

Short note – Fixed Income Research – July 1, 2009

## Croatia: 1Q C/A

1Q C/A deficit narrows 29% y/y

in million €			
	1Q 2009	1Q 2008	% change
Current Account	-1.820	-2.556	(-29)
Goods	-1.730	-2.565	(-33)
Services	127	99	29
Income	-418	-311	(34)
Current Transfers	200	221	-10

Source: CNB

- The 1Q C/A deficit landed in the expected region at EUR 1.8bn, declining a robust 29% y/y and bringing the 4Q MA current account deficit down from 9.4% in 4Q08 to 8% in 1Q09. As the trade balance figures suggested, the adjustment occurred, given the narrowing of the merchandise account deficit by 33% y/y to EUR 1.7bn. Imports were heavily hit by depleting domestic demand (-24% y/y), while exports performed somewhat better (-14% y/y). The service account, of secondary importance in 1Q, recorded a slightly higher surplus (ca. EUR 130mn), while tourism related inflows recorded a relatively mild 6% decrease in 1Q. On the other hand, the income account showed more negative trends, with the deficit widening by 34% y/y to EUR 418mn, as a result of the higher cost of debt repayment and stronger profit repatriation in the present environment. Current transfers also offered relatively little surprise, recording a 10% y/y lower surplus at EUR 200mn.
- On the financing side, net FDI moderated significantly (-64% y/y), thus covering just above 20% of the 1Q C/A deficit, while 4Q MA coverage declined from 72% to 67% in 1Q. The portfolio investments account recorded almost a EUR 0.5bn deficit, mainly as a result of the repayment of a government Eurobond in 1Q. On the other hand, other investments recorded a significant surplus (EUR 1.7bn), as a result of the modified bank FA/FL coverage ratio, allowing banks to withdraw a significant proportion of foreign assets.
- Overall, 1Q C/A met our expectations; thus, we continue to expect the C/A deficit in the region around 6% of GDP, in line with the real economy outlook and expected 4.5% GDP decline. The merchandise account should remain supportive in the coming quarters, given the continuing weakness in domestic demand, and with the lower commodity prices, should support the figures in nominal terms. While financing needs remain high, the so far stable refinancing and declining C/A deficit support a stable FX outlook, but still largely dependent on the external environment and budget performance. With risks related to the fiscal side and the CNB remaining clearly focused on a stable exchange rate, room for any monetary policy relaxation is very thin and unlikely.

*Analyst: Alen Kovac  
 Akovac2@erstebank.com  
 Erste Bank Croatia*

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## Croatian PM confirms resignation

At a press conference today, Croatian Prime Minister Ivo Sanader announced his resignation. He also resigned all duties in his party, the Croatian Democratic Union, and confirmed that he does not intend to pursue the post of president. Sanader dismissed speculation regarding health problems and the possibility of his moving to a position in a European institution. He did not clear up the exact reasons for his resignation, but did state that he is completely retiring from political activity. This decision was communicated to members of his party, coalition partners and President Stipe Mesic. Sanader proposed current Vice President Jadranka Kosor for the PM position and that of the president of the Croatian Democratic Union party. He also suggested that Andrija Hebrang compete for the presidential post. The Government of Croatia is to change as well. Current Agriculture Minister Bozidar Pankretic is to become vice president, to be replaced as agriculture minister by Petar Cobankovic. Two other resignations came from Minister of Science, Education and Sports Dragan Primorac and Secretary General Ivan Jarnjak. These announcements came as a surprise and the Croatian equity market reacted negatively, witnessing severe losses. By 2.30pm, the market was already 6% in red territory.

*Analyst: Davor Spoljar  
dspoljar@erstebank.com  
Erste securities Zagreb*

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