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Emerging Markets Analysis

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Economic Analysis Division

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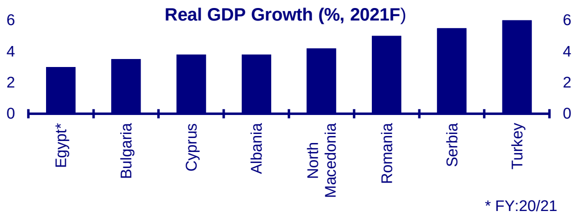
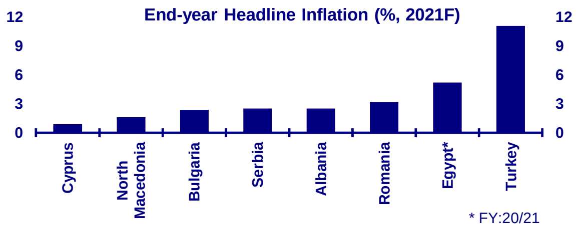
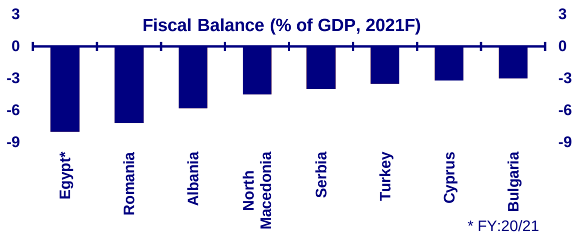
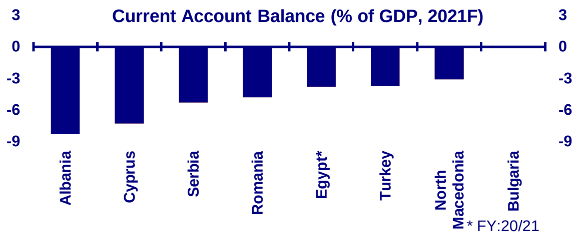
Bi-Weekly Report

9 - 22 March 2021





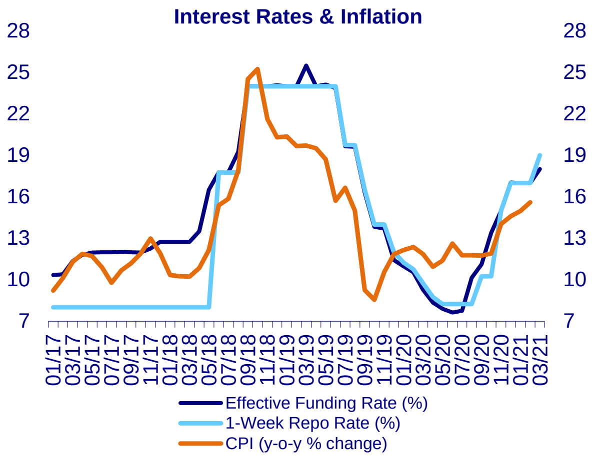


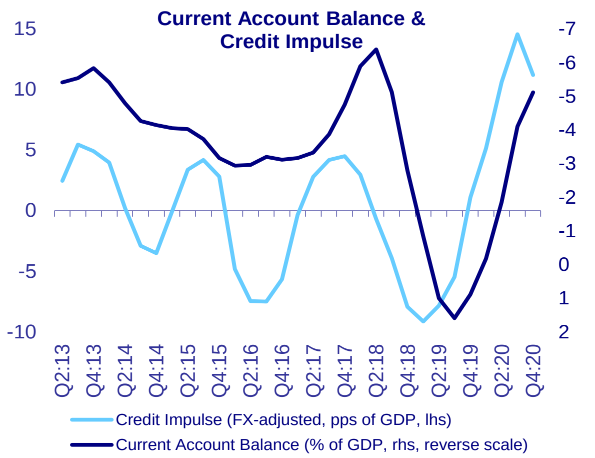


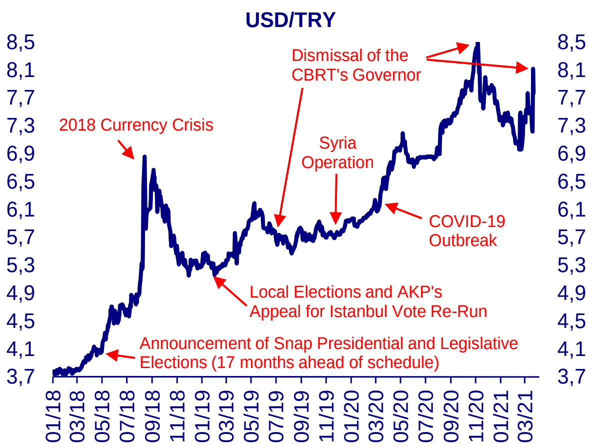
Sources: National authorities & NBG estimates

Turkey

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







	22 Mar.	3-M F	6-M F	12-M F
1-m TRIBOR (%)	19.9	18.0	16.0	14.5
TRY/EUR	9.66	9.70	9.72	9.75
Sov. Spread (2025, bps)	556	510	470	400

	22 Mar.	1-W %	YTD %	2-Y %
ISE 100	1,379	-11.3	-6.6	38.2

	2018	2019	2020	2021F	2022F
Real GDP Growth (%)	2.8	0.9	1.8	6.0	3.6
Inflation (eop, %)	20.3	11.8	14.6	11.2	9.9
Cur. Acct. Bal. (% GDP)	-2.8	0.9	-5.1	-3.7	-3.0
Fiscal Bal. (% GDP)	-1.9	-2.9	-3.4	-3.5	-2.8

Sources: Reuters, CBRT & NBG estimates

Central Bank Governor's removal after aggressive policy rate hike triggers sell-off in Turkish assets. In a surprise move, two days after a larger-than-expected 200 bp policy rate hike, President R. T. Erdogan replaced the Central Bank 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 at a critical juncture for the Turkish economy (see below). Recall that this is the third change in the central bank's leadership since mid-2019, with the previous one coming less than 5 months ago.

The outgoing Governor, N. Agbal, had won market praise for aggressively tightening monetary policy in an effort to stabilize the exchange rate, which has been on a downward trend since early-2018 (with cumulative losses against the USD amounting to c. 50.0%), and tame inflation, which is currently running at an annual pace of nearly 16.0%, i.e. more than 3 times the CBRT's target. Specifically, during Agbal's short tenure, the key 1-week repo rate was raised by a massive 875 bp to 19.0% (or c. 3.0% in real *ex-post* terms, well above that of Turkey's peers), prompting the return of foreign investors to domestic financial markets, with the latter delivering some of the best performances among emerging markets in that period.

Unsurprisingly, Agbal's removal triggered a sell-off in Turkish assets, with the TRY losing 9.0% of its value against the USD, despite reported interventions by state-owned banks, reversing a significant part of the gains recorded since his appointment in early-November. At the same time, the 5-year CDS spread jumped by more than 150 bps to 455 bps, the highest since November 2020.

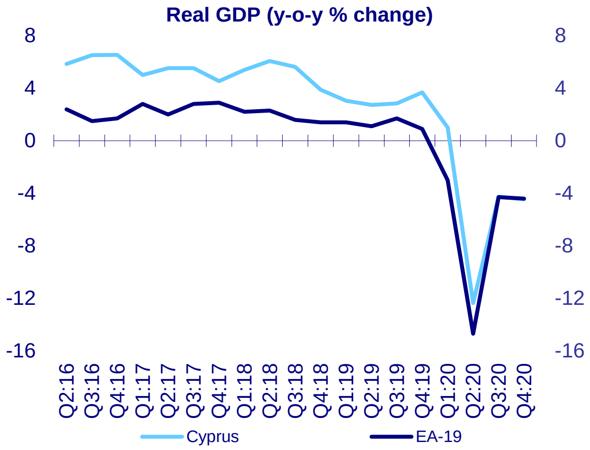
Unwinding prematurely and in a frontloaded manner the tight monetary policy pursued so far could undermine market sentiment, putting at risk macroeconomic and financial stability. In our view, the prospect of a renewed easing in monetary policy has increased considerably following the change in the helm of the CBRT. Depending on its timing and extent, such a move could endanger macroeconomic and financial stability, in view of Turkey's vulnerabilities.

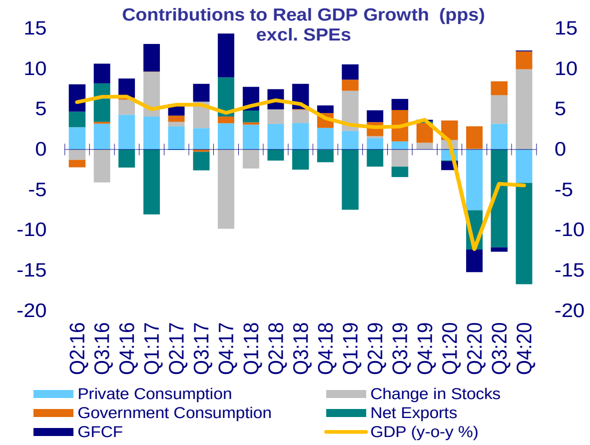
The main source of concern arises from Turkey's weak external position. Indeed, a sharp deterioration in external imbalances (note that the current account balance turned into a deficit of 5.1% of GDP in FY:20 from a surplus of 0.9% a year ago), on the back, *inter alia*, of a still sizeable, yet gradually declining (at least until recently, see chart) credit impulse, has drained the CBRT's FX reserves. Excluding gold (worth USD 42.2bn), FX reserves currently stand at USD 53.5bn (down USD 25.1bn since end-2019). 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 have turned negative (c. USD -45.0bn), 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 USD 190bn or c. 24.0% of GDP is coming due over the next 12 months, mainly from the banking sector). Should policies fail to contain (or even worse, exacerbate again) external imbalances, markets could sway away from covering Turkey's financing needs, prompting a fresh currency crisis. Worryingly, Turkey's net international investment position (currently standing at -56.0% of GDP) is slightly weaker than it was before the 2018 currency crisis (-50.0% of GDP).

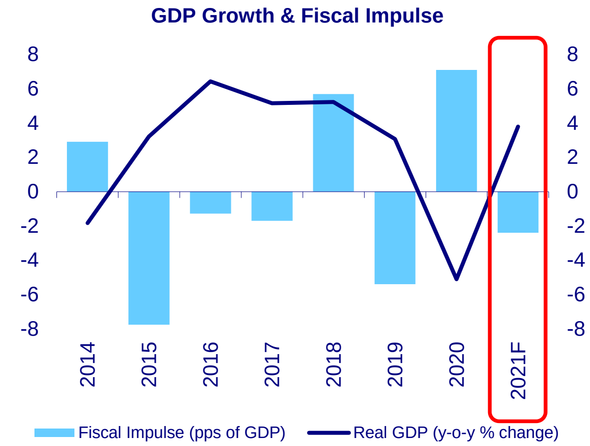
All said, we keep our macroeconomic forecasts on hold, for the time being, recognizing, however, that risks have been significantly skewed to the downside. The next Monetary Policy Commission meeting is scheduled for April 15th, when we expect to have a more clear view on the future monetary policy path. Until then, volatility in the Turkish financial markets is set to remain elevated.

Cyprus

BBB- / Ba2 / BBB- (S&P / Moody's / Fitch)







	22 Mar.	3-M F	6-M F	12-M F
1-m EURIBOR (%)	-0.55	-0.55	-0.55	-0.52
EUR/USD	1.19	1.19	1.20	1.21
Sov. Spread (2025. bps)	88	85	87	90

	22 Mar.	1-W %	YTD %	2-Y %
CSE Index	59.5	-2.3	5.2	-8.1

	2018	2019	2020E	2021F	2022F
Real GDP Growth (%)	5.2	3.1	-5.1	3.8	4.0
Inflation (eop. %)	1.7	0.7	-1.1	0.9	1.2
Cur. Acct. Bal. (% GDP)	-3.9	-6.3	-9.7	-7.9	-5.7
Fiscal Bal. (% GDP)	-3.5	1.5	-5.0	-3.2	-2.0

Sources: Reuters, CyStat, Ministry of Finance & NBG estimates

Economic recovery lost steam in Q4:20, amid a second COVID-19 wave. The reintroduction of some social-distancing measures at end-2020 caused the economy to lose momentum, with GDP dropping at a broadly steady pace of 4.5% y-o-y for a second consecutive quarter in Q4:20 (though up 1.4% q-o-q s.a. following a rise of 8.9% in Q3:20, when the economy re-opened from the first lockdown). The main growth factor was the sharp increase in inventories (see chart), though this item also contains statistical discrepancies and could reflect stronger domestic absorption. The latter appeared to have weakened abruptly again in Q4:20, driven by private consumption. Unsurprisingly, net exports remained a sizeable drag on overall growth, reflecting the plunge in tourism receipts. With the Q4:20 outcome, full-year GDP contraction reached 5.1%, comparing well with the euro area average (down 6.6%). Indeed, despite being heavily exposed to the hard-hit tourism sector, the Cypriot economy recorded modest GDP losses in FY:20, thanks, *inter alia*, to strong policy support, including: i) several emergency schemes, which, together with the impact of automatic stabilizers, led to a large fiscal impulse (c. 7.0 pps of GDP); and ii) a loan repayment moratorium for affected entities, which had one the highest participation rates in euro area (c. 50.0%).

GDP is set to rebound in FY:21, but modestly (up 3.8%), due to scarring effects of the pandemic. We estimate economic activity to have remained subdued in Q1:21, reflecting the extension of social-distancing measures and still heightened uncertainty. On a positive note, the better-targeting of the restrictions means that the share of economic activity affected was likely smaller compared with FY:20.

Assuming that the epidemiological situation improves over the next weeks, allowing for a gradual resumption of activity, economic recovery should gain momentum. Indeed, strong pent-up demand, on the back of high savings, together with dissipating uncertainty, following vaccine rollout, bode well for a strong rebound in private consumption. Note, though, that the phasing-out of the employment schemes and the expiry of the loan repayment moratorium (due in mid-2021) pose downside risks.

Fixed investment should also gain steam this year, driven by higher EU-backed (NGEU) public capital spending. On the other hand, despite accommodative financing conditions (which are supplemented by several loan guarantee schemes), private investment is set to recover sluggishly this year, on the back of weak corporate profitability and spare capacity. Note that the abolition of the "Golden Visa" scheme bodes ill for residential construction activity.

Public consumption is set to continue sustaining economic growth in FY:21, albeit to a smaller extent than in FY:20, reflecting the phasing-out of the crisis-era cuts in public sector wages and the impact of the reform of the NHIS.

Importantly, net exports should improve this year, in line with a revival in tourism activity (which, nonetheless, will remain significantly lower than its pre-COVID-19 levels -- c. 14.0% of GDP). In fact, the actual pace of recovery of the tourism sector will be linked to the speed of the vaccine rollout and the relative contagion rate in Cyprus compared with its regional competitors. In any case, net exports are set to remain a drag on growth in FY:21, as stronger domestic demand will feed into imports.

All said, we see GDP growth rebounding to 3.8% in FY:21. The large public and private sector debt burden and high NPL levels remain key vulnerabilities that could impede future growth.

Legislative elections are scheduled to be held at end-May. According to the latest polls, no party is expected to secure an outright majority, meaning that the Government would still need to seek parliamentary support on a case-by-case basis.

TURKEY					
	2018	2019	2020e	2021f	2022f
Real Sector					
Nominal GDP (USD million)	777,122	761,093	719,124	788,573	851,484
GDP per capita (EUR)	8,056	8,175	7,459	7,682	8,097
GDP growth (real, %)	2.8	0.9	1.8	6.0	3.6
Unemployment rate (%, aop)	11.0	13.7	13.2	13.0	12.2
Prices and Banking					
Inflation (%, eop)	20.3	11.8	14.6	11.2	9.9
Inflation (%, aop)	16.2	15.4	12.3	14.4	10.1
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	168,433	182,582	190,679
Merchandise imports (USD million)	219,635	198,997	206,267	221,301	228,852
Trade balance (USD million)	-40,726	-16,751	-37,834	-38,719	-38,173
Trade balance (% of GDP)	-5.2	-2.2	-5.3	-4.9	-4.5
Current account balance (USD million)	-21,743	6,759	-36,765	-29,079	-25,265
Current account balance (% of GDP)	-2.8	0.9	-5.1	-3.7	-3.0
Net FDI (USD million)	9,235	6,323	4,731	5,441	6,529
Net FDI (% of GDP)	1.2	0.8	0.7	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	5.2
Public Finance					
Primary balance (% of GDP)	0.0	-0.5	-0.8	-0.9	-0.4
Fiscal balance (% of GDP)	-1.9	-2.9	-3.4	-3.5	-2.8
Gross public debt (% of GDP)	30.2	32.6	43.0	40.0	38.4
External Debt					
Gross external debt (USD million)	442,758	434,503	440,000	445,000	455,000
Gross external debt (% of GDP)	57.0	57.1	61.2	56.4	53.4
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	36.6	35.7
Financial Markets					
Policy rate (Effective funding rate, %, eop)	24.1	11.4	17.0	14.0	11.8
Policy rate (Effective funding rate, %, aop)	17.7	20.7	10.5	15.9	12.9
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	8.00	8.40
Exchange rate: USD (aop)	4.84	5.68	7.02	7.76	8.20

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

CYPRUS	2018	2019	2020e	2021f	2022f
Real Sector					
Nominal GDP (EUR million)	21,432	22,287	21,000	21,907	23,011
GDP per capita (EUR)	24.806	25.442	23.702	24.450	25.399
GDP growth (real, %)	5.2	3.1	-5.1	3.8	4.0
Unemployment rate (%, aop)	8.4	7.1	7.6	7.9	7.2
Prices and Banking					
Inflation (%, eop)	1.7	0.7	-1.1	0.9	1.2
Inflation (%, aop)	1.4	0.3	-0.6	0.5	1.0
Loans to the Private Sector (% change, eop)	-22.0	-7.4	-5.6		
Customer Deposits (% change, eop)	-1.9	0.0	-0.6		
Loans to the Private Sector (% of GDP)	154.3	137.4	137.6		
Retail Loans (% of GDP)	69.5	63.3	63.8		
Corporate Loans (% of GDP)	84.9	74.1	73.8		
Customer Deposits (% of GDP)	193.3	185.9	196.0		
Loans to Private Sector (% of Deposits)	79.8	73.9	70.2		
Foreign Currency Loans (% of Total Loans)	- - -	- - -	- - -		
External Accounts					
Merchandise exports (EUR million)	3,689	3,106	2,904	3,035	3,172
Merchandise imports (EUR million)	8,225	7,741	6,812	7,220	7,726
Trade balance (EUR million)	-4,537	-4,634	-3,907	-4,185	-4,554
Trade balance (% of GDP)	-21.2	-20.8	-18.6	-19.1	-19.8
Current account balance (EUR million)	-0,842	-1,406	-2,037	-1,730	-1,300
Current account balance (% of GDP)	-3.9	-6.3	-9.7	-7.9	-5.7
Net FDI (EUR million)	4,734	5,312	1,594	2,072	2,797
Net FDI (% of GDP)	22.1	23.8	7.6	9.5	12.2
International reserves (EUR million)	- - -	- - -	- - -	- - -	- - -
International reserves (Months[a])	- - -	- - -	- - -	- - -	- - -
Public Finance					
Primary balance (% of GDP)	-1.1	3.8	-2.7	-1.0	0.2
Fiscal balance (% of GDP)	-3.5	1.5	-5.0	-3.2	-2.0
Central Government debt (% of GDP)	99.2	94.0	118.2	116.5	112.9
External Debt					
Gross external debt (EUR million)	192,933	189,212	189,000	188,000	186,500
Gross external debt (% of GDP)	900.2	849.0	900.0	858.2	810.5
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	0,0	0,0
Policy rate (ECB refinancing rate, %, aop)	0,0	0,0	0,0	0,0	0,0
3-Y T-bill rate (%, eop)	0,8	-0,1	-0,1	0,0	0,3
Exchange rate: USD (eop)	1,147	1,121	1,221	1,210	1,230
Exchange rate: USD (aop)	1,181	1,119	1,142	1,205	1,220

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