



COUNTRIES IN FOCUS:

Cyprus & North Macedonia

CYPRUS1

Following another year of strong performance, tourism activity in Cyprus has nearly returned to pre-pandemic levels, contributing to the overperformance of the economy compared with the euro area average

Subdued growth in the EU and a highly uncertain regional geopolitical backdrop cannot but weigh on tourist inflows next year, despite authorities' efforts to diversify source markets and upgrade the country's tourism profile

Real estate market continues to overperform, on the back of surging (mostly external) demand

Under the burden of tightened financing conditions, the real estate market is set to eventually cool down, albeit moderately

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Higher interest rates boost banks' profits, despite an increase in the cost of risk

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NBG – Economic Analysis Division

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Emerging Markets Analysis

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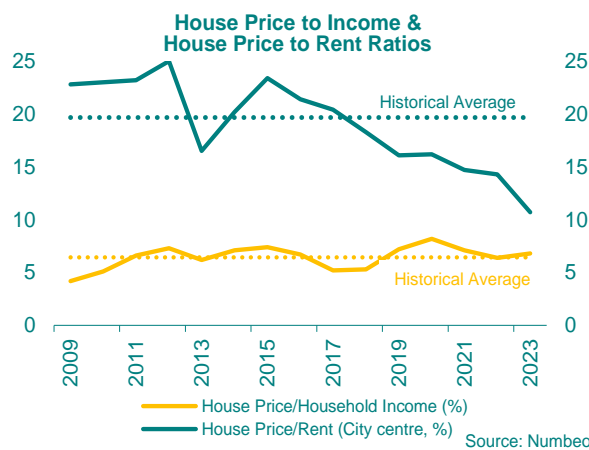
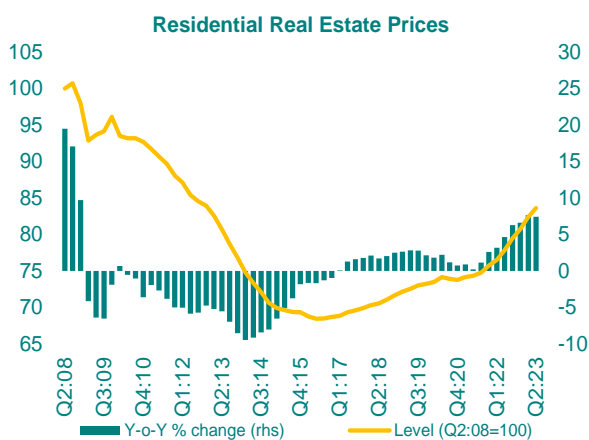
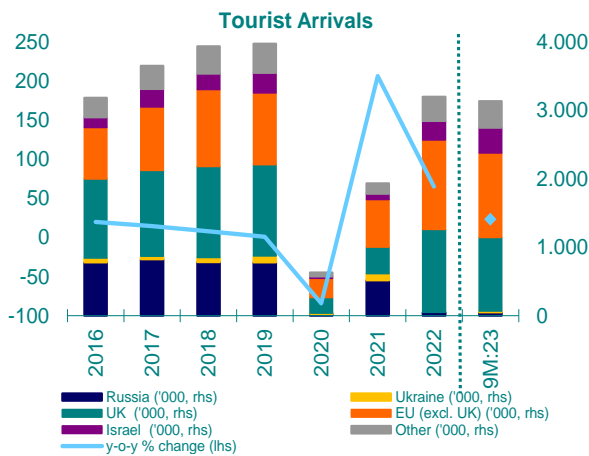
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Cyprus

BBB / Baa2 / BBB (S&P/ Moody's / Fitch)



	13 Nov.	3-M F	6-M F	12-M F
1-M EURIBOR (%)	3.8	3.7	3.6	3.3
EUR/USD	1.07	1.08	1.08	1.08
Sov. Spread (2028, bps)	99	100	97	93

	13 Nov.	1-W %	YTD %	2-Y %
CSE 100	126	-1.3	41.1	89.9

	2020	2021	2022	2023F	2024F
Real GDP Growth (%)	-3.4	9.9	5.1	2.5	2.5
Inflation (eop, %)	-1.1	4.8	7.9	3.5	2.3
Cur. Acct. Bal. (% GDP)	-10.0	-6.1	-7.9	-7.5	-6.1
Fiscal Bal. (% GDP)	-5.7	-1.9	2.4	2.2	2.2

Sources: Reuters, CYSTAT, CBC, Numbeo & NBG estimates

Following another year of strong performance, tourism activity in Cyprus has nearly returned to pre-pandemic levels. Despite economic headwinds (see below), tourist arrivals to Cyprus continued to increase at a robust pace in 9M:23 (up 23.4% y-o-y, to 3.1mn, only slightly behind the levels seen during the same period in 2019), benefiting from still strong global pent-up demand for tourism services.

In terms of source countries, the y-t-d performance has been supported by a jump in arrivals from the EU (especially Poland and Romania) and Israel. The tourist inflows from these countries have, in fact, broadly offset the collapse in arrivals from Russia (accounting for a whopping 27% of total arrivals in FY:21), following an EU ban on Russian flights.

However, reflecting underlying pressures on households' disposable income and weakening sentiment, tourists spent less days on the island (with the average number of overnight stays dropping by 2 y-o-y to c. 8 on average in 7M:23). Unsurprisingly, spending per tourist per stay rose by c. 17% y-o-y, at the same time, amid elevated inflation. All said, tourism receipts are estimated to have increased broadly at the same pace with tourist arrivals, providing a critical contribution to GDP growth.

Subdued growth in the EU and a highly uncertain regional geopolitical backdrop cannot but weigh on tourist inflows next year.

Growth in the tourism sector & related activities (accounting for more than 12% of the country's FY:22 GDP) is due to be significantly affected next year by the impact of subdued economic growth in the EU and tourists' concomitant turn to more affordable holiday destinations, on the one hand, and reduced tourist flows from Israel (2nd largest source country after the UK, accounting for c. 9% of total arrivals in FY:22), amid tensions in the Middle East, on the other hand. Note that some cancellations of bookings from Israel have been already recorded. On a positive note, authorities' efforts to diversify further source markets and upgrade the county's tourism profile through large infrastructure projects (including marinas and the largest casino in EU, the construction of which was completed in mid-2023) bode well for the industry's future.

Real estate market continues to overperform, on the back of surging (mostly external) demand.

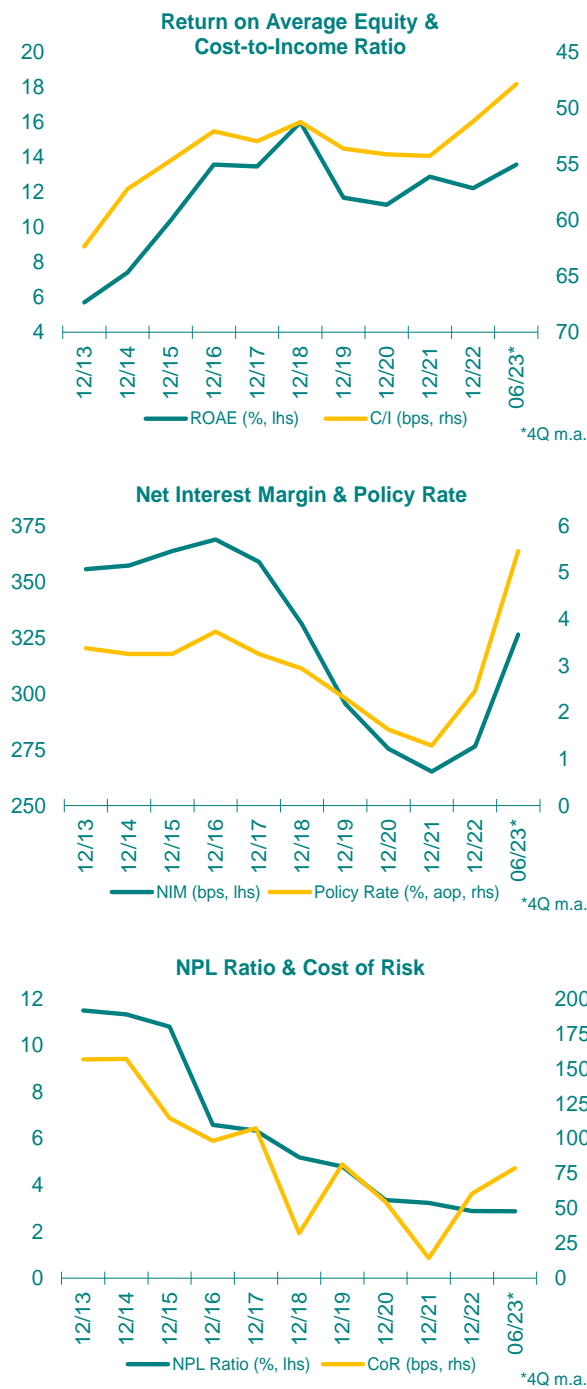
Real estate prices continued to increase at a fast pace in H1:23 (up 7.5% y-o-y, following a rise of 5.2% in FY:22, with prices, however, still standing lower than their pre-GFC highs), mainly reflecting strong demand. The latter has been mostly driven by the foreign segment (accounting for 45% of total property sales in H1:23, up from 35% in 2021), following the massive relocation of foreign companies to the island (with 1600 firms with 12,500 employees having been registered domestically in FY:22), in the context of Cyprus' headquartering policy, and, to a lesser extent, migration from Russia and Ukraine. In response to solid demand for real estate, and despite higher construction costs, supply of real estate has increased, with the production index of building construction posting its first increase on annual basis in H1:23, following 1½ year of negative readings.

Under the burden of tightened financing conditions, the real estate market is set to eventually cool down, albeit moderately.

Given the high share of variable rate mortgage loans, rising interest rates should weigh on domestic demand for real estate, especially in view of high household indebtedness (amounting to 72% of GDP against an EU average of 55%). External demand should be also affected by tightening global financing conditions, albeit modestly, assuming continuing immigration flows to Cyprus (including from Israel). All said, real estate price inflation should moderate over the next quarters, with the envisaged stabilization in construction costs also helping to this end. Importantly, with price misalignment measures hovering around or below historical averages (see chart), an abrupt correction seems a distant prospect.

North Macedonia

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



Higher interest rates boost banks' profits, despite an increase in the cost of risk. In H1:23, banks' profits surged by 35.7% y-o-y to MKD 7.4bn (equivalent to 0.8% of GDP), with (annualised) ROAE and ROAA strengthening to 17.1% and 2.1% in H1:23, respectively, among the highest in the region, from 14.3% and 1.7% in H1:22.

Stronger net interest income (NII, up 43.6% y-o-y in H1:23) was the main driver behind the jump in profitability. Indeed, fast repricing of loans, in an environment of rising interest rates (with the NBRNM's key policy rate standing at 6.0% in mid-2022, up from 1.25% in early-2022), lifted the net interest margin (NIM) to 351 bps in H1:23 -- more than double that of EU banks -- from 264 bps in H1:22. At the same time, banks' loan portfolio continued to expand at a solid pace (up 6.5% y-o-y in June), yet lower than that observed a year ago (up 9.8%).

Net non-interest income (NNII) also increased in H1:23, but modestly (up 4.9% y-o-y), driven by net fees and commission income. Stronger top line revenue was partly offset by a broad-based rise in operating expenses (up 13.6% y-o-y in H1:23), in line with higher inflation. That said, the annualised cost-to-income ratio improved sharply to c. 45% in H1:23, below that of EU banks (c. 56%).

Unsurprisingly, given challenges lying ahead (see below), provisioning charges were raised significantly in H1:23, albeit from a low base, curtailing banks' profitability. Indeed, the cost of risk was nearly tripled to 61 bps in H1:23, despite the NPL ratio remaining subdued, at 2.9% in June (with corporates accounting for the bulk of NPLs) against 3.2% a year ago, reflecting, *inter alia*, the impact of solid credit expansion.

Elevated provisioning needs are set to impact profitability, albeit from high levels. Under the burden of elevated inflation and high interest rates, economic activity is set to remain weak in the period ahead (with GDP growth easing to 1.5% in FY:23 from 2.1% in FY:22, before picking-up modestly to 2.2% in FY:24), straining the private sector's debt repayment capacity (with challenges, however, mitigated by its relatively low indebtedness -- c. 100% of GDP, below the indicative threshold of 140%). As a result, we expect asset quality pressures to intensify in the period ahead (note that underperforming loans currently account for c. 13.0% of banks' loan portfolio), prompting banks to build up provisions at a faster pace. Importantly, the high NPL coverage ratio (standing at 70.4% in June, well above the EU average of c. 43.0%) provides some comfort on future provisioning needs.

At the same time, NII should continue growing, albeit at a much weaker pace than before, reflecting slowing credit uptake. Note that with the NBRNM having most likely completed its tightening cycle, there is limited upside potential for further significant widening in the NIM. Looking further ahead, banks' comfortable liquidity position (with a loan-to-deposit ratio of less than 90%) advocates for a slow adjustment in the NIM, when interest rates start to fall.

On the other hand, elevated inflation, together with the continuing digital transformation of the banking system, mean that operating expenses cannot but remain on upward trend in the period ahead.

All said, banks should see profitability indicators peaking in FY:23, before moderating to still healthy levels from 2024 onwards. Importantly, strong profitability has been translated into stronger capital buffers, with the capital adequacy ratio firming to 18.2% in June from 17.7% at end-2022, well above the minimum regulatory threshold of 8.0%, providing a line of defense against potential losses.

A reversal in real estate prices (with the latter having gone up c. 40% since end-2020) is a key risk to consider in the period ahead, with the NBRNM responding with tighter loan-to-value and debt service-to-income ratios and a hike in the counter-cyclical buffer (up 0.5 pps, effective as of in August 2023).

	13 Nov.	3-M F	6-M F	12-M F
1-m SKIBOR (%)	4.2	4.4	4.4	4.2
MKD/EUR	61.6	61.6	61.6	61.6
Sov. Spread (2028, bps)	386	380	360	340

	13 Nov.	1-W %	YTD %	2-Y %
MBI 100	5,871	-0.2	3.9	-1.3

	2020	2021	2022	2023F	2024F
Real GDP Growth (%)	-4.7	3.9	2.1	1.6	2.4
Inflation (eop, %)	2.2	4.9	18.7	3.7	3.4
Cur. Acct. Bal. (% GDP)	-2.9	-3.1	-6.0	-1.5	-2.6
Fiscal Bal. (% GDP)	-8.0	-5.4	-4.5	-4.7	-3.8

Sources: Reuters, NBRNM, MAKSTAT & NBG estimates

DETAILED MACROECONOMIC DATA

CYPRUS					
	2020	2021	2022	2023f	2024f
Real Sector					
Nominal GDP (EUR million)	22,087	24,928	27,777	29,566	31,184
GDP per capita (EUR)	24.761	27.687	30.516	32.128	33,550
GDP growth (real, %)	-3.4	9.9	5.1	2.5	2.5
Unemployment rate (% aop)	7.6	7.5	6.8	6.3	6.0
Prices and Banking					
Inflation (% eop)	-1.1	4.8	7.9	3.5	2.3
Inflation (% aop)	-0.6	2.4	8.4	3.8	2.9
Loans to the Private Sector (% change, eop)	-5.6	-5.0	-12.1		
Customer Deposits (% change, eop)	-0.6	5.4	2.8		
Loans to the Private Sector (% of GDP)	130.8	110.1	86.8		
Retail Loans (% of GDP)	60.6	49.0	41.4		
Corporate Loans (% of GDP)	70.2	61.1	45.4		
Customer Deposits (% of GDP)	186.4	174.1	160.7		
Loans to Private Sector (% of Deposits)	70.2	63.2	54.0		
Foreign Currency Loans (% of Total Loans)	---	---	---		
External Accounts					
Merchandise exports (EUR million)	2,969	3,693	4,581	4,651	4,811
Merchandise imports (EUR million)	7,180	8,092	10,555	11,093	11,431
Trade balance (EUR million)	-4,211	-4,398	-5,973	-6,442	-6,620
Trade balance (% of GDP)	-19.1	-17.6	-21.5	-21.8	-21.3
Current account balance (EUR million)	-2,202	-1,514	-2,203	-2,209	-1,916
Current account balance (% of GDP)	-10.0	-6.1	-7.9	-7.5	-6.2
Net FDI (EUR million)	7,454	7,748	8,446	10,768	13,460
Net FDI (% of GDP)	33.7	31.1	30.4	36.5	43.2
International reserves (EUR million)	---	---	---	---	---
International reserves (Months ^a)	---	---	---	---	---
Public Finance					
Primary balance ^b (% of GDP)	-3.5	-0.1	3.9	3.6	3.5
Fiscal balance ^b (% of GDP)	-5.7	-1.9	2.4	2.2	2.2
Gross public debt (% of GDP)	114.9	99.3	85.6	81.5	75.0
External Debt					
Gross external debt (EUR million)	175,543	172,529	169,326	168,326	166,826
Gross external debt (% of GDP)	794.8	692.1	609.6	569.3	536.0
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	2.5	4.5	4.3
Policy rate (ECB refinancing rate, %, aop)	0.0	0.0	0.7	3.8	4.4
10-Y T-bill rate (% eop)	0.2	0.7	4.2	4.0	4.0
Exchange rate: USD (eop)	1.221	1.137	1.070	1.060	1.080
Exchange rate: USD (aop)	1.142	1.183	1.053	1.077	1.068

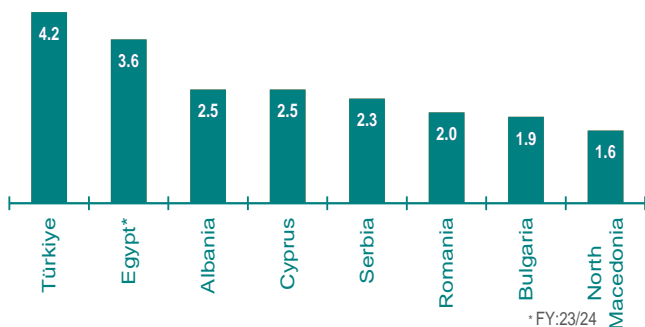
f: NBG forecasts; a: months of imports of GNFS; b: cash basis

NORTH MACEDONIA					
	2020	2021	2022	2023f	2024f
Real Sector					
Nominal GDP (EUR million)	10,874	11,708	12,917	14,366	15,226
GDP per capita (EUR)	5,889	6,374	7,061	7,885	8,390
GDP growth (real, %)	-4.7	3.9	2.1	1.6	2.4
Unemployment rate (% aop)	16.4	15.4	14.4	13.3	13.1
Prices and Banking					
Inflation (% eop)	2.2	4.9	18.7	3.7	3.4
Inflation (% aop)	1.2	3.2	14.0	9.5	3.5
Loans to the Private Sector (% change, eop)	4.7	8.0	9.3		
Customer Deposits (% change, eop)	6.2	8.5	5.1		
Loans to the Private Sector (% of GDP)	53.0	53.2	52.7		
Retail Loans (% of GDP)	27.8	27.8	27.1		
Corporate Loans (% of GDP)	25.2	25.3	25.6		
Customer Deposits (% of GDP)	61.0	61.5	58.6		
Loans to Private Sector (% of Deposits)	86.8	86.5	89.9		
Foreign Currency Loans (% of Total Loans)	41.6	40.7	42.5		
External Accounts					
Merchandise exports (EUR million)	4,820	6,000	7,346	7,793	8,161
Merchandise imports (EUR million)	6,623	8,371	10,799	10,744	11,424
Trade balance (EUR million)	-1,804	-2,370	-3,453	-2,951	-3,263
Trade balance (% of GDP)	-16.6	-20.2	-26.7	-20.5	-21.4
Current account balance (EUR million)	-0,318	-0,366	-0,772	-0,209	-0,400
Current account balance (% of GDP)	-2.9	-3.1	-6.0	-1.5	-2.6
Net FDI (EUR million)	0,155	0,388	0,670	0,670	0,704
Net FDI (% of GDP)	1.4	3.3	5.2	4.7	4.6
International reserves (EUR million)	3,360	3,643	3,863	4,113	4,363
International reserves (Months ^a)	5.3	4.5	3.7	3.9	3.9
Public Finance					
Primary balance (% of GDP)	-6.8	-4.1	-3.3	-3.5	-2.5
Fiscal balance (% of GDP)	-8.0	-5.4	-4.5	-4.7	-3.8
Gross public debt ^b (% of GDP)	59.3	60.5	59.1	58.8	59.6
External Debt					
Gross external debt (EUR million)	8,536	9,577	10,856	11,493	12,028
Gross external debt (% of GDP)	78.5	81.8	84.0	80.0	79.0
External debt service (EUR million)	3,023	2,574	2,621	3,393	3,136
External debt service (% of reserves)	90.0	70.7	67.9	82.5	71.9
External debt service (% of exports)	48.3	33.2	27.1	32.8	28.8
Financial Markets					
28-d CB bill rate (% eop)	1.5	1.3	4.8	6.3	5.3
28-d CB bill rate (% aop)	1.6	1.3	2.5	5.8	6.0
1-Y T-bill rate ^c (% eop)	0.4	0.7	3.5	4.3	3.7
Exchange rate: EUR (eop)	61.6	61.6	61.6	61.6	61.6
Exchange rate: EUR (aop)	61.5	61.5	61.5	61.6	61.6

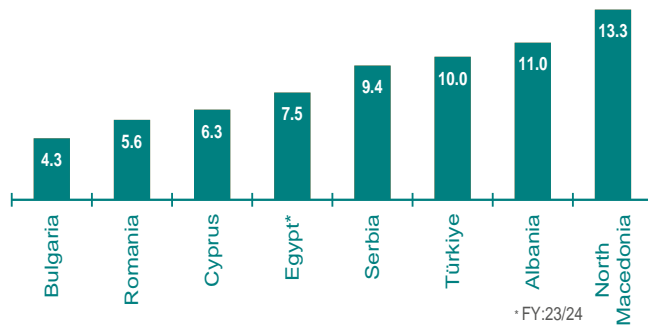
f: NBG forecasts; a: months of imports of GNFS; b: incl. guaranteed debt; c: primary market

REGIONAL SNAPSHOT: MACROECONOMIC INDICATORS

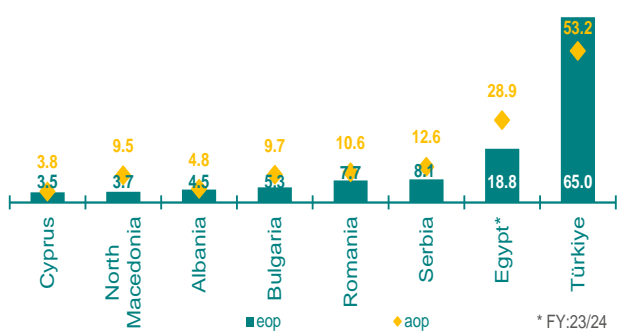
Real GDP Growth (% , 2023F)



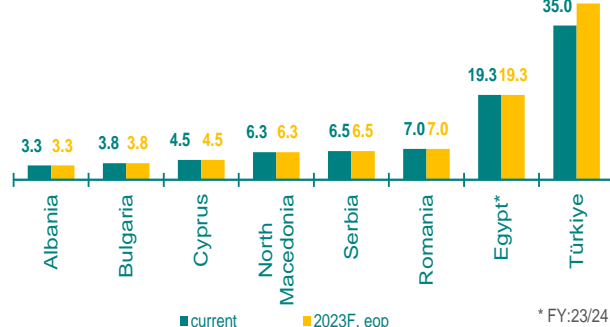
Unemployment (% , 2023F, aop)



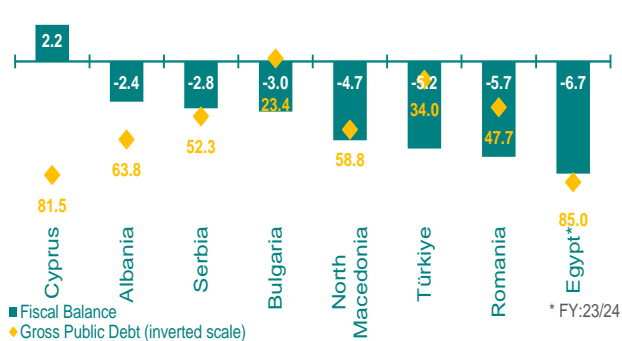
Headline inflation (% , 2023F)



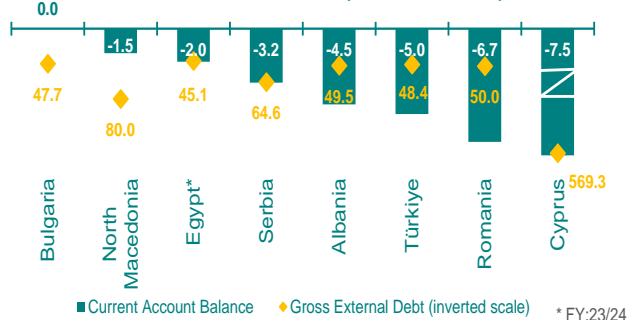
Policy rates (%)



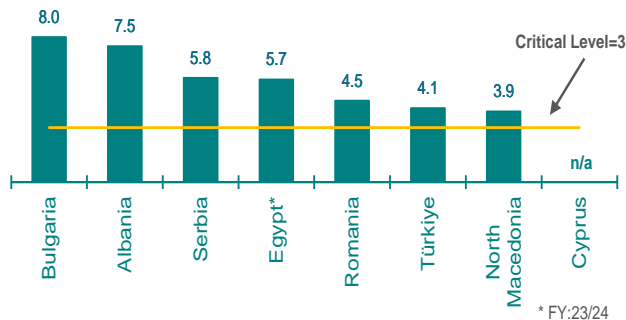
Public Finance (% of GDP, 2023F)



External Accounts (% of GDP, 2023F)

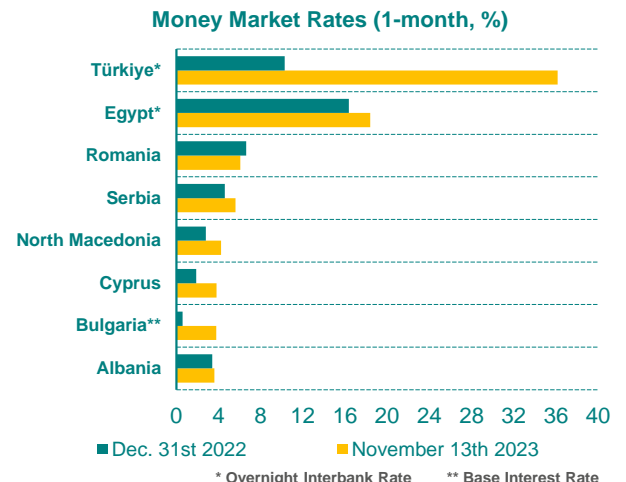
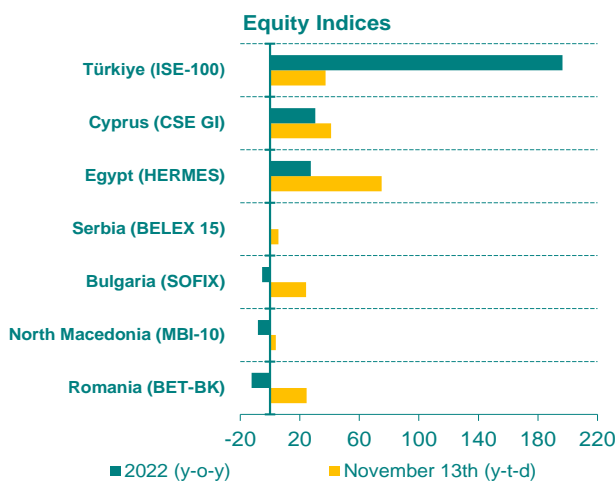
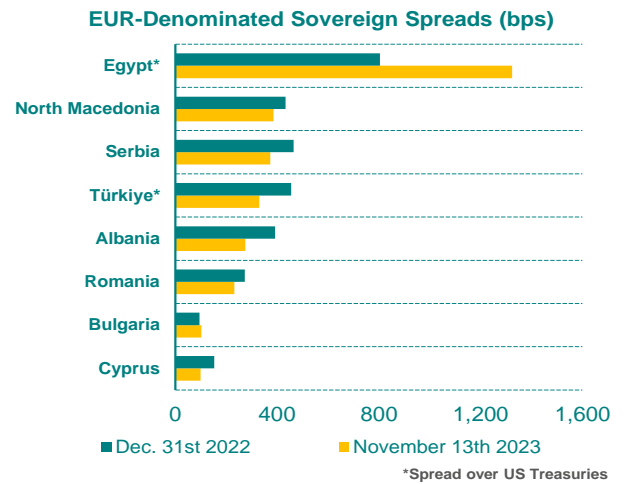
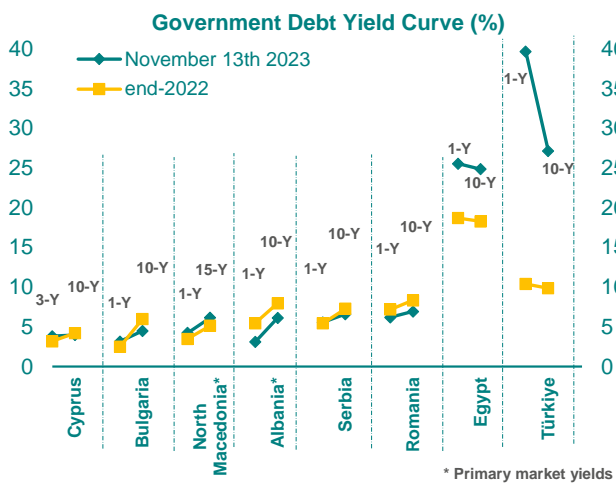
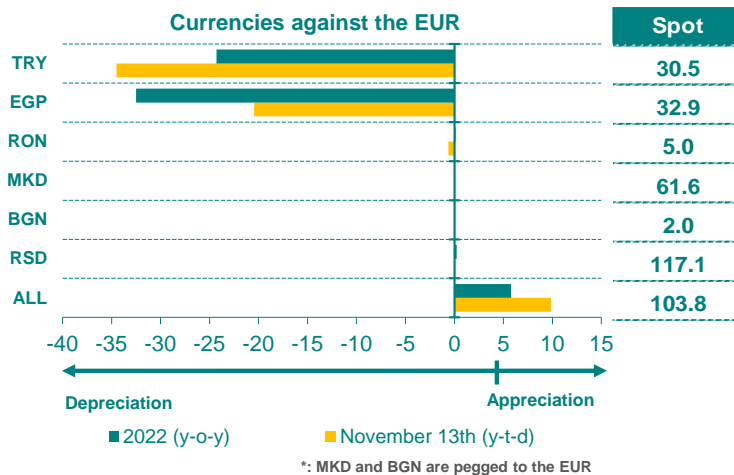


FX Reserves (Months of Imports, 2023F)



Sources: National Sources & NBG estimates

REGIONAL SNAPSHOT: FINANCIAL MARKETS



Sources: Reuters & NBG estimates

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