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Emerging Markets Analysis

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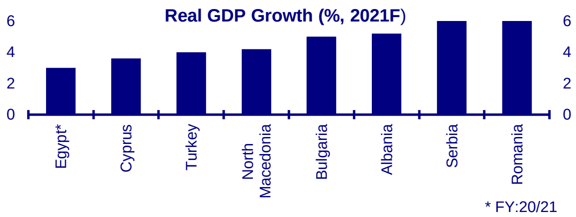
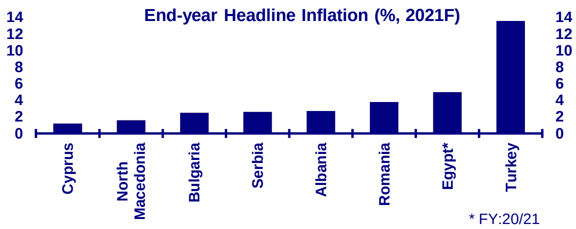
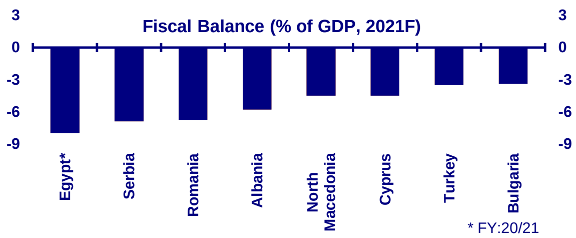
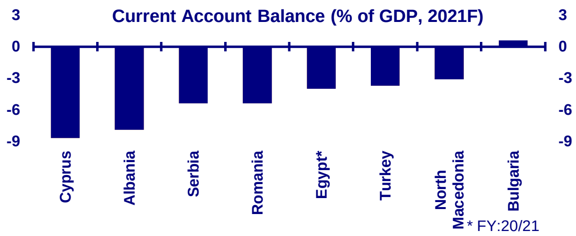








Sources: National authorities & NBG estimates

Economic Analysis Division

Emerging Markets Analysis

Bi-Weekly Report

11 - 24 May 2021

A weaker TRY and higher energy prices pushed up headline inflation to a nearly 2-year high of 17.1% y-o-y in April from 14.6% at end-2020

Headline inflation is set to ease modestly, ending the year at 13.6% y-o-y, above the CBRT's inflation target (12.2% y-o-y)

Challenging inflation dynamics and a weak TRY prompt the CBRT to remain on hold

A premature and frontloaded easing in monetary policy could undermine market sentiment, putting at risk macroeconomic and financial stability

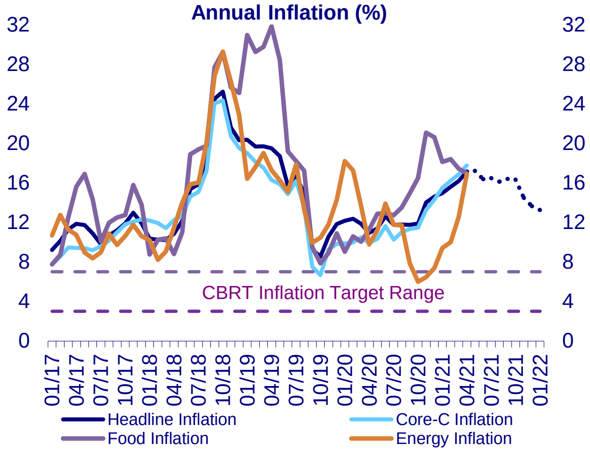
Albeit easing, due to the COVID-19 fallout, GDP growth remained positive in H1:20/21, thanks, *inter alia*, to Government support measures and public sector activity

GDP growth is set to rebound strongly in FY:21/22, driven by net exports

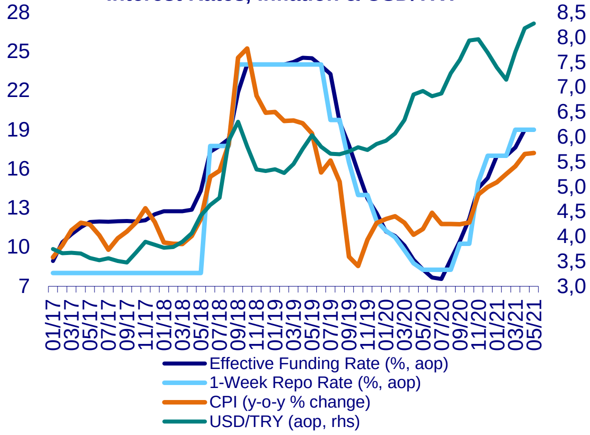
Turkey

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

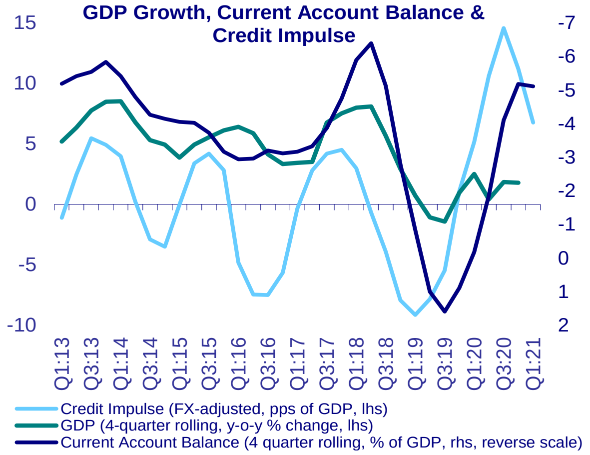
Annual Inflation (%)



Interest Rates, Inflation & USD/TRY



GDP Growth, Current Account Balance & Credit Impulse



	24 May	3-M F	6-M F	12-M F
1-m TRIBOR (%)	20.0	20.0	15.5	14.3
TRY/USD	8.38	8.35	8.35	8.50
Sov. Spread (2025, bps)	464	455	440	400

	24 May	1-W %	YTD %	2-Y %
ISE 100	1,452	-0.1	-1.7	68.7

	2018	2019	2020	2021F	2022F
Real GDP Growth (%)	2.8	0.9	1.8	4.0	4.3
Inflation (eop, %)	20.3	11.8	14.6	13.6	10.4
Cur. Acct. Bal. (% GDP)	-2.8	0.9	-5.2	-3.7	-2.7
Fiscal Bal. (% GDP)	-1.9	-2.9	-3.4	-3.5	-3.0

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

A weaker TRY and higher energy prices pushed up headline inflation to a nearly 2-year high of 17.1% y-o-y in April from 14.6% at end-2020. Core inflation accelerated markedly in April (to 17.8% y-o-y from 14.3% at end-2020), in line with the sharp depreciation of the TRY (see below) and strong domestic demand. Indeed, despite the lack of opportunity and/or confidence to spend amid a severe 3rd wave of COVID-19, domestic demand has remained quite resilient, underpinned by still robust, yet slowing, credit growth. Adding to price pressures, energy inflation surged in April (to 16.8% y-o-y from 7.4% at end-2020), reflecting, in addition to the impact of the weaker TRY, that of higher global oil prices (the price of Brent was up c. 250% y-o-y in USD terms).

Headline inflation is set to ease in the period ahead, but remain above the CBRT's inflation target. Against the backdrop of tight monetary policy conditions, we expect core inflation to embark on a (slow) downward path in the following months. At the same time, non-core inflation should also decelerate, albeit modestly, with lower food inflation more than compensating for stubbornly high energy inflation (note that Turkey is almost fully dependent on imports to meet its energy needs). All said, we see headline inflation ending the year at 13.6% y-o-y, above the CBRT's target of 12.2%. High inertia, due to still unanchored inflation expectations, together with strong underlying cost-push pressures (note that the Producer Price Index was up over 35% y-o-y in April), pose upside risks to our forecast.

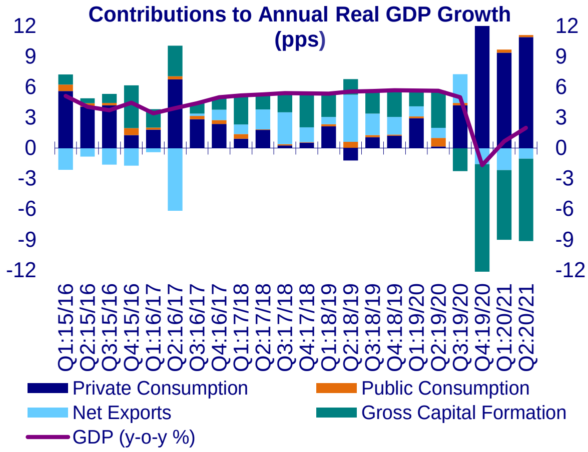
Challenging inflation dynamics and a weak TRY prompt the CBRT to remain on hold. In May, the CBRT maintained its key rate unchanged at a high of 19.0% (or 1.6% in real *ex-post* terms) for a 2nd consecutive month after the change at the bank's helm. Recall that, in a surprise move in March, President R.T. Erdogan replaced market-friendly Governor N. Agbal, with S. Kavcioglu, a former lawmaker of the ruling AK Party and vocal critic of high interest rates, raising fresh concerns over the independence of the CBRT. The scope of the reshuffling was later extended to include another 3 (out of total 7) MPC members. The result of these interventions was a sell-off in Turkish assets, with the TRY having lost c. 15.0% of its value against the USD since March (following losses of c. 50.0% over the previous 3 years), contributing significantly, in turn, to the jump in inflation.

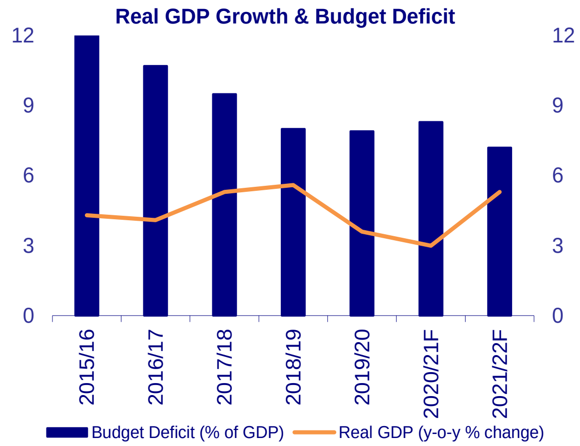
Looking ahead, the inflation outlook is key to the CBRT's future rate path, with the MPC stating that "*the current (tight) monetary policy stance will be maintained until the significant fall in the (bank's) forecast path is achieved*". Assuming no fresh pressure on the TRY, this means that the first policy rate cut will likely come in early-Q4:21, when headline inflation is projected to embark on a slow downward trend.

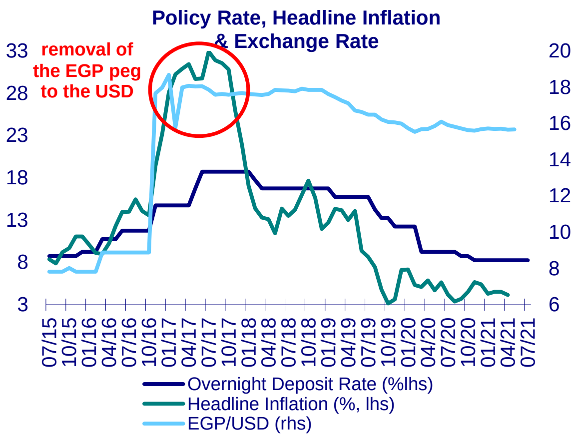
A premature and frontloaded easing in monetary policy could undermine market sentiment, putting at risk macroeconomic and financial stability. The main source of concern arises from Turkey's weak external position. Indeed, the current account deficit remains markedly high (at 5.1% of GDP in March against just 0.2% a year ago), on the back, *inter alia*, of a still positive, yet rapidly narrowing, credit impulse (see chart), maintaining pressure on the CBRT's FX reserves. The latter currently stand at USD 47.7bn, having been depleted by c. ⅔rds over the past 2 years. However, adjusting for the CBRT's short-term borrowing (mainly in the form of swaps with domestic banks) and banks' required reserves, net FX reserves are highly negative (c. USD -51.0bn), leaving the economy highly vulnerable to changes in market sentiment, in view of the country's high external debt rollover needs (note that debt worth over USD 190bn or 25.0% of GDP is coming due over the next 12 months, mainly from the banking sector). Should policies fail to contain external imbalances, markets could sway away from covering Turkey's financing needs, prompting a fresh currency crisis.

Egypt

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







	24 May	3-M F	6-M F	12-M F
O/N Interbank Rate (%)	10.5	10.5	10.5	10.8
EGP/USD	15.67	15.82	15.93	16.10
Sov. Spread (2025, bps)	404	390	375	350

	24 May	1-W %	YTD %	2-Y %
EGX 30	10,761	0.8	-0.8	-21.9

	17/18	18/19	19/20E	20/21F	21/22F
Real GDP Growth (%)	5.3	5.6	3.6	3.0	5.3
Inflation (eop. %)	14.4	9.4	5.6	5.0	6.9
Cur. Acct. Bal. (% GDP)	-2.4	-3.6	-3.1	-4.0	-3.4
Fiscal Bal. (% GDP)	-9.5	-8.0	-7.9	-8.3	-7.2

Sources: Reuters, CBE, MoF & NBG estimates

Albeit easing, due to the COVID-19 fallout, GDP growth remained positive in H1:20/21, thanks, *inter alia*, to Government support measures and public sector activity. GDP growth slowed down markedly to 1.3% y-o-y in H1:20/21 from 5.6% a year ago, with Egypt outperforming, however, the vast majority of emerging markets globally. This achievement was mainly attributed to: i) uninterrupted activity in the heavily-weighted public sector (accounting for c. $^1/_3$ of GDP); and ii) the relatively milder restrictions imposed domestically, against the backdrop of a low registered COVID-19 infection rate.

A look at the breakdown suggests that gross capital formation (GCF) was the main driver behind the slowdown in economic growth in H1:20/21. The drop in investment activity would have been sharper had the state not proceeded with several multi-year infrastructure megaprojects. Adding to the economic slowdown, net exports deteriorated sharply in H1:20/21, following the abrupt drop in external demand. In fact, Egypt would not have escaped recession had private consumption (accounting for 85% of GDP) not strengthened at the same time. Indeed, despite limited spending options amid the pandemic, private consumption rebounded in H1:20/21, mainly thanks to state support (including financial aid to vulnerable groups and tax reductions).

The 2nd and the (ongoing) 3rd wave of the pandemic are estimated to have affected economic activity in H2:20/21, albeit modestly, reflecting, *inter alia*, significant progress in digital transformation. All said, in view of the strong positive base effect from the plunge in economic activity in Q4:19/20, when COVID-19 erupted, we see GDP growth easing to a still solid 3.0% in FY:20/21 from 3.6% in FY:19/20.

GDP growth is set to rebound strongly in FY:21/22, driven by net exports. Following their sharp deterioration in FY:20/21, net exports would be able to sustain the recovery next year. Indeed, the revival in tourism, together with increased Suez Canal receipts and higher energy (natural gas) production, should boost exports in FY:21/22.

At the same time, growth in domestic demand should remain robust, with its composition moving towards a more balanced structure. Indeed, following the expiry of the emergency schemes enacted to sustain disposable income during the pandemic, private consumption should grow next year, albeit at a more measured pace compared with FY:20/21, underpinned by improving confidence and strong pent-up demand, amid record-high savings. On the other hand, GCF is set to gain steam in FY:21/22, with the public sector once again providing a critical boost.

Economic activity should receive little help from fiscal policy next year. Indeed, the unwinding of COVID-19 relief measures, together with the impact of the (IMF-mandated) revenue measures, should more than compensate for the cost of looser incomes policy, with the budget deficit projected to narrow to 7.2% of GDP in FY:21/22 from 8.3% in FY:20/21.

At the same time, we see no major change in monetary policy. Recall that the CBE has cut its key rate by 400 bps (to 8.25%) to mitigate the COVID-19 fallout. Still, the implied *ex-post* real rate remains markedly high (currently at over 3.0%, well above that of its peers), highlighting the CBE's bias towards FX stability. In view of the relatively benign inflation outlook, we expect the CBE to remain on hold (at least for most part of next year), maintaining its focus on stimulating credit activity through its loan guarantee and subsidy schemes.

All said, we project GDP growth rebounding to 5.3% in FY:21/22. Besides the uncertainty over the duration of COVID-19 and progress on the vaccine front, other downside risks include the potential of a global risk repricing as well as geopolitical tensions (including a long-standing standoff with Ethiopia over water resources).

TURKEY					
	2018	2019	2020	2021f	2022f
Real Sector					
Nominal GDP (USD million)	777,122	761,093	719,124	754,155	830,946
GDP per capita (EUR)	8,056	8,175	7,459	7,332	7,902
GDP growth (real, %)	2.8	0.9	1.8	4.0	4.3
Unemployment rate (%, aop)	11.0	13.7	13.2	13.1	12.4
Prices and Banking					
Inflation (%, eop)	20.3	11.8	14.6	13.6	10.4
Inflation (%, aop)	16.2	15.4	12.3	16.0	11.2
Loans to the Private Sector (% change, eop)	14.2	10.8	34.8		
Customer Deposits (% change, eop)	18.5	23.5	33.0		
Loans to the Private Sector (% of GDP)	63.7	61.4	70.8		
Retail Loans (% of GDP)	13.8	13.9	16.8		
Corporate Loans (% of GDP)	49.9	47.5	54.1		
Customer Deposits (% of GDP)	50.8	54.5	62.1		
Loans to Private Sector (% of Cust. Deposits)	125.4	112.6	114.1		
Foreign Currency Loans (% of Total Loans)	39.9	38.3	34.2		
External Accounts					
Merchandise exports (USD million)	178,909	182,246	168,414	182,568	190,833
Merchandise imports (USD million)	219,635	198,997	206,280	219,269	225,761
Trade balance (USD million)	-40,726	-16,751	-37,866	-36,701	-34,928
Trade balance (% of GDP)	-5.2	-2.2	-5.3	-4.9	-4.2
Current account balance (USD million)	-21,743	6,759	-37,264	-27,540	-22,537
Current account balance (% of GDP)	-2.8	0.9	-5.2	-3.7	-2.7
Net FDI (USD million)	9,235	6,323	4,637	5,333	6,399
Net FDI (% of GDP)	1.2	0.8	0.6	0.7	0.8
International reserves (USD million)	93,027	105,696	93,277	100,000	110,000
International reserves (Months[a])	4.5	5.6	4.9	4.9	5.3
Public Finance					
Primary balance (% of GDP)	0.0	-0.5	-0.8	-0.9	-0.6
Fiscal balance (% of GDP)	-1.9	-2.9	-3.4	-3.5	-3.0
Gross public debt (% of GDP)	30.2	32.6	43.0	40.0	40.6
External Debt					
Gross external debt (USD million)	443,803	435,491	450,048	445,000	455,000
Gross external debt (% of GDP)	57.1	57.2	62.6	59.0	54.8
External debt service (USD million)	82,913	85,286	70,786	80,000	85,000
External debt service (% of reserves)	89.1	80.7	75.9	80.0	77.3
External debt service (% of exports)	34.6	36.0	37.5	36.5	35.6
Financial Markets					
Policy rate (Effective funding rate, %, eop)	24.1	11.4	17.0	14.5	11.8
Policy rate (Effective funding rate, %, aop)	17.7	20.7	10.5	17.5	13.1
1-Y T-bill rate (%, eop)	21.5	11.3	15.1	15.0	12.8
Exchange rate: USD (eop)	5.29	5.95	7.43	8.35	8.65
Exchange rate: USD (aop)	4.84	5.68	7.02	8.08	8.50

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

EGYPT	2017/18*	2018/19*	2019/20*	2020/21f*	2021/22f*
Real Sector					
Nominal GDP (USD million)	211,064	265,720	328,100	333,113	363,418
GDP per capita (USD)	2.174	2.687	3.252	3.237	3.463
GDP growth (real, %)	5.3	5.6	3.6	3.0	5.3
Unemployment rate (%, aop)	9.9	7.9	8.0	8.1	8.0
Prices and Banking					
Inflation (%, eop)	14.4	9.4	5.6	5.0	6.9
Inflation (%, aop)	21.6	13.9	5.7	4.5	6.6
Loans to the Private Sector (% change, eop)	10.1	12.5	19.5		
Customer Deposits (% change, eop)	20.6	11.9	16.5		
Loans to the Private Sector (% of GDP)	24.4	22.9	25.0		
Retail Loans (% of GDP)	6.3	6.5	7.7		
Corporate Loans (% of GDP)	18.1	16.4	17.3		
Customer Deposits (% of GDP)	68.4	63.8	68.0		
Loans to Private Sector (% of Deposits)	35.7	35.8	36.8		
Foreign Currency Loans (% of Total Loans)	26.8	20.0	15.9		
External Accounts					
Merchandise exports (USD million)	25,827	28,495	26,376	27,158	29,406
Merchandise imports (USD million)	63,103	66,529	62,841	65,399	69,899
Trade balance (USD million)	-37,276	-38,034	-36,465	-38,241	-40,493
Trade balance (% of GDP)	-14.9	-12.6	-10.1	-9.6	-9.2
Current account balance (USD million)	-5,962	-10,894	-11,167	-16,060	-15,051
Current account balance (% of GDP)	-2.4	-3.6	-3.1	-4.0	-3.4
Net FDI (USD million)	7,448	7,862	7,102	5,681	6,676
Net FDI (% of GDP)	3.0	2.6	2.0	1.4	1.5
International reserves (USD million)	44,259	44,481	38,202	39,202	40,702
International reserves (Months[a])	7.9	7.5	6.7	7.0	6.5
Public Finance					
Primary balance (% of GDP)	0.4	2.0	1.9	0.8	1.5
Fiscal balance (% of GDP)	-9.5	-8.0	-7.9	-8.3	-7.2
Gross public debt (% of GDP)	97.4	90.4	87.5	93.0	91.0
External Debt					
Gross external debt (USD million)	92,644	108,699	123,491	130,000	140,000
Gross external debt (% of GDP)	36.9	35.9	34.0	32.7	31.7
External debt service [b] (USD million)	12,000	13,500	13,700	14,500	15,000
External debt service [b] (% of reserves)	27.1	30.4	35.9	37.0	36.9
External debt service (% of exports[c])	20.9	27.2	31.1	36.9	34.0
Financial Markets					
Policy rate (O/N deposit rate, %, eop)	16.8	15.8	9.3	8.3	8.5
Policy rate (O/N deposit rate, %, aop)	18.0	16.3	11.9	8.5	8.4
3-M T-bill rate (%, eop)	19.2	18.0	12.3	12.9	14.0
Exchange rate: USD (eop)	17.84	16.65	16.11	15.75	16.10
Exchange rate: USD (aop)	17.70	17.56	16.04	15.75	15.93

*: fiscal year starting in July and ending in June; f: NBG forecasts; a: months of imports of GNFS