



Economic Analysis Division

Southeastern Europe & Mediterranean Emerging Market Economies



Bi-Weekly Report

6 – 19 September 2022

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Romanian economy continued to overperform expectations in Q2:22 (GDP, up 5.3% y-o-y), thanks to still strong private consumption

Under the burden of record-high inflation, GDP growth is set to slow down abruptly in the remainder of the year

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Despite the implications of the Russia-Ukraine crisis and domestic energy production disruptions, GDP growth remained resilient in Q2:22 (up 3.9% y-o-y, broadly unchanged from Q1:22), bolstered by strong industrial output

GDP growth is set to ease in H2:22, reflecting the impact of surging inflation and weaker external demand

A new agreement with the IMF could alleviate external pressures from bulging energy bill

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Real GDP growth remained strong in Q2:22 (up 5.8% y-o-y, broadly flat against Q1:22), underpinned by a surge in tourism-related exports

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Romania

BBB- / Baa3 / BBB- (S&P / Moody's / Fitch)

Romanian economy continued to overperform expectations in Q2:22 (GDP, up 5.3% y-o-y), thanks to still strong private consumption. Despite rapidly rising inflation, private consumption continued to expand at an unsustainably robust pace in Q2:22 (see chart), reflecting surging consumption of services, following the re-opening of the economy, as well as a frontloading in consumption of goods, in light of the sharp upward adjustment in inflation expectations. At the same time, inventories (incl. statistical discrepancies) surged, amid heightened geopolitical uncertainty and skyrocketing commodity prices. Unsurprisingly, stronger domestic demand fed into imports, with net exports deteriorating sharply in Q2:22. All said, GDP growth moderated to a still solid 5.3% y-o-y (up 2.1% q-o-q s.a) in Q2:22 from 6.4% (up 5.1% q-o-q s.a.) in Q1:22, placing Romania among the top 3 EU countries in terms of post-COVID-19 economic performance.

Under the burden of record-high inflation, GDP growth is set to slow down abruptly in the remainder of the year. Strong second-round effects from the recent jump in energy prices should keep headline inflation at record-high levels until early next-year (see chart), biting seriously into households' (real) disposable income. This income effect and its adverse impact on consumer confidence cannot but weigh markedly on private consumption in the period ahead. On a positive note, record-high households' savings could provide some buffer against the inflation shock. Against the backdrop of slowing economic growth in the EU, net exports should remain a large drag on overall growth at the same time, despite the offsetting impact of weaker private consumption and easing strains in global supply chains. In fact, the large import content of fixed investment, which is expected to overperform in the period ahead, means that imports would continue to expand at a relatively solid pace. Indeed, despite poor business confidence, rising interest rates and construction costs, investment activity is set to progressively gain momentum, bolstered by EU funding, providing a critical contribution to GDP growth. Note that Romania is eligible to receive grants and loans worth EUR 29.1bn or more than 12.0% of its FY:21 GDP under the EU RRF in 2021-26, with the historical low EU funds absorption rate posing, however, serious challenges in this regard. Importantly, fiscal policy should help alleviate the impact of the inflation shock on economic activity during the remainder of the year. In fact, following a significant overperformance in H1:22, the Government has room for a (small) fiscal impulse in H2:22. However, the need to reduce the high structural budget deficit is expected to tie the Government's hands next year, despite the temporary suspension of EU fiscal rules. On the other hand, in an environment of record-high inflation, and widening external imbalances, the NBR cannot but tighten further its stance. As a result, we see the key rate at 6.25% at end-2022, up from 3.75% in mid-year and 1.75% at end-2021, with the effecting tightening (i.e. in terms of money market rates) projected to be much larger. All said, in view of the much-better-than-envisaged Q2:22 GDP print, we revise upwards our full-year GDP growth forecast to an eye-catching 6.9%. Despite the envisaged moderation in inflationary pressures next year, we see GDP growth easing to 2.5%, still above the euro area average (c. 1.0%), mainly due to the negative base effect from H1:22 GDP overperformance. Should the implications of the ongoing geopolitical tensions prove to be harsher than assumed (e.g. involving physical disruptions to energy supply), economic growth could be much lower than projected. An abrupt tightening in global financing conditions (including capital flow reversals) also poses a downside risk.

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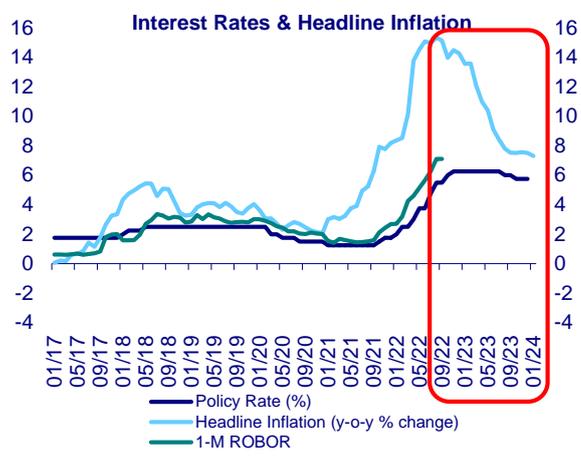
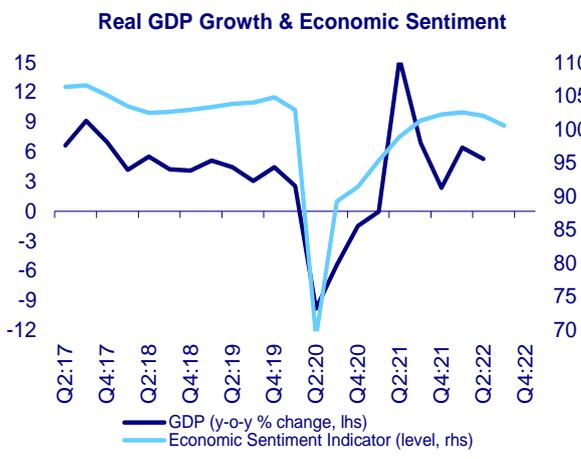
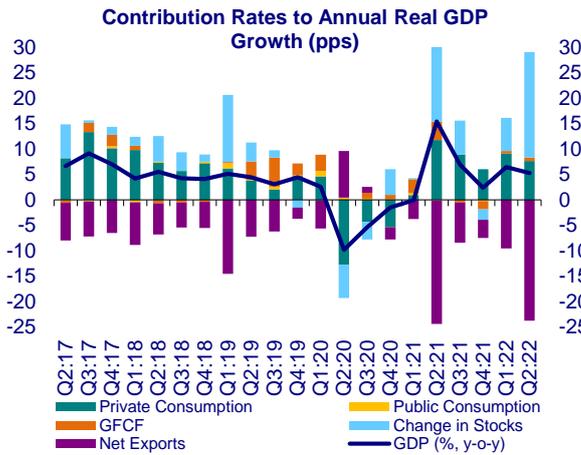
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	19 Sep.	3-M F	6-M F	12-M F
1-m ROBOR (%)	7.1	7.8	7.8	7.6
RON/EUR	4.93	4.95	4.98	5.03
Sov. Spread (2024, bps)	115	125	115	100

	19 Sep.	1-W %	YTD %	2-Y %
BET-BK	2,150	-2.9	-14.5	23.2

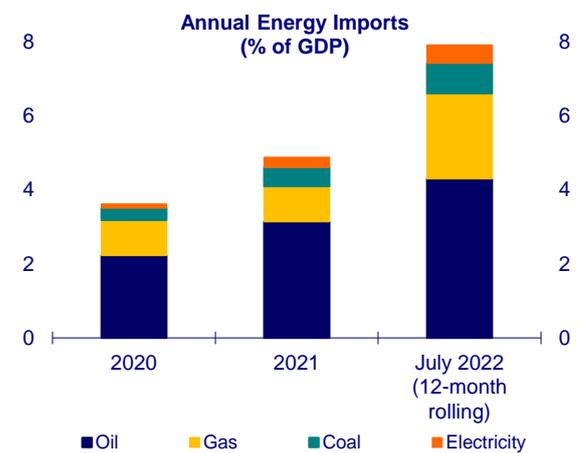
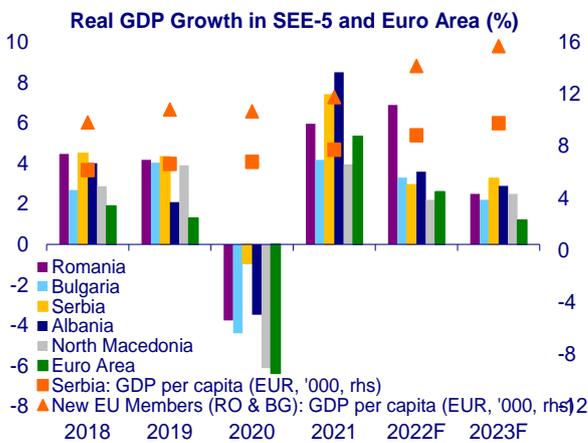
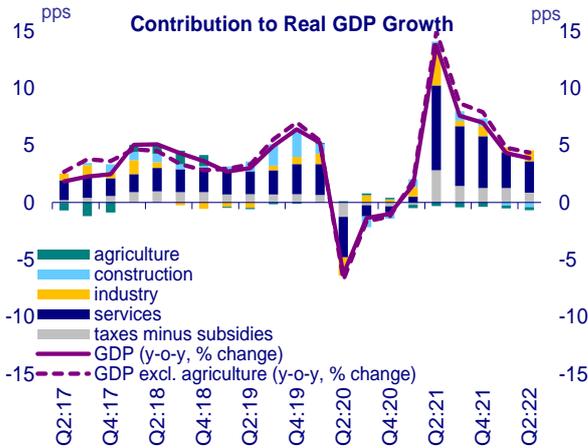
	2019	2020	2021	2022F	2023F
Real GDP Growth (%)	4.2	-3.8	6.0	6.9	2.5
Inflation (eop, %)	4.0	2.1	8.2	14.3	7.5
Cur. Acct. Bal. (% GDP)	-4.9	-5.0	-7.0	-8.2	-7.4
Fiscal Bal. (% GDP)	-4.6	-9.6	-6.8	-6.2	-5.5

Sources: Reuters, INSSE, NBR, Ministry of Finance & NBG estimates



Serbia

BB+ / Ba2 / BB+ (S&P / Moody's / Fitch)



	19 Sep.	3-M F	6-M F	12-M F
1-m BELIBOR (%)	3.0	3.8	4.3	4.3
RSD/EUR	117.2	117.5	117.5	117.5
Sov. Spread (2029, bps)	562	480	440	360

	19 Sep.	1-W %	YTD %	2-Y %
BELEX-15	850	0.6	3.5	23.4

	2019	2020	2021	2022F	2023F
Real GDP Growth (%)	4.3	-0.9	7.4	3.0	3.3
Inflation (eop, %)	1.9	1.3	7.9	9.8	4.0
Cur. Acct. Bal. (% GDP)	-6.9	-4.1	-4.4	-9.4	-8.2
Fiscal Bal. (% GDP)	-0.2	-8.0	-4.1	-3.5	-2.5

Sources: Reuters, OPBC & NBG estimates

Despite the implications of the Russia-Ukraine crisis and domestic energy production disruptions, GDP growth remained resilient in Q2:22 (up 3.9% y-o-y, broadly unchanged from Q1:22), bolstered by industrial output. Economic performance in Q2:22 was underpinned by the industrial and services sectors, both of which expanded at rates well above their long-term historical average.

Indeed, reflecting still strong external demand, industrial output grew at a solid pace, despite the plunge in power generation, due to technical breakdowns. Surging copper production, following the launch of a new major mine, did also provide a critical boost.

At the same time, despite deteriorating economic sentiment and the adverse impact of the steep hike in inflation on disposable income (which was, nonetheless, mitigated by the Government's measures, including a looser incomes policy and food and energy price caps), the services sector expanded at a fast pace in Q2:22, benefitting from the re-opening of the economy, a still tight labour and higher remittances.

All said, adjusting for the (temporary) negative supply shocks in the energy and agriculture sectors (with the latter having been affected by drought), we estimate GDP growth at more than 5.0% y-o-y Q2:22, placing Serbia among the top performers in the region.

GDP growth is set to ease in H2:22, reflecting the impact of surging inflation and weaker external demand. With inflation set to hit record-high levels in H2:22, eroding households' real disposable income, and consumer confidence deteriorating steadily, growth in private consumption cannot but weaken in the period ahead. At the same time, weaker external demand from the EU -- Serbia's main trade partner (absorbing 2/3 of the country's exports) -- along with rising input costs should weigh on exports. All said, we see GDP growth slowing to 3.0% this year from (a 17-year high) 7.4% in FY:21.

Looking further ahead, we expect economic momentum to pick up gradually, especially in H2:23, in line with easing price pressures and a more favourable global backdrop, leaving FY:23 GDP growth broadly flat at 3.3% -- the highest in SEE-5. Importantly, Serbia's increased export capacity & diversification, following past years' strong FDI inflows, as well as the EU's ongoing decoupling from Russian supplies and nearshoring of production should benefit the economy in the longer-term. Downward risks to our forecasts arise from: i) weaker growth in the EU, in the event of a cut-off in Russian gas supplies; ii) protracted shortfalls in domestic power generation; and iii) possible EU sanctions on Serbia's sole refinery, majority-owned by Russia's Gazprom.

A new agreement with the IMF could alleviate external pressures from bulging energy bill. External imbalances have been widening at a rapid pace, driven by the energy bill, reflecting not only the impact of higher global energy prices but also that of increased demand to compensate for the shortfall in domestic power generation, due to technical breakdowns. Note that the price effect would have been larger had it not been for Serbia's favourable gas contract with Russia (with gas imports, nonetheless, accounting for just 30% of total energy imports as opposed to oil imports, which account for more than 55% of imported energy). All said, the current account deficit jumped to 8.3% on a 12-month rolling basis in July from 4.9% at end-2021 (with the energy accounting for 90% of the increase) and is projected to hover around that level until end-2023, implying a significant external financing gap. Worryingly, tightening global financing conditions suggest that plugging this gap should not be an easy task for Serbia, despite the recent private placements on sovereign Eurobonds (totaling EUR 0.7bn, or 1.2% of GDP) and an agreement with UAE on a USD 1.0bn loan. As a result, recourse to the IMF is seen as increasingly likely, with Serbia reportedly already seeking a (precautionary) Stand-By Agreement.



Cyprus

BBB / Ba1 / BBB- (S&P / Moody's / Fitch)

GDP growth remained strong in Q2:22 (up 5.8% y-o-y, broadly flat against Q1:22), underpinned by a surge in tourism-related exports. The robust economic growth rate (placing Cyprus among the top positions in Euro Area rankings) came on the back of a tourism-driven surge in exports (with tourist arrivals up by a whopping 200% y-o-y in Q2:22, recovering to 77% of their pre-COVID-19 level against just 25% in Q2:21). Interestingly, this outstanding performance occurred despite the abrupt drop in tourist arrivals from Russia (the largest source country, accounting for 26.8% of total tourists in FY:21), following an EU-wide ban on Russian flights, and Ukraine (4.4% of Cyprus' tourist arrivals in FY:21). Indeed, arrivals from other major source countries, especially the UK, Germany, Poland & Israel, rebounded strongly in Q2:22, in line with the easing of COVID-19 social distancing and travel restrictions and the concomitant improvement in tourist confidence, on the one hand, and strong pent-up demand, on the other hand.

Importantly, exports of non-tourism services (mainly financial, shipping and ICT) have also remained strong, despite sanctions on Russian companies (accounting for a sizeable 9.0% of GDP in FY:21 -- the highest in the euro area), reflecting increasing demand by foreign (especially Russian, Ukrainian and Belarusian) ICT companies to relocate in Cyprus.

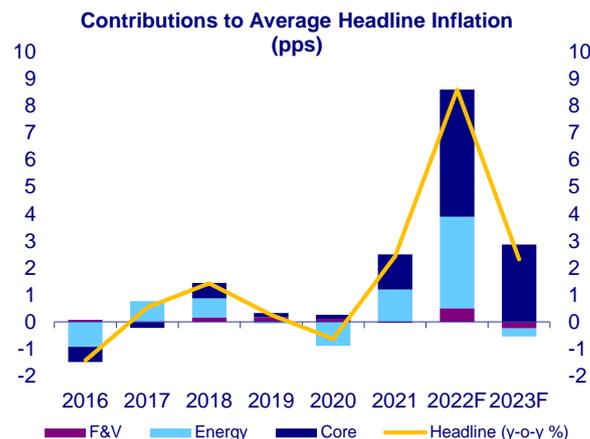
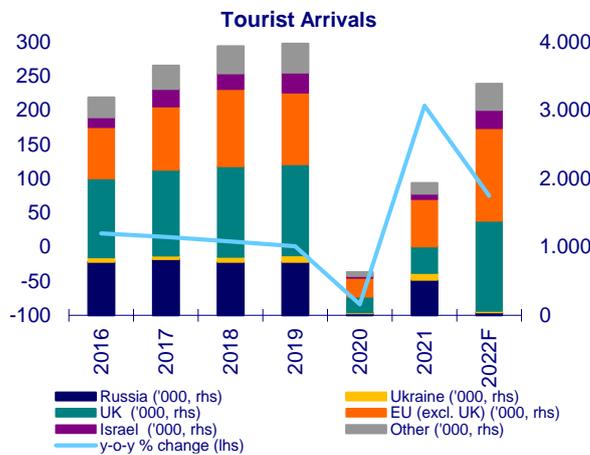
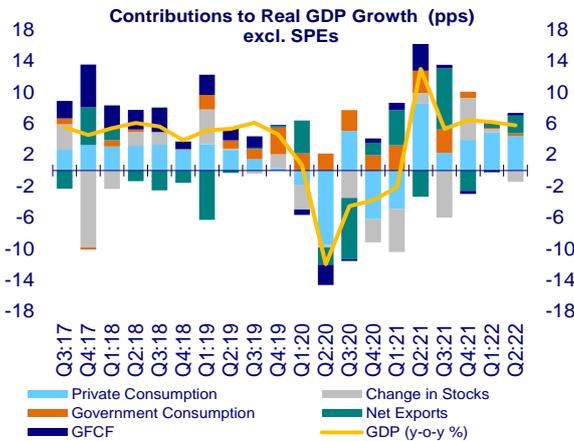
At the same time, despite the steep hike in inflation and the deterioration in economic sentiment, private consumption remained resilient, continuing to provide the largest contribution to economic growth. This performance was main underpinned by positive spill-overs from the overperformance in the tourism & related sector (accounting for 9.3% of GDP in FY:21). State support (mainly in the form of subsidies) also helped in mitigating the impact of the inflation shock.

The strong H1:22 performance is set to wear-off in H2:22, reflecting headwinds from record-high inflation. Eroded household purchasing power, together with tightening financial conditions and weakening consumer confidence, should eventually weigh on private consumption in the period ahead. At the same time, net exports' contribution to overall growth should diminish, amid slowing economic growth in Cyprus' main tourism markets.

All said, in view of the better-than-expected Q2:22 outcome, we revised upwardly our FY:22 GDP growth forecast to 4.6%, well above our forecast for the Euro Area (up 2.6%).

GDP growth is expected to moderate to 2.2% in FY:23 -- close to its long-term potential -- mainly due to a weak statistical carry-over effect (of just 0.5 pps from Q4:22 against 2.5 pps from Q4:21). In terms of growth drivers, investment activity should gain steam in FY:23, bolstered by EU funding (Cyprus is due to receive EUR 1.2bn under the EU RRF over 2021-26, or 5.1% of the FY:21 GDP) and a less bleak business confidence. At the same time, following their FY:22 overperformance, private consumption and net exports should continue to grow, albeit at a slow pace, with the former supported by automatic public wage & pension indexation (to 50% of FY:22 inflation) and high savings. Importantly, political continuity is expected to be maintained after the early-February 2023 presidential elections, given main candidates' consensus on policies and important reforms.

Our GDP growth forecast could be downwardly revised in the event of a disruption in Russian gas flows to Europe. Indeed, although Cyprus does not import natural gas but only oil, negative spillovers from higher-than-projected imported inflation and weaker-than-envisioned external demand would weigh on domestic economic growth.



	19 Sep.	3-M F	6-M F	12-M F
1-m EURIBOR (%)	0.69	1.65	2.40	2.45
EUR/USD	1.00	1.01	1.01	1.03
Sov. Spread (2025. bps)	98	100	95	85

	19 Sep.	1-W %	YTD %	2-Y %
CSE Index	74	-0.1	8.3	63.0

	2019	2020	2021	2022	2023 F
Real GDP Growth (%)	5.3	-5.0	5.5	4.6	2.2
Inflation (eop. %)	0.7	-1.1	4.8	9.7	2.6
Cur. Acct. Bal. (% GDP)	-5.7	-10.1	-7.2	-8.8	-7.2
Fiscal Bal. (% GDP)	1.3	-5.6	-1.7	-1.5	-1.0

Sources: Reuters, Cystat & NBG estimates



DETAILED MACROECONOMIC DATA

ROMANIA					
	2019	2020	2021	2022f	2023f
Real Sector					
Nominal GDP (EUR million)	223,269	219,004	240,279	290,111	321,348
GDP per capita (EUR)	11,500	11,330	12,432	15,011	16,629
GDP growth (real, %)	4.2	-3.8	6.0	6.9	2.5
Unemployment rate(ILO definition, %, aop)	4.9	6.1	5.6	5.5	5.5
Prices and Banking					
Inflation (% eop)	4.0	2.1	8.2	14.3	7.5
Inflation (% aop)	3.8	2.6	5.0	13.2	9.6
Loans to the Private Sector (% change, eop)	7.0	5.0	14.3		
Customer Deposits (% change, eop)	12.6	15.3	13.7		
Loans to the Private Sector (% of GDP)	24.6	25.9	26.5		
Retail Loans (% of GDP)	13.5	14.2	13.9		
Corporate Loans (% of GDP)	11.1	11.7	12.5		
Customer Deposits (% of GDP)	33.1	38.2	38.9		
Loans to Private Sector (% of Deposits)	74.5	67.8	68.1		
Foreign Currency Loans (% of Total Loans)	32.0	29.7	26.5		
External Accounts					
Merchandise exports (EUR million)	63,066	57,560	70,194	80,209	85,842
Merchandise imports (EUR million)	80,918	76,509	93,355	110,828	116,642
Trade balance (EUR million)	-17,852	-18,949	-23,161	-30,619	-30,800
Trade balance (% of GDP)	-8.0	-8.7	-9.6	-10.6	-9.6
Current account balance (EUR million)	-10,907	-10,900	-16,753	-23,798	23,722
Current account balance (% of GDP)	-4.9	-5.0	-7.0	-8.2	-7.4
Net FDI (EUR million)	4,848	2,960	7,306	9,515	11,022
Net FDI (% of GDP)	2.2	1.4	3.0	3.3	3.4
International reserves (EUR million)	32,926	37,379	40,475	42,217	44,632
International reserves (Months ^a)	4.0	4.9	4.3	3.8	3.8
Public Finance					
Primary balance (% of GDP)	-3.4	-8.2	-5.2	-4.8	-4.1
Fiscal balance (% of GDP)	-4.6	-9.6	-6.8	-6.2	-5.5
Gross public debt ^b (% of GDP)	35.0	46.9	48.5	49.0	50.5
External Debt					
Gross external debt (EUR million)	109,783	126,750	134,617	145,056	153,604
Gross external debt (% of GDP)	49.2	57.9	56.0	50.0	47.8
External debt service (EUR million)	17,442	17,291	16,079	17,000	17,250
External debt service (% of reserves)	53.0	46.3	39.7	40.3	38.6
External debt service (% of exports)	19.4	21.3	16.4	15.0	14.3
Financial Markets					
Policy rate (1-w repo rate, %, eop)	2.5	1.5	1.8	6.3	5.8
Policy rate (1-w repo rate, %, aop)	2.5	1.8	1.4	4.3	6.1
10-Y Bond Yield (% eop)	4.5	3.1	5.1	8.2	7.7
Exchange rate: EUR (eop)	4,786	4,863	4,946	4,950	5,050
Exchange rate: EUR (aop)	4,743	4,835	4,919	4,930	5,000

f: NBG forecasts; a: months of imports of GNFS; b: ESA 2010



SERBIA					
	2019	2020	2021	2022f	2023f
Real Sector					
Nominal GDP (EUR million)	46,052	46,822	53,351	60,758	66,840
GDP per capita (EUR)	6,631	6,787	7,723	8,830	9,753
GDP growth (real, %)	4.3	-0.9	7.4	3.0	3.3
Unemployment rate (% aop)	11.2	9.7	11.1	10.1	9.5
Prices and Banking					
Inflation (% eop)	1.9	1.3	7.9	9.8	4.0
Inflation (% aop)	1.9	1.6	4.1	10.6	6.5
Loans to the Private Sector (% change, eop)	8.9	12.2	10.1		
Customer Deposits (% change, eop)	7.8	17.4	13.3		
Loans to the Private Sector (% of GDP)	44.3	49.0	47.4		
Retail Loans (% of GDP)	20.5	22.6	22.4		
Corporate Loans (% of GDP)	23.8	26.4	25.0		
Customer Deposits (% of GDP)	45.2	52.3	52.1		
Loans to Private Sector (% of Deposits)	98.0	93.6	91.0		
Foreign Currency Loans (% of Total Loans)	66.9	62.7	61.7		
External Accounts					
Merchandise exports (EUR million)	16,415	16,079	20,756	24,662	26,114
Merchandise imports (EUR million)	22,038	21,280	26,685	33,835	35,324
Trade balance (EUR million)	-5,623	-5,201	-5,929	-9,173	-9,209
Trade balance (% of GDP)	-12.2	-11.1	-11.1	-15.1	-13.8
Current account balance (EUR million)	-3,161	-1,929	-2,343	-5,690	-5,472
Current account balance (% of GDP)	-6.9	-4.1	-4.4	-9.4	-8.2
Net FDI (EUR million)	3,551	2,938	3,625	3,897	4,384
Net FDI (% of GDP)	7.7	6.3	6.8	6.4	6.6
International reserves (EUR million)	13,379	13,492	16,455	13,661	13,574
International reserves (Months ^a)	5.7	6.1	6.0	4.0	3.8
Public Finance					
Primary balance (% of GDP)	1.8	-6.0	-2.4	-1.8	-0.8
Fiscal balance (% of GDP)	-0.2	-8.0	-4.1	-3.5	-2.5
Central Government debt (% of GDP)	52.8	57.9	57.2	56.2	53.4
External Debt					
Gross external debt (EUR million)	28,254	30,787	36,536	37,670	39,770
Gross external debt (% of GDP)	61.4	65.8	68.5	62.0	59.5
External debt service (EUR million)	6,400	3,900	4,700	4,900	4,600
External debt service (% of reserves)	47.8	28.9	28.6	35.9	33.9
External debt service (% of exports)	27.4	17.5	16.5	14.9	13.2
Financial Markets					
Policy rate (2-w repo rate, % eop)	2.3	1.0	1.0	4.3	4.8
Policy rate (2-w repo rate, % aop)	2.7	1.5	1.0	2.6	4.7
10-Y T-bill rate (% eop)	3.0	3.1	4.1	7.8	7.4
Exchange rate: EUR (eop)	117.5	117.5	117.5	117.5	117.5
Exchange rate: EUR (aop)	117.7	117.5	117.5	117.5	117.5

f: NBG forecasts; a: months of imports of GNFS



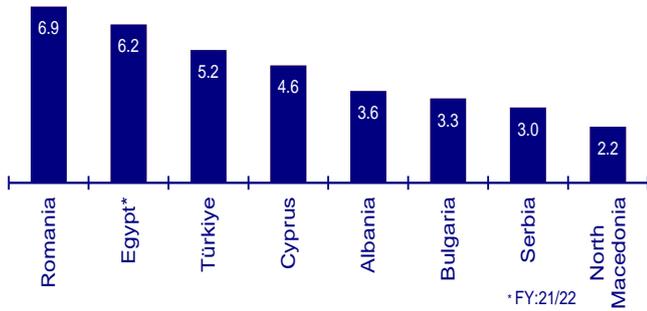
CYPRUS					
	2019	2020	2021	2022f	2023f
Real Sector					
Nominal GDP (EUR million)	23,010	21,618	23,437	26,625	28,309
GDP per capita (EUR)	26.090	24.235	26.031	29.251	30.762
GDP growth (real, %)	5.3	-5.0	5.5	4.6	2.2
Unemployment rate (% aop)	7.1	7.6	7.5	6.6	6.5
Prices and Banking					
Inflation (% eop)	0.7	-1.1	4.8	8.7	2.8
Inflation (% aop)	0.3	-0.6	2.4	8.6	4.0
Loans to the Private Sector (% change, eop)	-7.4	-5.6	-5.0		
Customer Deposits (% change, eop)	0.0	-0.6	5.4		
Loans to the Private Sector (% of GDP)	133.1	133.7	117.2		
Retail Loans (% of GDP)	61.3	61.9	52.1		
Corporate Loans (% of GDP)	71.7	71.7	65.0		
Customer Deposits (% of GDP)	180.0	190.4	185.2		
Loans to Private Sector (% of Deposits)	73.9	70.2	63.3		
Foreign Currency Loans (% of Total Loans)	---	---	---		
External Accounts					
Merchandise exports (EUR million)	3,080	2,967	3,587	4,038	4,008
Merchandise imports (EUR million)	7,711	7,118	7,879	9,161	9,119
Trade balance (EUR million)	-4,631	-4,151	-4,292	-5,123	-5,110
Trade balance (% of GDP)	-20.1	-19.2	-18.3	-19.2	-18.1
Current account balance (EUR million)	-1,308	-2,177	-1,696	-2,342	-2,049
Current account balance (% of GDP)	-5.7	-10.1	-7.2	-8.8	-7.2
Net FDI (EUR million)	-0,082	3,864	2,226	2,226	2,838
Net FDI (% of GDP)	-0.4	17.9	9.5	8.4	10.0
International reserves (EUR million)	---	---	---	---	---
International reserves (Months ^a)	---	---	---	---	---
Public Finance					
Primary balance ^b (% of GDP)	3.5	-3.5	0.1	0.8	1.0
Fiscal balance ^b (% of GDP)	1.3	-5.6	-1.7	-1.0	-0.8
Gross public debt (% of GDP)	91.1	115.0	103.6	91.5	86.0
External Debt					
Gross external debt (EUR million)	194,036	190,427	192,715	188,500	186,500
Gross external debt (% of GDP)	843.3	880.9	822.3	708.0	658.8
External debt service (EUR million)	---	---	---	---	---
External debt service (% of reserves)	---	---	---	---	---
External debt service (% of exports)	---	---	---	---	---
Financial Markets					
Policy rate (ECB refinancing rate, % eop)	0,0	0,0	0,0	2.5	2.8
Policy rate (ECB refinancing rate, % aop)	0,0	0,0	0,0	0.6	2.7
3-Y T-bill rate (% eop)	-0,1	-0,1	-0,2	2,0	2,4
Exchange rate: USD (eop)	1,121	1,221	1,137	1,010	1,030
Exchange rate: USD (aop)	1,119	1,142	1,183	1,050	1,020

f: NBG forecasts; a: months of imports of GNFS; b: cash basis

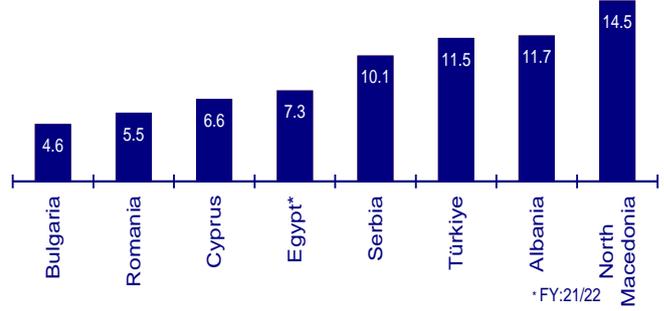


REGIONAL SNAPSHOT: MACROECONOMIC INDICATORS

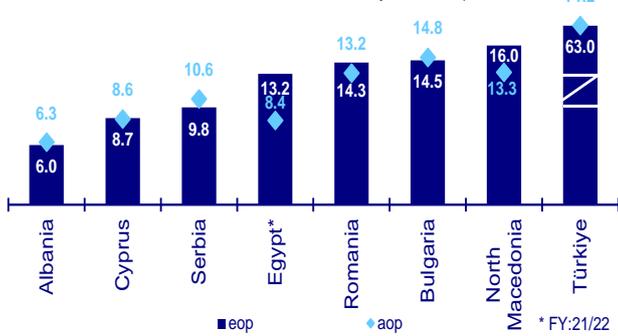
Real GDP Growth (% , 2022F)



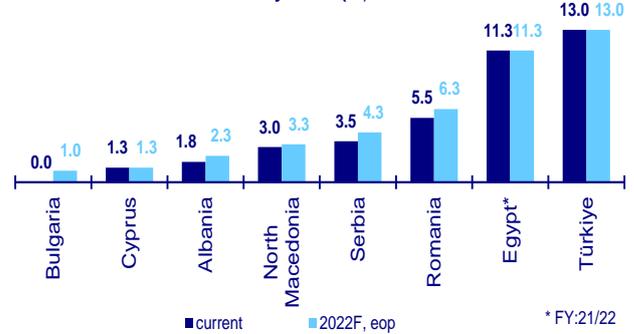
Unemployment (% , 2022F, aop)



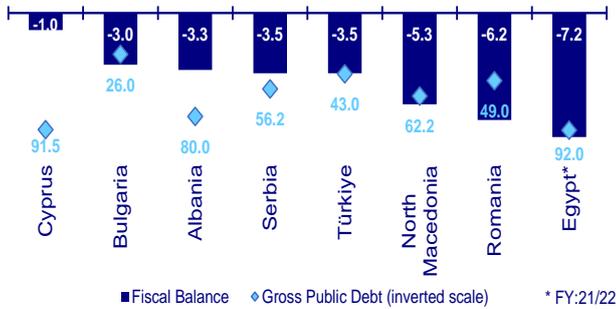
Headline inflation (% , 2022F)



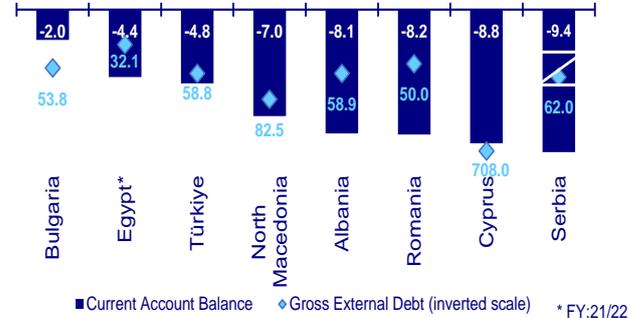
Policy rates (%)



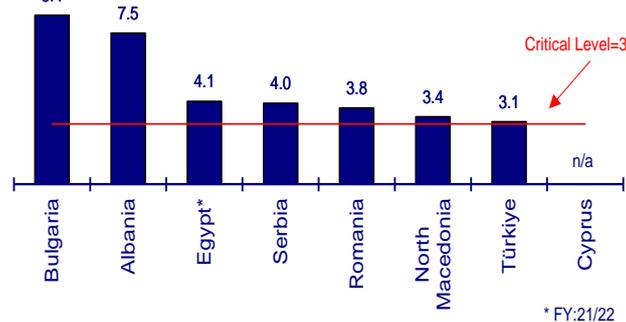
Public Finance (% of GDP, 2022F)



External Accounts (% of GDP, 2022F)



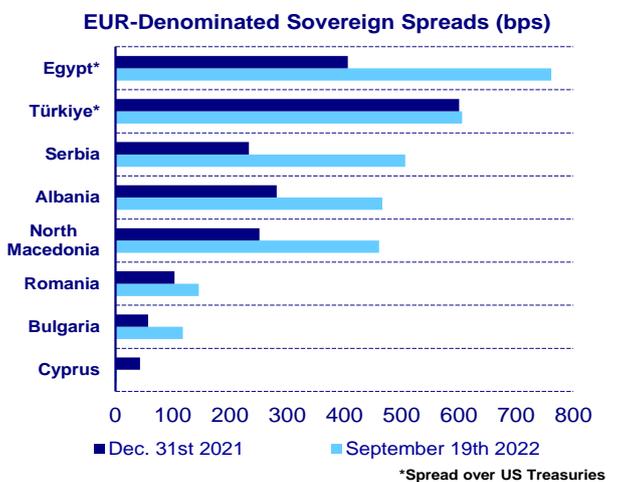
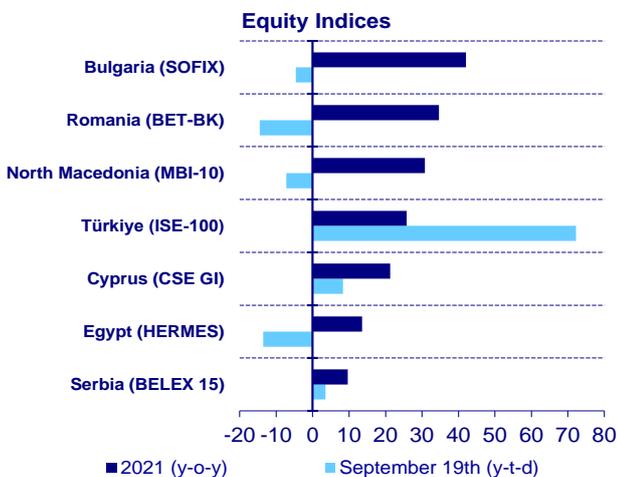
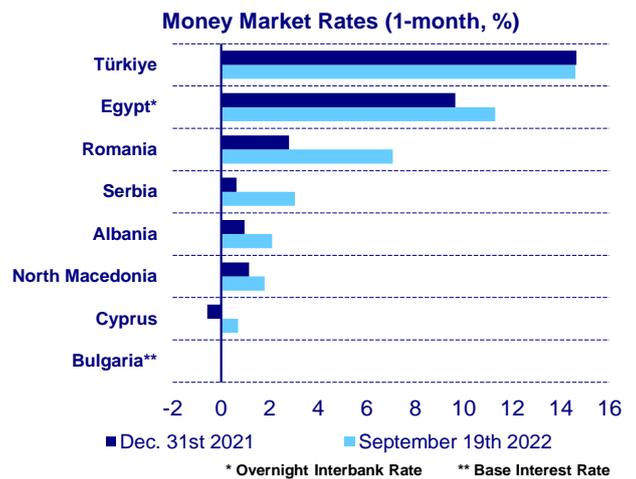
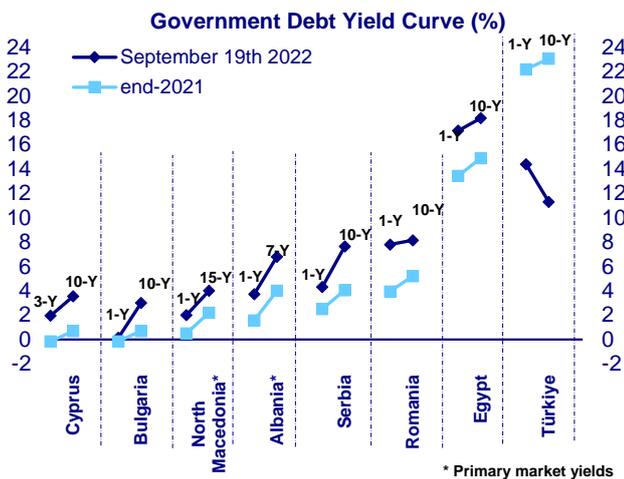
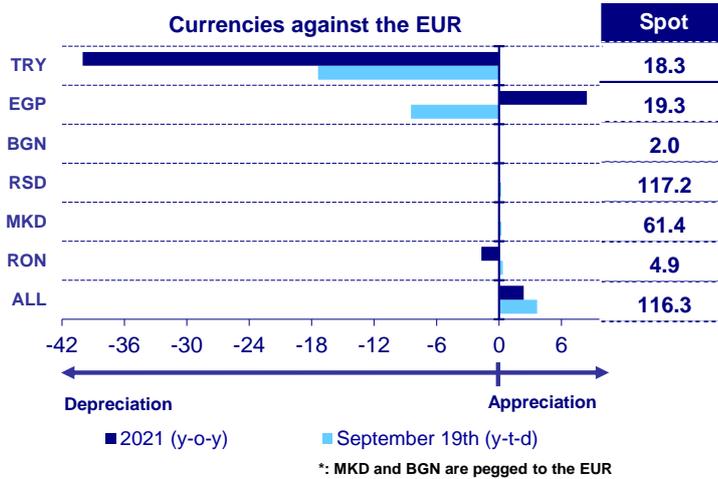
FX Reserves (Months of Imports, 2022F)



Sources: National Sources & NBG estimates



REGIONAL SNAPSHOT: FINANCIAL MARKETS



Sources: Reuters & NBS estimates



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