



# Economic Analysis Division Emerging Markets Analysis

## Bi-Weekly Report 9 - 22 February 2021



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### Emerging Markets Analysis

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### Special Focus Bulgarian Banking Sector: Trends & Prospects

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Amid a weak operating environment, due to COVID-19 fallout, Bulgarian banks' profitability deteriorated sharply in FY:20

Despite broadly stable asset quality metrics, banks were prompted to increase provisioning in FY:20, in light of rising credit risk

Weaker net interest income and net non-interest income, together with higher operating expenses, put pressure on pre-provision income in FY:20

Profitability is set to remain under pressure in FY:21, with banks' strong capital adequacy providing, however, a line of defense against potential losses

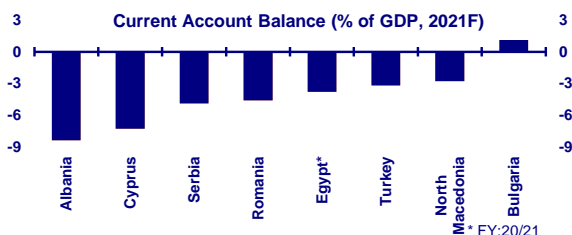
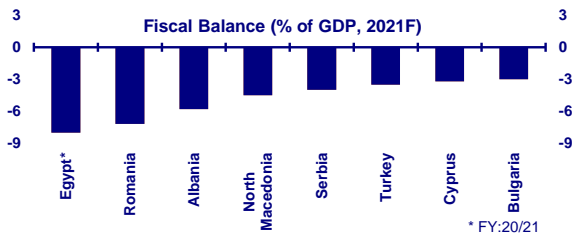
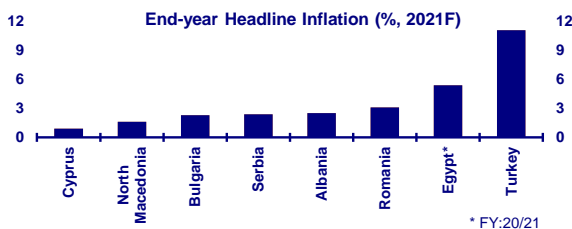
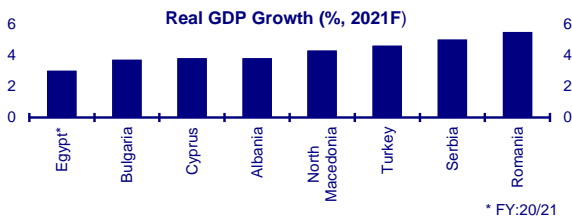
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A massive increase in spending to weather the impact of the COVID-19 shock pushed up the budget deficit to a record-high of 8.1% of GDP in FY:20 from 2.0% in FY:19

The FY:21 budget deficit is set to narrow modestly to 4.9% of GDP, in line with its target

Monetary policy should remain accommodative throughout 2021

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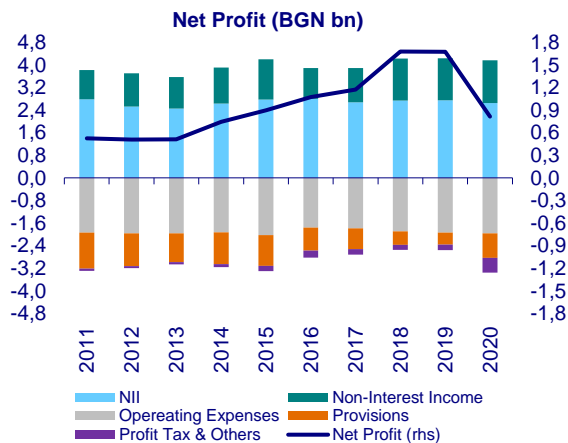


Sources: National authorities & NBG estimates



# Bulgaria

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



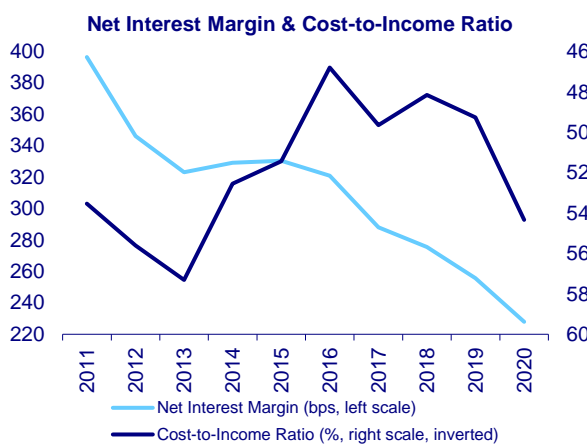
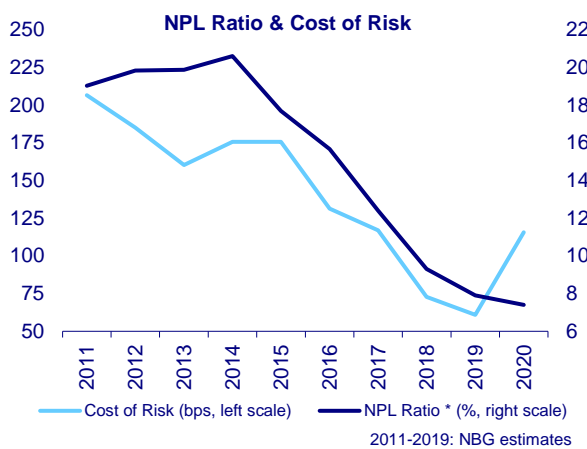
**Amid a weak operating environment, due to COVID-19 fallout, Bulgarian banks' profitability deteriorated sharply in FY:20.** After remaining broadly stable over the previous two years, the banking system's net profit (after tax) dropped by 51.4% in FY:20 to BGN 815mn (EUR 416mn or 0.7% of GDP), reflecting the impact of the pandemic. As a result, ROAA and ROAE moderated to a 7-year low of 0.7% and 5.5% in FY:20, respectively, from 1.5% and 11.9% in FY:19.

**Despite broadly stable asset quality metrics, banks were prompted to increase provisioning in FY:20, in light of rising credit risk.** Indeed, with the economy plunging into recession (GDP is estimated to have contracted by 3.9% in FY:20), household and corporate balance sheets have come under stress, with negative implications on debt repayment capacity. As a result of rising credit risk, banks increased significantly provisioning charges in FY:20 (up 101.6%, with the cost of risk jumping to 116 bps from a low of just 61 bps in FY:19), despite the stable NPE ratio. Indeed, the introduction of a debt payment moratorium (effective until March 2021, with take up amounting to c. 15% of the stock of loans) temporarily mitigated asset quality deterioration, with the NPE ratio standing at 7.4% at end-2020, slightly lower than at end-2019, but still higher than that of Bulgaria's peers. Importantly, the NPE coverage ratio stood at slightly above 60.0% at end-2020, well above that of the euro area (c. 45%).

**Weaker net interest income and net non-interest income, together with higher operating expenses, put pressure on pre-provision income in FY:20.** Net interest income declined moderately in FY:20 (down 3.5% against no change in FY:19), mainly as a result of deferred debt payments, in the context of the debt moratorium enacted by the BNB. The drop in net interest income came against the backdrop of a slightly lower net interest margin (standing at 228 bps in FY:20 against 256 bps in FY:19, still double that of euro area banks), reflecting a further compression in lending interest rates, amid increased liquidity in the market. Note that deposit interest rates have already hit rock-bottom. In this environment, credit to the private sector continued to expand (up 4.5% y-o-y at end-2020), albeit at a slower pace compared with end-2019 (up 7.4%).

Net non-interest income also dropped in FY:20 (down 18.5% against broadly no change in FY:19), driven by lower net fees and commission income and, to a lesser extent, weaker trading gains. Adding to profitability pressures, operating expenses rose modestly in FY:20 (up 1.5%), likely due to higher COVID-19-related expenses. All said, the efficiency of the banking system deteriorated slightly, with the cost-to-income ratio rising to 54.3% in FY:20 from 49.3% in FY:19, still better than the euro area average (c. 65%).

**Profitability is set to remain under pressure in FY:21, with banks' strong capital adequacy providing, however, a line of defense against potential losses.** In view of the upcoming expiry of the debt moratorium and the protracted impact of COVID-19 on the economy (GDP is due to return to its pre-crisis levels only in early-2022), the asset quality metrics are expected to deteriorate in the period ahead, prompting banks to continue to build up provisions. In this environment, net interest income is also set to remain weak, keeping pressure on banks' profitability and capital. Importantly, banks' strong capital adequacy (the total capital adequacy ratio stood at 22.9% in September, above the minimum regulatory threshold of 14%, having benefited from by the BNB-mandated capitalization of banks' FY:19 profits -- amounting to c. 1.4% of GDP), suggests that there is significant headroom to absorb any potential stress. Note that, following Bulgaria's access into the Banking Union at end-2020, Bulgarian banks have access to the Single Resolution Fund.



	22 Feb.	3-M F	6-M F	12-M F
Base Interest Rate (%)	0.0	0.0	0.0	0.1
BGN/EUR	1.96	1.96	1.96	1.96
Sov. Spread (2022, bps)	55	55	52	50

	22 Feb.	1-W %	YTD %	2-Y %
SOFIX	498	0.7	11.4	-14.4

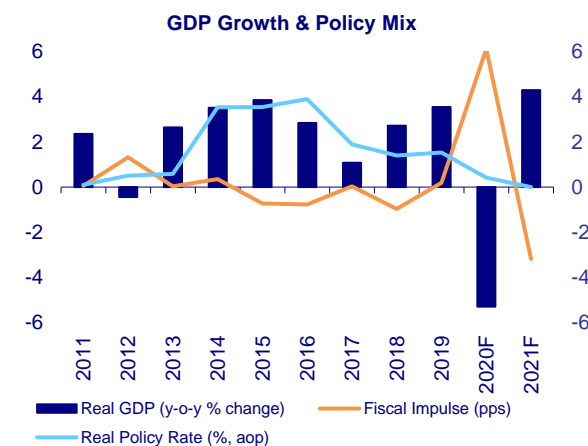
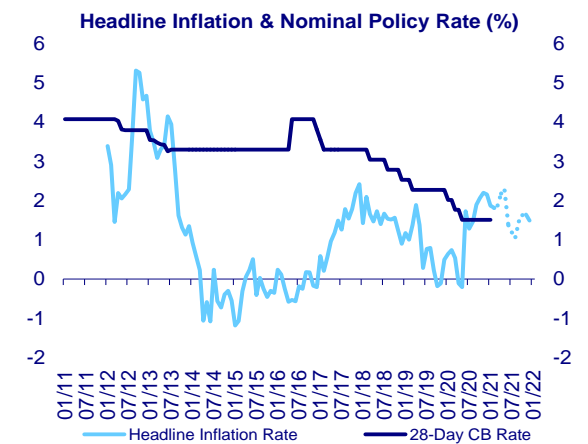
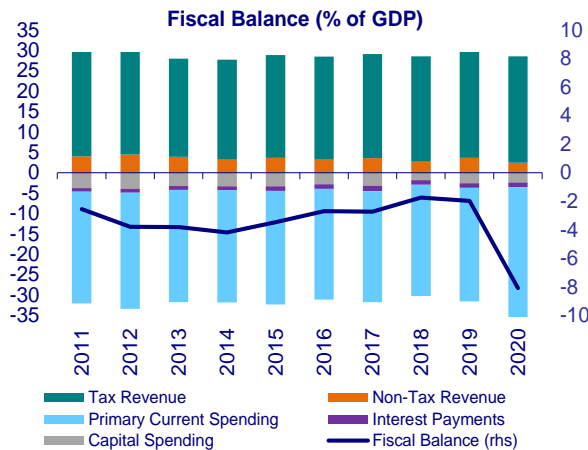
	2018	2019	2020E	2021F	2022F
Real GDP Growth (%)	3.1	3.7	-3.9	3.7	4.0
Inflation (eop, %)	2.7	3.8	0.1	2.3	2.6
Cur. Acct. Bal. (% GDP)	1.0	3.0	0.1	1.1	1.0
Fiscal Bal. (% GDP)	0.1	-1.0	-3.0	-3.0	-1.2

Sources: Reuters, BNB & NBG estimates



# North Macedonia

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



A massive increase in spending to weather the impact of the COVID-19 shock pushed up the budget deficit to a record-high of 8.1% of GDP in FY:20 from 2.0% in FY:19. Indeed, current spending surged in FY:20 (up 5.2 pps to 34.1% of GDP), inflated by the cost of the COVID-19 relief measures. Besides increased healthcare spending, the latter include: i) subsidies on private sector wages and social security contributions; ii) direct financial support, involving cash handouts, to vulnerable households; and iii) targeted support to the HoReCa sector. Note that tax revenue remained intact in FY:20 (at 26.0% of GDP), as the drop in revenue from indirect taxes, due to the recession, was broadly offset by the rise in revenue from social security contributions, reflecting, not only, the beneficial impact of the state-sponsored employment schemes on the tax base, but also the hike in the underlying rate in early-2020. All said, the budget deficit widened markedly to 8.1% of GDP in FY:20 from 2.0% in FY:19, with the implied fiscal impulse being broadly in line with that of North Macedonia's peers. As a result of the sharp deterioration in the primary balance and the economic contraction, gross public debt (incl. guaranteed debt) jumped to 59.5% of GDP at end-2020 from 49.0% at end-2019.

**The FY:21 budget deficit is set to narrow modestly to 4.9% of GDP, in line with its target.** Following the unwinding of the universal support measures implemented in FY:20 and their replacement with targeted sector support (mainly through employment measures), we expect current spending to drop this year, albeit moderately. At the same time, tax revenue is due to strengthen, following the economic recovery (see table). All said, we are comfortable with the budget deficit target of 4.9% of GDP, although we recognise that there are downside risks to our forecast, reflecting the need for additional measures, should the fallout from COVID-19 turns out to be larger than expected. In the event, the under-execution of the (admittedly optimistic) public investment programme (up 0.8 pps to 3.2% of GDP) could open up some fiscal space.

Gross financing needs are projected at a high of c. 12.0% of GDP in FY:21, including the repayment of a Eurobond worth 4.4% of GDP. As a result, we expect the domestic authorities to tap global debt markets once again this year. Importantly, the country's fiscal reserves (amounting to c. 4.0% of GDP) provide some buffer against external shocks. All said, we see gross public debt (including guaranteed debt) rising further to 60.8% of GDP at end-2021.

**Monetary policy should remain accommodative throughout 2021.** Recall that the NBRNM has responded to the crisis with a 50 bp cut in its key 28-day bill rate to a record-low of 1.5% (or -0.4% in real *ex-post* terms, which is broadly in line with that of its peers in the region), boosting, at the same time market liquidity, through a c. 60% reduction in the amount of bills offered to banks.

In addition, the central bank has eased the reserve requirement base for the amount of (new and restructured) credit granted to the sectors hit by the pandemic and amended regulations, with a view to encourage banks to restructure loans temporarily (including deferring debt payments, effective until March 2021).

All said, in view of accommodative monetary conditions globally, on the one hand, and the favourable domestic inflation outlook (see chart), on the other hand, we expect interest rates to remain subdued throughout this year, assuming that pressures on the MKD remain contained. Importantly, the central bank has adequate firepower to defend the currency peg against the EUR, with its FX reserves currently standing at EUR 3.4bn, covering more than 5 months of GNFS imports and 150% of short-term external debt.

	22 Feb.	3-M F	6-M F	12-M F
1-m SKIBOR (%)	1.2	1.2	1.2	1.3
MKD/EUR	61.6	61.6	61.6	61.6
Sov. Spread (2025. bps)	191	185	180	160

	22 Feb.	1-W %	YTD %	2-Y %
MBI 10	5,088	0.4	8.1	37.4

	2018	2019	2020E	2021F	2022F
Real GDP Growth (%)	2.7	3.6	-5.3	4.3	4.0
Inflation (oop. %)	0.9	0.5	2.2	1.6	1.8
Cur. Acct. Bal. (% GDP)	-0.1	-3.3	-3.4	-2.8	-2.0
Fiscal Bal. (% GDP)	-1.8	-2.0	-8.1	-4.9	-3.5

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



<b>BULGARIA</b>					
	<b>2018</b>	<b>2019</b>	<b>2020e</b>	<b>2021f</b>	<b>2022f</b>
<b>Real Sector</b>					
Nominal GDP (EUR million)	56,111	61,239	60,145	63,368	67,551
GDP per capita (EUR)	8,016	8,810	8,702	9,224	9,892
GDP growth (real, %)	3.1	3.7	-3.9	3.7	4.0
Unemployment rate(ILO definition, %, aop)	5.2	4.2	5.0	5.2	4.8
<b>Prices and Banking</b>					
Inflation (% eop)	2.7	3.8	0.1	2.3	2.6
Inflation (% aop)	2.8	3.1	1.7	1.6	2.5
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		
<b>External Accounts</b>					
Merchandise exports (EUR million)	27,744	29,119	27,164	28,786	30,369
Merchandise imports (EUR million)	30,443	32,011	28,892	30,761	33,021
Trade balance (EUR million)	-2,699	-2,891	-1,729	-1,976	-2,652
Trade balance (% of GDP)	-4.8	-4.7	-2.9	-3.1	-3.9
Current account balance (EUR million)	0,554	1,847	0,068	0,699	0,687
Current account balance (% of GDP)	1.0	3.0	0.1	1.1	1.0
Net FDI (EUR million)	0,779	0,825	0,412	0,485	0,581
Net FDI (% of GDP)	1.4	1.3	0.7	0.8	0.9
International reserves (EUR million)	25,072	24,836	30,848	32,532	33,701
International reserves (Months <sup>a</sup> )	8.5	8.0	11.2	11.0	10.5
<b>Public Finance</b>					
Primary balance (% of GDP)	0.8	-0.4	-2.5	-2.5	-0.7
Fiscal balance (% of GDP)	0.1	-1.0	-3.0	-3.0	-1.2
Gross public debt <sup>b</sup> (% of GDP)	22.3	20.2	25.2	26.2	25.6
<b>External Debt</b>					
Gross external debt (EUR million)	34,487	35,178	36,825	36,944	37,153
Gross external debt (% of GDP)	61.5	57.4	61.2	58.3	55.0
External debt service (EUR million)	7,415	6,598	7,023	6,800	8,000
External debt service (% of reserves)	29.6	26.6	22.8	20.9	23.7
External debt service (% of exports)	20.1	16.8	20.6	18.3	20.1
<b>Financial Markets</b>					
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



<b>NORTH MACEDONIA</b>					
	<b>2018</b>	<b>2019</b>	<b>2020e</b>	<b>2021f</b>	<b>2022f</b>
<b>Real Sector</b>					
Nominal GDP (EUR million)	10,759	11,221	10,825	11,482	12,180
GDP per capita (EUR)	5,180	5,397	5,207	5,523	5,859
GDP growth (real, %)	2.7	3.6	-5.3	4.3	4.0
Unemployment rate (% aop)	20.7	17.3	16.6	16.5	16.2
<b>Prices and Banking</b>					
Inflation (% eop)	0.9	0.5	2.2	1.6	1.8
Inflation (% aop)	1.5	0.8	1.2	1.7	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		
<b>External Accounts</b>					
Merchandise exports (EUR million)	4,883	5,323	4,813	5,113	5,431
Merchandise imports (EUR million)	6,619	7,293	6,621	6,974	7,342
Trade balance (EUR million)	-1,736	-1,970	-1,809	-1,861	-1,911
Trade balance (% of GDP)	-16.1	-17.6	-16.7	-16.2	-15.7
Current account balance (EUR million)	-0,007	-0,372	-0,373	-0,322	-0,239
Current account balance (% of GDP)	-0.1	-3.3	-3.4	-2.8	-2.0
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	3,535	3,785
International reserves (Months <sup>a</sup> )	4.4	4.6	5.4	5.2	5.3
<b>Public Finance</b>					
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 <sup>b</sup> (% of GDP)	48.4	49.0	59.5	60.8	60.6
<b>External Debt</b>					
Gross external debt (EUR million)	7,844	8,154	9,147	9,301	9,562
Gross external debt (% of GDP)	72.9	72.7	84.5	81.0	78.5
External debt service (EUR million)	2,228	2,468	3,306	3,629	2,960
External debt service (% of reserves)	77.7	75.6	98.4	104.9	80.3
External debt service (% of exports)	34.5	35.5	54.9	55.7	43.0
<b>Financial Markets</b>					
28-d CB bill rate (% eop)	2.8	2.3	1.5	1.5	2.0
28-d CB bill rate (% aop)	2.9	2.3	1.6	1.5	1.7
1-Y T-bill rate <sup>c</sup> (% eop)	0.9	0.6	0.4	0.4	0.9
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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