Economic Analysis Division

Southeastern Europe & Mediterranean Emerging Market Economies

Bi-Weekly Report

1 - 14 November 2022

Countries in Focus in this Issue:
Serbia, North Macedonia & Albania

NBG - Economic Analysis Division
https://www.nbg.gr/en/group/studies-and-economic-analysis

Emerging Markets Analysis

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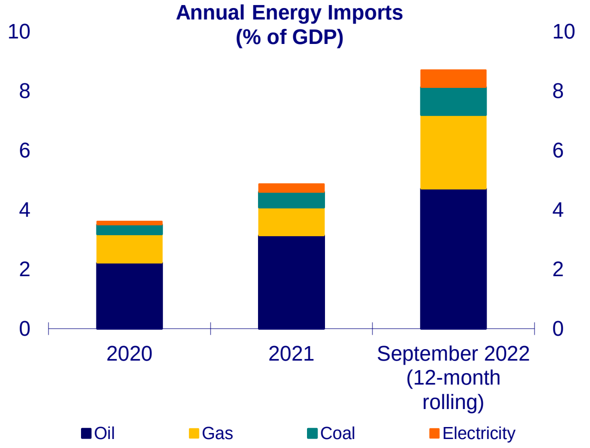
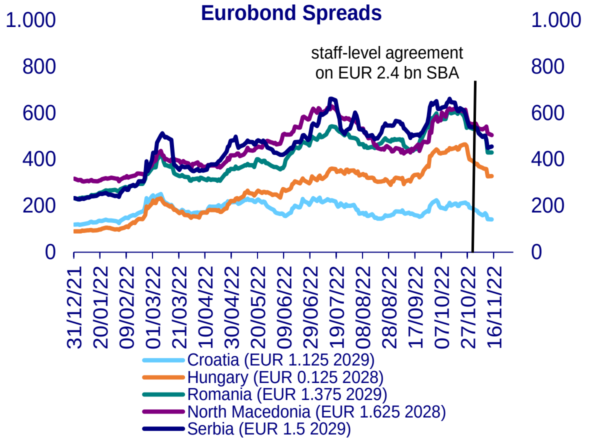
Serbia

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

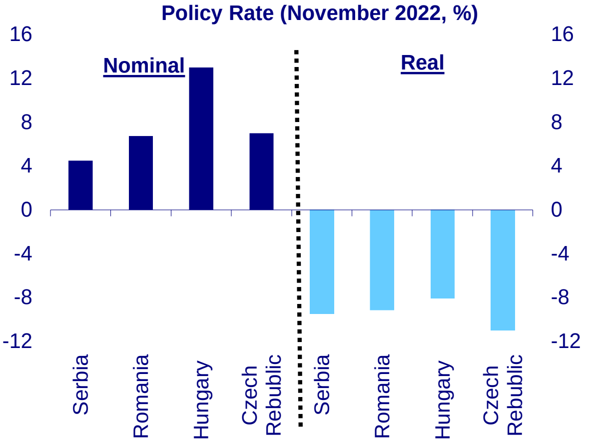
Annual Energy Imports (% of GDP)



Eurobond Spreads



Policy Rate (November 2022, %)



	14 Nov.	3-M F	6-M F	12-M F
1-m BELIBOR (%)	3.8	4.8	4.8	4.8
RSD/EUR	117.2	117.5	117.5	117.5
Sov. Spread (2029, bps)	444	410	380	300

	14 Nov.	1-W %	YTD %	2-Y %
BELEX-15	789	0.2	-3.8	11.1

	2019	2020	2021	2022F	2023F
Real GDP Growth (%)	4.3	-0.9	7.4	2.2	1.4
Inflation (eop, %)	1.9	1.3	7.9	15.5	7.4
Cur. Acct. Bal. (% GDP)	-6.9	-4.1	-4.5	-9.4	-8.0
Fiscal Bal. (% GDP)	-0.2	-8.0	-4.1	-3.8	-2.8

Sources: Reuters, IMF, OPBC, NBS & NBG estimates

The IMF reached a staff-level agreement with Serbia on a EUR 2.4bn 2-year Stand-By Arrangement (SBA) that will help alleviate external and fiscal pressures from a bulging energy bill. The agreement is subject to the IMF Executive Board approval, expected in December, and will replace the country's existing non-financing Policy Coordination Instrument (PCI). Serbian authorities intend to withdraw only the first disbursement of the financing available (estimated up to EUR 0.7-0.8bn or 1.2% of GDP) to plug the widening external and fiscal financing gaps and treat the remaining access as precautionary. Although details were not disclosed, we expect that the new IMF-supported programme should entail fiscal consolidation and structural reforms, primarily focusing on the energy sector, including adjustments in energy tariffs.

Regarding external imbalances, the current account deficit (CAD) has been widening at a rapid pace since the beginning of the year (up 2.4 pps to 4.6% of GDP in 8M:22), driven by a ballooning energy bill (up 3.4 pps to 5.5% of GDP in 8M:22). The latter was attributed not only to the impact of higher global energy prices but also to that of increased demand to compensate for the shortfall in domestic power generation, due to technical breakdowns and insufficient domestic coal mining. Note that the price effect would have been larger had it not been for Serbia's favourable gas contract with Russia (with gas imports, nonetheless, accounting for just 30% of total energy imports as opposed to oil imports, which account for more than 55% of imported energy, see chart).

The bulging energy bill has also induced substantial fiscal costs, mainly reflecting the large losses written by state-owned energy enterprises (SOEs), under the Government's gas and electricity price-cap schemes. Fiscal support for the energy sector is estimated at 1.0% of GDP thus far, with another 1.0% of GDP projected to be needed this winter (keeping the budget deficit close to the 4% of GDP threshold).

Plugging the external and fiscal financing gaps has not been an easy task for Serbia, in view of rapidly rising borrowing costs on both domestic and international debt markets. The latter reflect not only tightening (domestic and global) monetary policy conditions but also Serbia's political isolation from the rest of Europe, following its refusal to join Western sanctions against Russia. As a result, Serbia's 7-year debt yield has shifted by 390 bps since the beginning of the year, with sovereign Eurobond spreads almost tripling, at the same time, markedly above those of its peers (see chart). Note that the implied financing gaps would have been larger had it not been, a series of private placements on sovereign Eurobonds (totalling EUR 0.7bn) and an agreement with UAE on a USD 1.0bn loan.

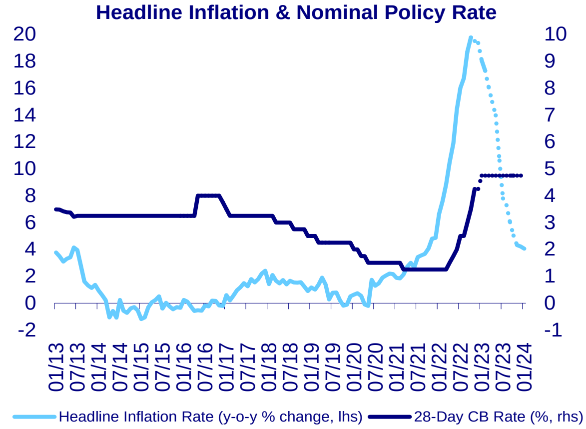
In view of persistent inflationary pressures, the NBS is expected to continue its tightening cycle until mid-2023. In response to heightened inflationary pressures, the NBS hiked its 2-week repo rate by a further 50 bps to 4.5% at its November meeting, bringing the total rate hikes to 350 bps since the outbreak of the Russian-Ukraine conflict. Still, the extent of tightening is much smaller than that carried out by regional central banks, reflecting relatively more modest inflationary pressures, with the latter attributed, *inter alia*, to RSD stability and the impact of the Government's measures (including temporary caps on several basic food prices & price caps on energy prices for households & companies).

Looking ahead, despite the poor economic outlook, we expect the NBS to turn more hawkish, with a view not only to facilitating the external adjustment, but mostly to taming inflation expectations ahead of the IMF-mandated adjustments in electricity, gas & heating prices for households & industries and their second-round effects. Although no details have been disclosed yet, we revise upwards our CPI outlook and we now expect inflation to remain in double-digits until mid-2023, falling within NBS's target range only in 2024. In this context, we expect the NBS to raise further its key policy rate by at least 100 bps by mid-2023.

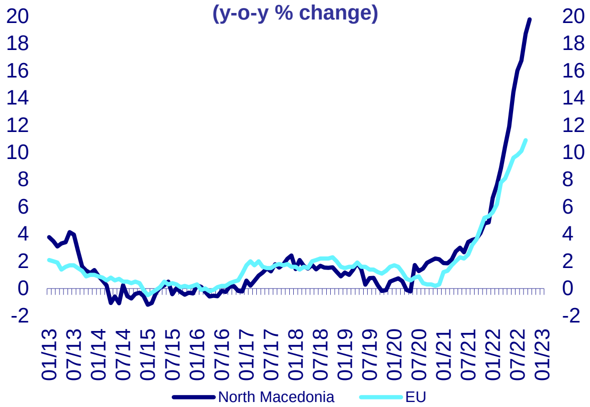
North Macedonia

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

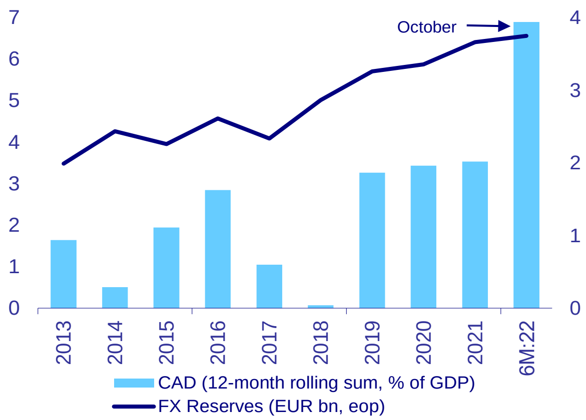
Headline Inflation & Nominal Policy Rate



Headline Inflation (y-o-y % change)



Current Account Deficit & FX Reserves



	14 Nov.	3-M F	6-M F	12-M F
1-m SKIBOR (%)	2.2	2.6	3.0	3.5
MKD/EUR	61.6	61.6	61.6	61.6
Sov. Spread (2028, bps)	491	520	480	400

	14 Nov.	1-W %	YTD %	2-Y %
MBI 100	5,574	-0.4	-9.4	26.4

	2019	2020	2021	2022F	2023F
Real GDP Growth (%)	3.9	-6.1	4.0	2.2	2.4
Inflation (eop. %)	0.5	2.2	4.9	19.4	4.2
Cur. Acct. Bal. (% GDP)	-3.3	-3.4	-3.5	-7.2	-5.6
Fiscal Bal. (% GDP)	-2.0	-8.2	-5.4	-5.3	-4.6

Sources: Reuters, NBRNM, Eurostat & NBG estimates

Against the backdrop of record-high inflation and widening external imbalances, the central bank has embarked on an aggressive rate hiking cycle. The NBRNM has increased its policy rate by 300 bps to 4.25% since April, with borrowing costs having reached their highest level in 12 years.

The main factors driving the central bank's push for higher rates are:

i) The significant upward shift in the inflation outlook. Following global trends, domestic headline inflation has climbed to record-high levels, hitting 19.8% y-o-y in October against 4.9% at end-2021 (and a 10-year average of just 1.3%), markedly surpassing that of the EU, whom, historically, had been closely tracking (reflecting the high share of high import intensity items in North Macedonia's CPI index -- c. 90% -- and the MKD's peg with the EUR). This performance was attributed not only to the jump in global energy and food prices, in the aftermath of the Russia-Ukraine crisis, and concomitant second-round effects, but also to strong wage pressures (with net wages up 11.5% y-o-y in August and 9.6% in 8M:22, following, *inter alia*, a 18% hike in the minimum wage in April) and rapidly rising inflation expectations. A material easing in inflationary pressures is expected only after next mid-year, mostly thanks to positive base effects related to the hike in energy prices in late-2021-early-2022. Still, headline inflation is unlikely to fall below 4.0% before 2024; and

ii) Widening external imbalances, stemming from higher global energy prices and the concomitant adverse terms-of-trade impact. According to the latest data, the (12-month rolling) current account deficit has come under strong pressure, doubling in just 6 months to a multi-year high of 6.9% of GDP in June. Underlying external pressures were (temporarily) compounded by a short-lived episode of LC deposit withdrawals and their conversion to EUR at the onset of the Russia-Ukraine conflict. Nevertheless, confidence in the MKD was soon restored, with the ECB's move to extend the NBRNM's access to a EUR 400mn repo-line until early-2023 helping to this end. Proceeds from the issuance of a sovereign Eurobond and an EU grant (combined worth EUR 475mn) did also provide a relief. All said, pressure on external accounts is unlikely to ease over the projection horizon, with the CAD projected to return to more sustainable levels (c. 4.0% of GDP, i.e. the level implied by the economy's fundamentals) only in 2024.

Note that the magnitude of the rate hikes carried out so far has been smaller than the regional average, reflecting limited financial (especially portfolio) linkages between North Macedonia and the rest of the world.

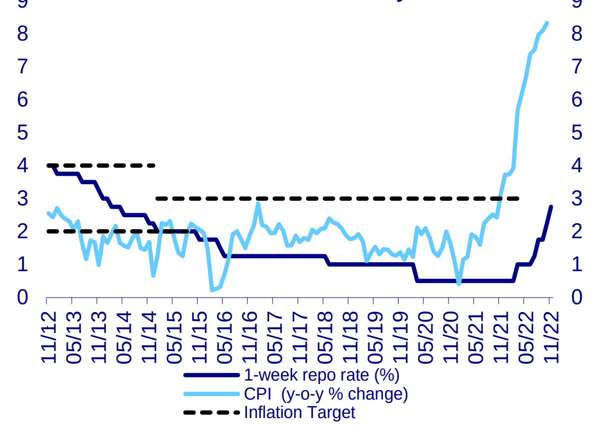
Increasing signs that the rate hiking cycle is nearing an end. Despite strong downside risks to economic outlook, the NBRNM cannot but maintain its tightening bias to tame inflation expectations and excess demand, eventually bringing domestic inflation down, in line with that in the EU. As a result, we expect the NBRNM to raise its key rate by an additional 50 bps to 4.75% by early-2023 and maintain it at that level over the medium term. At the same time, the NBRNM should actively manage liquidity and take further steps to reduce euroization (with the share of FX deposits to total deposits currently standing at c. 47.0%).

Importantly, the NBRNM's FX reserves remain at adequate levels (EUR 3.75bn, equivalent to more than 500% of the monetary base or nearly 4 months of GNFS imports), safeguarding the MKD's longstanding peg with the EUR, and, thus, mitigating risks stemming from the economy's high FX exposure (note that gross external debt stands at slightly over 80% of GDP, out of which 40% is owed by the public sector). In any case, the recent agreement with the IMF on a 2-year precautionary arrangement (PLL, worth EUR 530mn) should provide a critical safety net, in the event external financing conditions deteriorate abruptly.

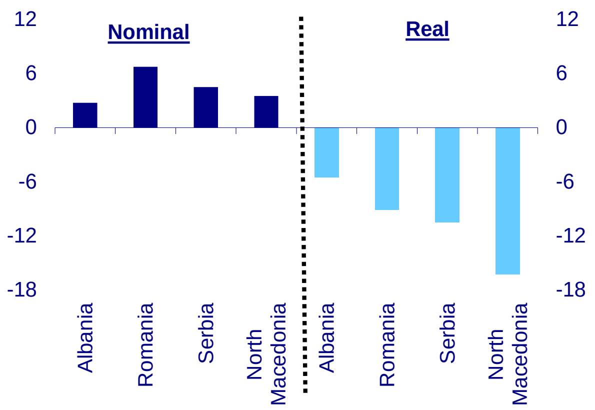
Albania

B+ / B1 / NR (S&P / Moody's / Fitch)

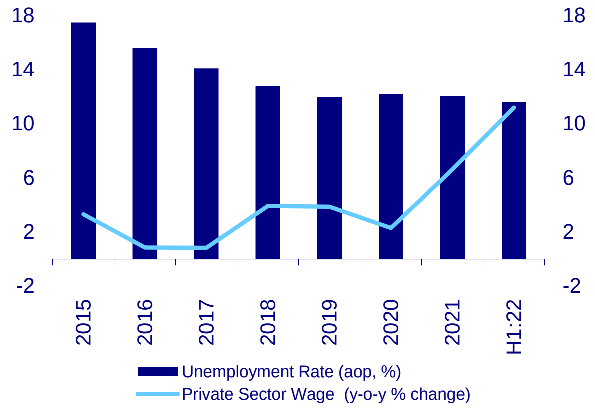
Inflation and Nominal Policy Rate



Policy Rate (November 2022, %)



Labour Market



	14 Nov.	3-M F	6-M F	12-M F
1-m TRIBOR (mid, %)	3.3	4.3	4.8	4.8
ALL/EUR	116.7	120.1	120.4	121.2
Sov. Spread (2027, bps)	455	435	415	380

	14 Nov.	1-W %	YTD %	2-Y %
Stock Market	- - -	- - -	- - -	- - -

	2019	2020	2021	2022F	2023F
Real GDP Growth (%)	2.1	-3.5	8.5	3.0	1.8
Inflation (eop, %)	1.1	1.1	3.7	7.9	4.2
Cur. Acct. Bal. (% GDP)	-7.9	-8.7	-7.5	-7.2	-6.4
Fiscal Bal. (% GDP)	-1.9	-6.7	-4.5	-3.3	-3.0

Sources: Reuters, InStat, BoA & NBG estimates

Rapidly rising inflation prompts the Bank of Albania (BoA) to proceed with another 50 bp hike in its key 1-week repo rate, to 2.75%, at its November meeting. The move brought the total hikes to 225 bps since the initiation of the monetary policy tightening cycle in March, when the Russia-Ukraine crisis broke out. The rate hike was prompted by the sustained acceleration in headline inflation (to a 2½-decade high of 8.3% y-o-y in October from 3.7% in December and a long-term average of just 1.7%, overshooting the BoA's target of 3.0% for the first time in 12 years).

Note that the increase in prices has been broad-based, with food and energy prices accounting for c. 40% of the rise in headline inflation. Worryingly, although food and energy inflation seem to have peaked, core inflation has yet to show any sign of easing, fuelled by:

i*) strong demand side pressures,* supported, *inter alia,* by tight labour market conditions. Note that growth in real *ex-post* wages in the private sector is still positive (up 5.4% y-o-y in H2:22) and trending up, while employment growth has accelerated strongly (up 5.1% y-o-y in H1:22), boosting the employment rate above its 2019 level. These factors, along with the impact of the state's income-support measures (including cash assistance), aimed at mitigating the impact of high inflation on disposable income, have fuelled private consumption beyond pre-crisis levels; and

ii) rising input production costs combined with the high utilisation rate of domestic production capacity. Indeed, the jump in global commodity prices, in the aftermath of the Russia-Ukraine conflict, together with the high utilisation of domestic production capacity (the industrial utilisation rate currently stands at 81.7% against a pre-COVID-19 average of 74.5%), have pushed up producer price inflation (PPI) to 20.4% y-o-y in Q2:22 from 5.4% in Q4:21.

Note that, Albania's inflation would have been even higher had the Government not: i) kept electricity prices stable for both households and companies; and ii) imposed temporary controls on transport fuel and key food prices.

Meanwhile, the appreciation of the Lek against the EUR (up 4.2% y-o-y) has also helped in containing the impact of higher imported inflation on domestic inflation. Lek appreciation has been driven by the narrowing current account deficit (to 6.4% of GDP in Q2:22, on a 4-quarter rolling basis, from 7.5% in Q4:21). Indeed, despite the impact of the steep hike in global food and energy prices, the sharp drop in domestic hydroelectric power production, and still solid consumption-driven domestic demand, external imbalances have narrowed, reflecting: i) stronger exports of services (especially tourism, transport, business-related and manufacturing services); ii) lower investment-related imports, following the completion of high import-content post-earthquake reconstruction projects; iii) a recovery in exports of construction materials and metals, which benefitted from price advantages and tight supply chains.; and iv) a pick-up in remittances.

All said, inflation expectations have been steadily rising, hitting multi-year highs, thus raising pressure on the BoA to act before the latter become entrenched, fuelling a wage-price spiral. As a result, despite weakening economic growth (to a mere 1.8% y-o-y in FY:23, well below its long-term potential of 3¾% and an average of 3.0% over the past 5 years), we see the BoA proceeding with another 150 bp rate hikes in early-2023, bringing the key policy rate to (a 9-year high) of 4.25%. The first policy rate cut is unlikely to come earlier than in H2:24, when headline inflation is projected to fall below the 3.0% target. Should fiscal policy fail to align with the need of containing domestic demand, the central bank should stand ready to act accordingly.

DETAILED MACROECONOMIC DATA

SERBIA					
	2019	2020	2021	2022f	2023f
Real Sector					
Nominal GDP (EUR million)	46,052	46,822	53,351	61,035	69,396
GDP per capita (EUR)	6,631	6,787	7,723	8,870	10,126
GDP growth (real, %)	4.3	-0.9	7.4	2.2	1.4
Unemployment rate (%, aop)	11.2	9.7	11.1	9.7	9.5
Prices and Banking					
Inflation (%, eop)	1.9	1.3	7.9	15.5	7.4
Inflation (%, aop)	1.9	1.6	4.1	12.0	12.2
Loans to the Private Sector (% change, eop)	8.9	12.2	10.1		
Customer Deposits (% change, eop)	7.8	17.4	13.3		
Loans to the Private Sector (% of GDP)	44.3	49.0	47.4		
Retail Loans (% of GDP)	20.5	22.6	21.9		
Corporate Loans (% of GDP)	23.8	26.4	25.4		
Customer Deposits (% of GDP)	45.2	52.3	52.1		
Loans to Private Sector (% of Deposits)	98.0	93.6	91.0		
Foreign Currency Loans (% of Total Loans)	66.9	62.1	61.1		
External Accounts					
Merchandise exports (EUR million)	16,415	16,079	20,771	24,680	26,133
Merchandise imports (EUR million)	22,038	21,280	26,697	33,849	35,339
Trade balance (EUR million)	-5,623	-5,201	-5,926	-9,169	-9,206
Trade balance (% of GDP)	-12.2	-11.1	-11.1	-15.0	-13.3
Current account balance (EUR million)	-3,161	-1,929	-2,389	-5,750	-5,535
Current account balance (% of GDP)	-6.9	-4.1	-4.5	-9.4	-8.0
Net FDI (EUR million)	3,551	2,938	3,724	4,003	4,504
Net FDI (% of GDP)	7.7	6.3	7.0	6.6	6.5
International reserves (EUR million)	13,379	13,492	16,455	15,057	16,076
International reserves (Months[a])	5.7	6.1	6.0	4.4	4.5
Public Finance					
Primary balance (% of GDP)	1.8	-6.0	-2.4	-2.1	-1.2
Fiscal balance (% of GDP)	-0.2	-8.0	-4.1	-3.8	-2.8
Central Government debt (% of GDP)	52.8	57.9	57.1	56.2	53.4
External Debt					
Gross external debt (EUR million)	28,254	30,787	36,536	37,843	41,291
Gross external debt (% of GDP)	61.4	65.8	68.5	62.0	59.5
External debt service (EUR million)	6,400	3,900	4,700	4,900	4,600
External debt service (% of reserves)	47.8	28.9	28.6	32.5	28.6
External debt service (% of exports)	27.4	17.5	16.5	14.9	13.2
Financial Markets					
Policy rate (2-w repo rate, %, eop)	2.3	1.0	1.0	5.0	5.5
Policy rate (2-w repo rate, %, aop)	2.7	1.5	1.0	2.6	5.5
10-Y T-bill rate (%, eop)	3.0	3.1	4.1	8.0	7.0
Exchange rate: EUR (eop)	117.5	117.5	117.5	117.5	117.5
Exchange rate: EUR (aop)	117.7	117.5	117.5	117.5	117.5

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

Sources: National Sources & NBG estimates

NORTH MACEDONIA	2019	2020	2021	2022f	2023f
Real Sector					
Nominal GDP (EUR million)	11,274	10,657	11,754	13,702	15,490
GDP per capita (EUR)	6,074	5,772	6,399	7,490	8,502
GDP growth (real, %)	3.9	-6.1	4.0	2.2	2.4
Unemployment rate (%, aop)	17.3	16.4	15.7	14.5	14.5
Prices and Banking					
Inflation (%, eop)	0.5	2.2	4.9	19.4	4.2
Inflation (%, aop)	0.8	1.2	3.2	14.1	10.4
Loans to the Private Sector (% change, eop)	6.1	4.7	8.0		
Customer Deposits (% change, eop)	9.8	6.2	8.5		
Loans to the Private Sector (% of GDP)	48.9	54.1	53.0		
Retail Loans (% of GDP)	24.9	28.4	27.7		
Corporate Loans (% of GDP)	24.0	25.7	25.2		
Customer Deposits (% of GDP)	55.5	62.3	61.2		
Loans to Private Sector (% of Deposits)	88.1	86.8	86.5		
Foreign Currency Loans (% of Total Loans)	41.5	41.6	40.7		
External Accounts					
Merchandise exports (EUR million)	5,347	4,817	5,996	6,650	7,106
Merchandise imports (EUR million)	7,296	6,622	8,371	9,812	10,359
Trade balance (EUR million)	-1,949	-1,805	-2,375	-3,162	-3,253
Trade balance (% of GDP)	-17.3	-16.9	-20.2	-23.1	-21.0
Current account balance (EUR million)	-0,368	-0,366	-0,416	-0,986	-0,872
Current account balance (% of GDP)	-3.3	-3.4	-3.5	-7.2	-5.6
Net FDI (EUR million)	0,363	0,155	0,435	0,511	0,575
Net FDI (% of GDP)	3.2	1.5	3.7	3.7	3.7
International reserves (EUR million)	3,263	3,360	3,665	3,515	3,465
International reserves (Months[a])	4.6	5.3	4.6	3.7	3.5
Public Finance					
Primary balance (% of GDP)	-0.8	-7.0	-4.1	-4.0	-3.3
Fiscal balance (% of GDP)	-2.0	-8.2	-5.4	-5.3	-4.6
Gross public debt [b] (% of GDP)	48.8	60.5	60.3	61.7	61.5
External Debt					
Gross external debt (EUR million)	8,154	8,536	9,577	10,688	11,463
Gross external debt (% of GDP)	72.3	80.1	81.5	78.0	74.0
External debt service (EUR million)	2,468	3,300	3,550	3,300	3,700
External debt service (% of reserves)	75.6	98.2	96.9	93.9	106.8
External debt service (% of exports)	35.4	52.7	45.9	38.1	39.8
Financial Markets					
28-d CB bill rate (%, eop)	2.3	1.5	1.3	4.3	4.8
28-d CB bill rate (%, aop)	2.3	1.6	1.3	2.4	4.8
1-Y T-bill rate [c] (%, eop)	0.6	0.4	0.5	2.8	3.2
Exchange rate: EUR (eop)	61.4	61.6	61.6	61.6	61.6
Exchange rate: EUR (aop)	61.4	61.5	61.5	61.6	61.6

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

Sources: National Sources & NBG estimates

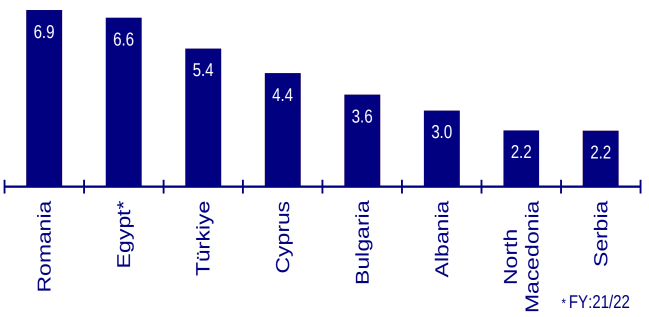
ALBANIA	2019	2020	2021	2022f	2023f
Real Sector					
Nominal GDP (EUR million)	13,786	13,319	15,460	17,365	18,309
GDP per capita (EUR)	4,830	4,693	5,499	6,220	6,591
GDP growth (real, %)	2.1	-3.5	8.5	3.0	1.8
Unemployment rate (%, aop)	12.0	12.2	12.1	11.7	11.3
Prices and Banking					
Inflation (%, eop)	1.1	1.1	3.7	7.9	4.2
Inflation (%, aop)	1.4	1.6	2.0	6.8	5.3
Loans to the Private Sector (% change, eop)	6.1	8.9	8.6		
Customer Deposits (% change, eop)	3.2	8.0	9.2		
Loans to the Private Sector (% of GDP)	31.5	35.3	33.3		
Retail Loans (% of GDP)	11.7	13.0	13.1		
Corporate Loans (% of GDP)	19.8	22.3	20.2		
Customer Deposits (% of GDP)	58.5	65.0	61.7		
Loans to Private Sector (% of Deposits)	53.8	54.3	54.0		
Foreign Currency Loans (% of Total Loans)	49.0	48.1	47.5		
External Accounts					
Merchandise exports (EUR million)	0,907	0,794	1,265	1,897	2,002
Merchandise imports (EUR million)	4,050	3,776	5,094	6,291	6,574
Trade balance (EUR million)	-3,144	-2,982	-3,829	-4,934	-4,573
Trade balance (% of GDP)	-22.8	-22.4	-24.8	-25.3	-25.0
Current account balance (EUR million)	-1,089	-1,153	-1,166	-1,249	-1,179
Current account balance (% of GDP)	-7.9	-8.7	-7.5	-7.2	-6.4
Net FDI (EUR million)	1,036	0,894	0,990	1,188	1,307
Net FDI (% of GDP)	7.5	6.7	6.4	6.8	7.1
International reserves (EUR million)	3,360	3,942	4,972	5,111	5,488
International reserves (Months[a])	6.5	9.6	8.8	7.2	7.4
Public Finance					
Primary balance (% of GDP)	0.2	-4.6	-2.6	-1.5	-1.2
Fiscal balance (% of GDP)	-1.9	-6.7	-4.5	-3.3	-3.0
Gross public debt (% of GDP)	67.3	77.2	80.6	80.0	78.8
External Debt					
Gross external debt (EUR million)	8,246	8,548	9,740	10,140	10,640
Gross external debt (% of GDP)	59.8	64.2	63.0	58.4	58.1
External debt service (EUR million)	0,221	0,517	0,306	0,328	0,352
External debt service (% of reserves)	6.6	13.1	6.1	6.4	6.4
External debt service (% of exports)	5.0	13.3	4.9	3.5	3.6
Financial Markets					
Policy rate (1-week repo rate, %, eop)	1.0	0.5	0.5	2.8	4.3
Policy rate (1-week repo rate, %, aop)	1.0	0.6	0.5	1.5	4.1
1-Y T-bill rate [b] (%, eop)	1.8	1.8	1.6	5.8	2.8
Exchange rate: EUR (eop)	121.6	123.4	120.6	120.0	121.5
Exchange rate: EUR (aop)	122.7	123.4	122.2	119.2	120.8

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

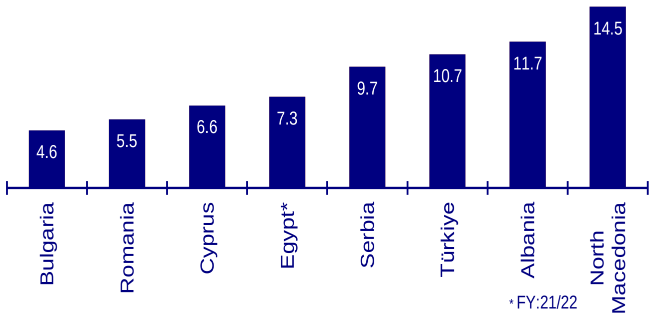
Sources: National Sources & NBG estimates

REGIONAL SNAPSHOT: MACROECONOMIC INDICATORS

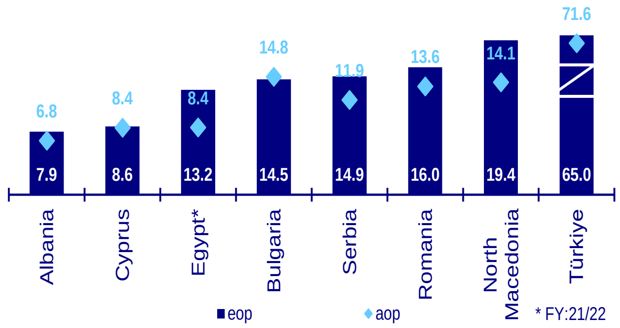
Real GDP Growth (%, 2022F)



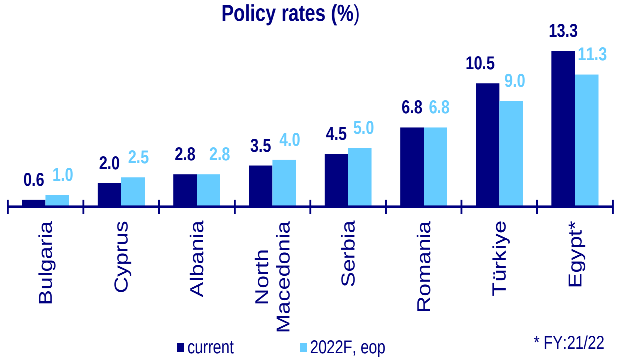
Unemployment (%, 2022F, aop)



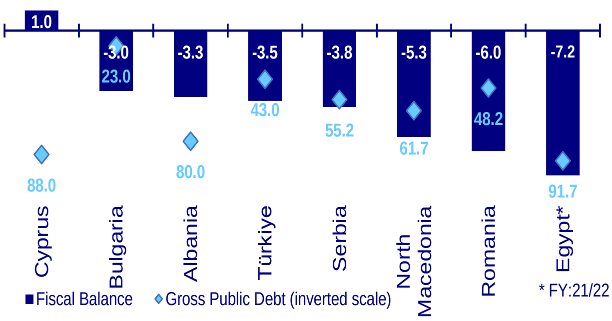
Headline inflation (%, 2022F)



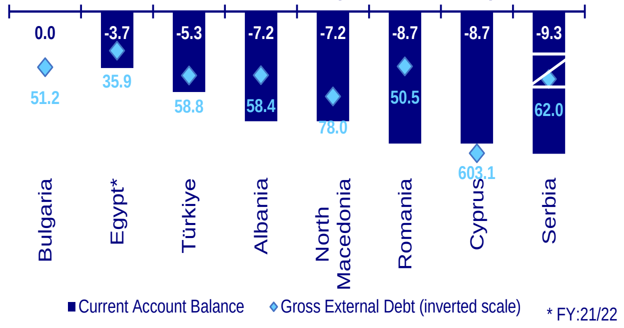
Policy rates (%)



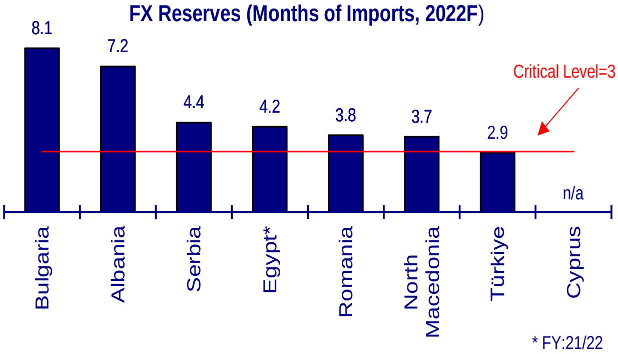
Public Finance (% of GDP, 2022F)



External Accounts (% of GDP, 2022F)

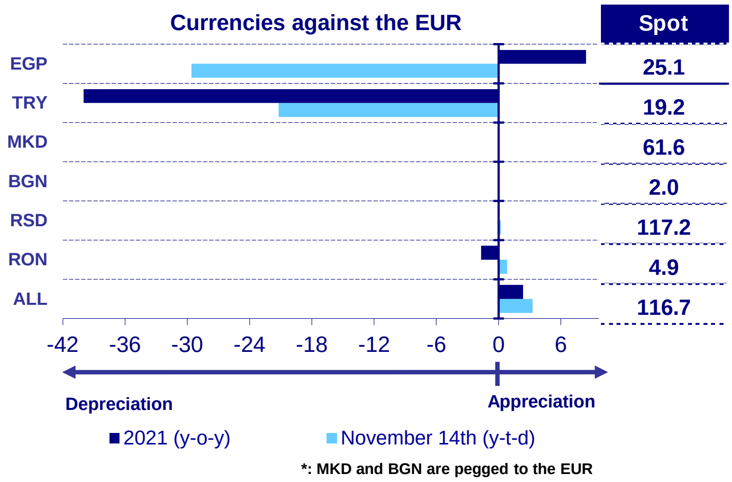


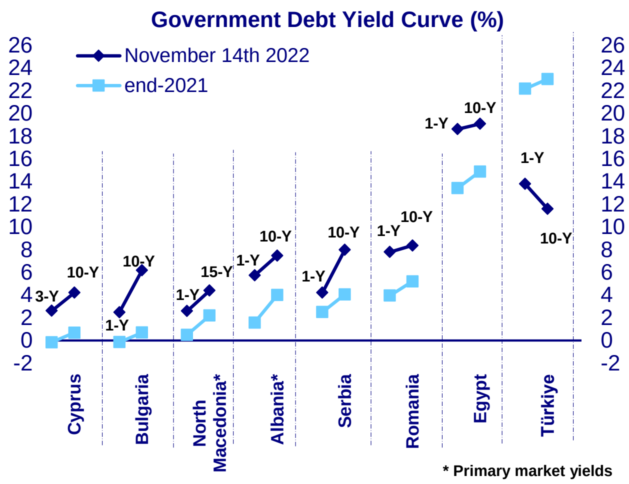
FX Reserves (Months of Imports, 2022F)

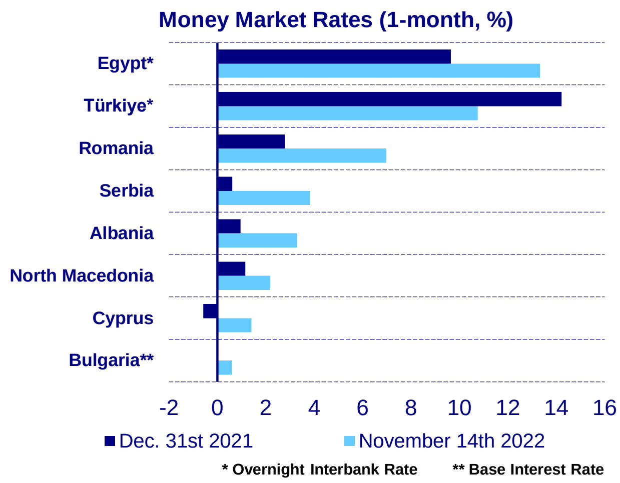


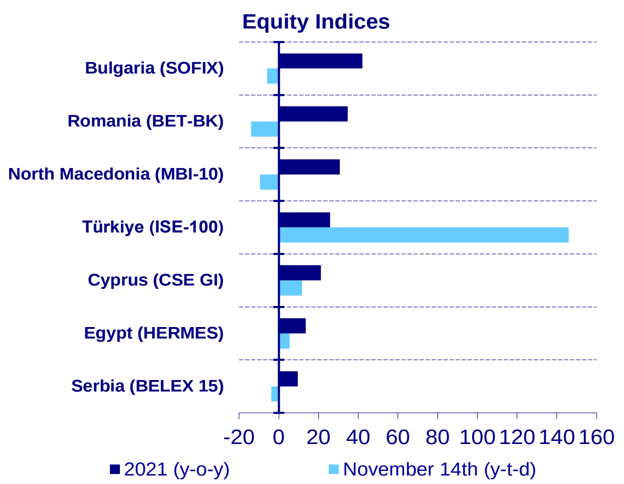
Sources: National Sources & NBG estimates

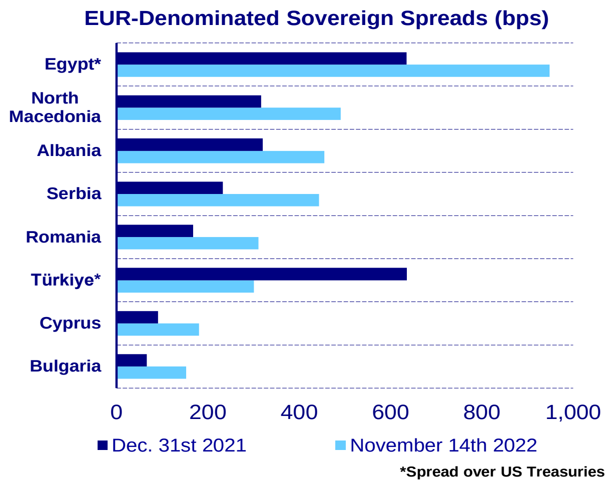
REGIONAL SNAPSHOT: FINANCIAL MARKETS











Sources: Reuters & NBG estimates

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