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Emerging Markets Analysis

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Economic Analysis Division

Emerging Markets Analysis

Bi-Weekly Report

8 - 21 June 2021

Despite headwinds from COVID-19, economic recovery continued at a fast pace in Q1:21, bringing GDP close to its pre-pandemic level

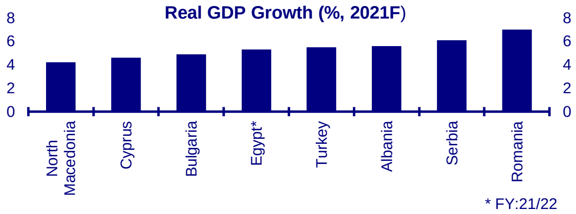
Economic activity is set to maintain momentum during the remainder of the year, helped by a procyclical fiscal stance and supportive base effects, with risks, however, being to the downside, due to heightened political uncertainty

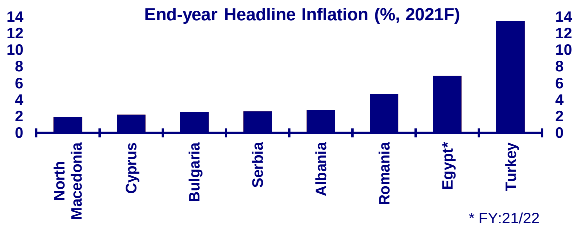
GDP rebounded strongly in Q1:21 (up 1.7% y-o-y), bringing the economy above its pre-pandemic level

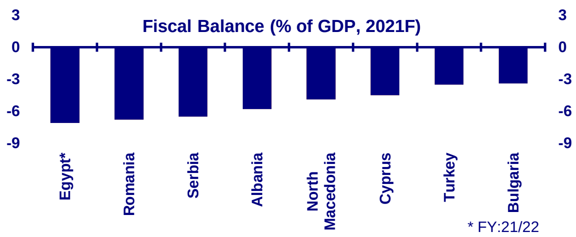
Strong favourable base effects, together with reviving domestic demand and the recovery in the EU, should help sustain robust GDP growth during the remainder of the year

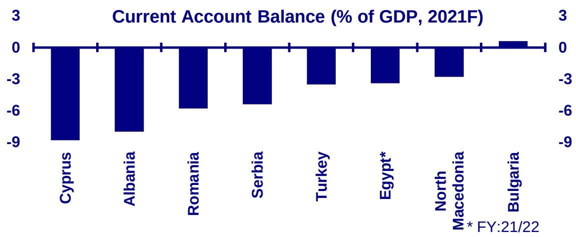
Still heightened uncertainty and a somewhat tighter fiscal stance stalled the economic recovery in Q1:21 (GDP down 1.9% y-o-y)

Economic recovery is set to regain firm ground during the remainder of the year, driven by domestic demand, as uncertainty dissipates and restrictions are lifted





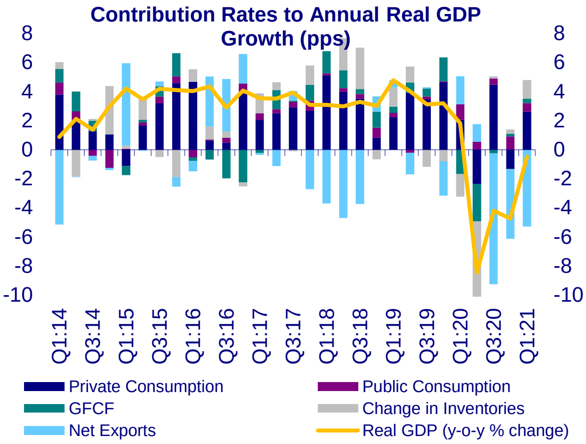


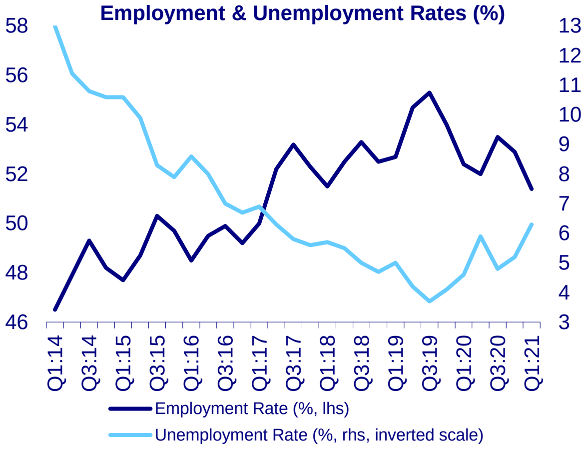


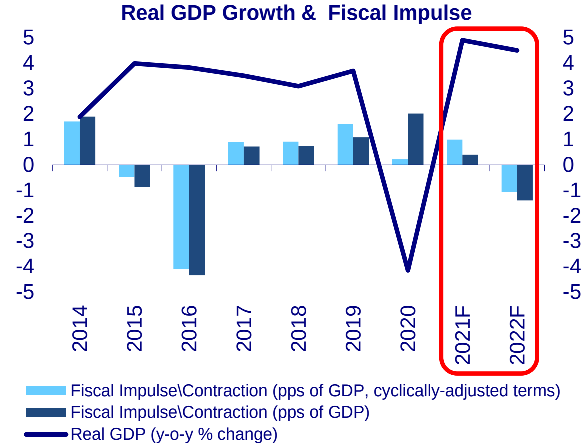
Sources: National authorities & NBG estimates

Bulgaria

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







	21 June	3-M F	6-M F	12-M F
Base Interest Rate (%)	0.0	0.0	0.0	0.0
BGN/EUR	1.96	1.96	1.96	1.96
Sov. Spread (2022, bps)	51	55	55	60

	21 June	1-W %	YTD %	2-Y %
SOFIX	558	2.4	24.6	-4.2

	2018	2019	2020	2021F	2022F
Real GDP Growth (%)	3.1	3.7	-4.2	4.9	4.4
Inflation (eop, %)	2.7	3.8	0.1	2.6	2.5
Cur. Acct. Bal. (% GDP)	0.9	1.8	-0.7	0.6	1.3
Fiscal Bal. (% GDP)	0.1	-1.0	-3.0	-3.4	-2.0

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

Despite headwinds from COVID-19, economic recovery continued at a fast pace in Q1:21, bringing GDP close to its pre-pandemic level. Although Bulgaria was significantly hit by the 2nd and 3rd COVID-19 waves (at the beginning and ending of Q1:21, respectively), authorities opted to proceed with rather soft containment measures, helping the economy to remain resilient. In this context, private consumption expanded at a robust pace (see chart), underpinned by improving confidence and strong wage growth (especially in the public sector). The acceleration in stock rebuilding provided another significant contribution to economic growth in Q1:21. Fixed investment also sustained GDP growth, but marginally, mostly due to a favourable base effect. Unsurprisingly, against the backdrop of stronger domestic demand, net exports deteriorated further in Q1:21. Their drag on overall growth would have been much larger, had exports to the EU not recovered. All said, GDP contraction moderated to 0.5% y-o-y (up 2.5% q-o-q s.a) in Q1:21 from 4.7% y-o-y in Q4:20 (up 2.2% q-o-q s.a.), significantly outperforming the EU average (down 1.3% y-o-y and 0.1% q-o-q s.a.).

Economic activity is set to maintain momentum during the remainder of the year, helped by a procyclical fiscal stance and supportive base effects, with risks, however, being to the downside, due to heightened political uncertainty. Looking ahead, economic activity should continue to expand at a strong pace, with its composition moving gradually towards a more balanced structure. Besides the uncertainty over the pandemic, a key downside risk to this outlook comes from the ongoing political crisis. Recall that, following an inconclusive April election, snap elections were called for July. According to the latest polls, the upcoming election will deliver another hung parliament, meaning that uncertainty is unlikely to ease soon.

In this environment, we expect growth in private consumption to maintain momentum, benefiting from the release of pent-up demand and a further improvement in sentiment, following the pick-up in vaccinations and the relaxation of containment measures. The upcoming expiry of the employment support schemes clouds this outlook, however, given the already considerable amount of slack in the labour market (the unemployment rate was up 1.7 pps y-o-y to 6.3% in Q1:21).

Similarly, fixed investment is due to rebound, driven, *inter alia*, by an EU-backed surge in capital spending, especially towards the end of the year. However, risks to this forecast are tilted to the downside, reflecting potential delays and inefficiencies in the implementation of the country's Recovery & Resilience plan, due to political uncertainty.

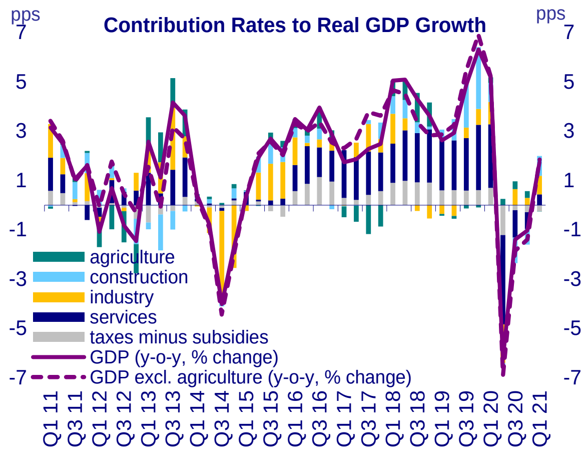
Net exports are also set to improve during the remainder of the year, in line with the recovery in the EU, adding (modestly) to economic growth. The envisaged revival in tourism activity should provide a strong boost to services' exports (note that the sector's contribution to GDP amounted to 10.0% in FY:19). Still, tourism activity would remain c. 40% below pre-crisis levels this year, with the gap expected to close only in 2023.

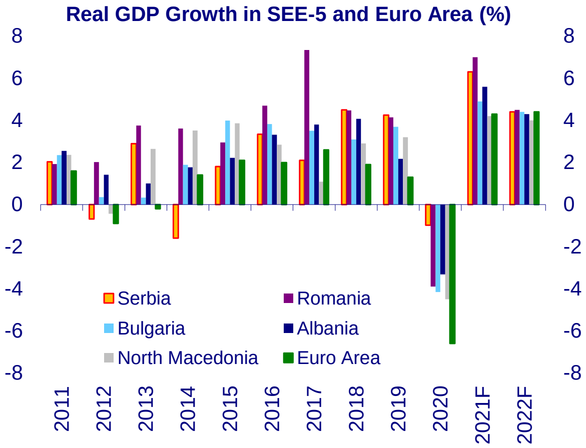
In contrast to most EU economies, which are set to witness a partial reversal in fiscal policy this year, Bulgaria will benefit from a somewhat procyclical stance (see chart). Key drivers include a looser incomes policy and increased social spending. At the same time, monetary conditions are set to remain highly accommodative, in line with the ECB's dovish stance.

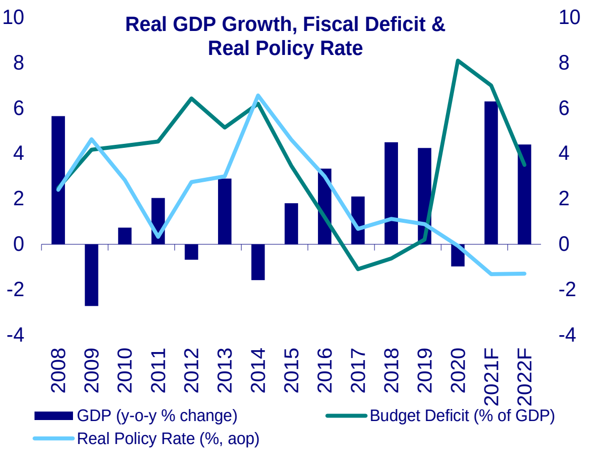
All said, in view of the much stronger-than-expected Q1:21 outcome, we revised upwards our FY:21 GDP growth forecast to 4.9% (from 3.5%). An upswing in EU-backed investment, together with positive labour market developments, should help keep GDP growth well above its long-term potential next year, at 4.5%. Importantly, although political risk is set to remain elevated in the short-term, we expect no slippage in progress with Bulgaria's strategic goals, such as euro area accession.

Serbia

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







	21 June	3-M F	6-M F	12-M F
1-m BELIBOR (%)	0.6	0.6	0.6	0.7
RSD/EUR	117.6	117.5	117.5	117.5
Sov. Spread (2021, bps)	176	170	165	150

	21 June	1-W %	YTD %	2-Y %
BELEX-15	776	-0.8	3.6	7.7

	2018	2019	2020	2021F	2022F
Real GDP Growth (%)	4.5	4.2	-1.0	6.3	4.4
Inflation (eop, %)	2.0	1.9	1.3	2.6	2.6
Cur. Acct. Bal. (% GDP)	-4.8	-6.9	-4.3	-5.4	-5.1
Fiscal Bal. (% GDP)	0.6	-0.2	-8.1	-6.5	-3.5

Sources: Reuters, OPBC & NBG estimates

GDP rebounded strongly in Q1:21 (up 1.7% y-o-y), bringing the economy above its pre-pandemic level. After contracting for 3 successive quarters, GDP expanded by a strong 1.7% y-o-y in Q1:21 (up 1.9% q-o-q s.a.), which marks the highest annual growth rate in SEE-5, pushing the economy above its pre-pandemic level (by c. 1.5%). The recovery was broadly based, with all sectors (excluding agriculture) posting positive growth.

Specifically, the construction sector was the main engine of economic expansion in Q1:21, recording double digit growth (and adding 0.8 pps to overall growth against a negative contribution of 0.6 pps in Q4:20), following a boost in public investment.

At the same time, the services sector sustained the economic recovery, for the first time since Q1:20, albeit marginally (adding 0.4 pps of GDP against a negative contribution of 0.7 pps in Q4:20), despite the reinstatement of some (mild) social distancing measures. This performance was driven by: i) the improvement in consumer confidence, following the fast vaccine rollout (comparing favourably with that in the EU); ii) the resilient labour market (with employment rising by 3.2% y-o-y in Q1:21); and iii) higher inflows of remittances.

Against the backdrop of recovering domestic demand, the industrial sector's contribution to growth increased in Q1:21 (to 0.8 pps from 0.3 pps in Q4:20), also reflecting: i) the better targeting of containment measures, both domestically and internationally, during the 2nd and 3rd COVID-19 waves that prevented large scale supply-side disruptions; ii) the extension of state support, which helped companies maintain operation; and iii) still solid external demand, supported by product and geographical diversification.

Strong favourable base effects, together with reviving domestic demand and the recovery in the EU, should help sustain robust GDP growth during the remainder of the year. In the wake of the lift of social distancing restrictions, we expect the services sector to emerge as the main driver of economic recovery. Stronger demand-side pressures, on the back, *inter alia*, of a loose incomes policy and additional income support measures (including wage subsidies and one-off payments to households) should also help to this end. In this environment, the industrial sector is also due to provide a further boost to economic growth, underpinned by the gradual release of pent-up demand, on the one hand, and stronger external demand from the EU, Serbia's main trade partner (absorbing ⅔ of the country's exports), on the other hand. Economic recovery should be also supported by the construction sector, which is set to continue to overperform, driven by higher public investment (according to the FY:21 revised budget, up 32.2% to 6.5% of GDP).

Importantly, the envisaged orderly fiscal adjustment should not to jeopardize economic recovery. Indeed, we see the budget deficit narrowing modestly to a still high 6.5% of GDP in FY:21 from a record 8.1% in FY:20.

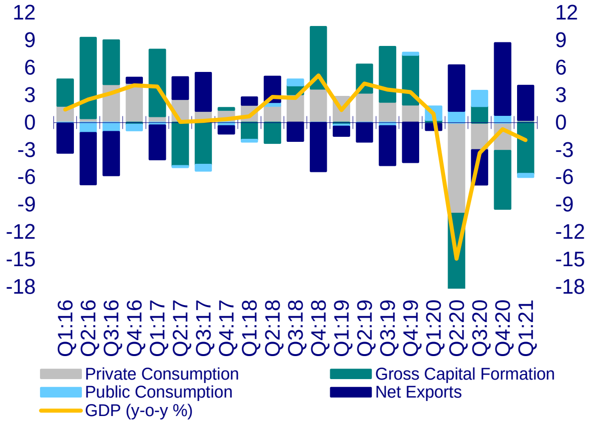
At the same time, monetary policy should remain accommodative. The NBS is set to keep its policy rate at historical lows at least by year-end, while focusing on stimulating credit activity, by providing liquidity to banks and effectively subsidizing new corporate loans.

All said, we see GDP growth at 6.3% in FY:21 -- among the highest in SEE-5 (after Romania). Following a strong rebound in FY:21, the pace of economic expansion is set to moderate to 4.4% in FY:22 – still well above its long-term potential (of slightly over 3.0%). The continuing engagement with the IMF, through a new Policy Coordination Instrument (endorsed by the IMF Board on June 18th), should also help cement confidence.

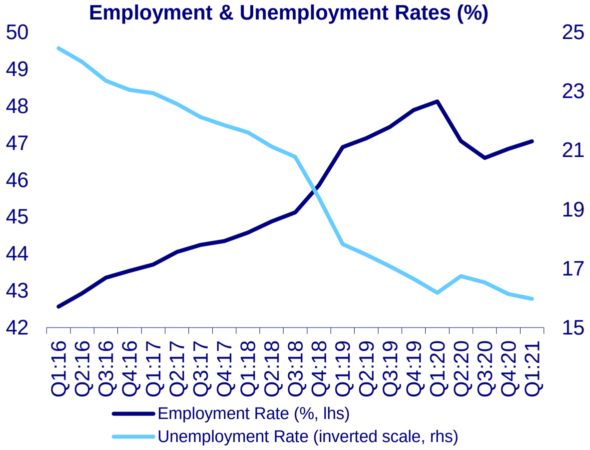
North Macedonia

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

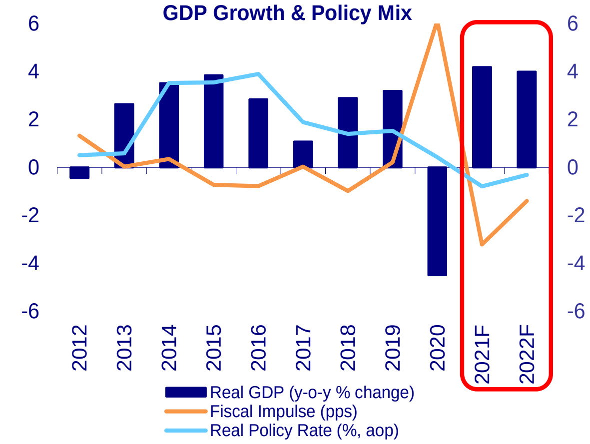
Contributions to Annual Real GDP Growth (pps)



Employment & Unemployment Rates (%)



GDP Growth & Policy Mix



	21 June	3-M F	6-M F	12-M F
1-m SKIBOR (%)	1.2	1.2	1.2	1.4
MKD/EUR	61.6	61.6	61.6	61.6
Sov. Spread (2025. bps)	210	205	195	170

	21 June	1-W %	YTD %	2-Y %
MBI 100	5,299	-2.0	12.6	39.5

	2018	2019	2020	2021F	2022F
Real GDP Growth (%)	2.9	3.2	-4.5	4.2	4.0
Inflation (eop. %)	0.9	0.5	2.2	1.9	1.9
Cur. Acct. Bal. (% GDP)	-0.1	-3.3	-3.5	-2.8	-2.6
Fiscal Bal. (% GDP)	-1.8	-2.0	-8.1	-4.9	-3.5

Sources: Reuters, Statistical Office, Ministry of Finance, NBRNM & NBG estimates

Still heightened uncertainty and a somewhat tighter fiscal stance stalled the economic recovery in Q1:21. Against the backdrop of successive COVID-19 waves, private consumption remained subdued in Q1:21, with its contribution to overall growth turning marginally positive, however, after 4 quarters of negative growth (see chart), mostly due to a positive base effect from Q1:20, when the pandemic erupted. On the other hand, gross capital formation (GCF) continued to decline at a fast pace for a 2nd consecutive quarter in Q1:21, reflecting a freeze in private investment, amid still heightened uncertainty and weak corporate profitability.

Unsurprisingly, in view of the large import base (amounting to 85% of GDP as compared with 65% for exports), this (mostly technical) improvement in private consumption was accompanied by a sharp deterioration in net exports. However, the latter more than offset the former, suggesting a substitution of domestic production by imports. At the same time, following the gradual shift to a tighter fiscal stance (see below), public consumption fell, weighing further on economic growth. As a result, GDP contraction deepened to 1.9% y-o-y in Q1:21 from 0.7% in Q4:20, leaving North Macedonia behind its peers in terms of recovery from the COVID-19 shock.

Economic recovery is set to regain firm ground during the remainder of the year, driven by domestic demand, as uncertainty dissipates and restrictions are lifted. In light of the drop in the infection rate and the growing (though still low compared with EU standards) vaccination coverage, authorities proceeded with the gradual reopening of the economy at end-Q2:21. Against this backdrop, economic recovery should gain momentum during the remainder of the year, driven by domestic demand, especially private consumption. The latter should benefit from improving confidence and strong pent-up demand, as well as the envisaged rebound in remittances, following their collapse in FY:20. The structurally weak labour market (unemployment stood at 16.0% in Q1:21, the highest in the region, reflecting, *inter alia*, a large informal economy and skills mismatches) poses, however, downside risks to this outlook. At the same time, GFC should strengthen, but modestly, helped by favourable base effects. The public sector is once again expected to give a critical boost (the FY:21 budget envisages a 50% hike in capital spending to c. 3.5% of GDP).

Despite the recovery in the EU, net exports are unlikely to sustain economic growth during the remainder of the year, reflecting the large import content of exports and recovering domestic demand. The ongoing disruptions in the automotive industry, due to the severe global shortage in computer chips, cloud further the outlook for exports (note that automotive related products account for c. 40% of the country's exports).

Following the economic recovery and the phasing-out of support measures, fiscal policy should turn contractionary this year. Indeed, we see the FY:21 budget deficit narrowing by 3.2 pps to 4.9% of GDP.

In contrast, monetary policy conditions are set to remain accommodative. Recall that the NBRNM has responded to the crisis with a 75 bp cut in its key rate to 1.25% (currently equivalent to -1.7% in real *ex-post* terms) and a series of liquidity-enhancing measures. In view of country's strong FX reserve position, we expect the NBRNM to remain on hold at least until year-end, despite the hawkish turn by several CEE central banks.

All said, we see GDP growth rebounding to 4.2% in FY:21, leaving the economy just short of its pre-pandemic level. Despite the envisaged (further) reversal in policies in FY:22, we project GDP to expand by a still solid 4.0%, with the structure of domestic demand turning more balanced and net exports continuing to weigh on overall growth. Besides the uncertainty over the evolution of the pandemic, other downside risks include a new delay in the opening of EU membership talks.

BULGARIA	2018	2019	2020	2021f	2022f
Real Sector					
Nominal GDP (EUR million)	56,111	61,239	60,642	64,822	69,298
GDP per capita (EUR)	8,016	8,810	8,773	9,436	10,148
GDP growth (real, %)	3.1	3.7	-4.2	4.9	4.4
Unemployment rate(ILO definition, %, aop)	5.2	4.2	5.1	5.4	5.0
Prices and Banking					
Inflation (%, eop)	2.7	3.8	0.1	2.6	2.5
Inflation (%, aop)	2.8	3.1	1.7	1.9	2.4
Loans to the Private Sector (% change, eop)	7.5	7.4	4.5		
Customer Deposits (% change, eop)	7.4	10.7	10.2		
Loans to the Private Sector (% of GDP)	49.7	48.9	52.0		
Retail Loans (% of GDP)	19.1	19.5	21.3		
Corporate Loans (% of GDP)	30.6	29.3	30.7		
Customer Deposits (% of GDP)	65.8	66.8	74.9		
Loans to Private Sector (% of Deposits)	75.4	73.2	69.4		
Foreign Currency Loans (% of Total Loans)	34.4	32.4	31.1		
External Accounts					
Merchandise exports (EUR million)	27,742	29,119	27,232	28,915	30,342
Merchandise imports (EUR million)	30,448	32,028	29,104	31,595	33,444
Trade balance (EUR million)	-2,706	-2,908	-1,872	-2,680	-3,102
Trade balance (% of GDP)	-4.8	-4.7	-3.1	-4.1	-4.5
Current account balance (EUR million)	0,532	1,121	-0,400	0,401	0,886
Current account balance (% of GDP)	0.9	1.8	-0.7	0.6	1.3
Net FDI (EUR million)	0,757	1,158	1,946	0,973	1,070
Net FDI (% of GDP)	1.3	1.9	3.2	1.5	1.5
International reserves (EUR million)	25,072	24,836	30,848	31,722	32,829
International reserves (Months[a])	8.5	8.0	11.1	10.5	10.1
Public Finance					
Primary balance (% of GDP)	0.8	-0.4	-2.5	-2.9	-1.5
Fiscal balance (% of GDP)	0.1	-1.0	-3.0	-3.4	-2.0
Gross public debt [b] (% of GDP)	22.3	20.2	25.0	26.7	27.1
External Debt					
Gross external debt (EUR million)	34,487	35,303	38,446	38,893	39,084
Gross external debt (% of GDP)	61.5	57.6	63.4	60.0	56.4
External debt service (EUR million)	7,415	6,957	7,041	7,000	8,200
External debt service (% of reserves)	29.6	28.0	22.8	22.1	25.0
External debt service (% of exports)	20.1	17.7	20.5	18.6	20.3
Financial Markets					
Base Interest Rate (%, eop)	0.0	0.0	0.0	0.0	0.0
Base Interest Rate (%, aop)	0.0	0.0	0.0	0.0	0.0
10-Y Bond Yield (%, eop)	0.9	0.4	0.4	0.4	0.7
Exchange rate: EUR (eop)	1.956	1.956	1.956	1.956	1.956
Exchange rate: EUR (aop)	1.956	1.956	1.956	1.956	1.956

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

SERBIA	2018	2019	2020	2021f	2022f
Real Sector					
Nominal GDP (EUR million)	42,939	46,017	46,493	50,704	54,268
GDP per capita (EUR)	6,149	6,608	6,703	7,340	7,887
GDP growth (real, %)	4.5	4.2	-1.0	6.3	4.4
Unemployment rate (%, aop)	12.7	10.4	9.0	9.6	9.2
Prices and Banking					
Inflation (%, eop)	2.0	1.9	1.3	2.6	2.6
Inflation (%, aop)	2.0	1.9	1.6	2.4	2.5
Loans to the Private Sector (% change, eop)	9.9	8.9	12.2		
Customer Deposits (% change, eop)	14.9	7.8	17.4		
Loans to the Private Sector (% of GDP)	43.5	44.4	49.4		
Retail Loans (% of GDP)	20.1	20.5	22.8		
Corporate Loans (% of GDP)	23.4	23.8	26.6		
Customer Deposits (% of GDP)	44.9	45.3	52.7		
Loans to Private Sector (% of Deposits)	96.9	98.0	93.6		
Foreign Currency Loans (% of Total Loans)	67.0	66.9	62.7		
External Accounts					
Merchandise exports (EUR million)	15,106	16,415	16,032	17,192	18,213
Merchandise imports (EUR million)	20,191	22,038	21,257	23,096	24,305
Trade balance (EUR million)	-5,085	-5,623	-5,224	-5,904	-6,092
Trade balance (% of GDP)	-11.8	-12.2	-11.2	-11.6	-11.2
Current account balance (EUR million)	-2,076	-3,161	-1,981	-2,737	-2,776
Current account balance (% of GDP)	-4.8	-6.9	-4.3	-5.4	-5.1
Net FDI (EUR million)	3,157	3,551	2,902	3,265	3,592
Net FDI (% of GDP)	7.4	7.7	6.2	6.4	6.6
International reserves (EUR million)	11,262	13,379	13,492	14,319	15,135
International reserves (Months[a])	5.4	5.7	6.4	5.9	5.9
Public Finance					
Primary balance (% of GDP)	2.8	1.8	-6.1	-4.6	-1.7
Fiscal balance (% of GDP)	0.6	-0.2	-8.1	-6.5	-3.5
Gross public debt (% of GDP)	54.4	52.8	58.4	60.3	58.9
External Debt					
Gross external debt (EUR million)	26,662	28,254	30,813	32,755	34,189
Gross external debt (% of GDP)	62.1	61.4	66.3	64.6	63.0
External debt service (EUR million)	5,600	6,400	3,900	4,800	4,900
External debt service (% of reserves)	49.7	47.8	28.9	33.5	32.4
External debt service (% of exports)	26.4	27.4	17.6	20.2	19.4
Financial Markets					
Policy rate (2-w repo rate, %, eop)	3.0	2.3	1.0	1.0	1.3
Policy rate (2-w repo rate, %, aop)	3.1	2.7	1.5	1.0	1.1
5-Y T-bill rate [b] (%, eop)	n.a.	n.a.	2.6	2.2	2.5
Exchange rate: EUR (eop)	118.2	117.5	117.5	117.5	117.5
Exchange rate: EUR (aop)	118.1	117.7	117.5	117.5	117.5

f: NBG forecasts; a: months of imports of GNFS; b: primary market

NORTH MACEDONIA	2018	2019	2020	2021f	2022f
Real Sector					
Nominal GDP (EUR million)	10,759	11,221	10,789	11,477	12,175
GDP per capita (EUR)	5,180	5,397	5,189	5,521	5,856
GDP growth (real, %)	2.9	3.2	-4.5	4.2	4.0
Unemployment rate (%, aop)	20.7	17.3	16.4	16.4	16.0
Prices and Banking					
Inflation (%, eop)	0.9	0.5	2.2	1.9	1.9
Inflation (%, aop)	1.5	0.8	1.2	2.1	2.0
Loans to the Private Sector (% change, eop)	7.2	6.1	4.7		
Customer Deposits (% change, eop)	9.5	9.8	6.2		
Loans to the Private Sector (% of GDP)	48.3	49.1	53.2		
Retail Loans (% of GDP)	23.6	25.0	27.9		
Corporate Loans (% of GDP)	24.7	24.1	25.3		
Customer Deposits (% of GDP)	53.0	55.8	61.3		
Loans to Private Sector (% of Deposits)	91.1	88.1	86.8		
Foreign Currency Loans (% of Total Loans)	40.4	41.5	41.6		
External Accounts					
Merchandise exports (EUR million)	4,883	5,323	4,813	5,191	5,472
Merchandise imports (EUR million)	6,619	7,293	6,621	7,100	7,462
Trade balance (EUR million)	-1,736	-1,970	-1,809	-1,909	-1,991
Trade balance (% of GDP)	-16.1	-17.6	-16.8	-16.6	-16.4
Current account balance (EUR million)	-0,007	-0,372	-0,373	-0,316	-0,313
Current account balance (% of GDP)	-0.1	-3.3	-3.5	-2.8	-2.6
Net FDI (EUR million)	0,604	0,363	0,206	0,242	0,296
Net FDI (% of GDP)	5.6	3.2	1.9	2.1	2.4
International reserves (EUR million)	2,867	3,263	3,360	3,660	3,860
International reserves (Months[a])	4.4	4.6	5.3	5.3	5.3
Public Finance					
Primary balance (% of GDP)	-0.6	-0.8	-6.9	-3.7	-2.3
Fiscal balance (% of GDP)	-1.8	-2.0	-8.1	-4.9	-3.5
Gross public debt [b] (% of GDP)	48.4	49.0	59.7	61.1	61.0
External Debt					
Gross external debt (EUR million)	7,844	8,154	8,630	8,987	9,290
Gross external debt (% of GDP)	72.9	72.7	80.0	78.3	76.3
External debt service (EUR million)	2,228	2,468	3,300	3,550	2,950
External debt service (% of reserves)	77.7	75.6	98.2	97.0	76.4
External debt service (% of exports)	34.5	35.5	52.7	52.6	41.4
Financial Markets					
28-d CB bill rate (%, eop)	2.8	2.3	1.5	1.3	1.8
28-d CB bill rate (%, aop)	2.9	2.3	1.6	1.3	1.5
1-Y T-bill rate [c] (%, eop)	0.9	0.6	0.4	0.4	0.8
Exchange rate: EUR (eop)	61.4	61.4	61.6	61.6	61.6
Exchange rate: EUR (aop)	61.4	61.4	61.5	61.6	61.6

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

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