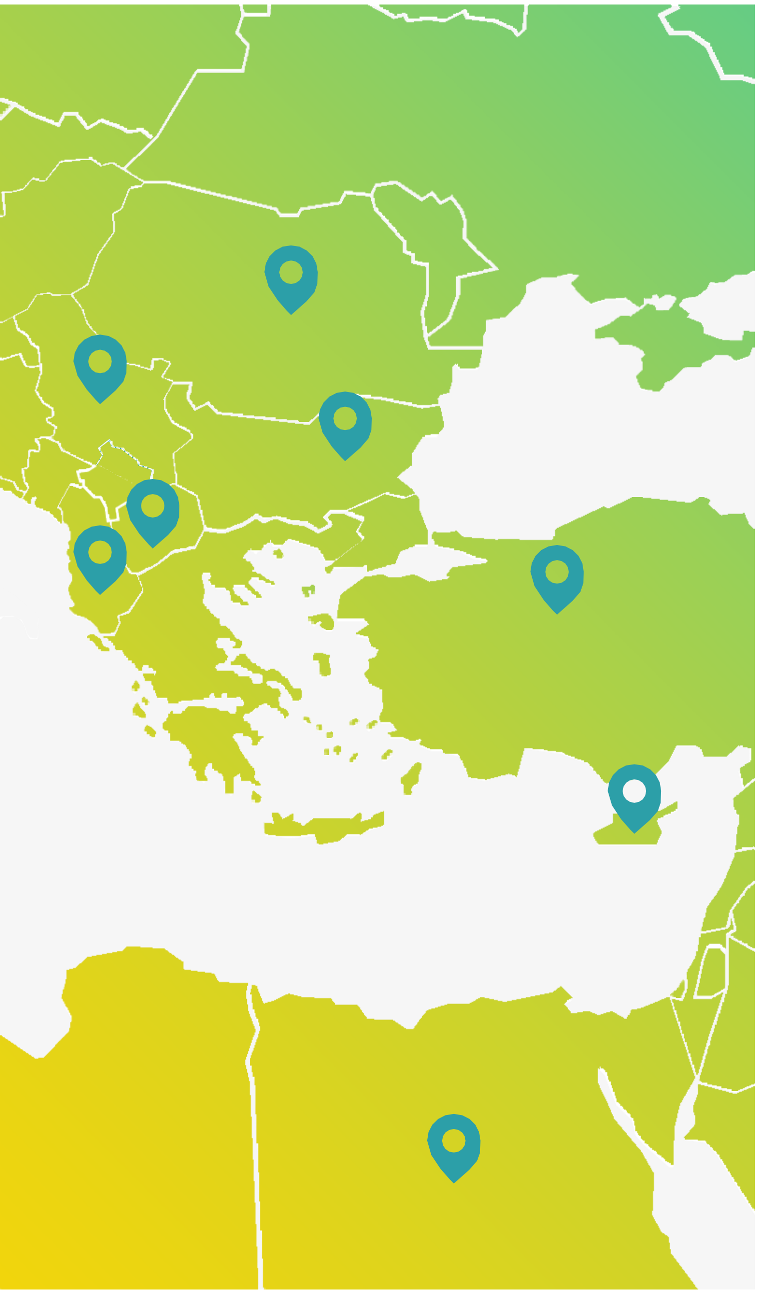
Bi-WEEKLY REPORT
Emerging Markets Analysis

21 February – 6 March 2023



COUNTRIES IN FOCUS:

Türkiye & Serbia

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Emerging Markets Analysis

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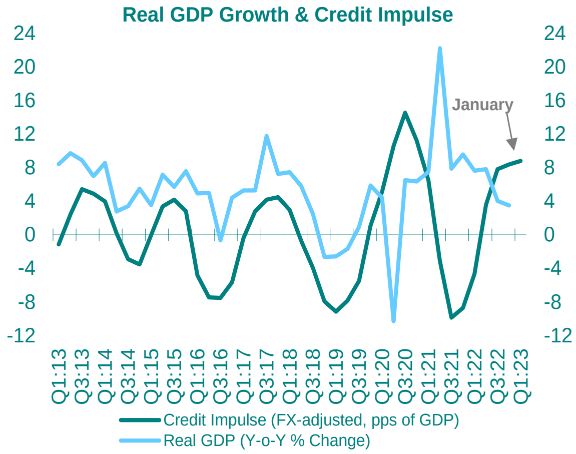
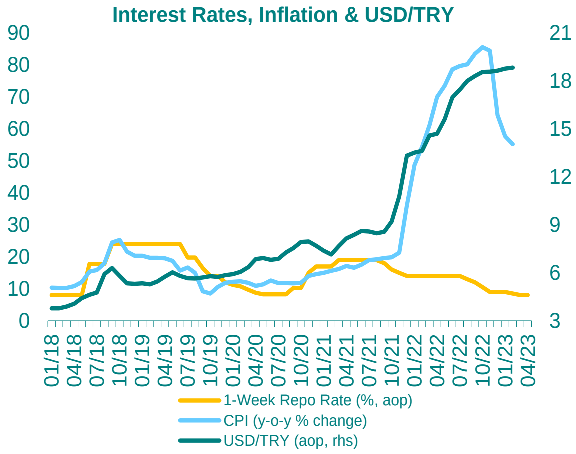
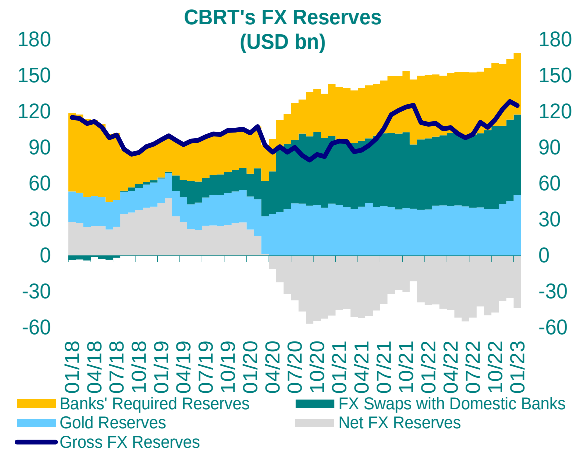
Türkiye

B+ / B2 / B+ (S&P/ Moody's / Fitch)







	6 Mar.	3-M F	6-M F	12-M F
O/N TLREF (%)	8.6	8.5	12,5	18,0
TRY/USD	18.90	19.80	20.05	21.80
Sov. Spread (2025, bps)	321	380	330	300

	6 Mar.	1-W %	YTD %	2-Y %
ISE 100	5,392	3.7	-2.1	17.4

	2020	2021	2022E	2023F	2024F
Real GDP Growth (%)	2.0	11.4	5.6	1.5	4.5
Inflation (eop, %)	14.6	36.1	64.3	36.0	22.0
Cur. Acct. Bal. (% GDP)	-4.4	-0.9	-5.4	-3.8	-3.1
Fiscal Bal. (% GDP)	-3.4	-2.7	-0.9	-5.5	-4.8

Sources: Reuters, CBRT, BDDK, Turkstat & NBG estimates

The CBRT cut its key rate by 50 bps (to 8.5%) to mitigate the fallout from the devastating earthquakes. The move, which was widely expected after the disaster, marks the resumption of the CBRT's rate-cutting cycle, with the 2-week repo rate now standing at 2½-year lows. Recall that, in stark contrast to global trends, and despite underlying imbalances (see below), the CBRT had aggressively cut interest rates over the past period (down 500 bps between August and November and 1000 bps since late-2021).

According to the CBRT, the rate cut was dictated by the need to "*keep financial conditions supportive to preserve the growth momentum in industrial production and the positive trend in employment after the earthquakes*". The latter resulted in a death toll of c. 45,000 people, with preliminary estimates putting the reconstruction costs at up to 9.0% of GDP, while curtailing this year's GDP growth by at least 1 pp (accounting for the impact of increased fiscal support), to 1.5%.

The rate cut had little impact on the TRY, which continued to trade near its all time-lows of 18.9 against the USD. Recall that the TRY lost 30% of its value in FY:22, following losses of 70% between FY:18-21. However, FX swings have been smaller lately, reflecting authorities tight grip on the exchange rate through direct interventions in the market and some "backdoor capital controls" (including exporters' requirement to sell a portion of their FX revenue to the CBRT), on the one hand, and a state scheme protecting TRY deposits against FX risk, on the other hand.

Looking ahead, authorities are expected to maintain their easing bias until the elections (due by mid-year), in which President Erdogan is set to face a tough fight, as suggested by his declining popularity, in the aftermath of the devastaiting earthquakes. Although there is little scope for additional rate cuts, we see the credit impulse strengthening further (see chart), fueled by an expansion in state-backed lending (with guarantees up to 2.7% of FY:22 GDP due to be provided to this end).

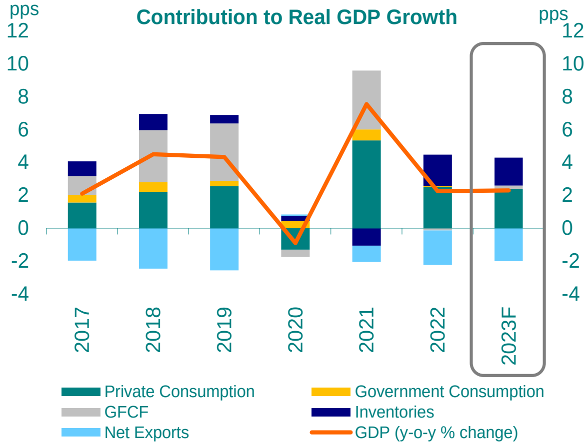
In light of elevated external imbalances, the expansionary monetary policy pursued by authorities could feed market volatility and potentially require adjustment. Given the economy's external imbalances (stemming from its complete reliance on imports to cover its energy needs -- with the energy trade deficit currently standing at slightly less than 10.0% of GDP, nearly double the current account deficit), this ultra-accommodative monetary policy has left Türkiye trapped into a vicious cycle of weakening TRY and skyrocketing inflation.

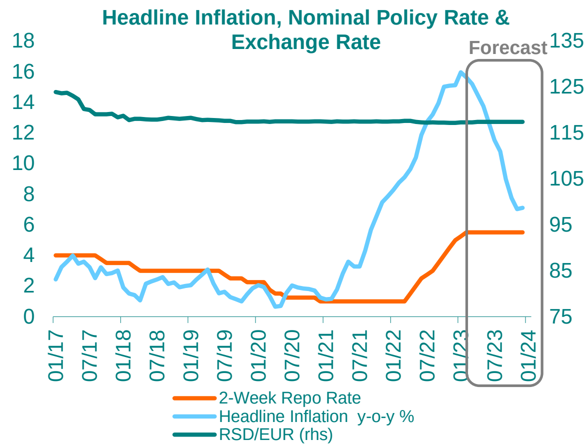
Worryingly, tightening global financing conditions, together with still srong demand-side pressures on the trade balance and the sizeable external debt payments looming in the short-term (worth c. 18.0% of projected FY:23 GDP), paint a gloomy picture for the TRY, despite the recent drop in global energy prices. The picture gets even worse when considering the CBRT's lack of ammunition, with its net FX reserves position having long turned negative (see chart). Albeit providing some relief, authorities' efforts to secure non-market financing support from Türkiye's partners do not significantly alter the big picture.

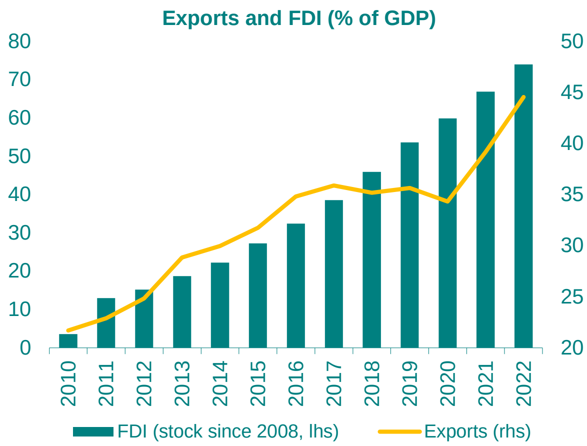
Regardless of the forthcoming election outcome, we expect authorities to eventually reverse policies in H2:23, albeit gradually so as not to jeopardize financial stability. Recall that, in 2018, the key rate was raised by 1600 bps to c. 3.0% in real *ex-post* terms, before the TRY stabilised. For illustrative purposes, note that the real *ex-post* policy rate currently stands at c. -30.0%, the lowest worldwide. Should authorities delay the adjustment, Türkiye risks snowballing into a full-fledged current crisis and deep recession. Importantly, Türkiye's low debt metrics (with gross public debt estimated at 37.5% of GDP at end-2022, well below that of its peers) provide the authorities with ample fiscal space to ensure the orderly unwinding of the sizeable monetary stimulus.

Serbia

B+ / B1 / NR (S&P / Moody's / Fitch)







	6 Mar.	3-M F	6-M F	12-M F
1-m BELIBOR (%)	5.0	5.3	5.6	5.6
RSD/EUR	117.2	117.5	117.5	117.5
Sov. Spread (2029, bps)	372	365	350	330

	6 Mar.	1-W %	YTD %	2-Y %
BELEX-15	891	1.3	8.0	19.7

	2020	2021	2022E	2023F	2024F
Real GDP Growth (%)	-3.5	8.5	4.2	2.6	3.8
Inflation (eop, %)	1.1	3.7	7.4	3.4	2.6
Cur. Acct. Bal. (% GDP)	-8.7	-7.5	-7.1	-6.7	-6.4
Fiscal Bal. (% GDP)	-6.7	-4.5	-3.3	-3.0	-2.4

Sources: Reuters, NBS, OPBC & NBG estimates

Serbia & Kosovo agree on EU plan to normalize long-strained relations, but uncertainty is unlikely to ease soon. At end-February, the leaders of Serbia and Kosovo agreed to back an EU-mediated proposal, aiming at restoring the ties between the two neighbours.

Under the plan, Serbia would stop objecting to Kosovo's membership in international organizations and recognize its documents and symbols, yet without officially recognizing its independence. At the same time, Kosovo would "ensure an appropriate level of self-management" for its Serbian minority. Note that the plan does not provide explicitly for the creation of an Association of Majority Serbian Municipalities in Kosovo, an issue Serbia has been long pressing for.

Although both parties agreed that "no further discussions" are needed on the plan, they did not seal a binding agreement. The latter would be made possible only once both parties agree on a roadmap for its implementation, a step, which, according to President Vucic, who, in fact, appears unwilling to consent to Kosovo's admission to the UN, would require "many more" sessions.

Recall that Kosovo, whose population is mainly ethnic Albanian, unilaterally declared independence in 2008, almost a decade after an armed conflict ended Serbia's rule. Since then, relations have been tensed, raising fears of a return to conflict. Note that the EU has mediated 33 agreements between Serbia and Kosovo over the past years, with very few of them having been implemented.

All said, there is little prospect of a breakthrough in Serbia-Kosovo negotiations. In this context, we also expect limited progress in Serbia's accession talks with the EU, the relations with which have been strained lately, due to the former's neutral stance on the Russia-Ukraine conflict.

GDP growth is set to remain subdued in FY:23, at 2.3%, unchanged from FY:22. Further IMF-mandated tariff adjustments by state-owned energy companies (to reflect underlying cost increases) and their second-round effects mean that inflation is set to remain elevated throughout the year. Nevertheless, despite the adverse impact of high inflation on (real) disposable income, private consumption should continue to grow, albeit modestly, thanks to an accommodative incomes policy (incl. hikes of 12.5% and 20.0% in public sector wages and pensions, respectively) and its spillover to the private sector.

On the other hand, amid elevated uncertainty and tightening financing conditions, fixed investment is unlikely to add much to overall growth in FY:23. The continuation of several large infrastructure projects suggests that the public sector should continue to play the lead role.

Net exports are also set to remain a drag on overall growth, in view of soft external demand from the EU (absorbing ⅔rds of Serbia's exports) and continuing build-up of energy and food reserves. Importantly, Serbia's increased export capacity & diversification, following past years' strong FDI inflows, suggests that net exports could add to economic growth as soon as external conditions allow.

Policies are not envisaged to sustain GDP growth this year. Indeed, amid elevated inflation and still wide external imbalances (largely driven by increased energy imports, in volume terms, due to persistent -- albeit moderating -- shortages in domestic electricity production), the NBS cannot but maintain its tightening bias (having already raised its key rate to 5.75% in early-2023 from a low of 1.0% a year ago).

All said, we see FY:23 GDP growth flat at 2.3%, reflecting, inter alia, a weak statistical carry-over effect (of 0.5 pps against 2.4 pps in FY:22), which should offset the impact of: i) the drought-related normalization in agricultural output; and ii) moderating shortages in domestic energy supplies. Importantly, the 2-year SBA with the IMF provides a safety net, in the event external financing conditions deteriorate abruptly.

DETAILED MACROECONOMIC DATA

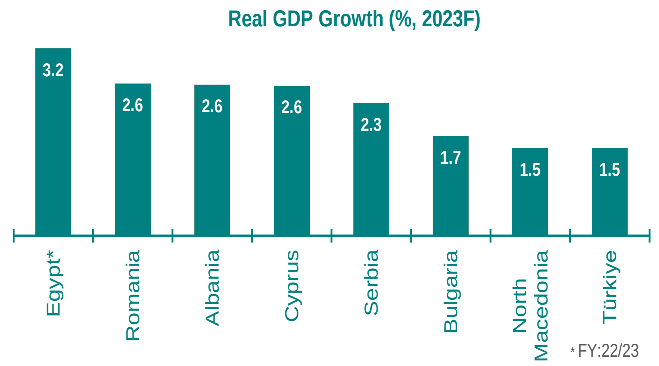
TÜRKIYE	2020	2021	2022e	2023f	2024f
Real Sector					
Nominal GDP (USD million)	719,168	815,755	905,475	1,080,930	1,284,412
GDP per capita (USD)	8,601	9,633	10,568	12,471	14,654
GDP growth (real, %)	2.0	11.4	5.6	1.5	4.5
Unemployment rate (%, aop)	13.2	12.0	10.5	10.5	10.0
Prices and Banking					
Inflation (%, eop)	14.6	36.1	64.3	36.0	22.0
Inflation (%, aop)	12.3	19.3	71.6	42.6	25.2
Loans to the Private Sector (% change, eop)	34.8	37.0	54.5		
Customer Deposits (% change, eop)	33.0	51.5	68.0		
Loans to the Private Sector (% of GDP)	70.8	67.6	50.4		
Retail Loans (% of GDP)	16.8	14.5	11.2		
Corporate Loans (% of GDP)	54.1	53.1	39.2		
Customer Deposits (% of GDP)	62.1	65.5	53.1		
Loans to Private Sector (% of Cust. Deposits)	114.1	103.2	94.9		
Foreign Currency Loans (% of Total Loans)	34.2	42.2	32.6		
External Accounts					
Merchandise exports (USD million)	168,378	224,686	252,416	259,824	278,139
Merchandise imports (USD million)	206,252	253,999	343,098	338,979	353,111
Trade balance (USD million)	-37,874	-29,313	-90,682	-79,154	-74,971
Trade balance (% of GDP)	-5.3	-3.6	-10.0	-7.3	-5.8
Current account balance (USD million)	-31,888	-7,232	-48,769	-40,668	-39,536
Current account balance (% of GDP)	-4.4	-0.9	-5.4	-3.8	-3.1
Net FDI (USD million)	4,456	6,874	8,052	8,857	10,186
Net FDI (% of GDP)	0.6	0.8	0.9	0.8	0.8
International reserves (USD million)	93,277	111,181	128,736	134,000	142,000
International reserves (Months[a])	4.9	4.7	3.3	4.7	4.6
Public Finance					
Primary balance (% of GDP)	-0.8	-0.2	1.1	-2.8	-0.2
Fiscal balance (% of GDP)	-3.4	-2.7	-0.9	-5.5	-4.8
Gross public debt (% of GDP)	39.7	41.8	37.5	39.0	38.5
External Debt					
Gross external debt (USD million)	432,848	441,064	460,000	482,500	507,500
Gross external debt (% of GDP)	60.2	54.1	50.8	44.6	39.5
External debt service (USD million)	70,931	74,311	80,000	85,000	90,000
External debt service (% of reserves)	76.0	66.8	62.1	63.4	63.4
External debt service (% of exports)	37.5	27.6	25.4	26.2	25.9
Financial Markets					
Policy rate (Effective funding rate, %, eop)	17.0	14.0	9.0	18.0	15.0
Policy rate (Effective funding rate, %, aop)	10.5	17.6	12.6	11.6	16.5
10-Y T-bill rate (%, eop)	12.5	23.1	9.9	13.0	12.0
Exchange rate: USD (eop)	7.43	13.32	18.69	21.50	22.75
Exchange rate: USD (aop)	7.02	8.89	16.57	20.09	22.13

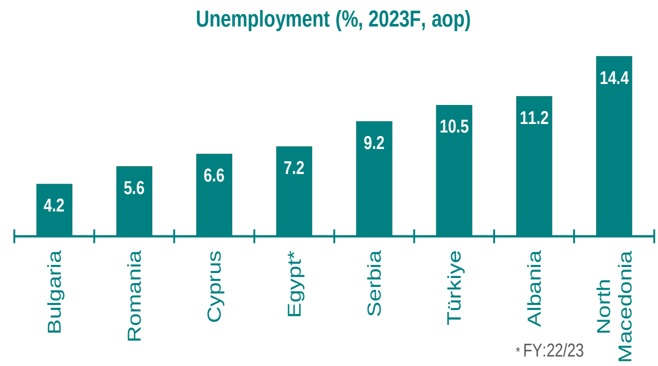
f: NBG forecasts; a: months of imports of GNFS

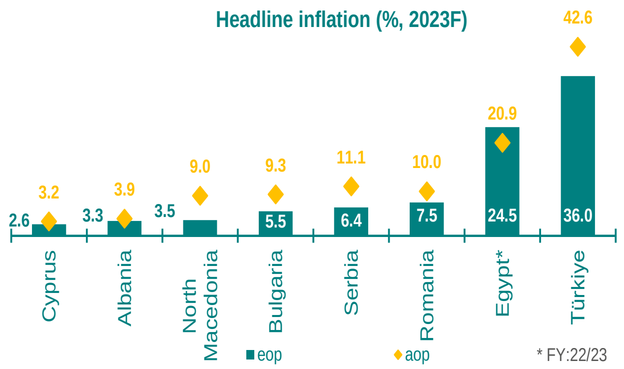
SERBIA	2020	2021	2022e	2023f	2024f
Real Sector					
Nominal GDP (EUR million)	46,841	53,363	60,404	68,652	74,541
GDP per capita (EUR)	6,789	7,808	8,901	10,177	11,094
GDP growth (real, %)	-0.9	7.5	2.3	2.3	3.6
Unemployment rate (%, aop)	9.7	11.1	9.3	9.2	8.8
Prices and Banking					
Inflation (%, eop)	1.3	7.9	15.1	6.4	3.5
Inflation (%, aop)	1.6	4.1	11.9	11.1	4.9
Loans to the Private Sector (% change, eop)	12.2	10.1	6.9		
Customer Deposits (% change, eop)	17.4	13.3	6.9		
Loans to the Private Sector (% of GDP)	49.0	47.4	44.7		
Retail Loans (% of GDP)	22.6	21.9	20.3		
Corporate Loans (% of GDP)	26.4	25.4	24.4		
Customer Deposits (% of GDP)	52.3	52.1	48.6		
Loans to Private Sector (% of Deposits)	93.6	90.9	92.1		
Foreign Currency Loans (% of Total Loans)	62.1	61.1	64.1		
External Accounts					
Merchandise exports (EUR million)	16,079	20,906	26,913	28,705	30,150
Merchandise imports (EUR million)	21,280	26,819	36,266	38,425	40,009
Trade balance (EUR million)	-5,201	-5,913	-9,353	-9,719	-9,859
Trade balance (% of GDP)	-11.1	-11.1	-15.5	-14.2	-13.2
Current account balance (EUR million)	-1,929	-2,350	-4,139	-4,277	-4,027
Current account balance (% of GDP)	-4.1	-4.4	-6.9	-6.2	-5.4
Net FDI (EUR million)	2,938	3,724	4,306	4,306	4,629
Net FDI (% of GDP)	6.3	7.0	7.1	6.3	6.2
International reserves (EUR million)	13,492	16,455	19,416	19,944	21,046
International reserves (Months[a])	6.1	5.9	5.2	5.0	5.0
Public Finance					
Primary balance (% of GDP)	-6.0	-2.4	-1.6	-1.3	-0.5
Fiscal balance (% of GDP)	-8.0	-4.1	-3.1	-3.0	-2.2
Central Government debt (% of GDP)	58.7	57.9	55.9	54.0	53.0
External Debt					
Gross external debt (EUR million)	30,787	36,488	40,592	43,937	45,097
Gross external debt (% of GDP)	65.7	68.4	67.2	64.0	60.5
External debt service (EUR million)	5,500	6,000	5,100	4,700	5,100
External debt service (% of reserves)	40.8	36.5	26.3	23.6	24.2
External debt service (% of exports)	24.7	20.9	13.4	11.6	11.9
Financial Markets					
Policy rate (2-w repo rate, %, eop)	1.0	1.0	5.0	5.8	4.5
Policy rate (2-w repo rate, %, aop)	1.5	1.0	2.6	5.7	5.3
10-Y T-bill rate (%, eop)	3.1	4.1	7.4	7.0	6.6
Exchange rate: EUR (eop)	117.5	117.5	117.2	117.5	117.5
Exchange rate: EUR (aop)	117.5	117.5	117.4	117.4	117.5

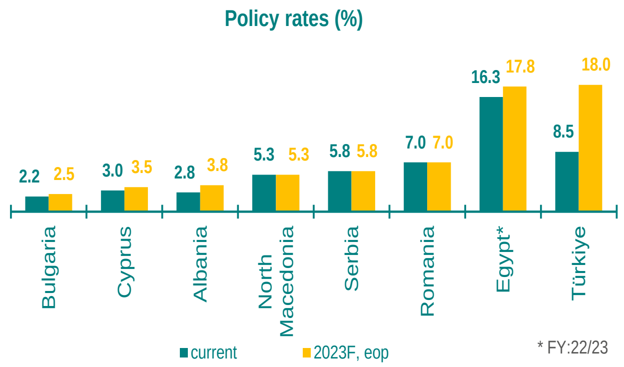
f: NBG forecasts; a: months of imports of GNFS

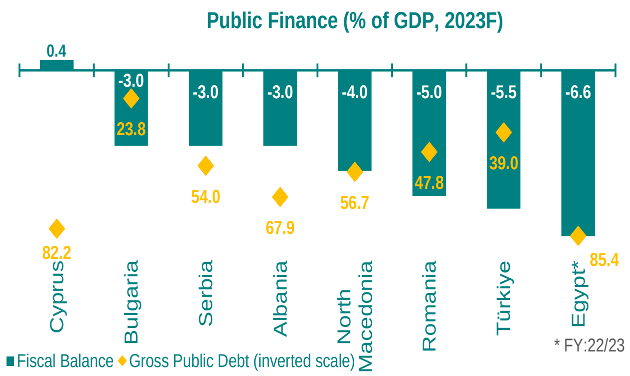
REGIONAL SNAPSHOT: MACROECONOMIC INDICATORS

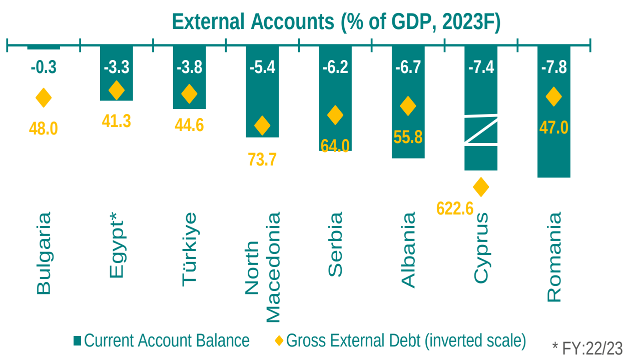


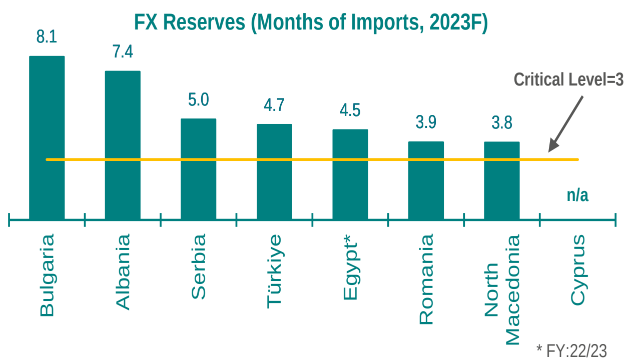






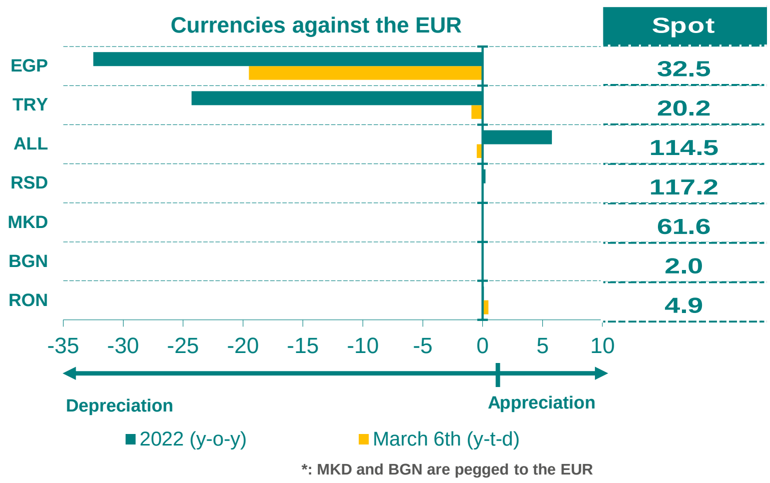


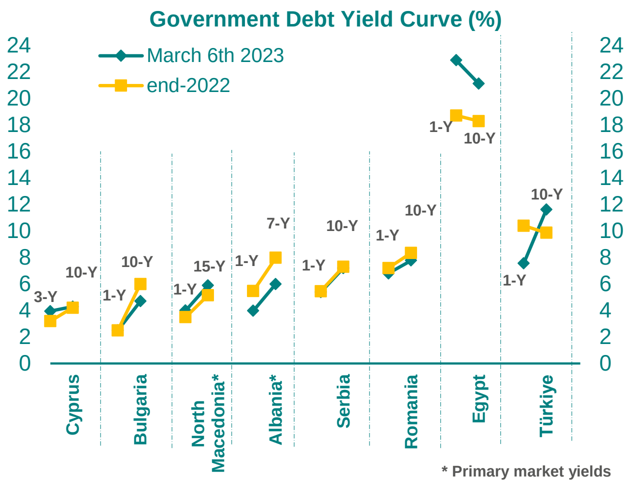


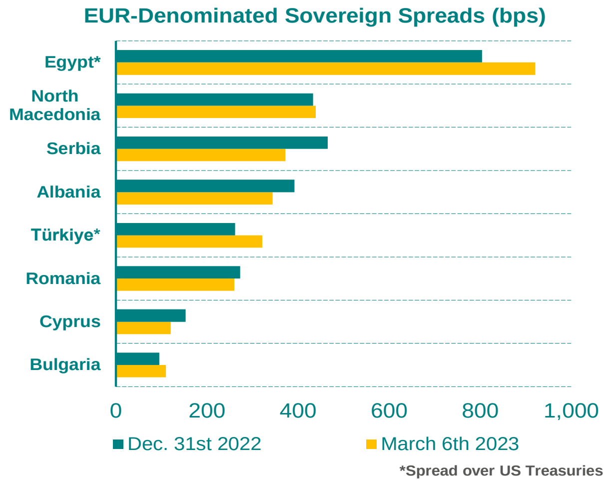


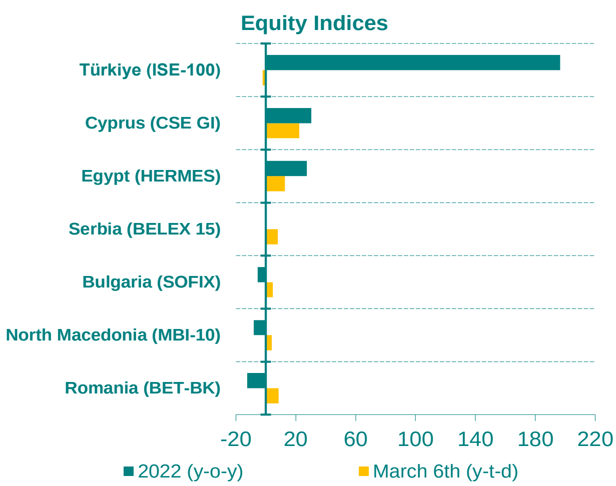
Sources: National Sources & NBG estimates

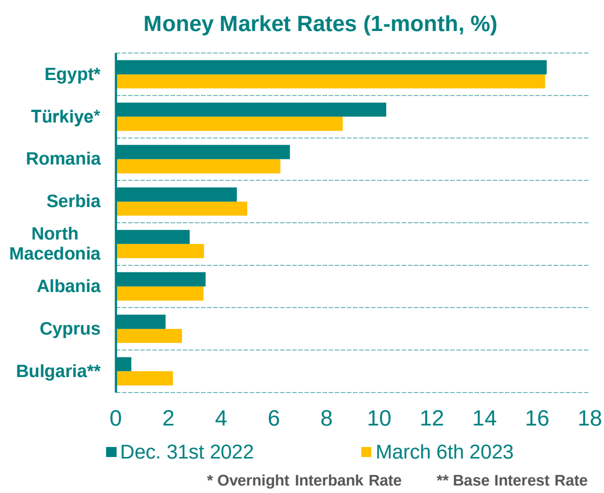
REGIONAL SNAPSHOT: FINANCIAL MARKETS











Sources: Reuters & NBG estimates