to a contraction of -3.0% YoY, should the IMF financial assistance continue and if the government ensures the necessary reforms and secures liquidity assistance. However we must emphasize that the situation remains particularly volatile.

Real GDP & Steel Production



Inflation & USD/UAH



Source: Piraeus Bank Research, National Sources, Bloomberg

As the sanctions against Russia continue and the current imbalances in Ukraine remain, the local currency continues to devalue, production lines have deteriorated, credit to the economy remains constrained and net exports have been reduced. This has led to a momentous rise in prices with inflation in the last months of the year at record highs since 2008. For 2014, average inflation increased at 12.1% from -0.3% in the previous year. We expect that inflationary pressures will continue and the consumer price index is anticipated to reach 19.5% in 2015 also due to higher gas prices.

While fiscal finances have proven very challenging, the much anticipated IMF deal has provided only some stability and fiscal consolidation is expected to be derailed as austerity deepens. We forecast that the fiscal deficit will widen further to 6.0% of GDP in 2014 and double in 2015 to 10.0% in the best case scenario. Revenues are basically non-existent and the financing of the fiscal finances has come to a halt, while the government's main challenge is the sustainability of its debt.

The devaluation of the Ukrainian Hryvnia and the deterioration in imports and exports have led to a favourable current account balance in 2014. This is expected to continue until the end of 2014, as we expect the current account deficit to amount to 3.5% of GDP and 2.0% in 2015. However, this correction is not always beneficial. At this point, we must note that direct, portfolio and other investments are at -4.1% of GDP in Jan-Nov, signalling the decreasing investment inflows in Ukraine.

Ukraine Economic Indicators

	2011	2012	2013	Q1 2014	Q2 2014	Q3 2014	2014f	2015f
% YoY								
Real GDP	5.4	0.2	0.0	-1.2	-4.6	-5.3	-6.0	-3.0
Inflation (avg)	8.0	0.6	-0.3	1.7	9.9	14.8	12.1	19.5
Monetary Policy Rate (eop)	7.75	7.5	6.5	6.5	9.5	12.5	14.0	--
% GDP								
Fiscal Balance	-1.8	-3.6	-4.4	0.2	-3.0	-2.9	-6.0	-10.0
Current Account Balance	-6.3	-8.1	-9.2	-1.0	-1.8	-2.6	-3.5	-2.0
USD/UAH (avg.)	8.0	8.1	8.2	9.1	11.8	12.6	12.0	--

Source: Piraeus Bank Research, National Sources

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