NATIONAL BANK OF GREECE

Economic Analysis & Research Division

Southeastern Europe & Mediterranean Emerging Market Economies

Bi-Weekly Report

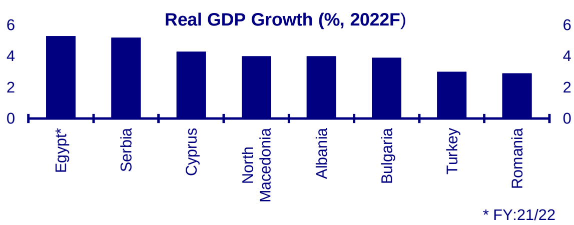
8 - 21 February 2022

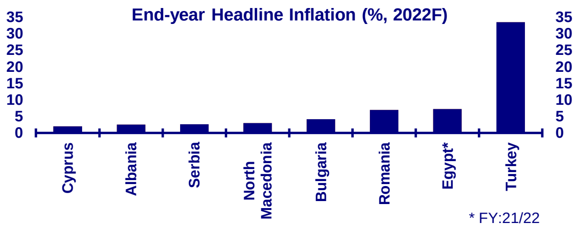
NBG - Economic Analysis & Research Division
https://www.nbg.gr/en/group/studies-and-economic-analysis

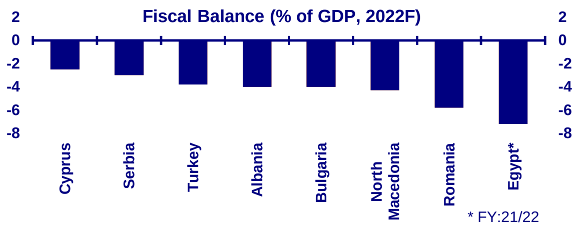
Southeastern Europe & Mediterranean Emerging Market Economies

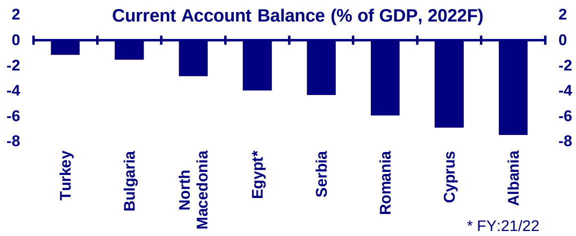
Head: Konstantinos Romanos-Louizos
☎ : +30 210 33 41 225
🖂 : romanos.louizos.k@nbg.gr

Louiza Troupi
☎ : +30 210 33 41 696
🖂 : troupi.louiza@nbg.gr









Sources: National authorities & NBG estimates

Annual headline inflation hit a 2-decade-high of 48.7% in January against 36.1% in December, mainly fuelled by the weaker TRY and soaring energy prices

Inflation is set to remain at extremely high levels throughout the year, weighing on the economy's performance

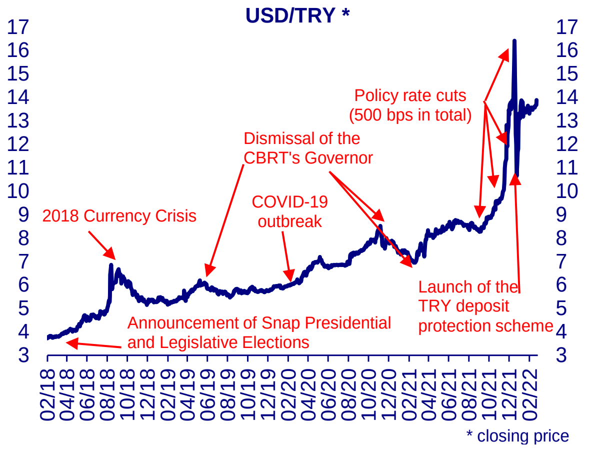
An adjustment in monetary policy is crucial to preserving macroeconomic and financial stability

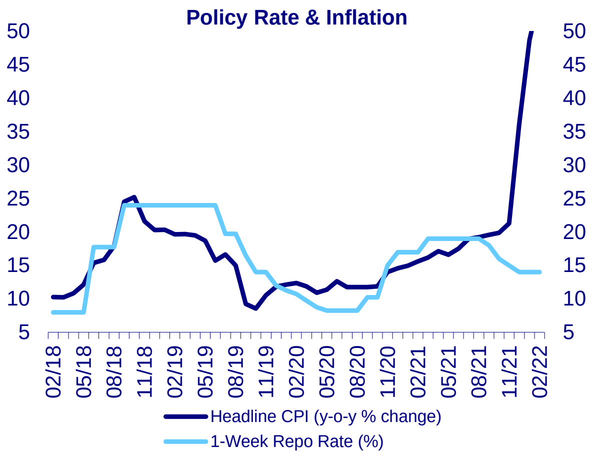
The NBS is set to continue tightening liquidity conditions at a gradual pace, with the first policy rate hike expected only after the April elections

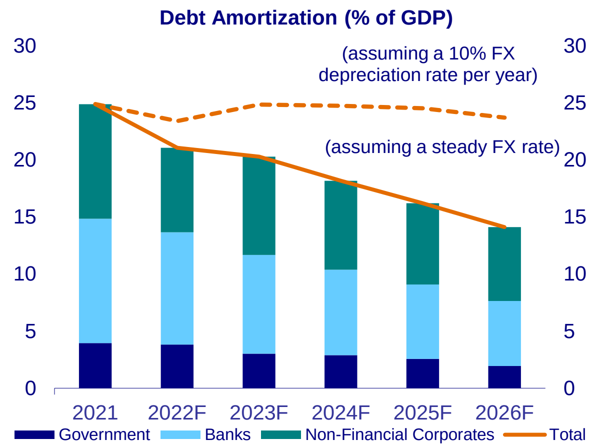
A faster tightening in monetary policy could occur should second round effects from higher energy prices, especially in view of the ongoing geopolitical tensions, keep inflation above the NBS's target

Turkey

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







	21 Feb.	3-M F	6-M F	12-M F
1-m TRIBOR (%)	14.6	14.5	14.3	14.0
TRY/USD	13.68	13.50	13.50	13.60
Sov. Spread (2025, bps)	509	500	490	460

	21 Feb.	1-W %	YTD %	2-Y %
ISE 100	2,038	1.8	9.7	74.4

	2019	2020	2021E	2022F	2023F
Real GDP Growth (%)	0.9	1.8	10.7	3.0	4.7
Inflation (eop, %)	11.8	14.6	36.1	33.5	18.0
Cur. Acct. Bal. (% GDP)	0.7	-4.9	-1.9	-1.2	-1.4
Fiscal Bal. (% GDP)	-2.9	-3.4	-2.8	-3.8	-3.0

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

Annual headline inflation hit a 2-decade-high of 48.7% in January against 36.1% in December, mainly fuelled by the weaker TRY and soaring energy prices. January's increase in consumer prices was broad based, mainly reflecting the impact of the sharp depreciation of the TRY (down 44.0% against the USD in 2021, on top of losses of c. 50% in 2018-20). The latter came in the aftermath of the easing delivered by the CBRT in late last year (incl. a cumulative policy rate cut of 500 bps to 14.0%), which was seen by markets as exacerbating the economy's underlying vulnerabilities (see below). As expected, energy prices made by far the biggest contribution to annual inflation in January (adding 6.0 pps to the headline figure), driven by the combined impact of weak TRY soaring energy prices on international markets.

Inflation is set to remain at extremely high levels throughout the year, weighing on the economy's performance. The continuing pass-through of the sharp depreciation of the TRY, together with strong underlying cost-push pressures (note that the PPI was up 93.5% y-o-y in January, with the latter also reflecting the impact of the recent 50% hike in the minimum wage), high inertia and steadily deteriorating inflation expectations, mean that inflation dynamics are unlikely to improve materially in the short-term. Assuming a broadly stable TRY, we see headline inflation hovering around 55.0% y-o-y in most part of the year, before easing to 33.5% at end-2022, thanks to positive base effects.

An adjustment in monetary policy is crucial to preserving macroeconomic and financial stability. With the CBRT remaining on hold since end-2021, and following the state's interventions, including the launch of a scheme protecting TRY deposits against FX risk and the adoption of a regulation requiring the sale of 25% of exporters' FX revenue, pressures on the TRY have eased lately. Still, we deem that a tightening in monetary policy is a *sine qua non* condition for breaking the vicious cycle of rising inflation and weakening TRY. Otherwise, and in view of Turkey's weak external position, the grounds for a renewed upsurge in market volatility will remain in place, threatening macroeconomic and financial stability.

Indeed, despite improving external trade dynamics, the current account still remains in deficit, with Turkey's almost complete reliance on imports to cover its energy needs being a key factor behind this imbalance. Worryingly, the picture gets much worse when considering the sizeable external debt payments looming in the short-term (amounting to USD 172bn or c. 21% of GDP). Against this backdrop, and with the CBRT's net FX reserves -- i.e. excluding gold, borrowings from domestic banks and banks' required reserves -- having long turned negative (currently at -USD 38.9bn), the outlook for the TRY remains bleak, especially in view of the weakening confidence in the Turkish economy.

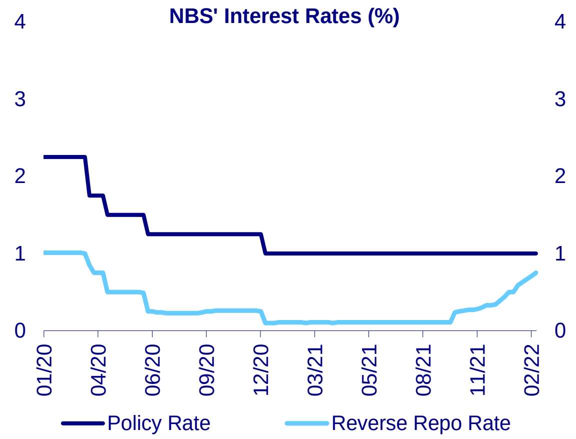
Note that, in addition to the high external financing needs, elevated dollarization (with FX deposits currently amounting to a sizeable USD 225bn, which is equivalent to c. ⅔ of total deposits or 28% of GDP) poses another threat to financial stability.

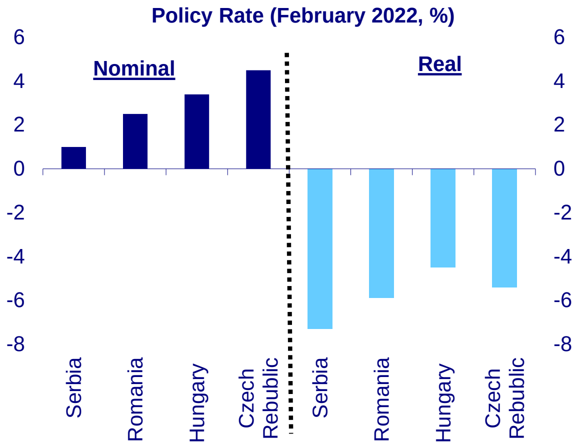
All said, a timely tightening in monetary policy is crucial to putting the economy on a sustainable growth path. Recall that, in 2018, authorities raised interest rates by 1600 bps to 24.0% (or c. 3.0% in real *ex-post* terms), before the TRY stabilised. For illustrative purposes, note that the real *ex-post* policy rate currently stands at c. -35.0%, the lowest worldwide. Worryingly, it is hard to foresee such a policy reversal, in view of President Erdogan's determination to lower interest rates ahead of the next general elections (due by mid-2023), in which he is set to face a tough fight, as suggested by his all-time low popularity.

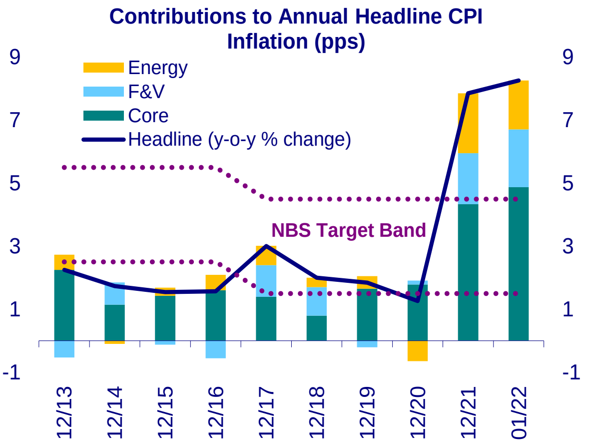
In a move confirming the economy's underlying vulnerabilities and uncertainty about the authorities' policy reaction, Fitch recently revised Turkey's long-term credit rating downwards by 1 notch to "B+".

Serbia

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







	21 Feb.	3-M F	6-M F	12-M F
1-m BELIBOR (%)	0.7	1.0	1.3	1.5
RSD/EUR	117.5	117.5	117.5	117.5
Sov. Spread (2021, bps)	306	290	275	250

	21 Feb.	1-W %	YTD %	2-Y %
BELEX-15	865	0.3	5.4	6.9

	2019	2020	2021E	2022F	2023F
Real GDP Growth (%)	4.3	-0.9	7.3	5.2	4.0
Inflation (eop, %)	1.9	1.3	7.9	2.6	2.6
Cur. Acct. Bal. (% GDP)	-6.9	-4.1	-4.5	-4.4	-4.4
Fiscal Bal. (% GDP)	-0.2	-8.0	-4.2	-3.0	-1.2

Sources: Reuters, OPBC, NBS & NBG estimates

The NBS is set to continue tightening liquidity conditions at a gradual pace, with the first policy rate hike expected only after the April elections. Unsurprisingly, at its February meeting, the NBS kept its 2-week repo rate unchanged at a record low of 1.0%. However, monetary policy conditions have become tighter, with the NBS having raised the amount of liquidity withdrawn from the banking system via reverse repo operations as well as the related interest rate (by 64 bps since October to 0.75% currently). Still, the extent of (underlying) tightening is much smaller than that carried out by regional central banks (namely Romania: up 125 bps to 2.5%, Hungary: up 280 bps to 3.4% and the Czech Republic: up 425 bps to 4.5%).

In our view, the NBS's "softer" stance is mainly dictated by:

i*) the temporary, supply-side driven nature of the spike in inflation, on the one hand, and still anchored inflation expectations, on the other hand.* Headline inflation jumped to an 8½-year high of 8.3% y-o-y in January from 7.9% at end-2021, having breached the upper bound of the NBS' target range (of 3±1.5%) for the first time since mid-2013. Unsurprisingly, the key driver behind this performance has been the surge in energy inflation, reflecting developments in global oil markets. A weather-induced surge in volatile food inflation has also taken a toll. Meanwhile, core inflation has also rebounded, but was mostly driven by second-round effects from higher commodity prices as well as the impact of disruptions in global supply chains (including higher shipping costs) rather than by stronger demand-side pressures. The surge in inflation would have been even sharper had the Government not put a temporary cap on five basic food staple prices and electricity prices for both households & companies.

Going forward, headline inflation is set to embark on a downward path as of Q2:22 and eventually fall within NBS' target range in Q4:22, mainly thanks to the gradual restoration of global supply chains and favourable base effects from the sharp increase in energy prices at end-2021. At the same time, we expect core inflation to remain in check, reflecting, *inter alia*, well anchored inflation expectations, which should help prevent the supply-side shocks from feeding into demand-side pressures. Note that Serbia's vulnerability to global energy supply risks is relatively limited, reflecting broad self-sufficiency in power generation (with the latter relying on domestically produced coal). Importantly, the NBS's bias towards FX stability also bodes well for inflation.

ii) *Serbia's strong external position*. Indeed, the current account deficit is set to narrow to 4.4% of GDP this year -- well below its pre-COVID level -- being more than fully covered by FDI inflows. At the same time, the NBS's FX reserves remain high, at EUR 16.1bn in January, covering as much as 6.0 months of GNFS imports. Note that the recent pressures on the RSD were only temporary, mainly stemming from surging energy imports, and were tempered by NBS interventions in the FX market.

Importantly, in view of still relatively limited portfolio flows with the rest of the world, Serbia could afford maintaining a negative interest rate differential with its peers, without that leading to strong depreciation pressures on the RSD. All said, we expect the NBS to raise its key rate, but gradually and modestly, to 2.25% by end-next year (up 125 bps from current levels). The start of the tightening cycle is expected only after the early-April (parliamentary, presidential and local) elections. Importantly, the latter should not weigh on investor confidence, as broad policy continuity is expected after the elections (with polls suggesting that President Vucic's market friendly ruling party will remain in office), under the auspices, *inter alia*, of the 30-month PCI with the IMF.

The NBS could frontload and/or proceed with larger-than-expected policy rate hikes should second round effects from higher commodity prices, especially in view of the ongoing geopolitical tensions, keep inflation above the NBS's target, de-anchoring inflation expectations.

TURKEY	2019	2020	2021e	2022f	2023f
Real Sector					
Nominal GDP (USD million)	760,669	718,977	774,597	808,734	967,691
GDP per capita (EUR)	8,170	7,458	7,689	8,206	9,568
GDP growth (real, %)	0.9	1.8	10.7	3.0	4.7
Unemployment rate (%, aop)	13.7	13.2	12.2	11.9	11.4
Prices and Banking					
Inflation (%, eop)	11.8	14.6	36.1	33.5	18.0
Inflation (%, aop)	15.4	12.3	19.3	54.0	16.4
Loans to the Private Sector (% change, eop)	10.8	34.8	37.0		
Customer Deposits (% change, eop)	23.5	33.0	51.5		
Loans to the Private Sector (% of GDP)	61.4	70.8	71.2		
Retail Loans (% of GDP)	13.9	16.8	15.2		
Corporate Loans (% of GDP)	47.5	54.1	56.0		
Customer Deposits (% of GDP)	54.5	62.1	69.0		
Loans to Private Sector (% of Cust. Deposits)	112.6	114.1	103.2		
Foreign Currency Loans (% of Total Loans)	38.3	34.2	42.2		
External Accounts					
Merchandise exports (USD million)	182,200	168,387	224,766	239,599	252,360
Merchandise imports (USD million)	198,981	206,250	253,927	263,171	279,625
Trade balance (USD million)	-16,781	-37,863	-29,161	-23,572	-27,265
Trade balance (% of GDP)	-2.2	-5.3	-3.8	-2.9	-2.8
Current account balance (USD million)	5,303	-35,537	-14,882	-9,404	-13,855
Current account balance (% of GDP)	0.7	-4.9	-1.9	-1.2	-1.4
Net FDI (USD million)	6,628	4,592	7,697	7,312	9,506
Net FDI (% of GDP)	0.9	0.6	1.0	0.9	1.0
International reserves (USD million)	105,696	93,277	111,181	119,000	131,500
International reserves (Months[a])	5.6	4.9	4.7	4.9	5.1
Public Finance					
Primary balance (% of GDP)	-0.6	-0.8	-0.2	-1.1	-0.3
Fiscal balance (% of GDP)	-2.9	-3.4	-2.8	-3.8	-3.0
Gross public debt (% of GDP)	32.6	39.7	41.5	39.6	38.8
External Debt					
Gross external debt (USD million)	416,413	433,099	455,000	465,000	490,000
Gross external debt (% of GDP)	54.7	60.2	58.7	57.5	50.6
External debt service (USD million)	84,967	70,931	74,311	80,000	85,000
External debt service (% of reserves)	80.4	76.0	66.8	67.2	64.6
External debt service (% of exports)	35.9	37.5	27.6	26.7	26.9
Financial Markets					
Policy rate (Effective funding rate, %, eop)	11.4	17.0	14.0	14.0	13.0
Policy rate (Effective funding rate, %, aop)	20.7	10.5	17.6	14.0	13.5
1-Y T-bill rate (%, eop)	11.3	15.1	22.2	17.5	14.0
Exchange rate: USD (eop)	5.95	7.43	13.32	13.50	14.00
Exchange rate: USD (aop)	5.68	7.02	8.89	13.50	13.75

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

SERBIA	2019	2020	2021e	2022f	2023f
Real Sector					
Nominal GDP (EUR million)	46,052	46,822	52,306	58,387	62,303
GDP per capita (EUR)	6,631	6,787	7,572	8,485	9,091
GDP growth (real, %)	4.3	-0.9	7.3	5.2	4.0
Unemployment rate (%, aop)	11.2	9.7	11.6	10.0	9.6
Prices and Banking					
Inflation (%, eop)	1.9	1.3	7.9	2.6	2.6
Inflation (%, aop)	1.9	1.6	4.1	6.1	2.6
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	48.3		
Retail Loans (% of GDP)	20.5	22.6	22.4		
Corporate Loans (% of GDP)	23.8	26.4	25.9		
Customer Deposits (% of GDP)	45.2	52.3	53.1		
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	21,823	22,866
Merchandise imports (EUR million)	22,038	21,280	26,685	27,841	28,912
Trade balance (EUR million)	-5,623	-5,201	-5,929	-6,018	-6,045
Trade balance (% of GDP)	-12.2	-11.1	-11.3	-10.3	-9.7
Current account balance (EUR million)	-3,161	-1,929	-2,343	-2,542	-2,720
Current account balance (% of GDP)	-6.9	-4.1	-4.5	-4.4	-4.4
Net FDI (EUR million)	3,551	2,938	3,625	3,988	4,387
Net FDI (% of GDP)	7.7	6.3	6.9	6.8	7.0
International reserves (EUR million)	13,379	13,492	16,455	16,701	16,867
International reserves (Months[a])	5.7	6.1	6.0	5.8	5.6
Public Finance					
Primary balance (% of GDP)	1.8	-6.0	-2.5	-1.3	0.4
Fiscal balance (% of GDP)	-0.2	-8.0	-4.2	-3.0	-1.2
Central Government debt (% of GDP)	52.9	58.2	56.5	55.8	53.3
External Debt					
Gross external debt (EUR million)	28,254	30,787	35,200	36,083	38,005
Gross external debt (% of GDP)	61.4	65.8	67.3	61.8	61.0
External debt service (EUR million)	6,400	3,900	4,800	4,900	4,700
External debt service (% of reserves)	47.8	28.9	29.2	29.3	27.9
External debt service (% of exports)	27.4	17.5	6.8	16.3	14.9
Financial Markets					
Policy rate (2-w repo rate, %, eop)	2.3	1.0	1.0	1.5	2.3
Policy rate (2-w repo rate, %, aop)	2.7	1.5	1.0	1.3	2.1
5-Y T-bill rate [b] (%, eop)	n.a.	2.6	2.1	2.8	3.4
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; b: primary market