NBG - Economic Analysis Division
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Emerging Markets Analysis

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Economic Analysis Division

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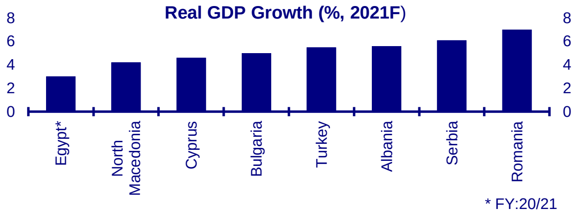
Bi-Weekly Report

25 May - 7 June 2021



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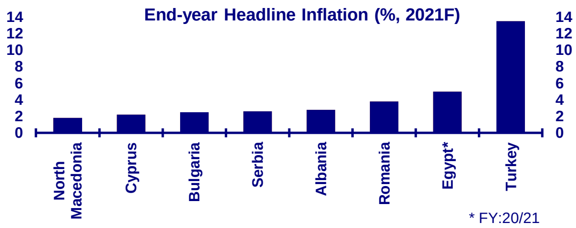

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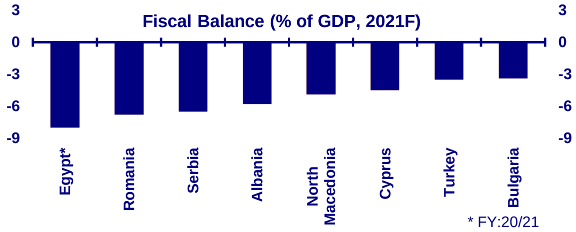
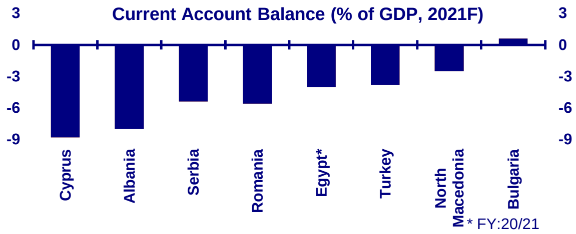
Despite an increasingly challenging backdrop, the large interest rate differential between Romania and its peers should allow the NBR to delay any tightening until mid-2022



A fragmented Parliament emerged from the May 30th general elections

Political continuity is expected to be maintained after the elections, despite possible delays in policy implementation



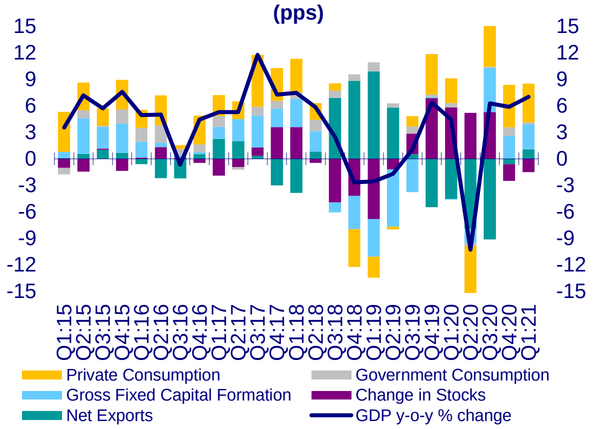
Sources: National authorities & NBG estimates

Please see disclosures on page 5

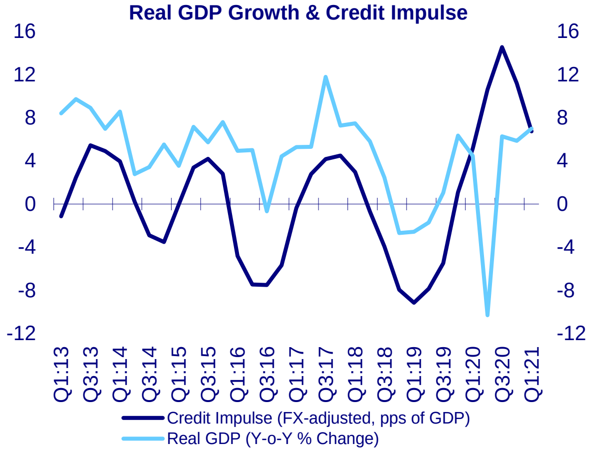
Turkey

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

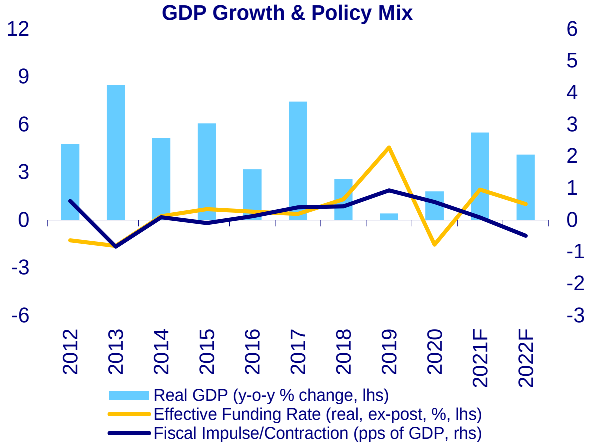
Contributions to Annual Real GDP Growth (pps)



Real GDP Growth & Credit Impulse



GDP Growth & Policy Mix



	7 June	3-M F	6-M F	12-M F
1-m TRIBOR (%)	19.9	18.0	16.0	14.3
TRY/USD	8.61	8.55	8.55	8.75
Sov. Spread (2025, bps)	453	450	430	380

	7 June	1-W %	YTD %	2-Y %
ISE 100	1,447	1.9	-2.0	54.3

	2018	2019	2020	2021F	2022F
Real GDP Growth (%)	2.8	0.9	1.8	5.5	4.1
Inflation (eop, %)	20.3	11.8	14.6	13.5	10.4
Cur. Acct. Bal. (% GDP)	-2.8	0.9	-5.2	-3.8	-2.9
Fiscal Bal. (% GDP)	-1.9	-2.9	-3.4	-3.5	-3.0

Sources: Reuters, CBRT, Turkstat & NBG estimates

Against the backdrop of a strong carry-over effect from the ultra-accommodative monetary policy carried out throughout most part of 2020, the Turkish economy posted another quarter of robust GDP growth. Recall that strong depreciation pressures on the TRY forced the CBRT to tighten its stance aggressively in Q4:20 (including a 675 bp policy rate hike). Albeit having slowing down since then, credit expansion remained strong on annual basis in Q1:21, providing a solid impulse to economic growth. Indeed, GDP grew by 7.0% y-o-y (up 1.7% q-o-q s.a. for a 2nd consecutive quarter) in Q1:21 following a rise of 5.9% in Q4:20, outperforming all its G20 peers except China.

A look at the breakdown suggests that private consumption (especially of durables and semi-durables) remained the main engine of growth in Q1:21, with its contribution easing slightly, however (see chart). Fixed investment also expanded for a 3rd consecutive quarter in Q1:21, driven by investments in machinery & equipment. Surprisingly, despite solid domestic demand, net exports' contribution to overall growth turned positive for the first time since Q3:19, in line with a pick-up in exports.

Note that, albeit continuing to add to overall growth, public consumption expanded at a much slower pace in Q1:21 than in Q4:20, reflecting the gradual shift to a neutral fiscal stance.

The (new) spike in FX volatility, reflecting fears of a premature and frontloaded easing in monetary policy, is due to take a toll on economic activity during the remainder of the year. Recall that in a surprise move in March, and just after a larger-than-expected 200 bp policy rate hike (to 19.0%, among the highest worldwide), President Erdogan replaced the Central Bank Governor, N. Agbal, with S. Kavcioglu, a vocal critic of high interest rates, raising fresh concerns over the future stance of the CBRT. This move triggered a sell-off in Turkish assets, with the TRY having lost c. 16% of its value against the USD since then (following losses of c. 50% in 2018-20), contributing significantly, in turn, to a jump in inflation. Although the CBRT has so far refrained from cutting rates, FX volatility remains high over fears of a premature and frontloaded easing in monetary policy (note that President Erdogan recently suggested that easing could begin as early as July).

In this uncertain environment, private consumption should continue to drive economic growth, with its contribution, however, narrowing markedly, especially in H2:21, when the positive COVID-19-related base effects will fade. Although the lay-off ban (effective until June 2021) is due to limit employment losses in the short-term, we highlight that the structurally weak labour market (with unemployment stuck at over 12.5% since end-2018) could hinder economic growth in the longer-term. At the same time, fixed investment is set to continue to expand, albeit modestly, as corporate balance sheets remain under stress, due to the impact of the weaker TRY (note that the non-financial sector's open FX position stands at a high of 30% of GDP).

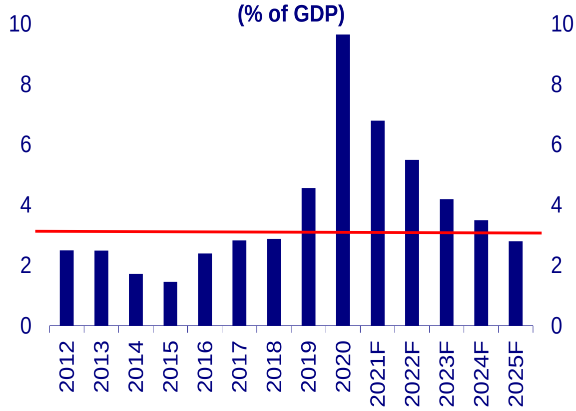
With domestic demand expanding at a more measured pace, net exports should sustain growth, reflecting: i) stronger external demand, especially in H2:21, on the back of global economic recovery; and ii) competitiveness gains. However, the large share of tourism, automotive and transportation industries in Turkey's exports means the latter are not expected to revert to their pre-crisis levels before 2022.

All said, we see GDP growth rebounding to 5.5% in FY:21 from 1.8% in FY:20. Assuming an appropriate monetary policy, and thus a declining country risk premium, we see GDP growth normalising to 4.1% in FY:22, with net exports providing a critical boost. The uncertainty over the evolution of COVID-19, together with elevated geopolitical tensions and a less conducive political backdrop ahead of presidential and legislative elections, due by June 2023, pose downside risks to this outlook.

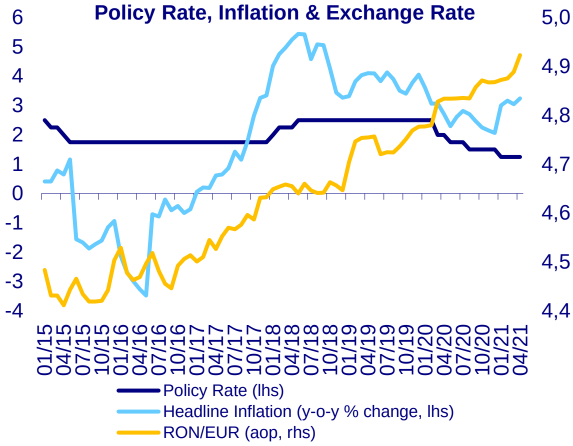
Romania

BBB- / Baa3 / BBB- (S&P / Moody's / Fitch)

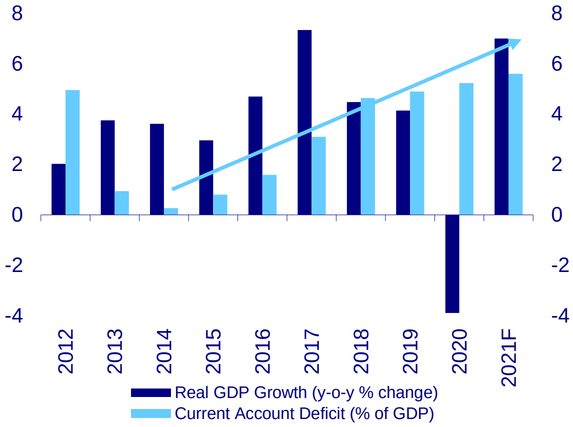
Consolidated Budget Deficit (% of GDP)



Policy Rate, Inflation & Exchange Rate



Real GDP Growth & Current Account Deficit



	7 June	3-M F	6-M F	12-M F
1-m ROBOR (%)	1.4	1.4	1.5	1.7
RON/EUR	4.92	4.93	4.94	4.96
Sov. Spread (2024, bps)	72	75	80	90

	7 June	1-W %	YTD %	2-Y %
BET-BK	2,203	-0.5	18.0	35.3

	2018	2019	2020E	2021F	2022F
Real GDP Growth (%)	4.5	4.1	-3.9	7.0	4.1
Inflation (eop, %)	3.3	4.0	2.1	3.8	3.0
Cur. Acct. Bal. (% GDP)	-4.6	-4.9	-5.2	-5.6	-5.1
Fiscal Bal. (% GDP)	-2.9	-4.6	-9.7	-6.8	-5.5

Sources: Reuters, INSSE, NBR, Ministry of Finance & NBG estimates

The budget deficit is set to narrow to a still high 6.8% of GDP in FY:21, suggesting the need for further serious fiscal consolidation. In 4M:21, the budget deficit narrowed by 0.8 pps y-o-y to 1.8% of GDP. This improvement was solely due to higher tax revenue, in line with the economic recovery (see below) and favourable base effects from the collection of deferred tax payments.

Importantly, fiscal consolidation is set to gain further momentum during the remainder of the year. Indeed, pressure on current spending is expected to ease gradually, following the unwinding of the COVID-19 emergency schemes. However, a significant part of these savings will used to cover the cost of the end-2020 hike in pensions (1.0 pp of GDP). At the same time, tax revenue is set to improve, reflecting the country's economic overperformance. Note that capital spending is also due to accelerate, albeit less so than envisaged in the FY:21 budget, with the bulk of the rise being budget neutral as it would be financed by the EU.

All said, we see the budget deficit narrowing to 6.8% of GDP in FY:21 from 9.7% in FY:20, slightly overperforming compared with its target of 7.2% of GDP. Still, the FY:21 budget deficit would remain among the highest in the EU, highlighting the structural nature of the problem. Indeed, budget flexibility remains limited, with personnel and social spending accounting for 80% of tax revenue in FY:19. In this context, we envisage a slow fiscal consolidation process, with the budget deficit eventually falling below the EU threshold of 3.0% of GDP only in FY:25.

Despite an increasingly challenging backdrop, the large interest rate differential between Romania and its peers should allow the NBR to delay any tightening until mid-2022. Recall that the NBR has responded to the COVID-19 shock with a 125 bp cut in its key rate, to a low of 1.25%, and a series of liquidity-enhancing measures.

However, with risks building up, and most regional central banks (i.e. Czech Republic, Hungary and Poland) set for a hawkish turn in 2021, we expect the NBR to eventually come under pressure to reverse some of the easing carried out during the crisis. Looking ahead, the main factors the NBR should need to consider include:

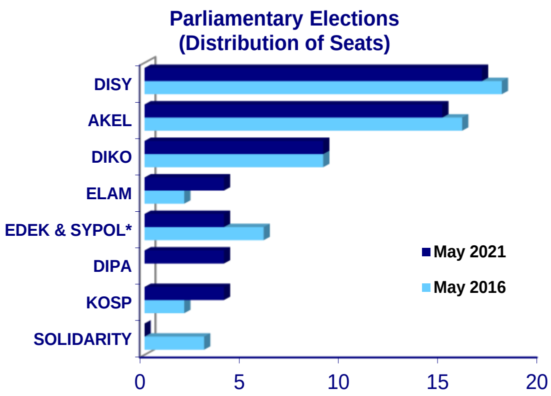
i) the fast pace of economic expansion and the ballooning current account deficit (CAD). Although the economy is far from being overheated, the GDP numbers for Q1:21 (down 0.2% y-o-y but up 2.8% q-o-q s.a.) suggest that economic activity maintains a very strong momentum, having returned to pre-pandemic levels 1-2 quarters earlier than expected. As a result, the CAD is projected to widen for a 7th consecutive year in FY:21 (to an alarmingly high level of 5.6% of GDP), adding pressure to the NBR's FX reserves. In this environment, any slowdown in the pace of fiscal consolidation would pose additional risks.

ii) the upward shift in the inflation outlook. Following global trends, domestic inflation has been rising rapidly since the beginning of the year, mainly reflecting higher commodity prices and negative base effects. According to our baseline scenario, headline inflation is expected to overshoot the upper-end of the NBR's target range (2.5±1%) in H2:21, and then settle in the upper half of that range. However, the underlying pressure on the RON poses a significant upside risk to our forecast, given the high FX pass-through to inflation (c. 20%).

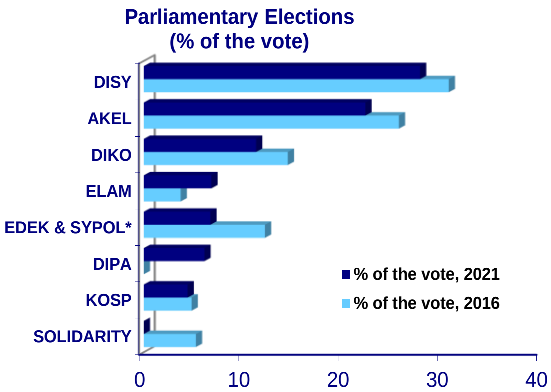
That said, we believe that the large nominal interest rate differential between Romania and its peers (currently at 65-115 bps) should buy the NBR some time to allow inflation to develop and the recovery to get firmly entrenched before acting. As a result, we see the first policy rate hike coming only after mid-2022. In the meantime, and depending on FX movements, we expect the NBR to adjust its liquidity management policy accordingly.

Cyprus

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



* EDEK & SYPOL run seperatly in 2016 elections, with each party securing 3 seats



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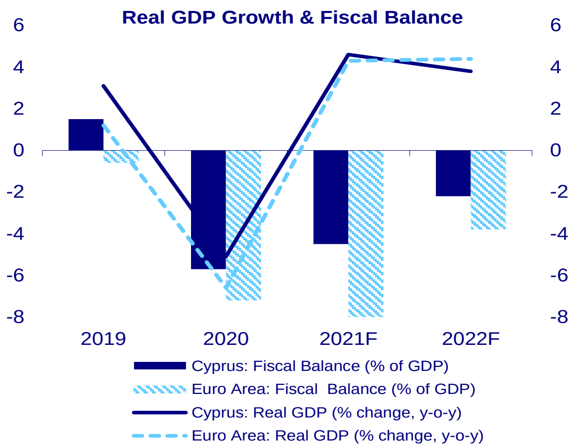

	7 June	3-M F	6-M F	12-M F
1-m EURIBOR (%)	-0.56	-0.55	-0.52	-0.49
EUR/USD	1.22	1.21	1.21	1.22
Sov. Spread (2020. bps)	53	55	60	70

	7 June	1-W %	YTD %	2-Y %
CSE Index	63.5	0.8	12.2	-9.6

	2018	2019	2020	2021F	2022F
Real GDP Growth (%)	5.2	3.1	-5.1	4.6	3.8
Inflation (eop. %)	1.7	0.7	-1.1	2.2	1.5
Cur. Acct. Bal. (% GDP)	-3.9	-6.3	-11.9	-8.8	-6.6
Fiscal Bal. (% GDP)	-3.5	1.5	-5.7	-4.5	-2.2

Sources: Reuters, Ministry of the Interior & NBG estimates

A fragmented Parliament emerged from the May 30th general elections. Although it brought virtual no change in terms of the control of the Parliament, the May election was marked by record high abstention (34.3%) and a large proportion of protest votes. As a result, both the country's main parties saw their popularity fall to 40-year lows, yet each party lost only one seat in the 56-seat parliament compared with the previous election, benefiting by the smaller number of parties crossing the 3.6% election threshold (7 against 8 in 2016).

Specifically, the conservative Democratic Rally (DISY) of the incumbent President, N. Anastasiades, won the election with 27.8% of the vote (against 30.7% in 2016), securing 17 out of 56 seats in the Parliament. Although DISY's popularity was affected by the eruption of the "Golden Visa" corruption scandal in late 2020, which led to the resignation of two lawmakers and the abolition of the scheme that had served as an important pillar of economic growth over the past 5 years, it managed to finish 1st for a 3rd consecutive election, capitalising on: i) the handling of the COVID-19 crisis, including the timely implementation of containment measures and the swift adoption of a large stimulus package that contained GDP contraction in FY:20 (to 5.1% against 6.6% in the euro area), despite the country's large dependence on the hard-hit tourism sector; and ii) Cyprus' strong pre-COVID-19 macroeconomic performance, as manifested by strong GDP growth rates and fiscal surpluses, as well as by progress in structural reforms.

The main opposition party, the pro-European Communist Party (AKEL), also lost ground in the election, garnering 22.3% of the vote (against 25.7% in 2016) and securing 15 seats.

The centre-right Democratic Party (DIKO), ranked 3rd, with 11.3% of the vote (versus 14.5% in 2016), maintaining, at the same time, its seats in the Parliament (9). DIKO's vote loss was in effect translated into gains for its splinter party, the Democratic Front (DIPA), which entered the parliament for the first time, receiving 6.1% of the vote (4 seats).

For the first time since its foundation, the Socialist party (EDEK), did not manage to retain its 4th place, securing 6.7% of the vote and 4 seats, despite its alliance with the center-left Citizens' Alliance (SYPOL).

In addition to the DIPA, the parties that managed to increase their number of seats compared with the previous election include the far-right National Popular Front (ELAM), which saw its support rise markedly, ranking 4th with 6.8% of the vote (up from 3.7% in 2016) and 4 seats, and the Ecology Movement (KOSP), which received 4.4% of the vote (against 4.8% in 2016), securing 3 seats.

Political continuity is expected to be maintained after the elections, despite possible delays in policy implementation. The result of the election is unlikely to lead to a change in policies before the next presidential elections, scheduled for 2023, as Cyprus operates a presidential political system -- i.e. the President appoints the Cabinet. Nevertheless, given that the DISY lacks an outright majority in Parliament, decision-making could prove complicated, with the Government likely needing to seek support on a case-by-case basis. Importantly, however, the country's sound institutions and the authorities' strong track record of policy and reform implementation should provide an important anchor of political stability, especially in view of the challenges facing the Government. The latter include the need to: i) improve the country's capacity to absorb the large amount of funds available under the EU's Recovery and Resilience Facility, so as to bring economic growth back on a solid and sustainable path; ii) return to primary fiscal surpluses, as soon as the impact of the pandemic fades, so as to put public debt back on a firm downward trend; and iii) proceed with the ongoing efforts to resume reunification talks after a 4-year stalemate.

TURKEY	2018	2019	2020	2021f	2022f
Real Sector					
Nominal GDP (USD million)	777,122	761,093	719,124	746,867	817,363
GDP per capita (EUR)	8,056	8,175	7,459	7,261	7,773
GDP growth (real, %)	2.8	0.9	1.8	5.5	4.1
Unemployment rate (%, aop)	11.0	13.7	13.2	13.0	12.4
Prices and Banking					
Inflation (%, eop)	20.3	11.8	14.6	13.5	10.4
Inflation (%, aop)	16.2	15.4	12.3	15.7	11.5
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	189,832
Merchandise imports (USD million)	219,635	198,997	206,280	220,971	227,131
Trade balance (USD million)	-40,726	-16,751	-37,866	-38,404	-37,299
Trade balance (% of GDP)	-5.2	-2.2	-5.3	-5.1	-4.6
Current account balance (USD million)	-21,743	6,759	-37,264	-28,662	-23,384
Current account balance (% of GDP)	-2.8	0.9	-5.2	-3.8	-2.9
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	96,000	105,000
International reserves (Months[a])	4.5	5.6	4.9	4.7	5.0
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	39.5	39.5	40.0
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	59.6	55.7
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	83.3	81.0
External debt service (% of exports)	34.6	36.0	37.5	36.5	35.8
Financial Markets					
Policy rate (Effective funding rate, %, eop)	24.1	11.4	17.0	15.0	11.5
Policy rate (Effective funding rate, %, aop)	17.7	20.7	10.5	17.6	12.5
1-Y T-bill rate (%, eop)	21.5	11.3	15.1	16.5	12.8
Exchange rate: USD (eop)	5.29	5.95	7.43	8.55	8.95
Exchange rate: USD (aop)	4.84	5.68	7.02	8.25	8.75

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

ROMANIA	2018	2019	2020	2021f	2022f
Real Sector					
Nominal GDP (EUR million)	204,633	223,104	218,306	238,296	254,312
GDP per capita (EUR)	10,477	11,497	11,251	12,282	13,108
GDP growth (real, %)	4.5	4.1	-3.9	7.0	4.1
Unemployment rate(ILO definition, %, aop)	4.2	3.9	5.0	5.5	5.0
Prices and Banking					
Inflation (%, eop)	3.3	4.0	2.1	3.8	3.0
Inflation (%, aop)	4.6	3.8	2.6	3.4	2.8
Loans to the Private Sector (% change, eop)	7.9	8.4	8.4		
Customer Deposits (% change, eop)	9.2	10.2	10.2		
Loans to the Private Sector (% of GDP)	25.6	25.9	25.9		
Retail Loans (% of GDP)	14.0	14.1	14.1		
Corporate Loans (% of GDP)	11.6	11.8	11.8		
Customer Deposits (% of GDP)	32.7	33.0	33.0		
Loans to Private Sector (% of Deposits)	78.4	78.4	78.4		
Foreign Currency Loans (% of Total Loans)	33.7	34.4	34.4		
External Accounts					
Merchandise exports (EUR million)	61,820	63,062	57,551	60,902	64,159
Merchandise imports (EUR million)	77,160	80,918	76,717	82,286	85,970
Trade balance (EUR million)	-15,340	-17,856	-19,166	-21,383	-21,811
Trade balance (% of GDP)	-7.5	-8.0	-8.8	-9.0	-8.6
Current account balance (EUR million)	-9,495	-10,913	-11,421	-13,353	-12,938
Current account balance (% of GDP)	-4.6	-4.9	-5.2	-5.6	-5.1
Net FDI (EUR million)	4,944	4,848	1,856	2,784	3,480
Net FDI (% of GDP)	2.4	2.2	0.9	1.2	1.4
International reserves (EUR million)	33,065	32,926	38,527	38,558	38,950
International reserves (Months[a])	4.3	4.0	5.1	4.7	4.5
Public Finance					
Primary balance (% of GDP)	-1.5	-3.4	-8.3	-5.3	-4.0
Fiscal balance (% of GDP)	-2.9	-4.6	-9.7	-6.8	-5.5
Gross public debt [b] (% of GDP)	34.6	35.0	47.0	49.8	52.2
External Debt					
Gross external debt (EUR million)	99,841	109,783	125,927	132,016	138,092
Gross external debt (% of GDP)	48.8	49.2	57.7	55.4	54.3
External debt service (EUR million)	19,132	17,442	16,372	16,600	17,200
External debt service (% of reserves)	57.9	53.0	42.5	43.1	44.2
External debt service (% of exports)	22.3	19.4	20.1	19.2	18.7
Financial Markets					
Policy rate (1-w repo rate, %, eop)	2.5	2.5	1.5	1.3	1.8
Policy rate (1-w repo rate, %, aop)	2.4	2.5	1.8	1.3	1.5
10-Y Bond Yield (%, eop)	4.8	4.5	3.1	3.2	3.6
Exchange rate: EUR (eop)	4,652	4,786	4,863	4,935	4,970
Exchange rate: EUR (aop)	4,651	4,743	4,835	4,915	4,953

f: NBG forecasts; a: months of imports of GNFS; b: ESA 2010

CYPRUS	2018	2019	2020	2021f	2022f
Real Sector					
Nominal GDP (EUR million)	21,433	22,287	20,841	22.105	23,312
GDP per capita (EUR)	24.806	25.442	23.552	24.670	25.730
GDP growth (real, %)	5.2	3.1	-5.1	4.6	3.8
Unemployment rate (%, aop)	8.4	7.1	7.6	7.8	7.1
Prices and Banking					
Inflation (%, eop)	1.7	0.7	-1.1	2.2	1.5
Inflation (%, aop)	1.4	0.3	-0.6	1.4	1.6
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	138.7		
Retail Loans (% of GDP)	69.5	63.3	64.3		
Corporate Loans (% of GDP)	84.9	74.1	74.4		
Customer Deposits (% of GDP)	193.3	185.9	197.5		
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	2,964	3,077	3,187
Merchandise imports (EUR million)	8,225	7,741	7,141	7,498	7,783
Trade balance (EUR million)	-4,537	-4,634	-4,177	-4,422	-4,596
Trade balance (% of GDP)	-21.2	-20.8	-20.0	-19.7	-19.5
Current account balance (EUR million)	-0,842	-1,406	-2,476	-1,952	-1,538
Current account balance (% of GDP)	-3.9	-6.3	-11.9	-8.8	-6.6
Net FDI (EUR million)	4,734	5,312	2,020	2,626	3,545
Net FDI (% of GDP)	22.1	23.8	9.7	11.9	15.2
International reserves (EUR million)	- - -	- - -	- - -	- - -	- - -
International reserves (Months[a])	- - -	- - -	- - -	- - -	- - -
Public Finance					
Primary balance [b] (% of GDP)	-1.2	3.8	-3.6	-2.5	-0.1
Fiscal balance [b] (% of GDP)	-3.5	1.5	-5.7	-4.5	-2.2
Gross public debt (% of GDP)	99.2	94.0	118.2	112.4	105.8
External Debt					
Gross external debt (EUR million)	192,933	189,212	189,307	188,000	186,500
Gross external debt (% of GDP)	900.2	849.0	908.4	850.5	800.0
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	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	1,208	1,220

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