



Economic Analysis Division

Southeastern Europe & Mediterranean Emerging Market Economies

Bi-Weekly Report

4 – 17 October 2022



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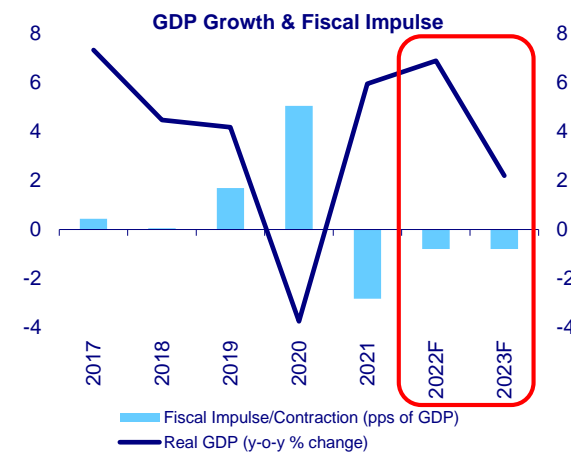
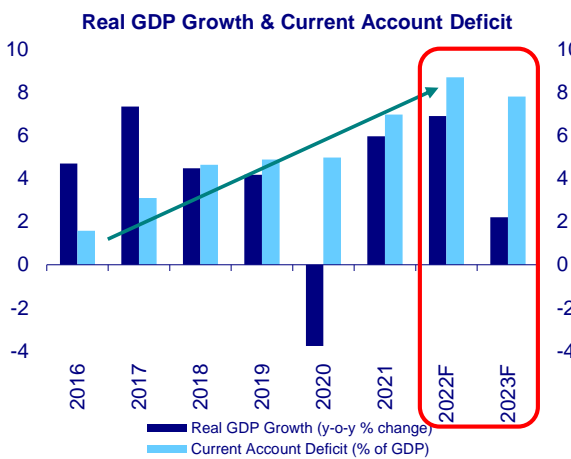
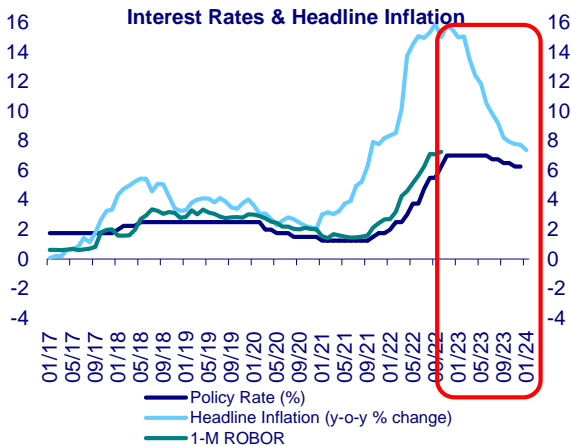
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Romania

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



Against the backdrop of record-high inflation and widening external imbalances, the NBR raised further its key 2-week repo rate by 75 bps (to 6.25%) in October. The NBR's move brings the total rate hikes to 500 bps since October 2021, with borrowing costs having reached their highest level in over a decade. Note that the extent of tightening carried out so far is much larger than suggested by the change in the key rate, as the money market yield curve has shifted upwards by c. 560 bps (for short-term tenors) to c. 640 bps (for long-term tenors) at the same time.

The main factors driving the NBR's push for higher interest rates include:

- first and foremost, the significant upward shift in the inflation outlook. Following global trends, domestic headline inflation has climbed to record-high levels (hitting 15.9% y-o-y in September against -- an already elevated -- 8.2% at end-2021), driven by the rise in international commodity (especially energy and food) prices, in the aftermath of the Russia-Ukraine crisis, and the concomitant second-round effects. With the latter having yet to be fully passed-through into prices, inflation is unlikely to ease markedly in the short-term (with its end-year level projected at 15.5% y-o-y). In fact, materially easing in inflationary pressures is expected only as next year, mostly thanks to positive base effects related to the jump in energy and food prices in late-2021-early-2022. Still, in view of the sizeable negative base effect from the elimination of the cap on electricity and gas prices in April '23, headline inflation is projected to remain above the NBR's target of 2.5±1% throughout next year as well. Importantly, labor market tightness (proxied by the job vacancy-to-unemployment rate ratio) still lags pre-pandemic levels, limiting the risk of a wage-price spiral.

- the alarmingly high current account deficit (CAD). The current account remains under strong pressure (widening further to a multi-year high of 8.7% of GDP on a 12-month rolling basis in August from 7.0% in FY:21), mainly reflecting strong economic growth (GDP growth rebounded to 5.8% y-o-y in H1:22 from 4.6% in H2:21) and the impact of rising global commodity prices. Even adjusting for these factors, the underlying CAD remains markedly high (at c. 5.5% of GDP, well above the level implied by economic fundamentals and desirable policy settings -- c. 2.0% of GDP, IMF estimate, Sep. '22), pointing, *inter alia*, to underlying structural imbalances.

The end of the rate hiking cycle appears near unless significant delays in necessary fiscal consolidation arise. Despite strong downside risks to the economic outlook, the NBR cannot but maintain its tightening bias to address the aforementioned challenges. In this context, we see the NBR raising its key rate by an additional 75 bps to 7.0% by end-year and maintaining it at that level at least by mid-2023. At the same time, we expect the NBR to continue to actively manage market liquidity, keeping money market rates in the upper half of its interest rate corridor (±1.0 pp around the key rate), broadly in line with those of its regional peers (namely Poland and the Czech Republic).

The NBR's policy tightening could prove to be more aggressive than currently envisaged, should significant delays in necessary fiscal consolidation arise. Note that, following a sizeable fiscal tightening in FY:21, the budget deficit is expected to narrow at a relatively slow pace this year and next (see table), reflecting policy support to alleviate the impact of the inflation shock on the economy. An unexpected and abrupt tightening in global financing conditions could also act as a catalyst, should it lead to increased capital outflows, adding pressure on the RON. Indeed, with the domestic economy having the highest FX pass-through to inflation in the region, the NBR's reaction functions appears to be particularly sensitive to FX movements.

	17 Oct.	3-M F	6-M F	12-M F
1-m ROBOR (%)	7.4	8.0	8.0	7.8
RON/EUR	4.93	4.96	4.98	5.01
Sov. Spread (2027, bps)	437	410	380	320

	17 Oct.	1-W %	YTD %	2-Y %
BET-BK	2,039	-0.5	-18.9	23.5

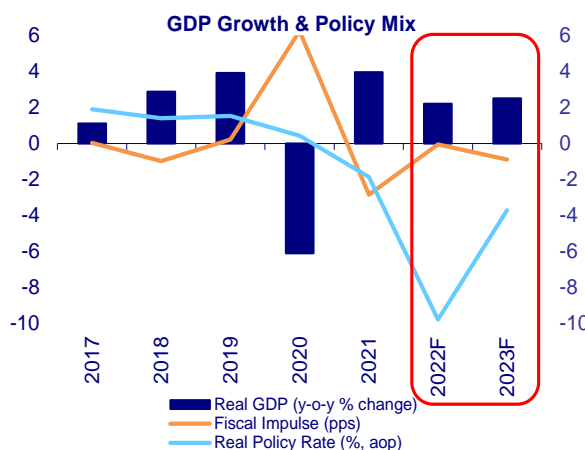
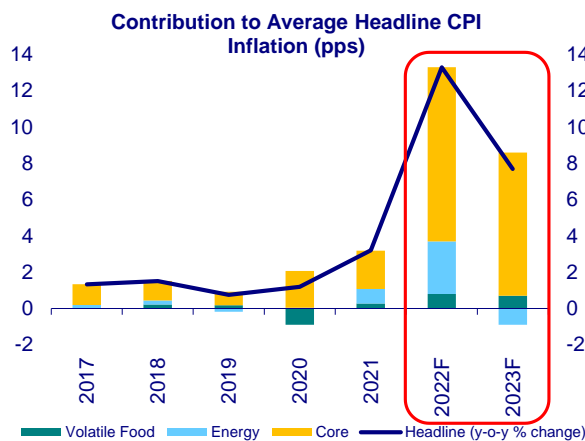
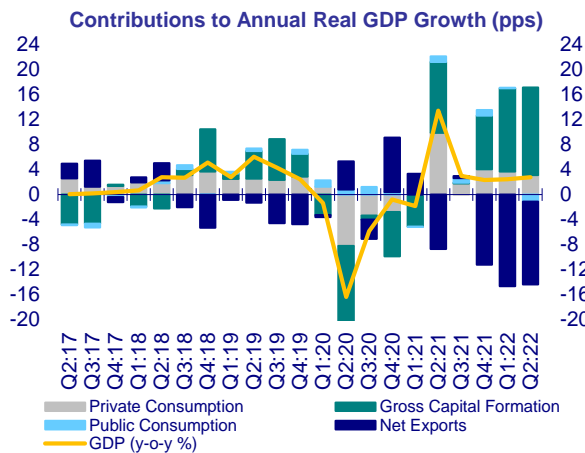
	2019	2020	2021	2022F	2023F
Real GDP Growth (%)	4.2	-3.8	6.0	6.9	2.2
Inflation (eop, %)	4.0	2.1	8.2	15.5	7.7
Cur. Acct. Bal. (% GDP)	-4.9	-5.0	-7.3	-8.7	-7.8
Fiscal Bal. (% GDP)	-4.6	-9.6	-6.8	-6.0	-5.2

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



North Macedonia

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



North Macedonia sees another quarter of relatively lacklustre GDP growth (up 2.8% y-o-y in Q2:22). Gross capital formation remained the main driver of economic expansion in Q2:22 (see chart), reflecting continued build-up in inventories, in the face of rising global commodity prices, on the one hand, and higher public investment, on the other hand. At the same time, following the re-opening of the economy, private consumption continued to grow at a solid pace, despite rapidly rising inflation. Unsurprisingly, in light of strong domestic demand, net exports remained a large drag on overall growth. All said, GDP growth picked-up slightly to 2.8% y-o-y in Q2:22 from 2.4% in Q1:22, still underperforming the regional average (up 4.3% y-o-y).

Although public investment is expected to continue to outperform, GDP growth is seen slowing down over the next quarters, driven by weakening private consumption and net exports. With inflation due to remain at current record-high levels until early next year and consumer confidence having already plunged, private consumption cannot but be significantly affected, despite strong state support (incl. a 18.5% hike in the minimum wage in April). High savings could, however, provide households some cushion against falling (real) disposable income.

At the same time, in view of slowing economic growth in the EU (especially in Germany, which absorbs c. 50% of the country's exports), net exports should remain a large drag on overall growth, despite weaker private consumption and easing strains in global supply chains.

That said, domestic economic growth should be mainly underpinned by fixed investment, which is expected to continue overperforming, led by the public sector. According to the Government's (ambitious) plans, public investment is set to rise gradually to 6.0% of GDP by FY:26 from 3.3% in FY:21. Solid FDI flows should also help to this end.

Fiscal policy should help alleviate the impact of the inflation shock on economic activity during the remainder of the year. In fact, following a budget overperformance in H1:22, we expect a small fiscal impulse in H2:22, with the full-year deficit remaining broadly flat at 5.3% of GDP. Fiscal consolidation should resume only next year, but at a slow pace.

On the other hand, in an environment of record-high inflation and widening external imbalances, the NBRNM cannot but tighten further its stance. As a result, we see the key rate at 4.0% by early-2023, up from 2.0% in mid-2022 and 1.25% at end-2021. Still, the implied tightening would be smaller than that of regional economies, reflecting, *inter alia*, limited financial linkages with the rest of the world.

All said, we see GDP growth at 2.2% in FY:22, bringing the economy back to its pre-COVID-19 levels, albeit with a significant delay compared with its peers. Assuming some easing in inflationary pressures next year, we expect GDP growth to pick up slightly to 2.4%.

Note that the country has some energy exposure to Russia, from which it covers the bulk of its gas needs (and 8.0% of its oil needs). However, gas accounts for just c. 10% of the country's total energy mix, suggesting limited direct risks in the event of a cut-off in Russian supplies.

Worryingly, political noise is set to remain elevated in the period ahead, mainly surrounding the controversial deal resolving the country's dispute with Bulgaria, which eventually, however, enabled the launch of long-awaited EU accession talks. Under the deal, North Macedonia must change its Constitution to recognize a Bulgarian minority in the country, a clause that the opposition, led by the VMRO-DPMNE, opposes fiercely. Given that the ruling coalition lacks a constitutional majority, further delays in the EU accession progress may be forthcoming.

Importantly, the (pending) 2-year precautionary agreement with the IMF (worth EUR 530mn) should serve as a policy anchor, while providing a safety net, should external financing conditions deteriorate abruptly.

	17 Oct	3-M F	6-M F	12-M F
1-m SKIBOR (%)	2.0	2.5	2.8	3.3
MKD/EUR	61.4	61.6	61.6	61.6
Sov. Spread (2028. bps)	619	580	540	440

	17 Oct	1-W %	YTD %	2-Y %
MBI 100	5,450	-2.8	-11.4	24.0

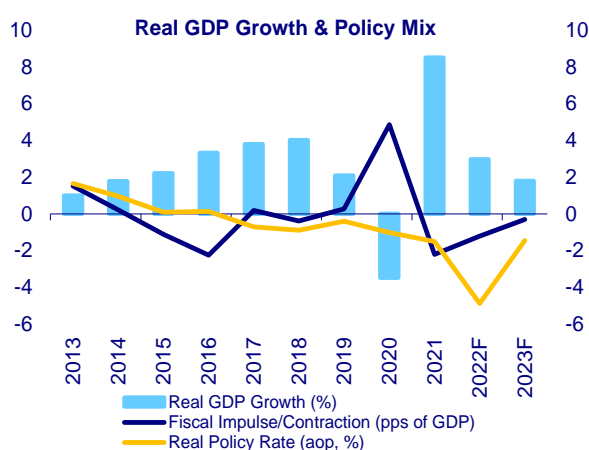
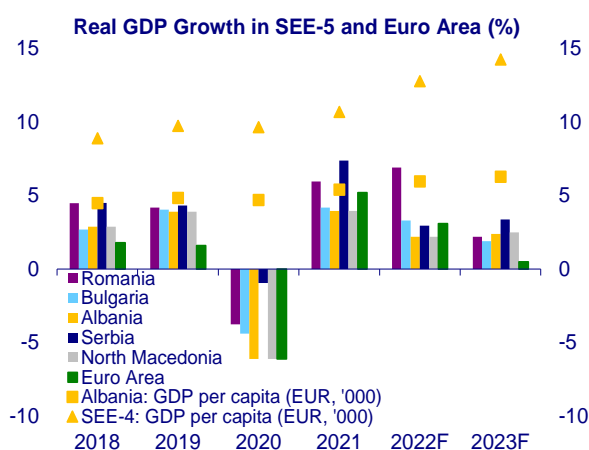
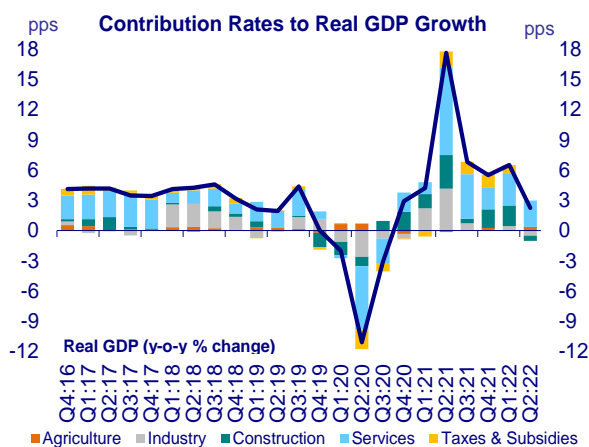
	2019	2020	2021	2022F	2023F
Real GDP Growth (%)	3.9	-6.1	4.0	2.2	2.4
Inflation (eop. %)	0.5	2.2	4.9	18.3	4.0
Cur. Acct. Bal. (% GDP)	-3.3	-3.4	-3.5	-6.8	-5.3
Fiscal Bal. (% GDP)	-2.0	-8.2	-5.4	-5.3	-4.6

Sources: Reuters, NBRNM & NBG estimates



Albania

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



	17 Oct.	3-M F	6-M F	12-M F
1-m TRIBOR (mid, %)	2.6	3.1	3.6	3.5
ALL/EUR	116.6	120.1	120.4	121.2
Sov. Spread (2027, bps)	499	490	480	440

Stock Market	17 Oct.	1-W %	YTD %	2-Y %
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	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	7.5	3.5
Cur. Acct. Bal. (% GDP)	-7.9	-8.7	-7.5	-7.2	-6.5
Fiscal Bal. (% GDP)	-1.9	-6.7	-4.5	-3.3	-3.0

Sources: Reuters, InStat & NBG estimates

GDP growth moderated abruptly in Q2:22 (to 2.2% y-o-y from 6.5% in Q1:22), following the fading of several supportive base effects (related to strong post-earthquake reconstruction activity, the re-opening of the highly important tourism sector from the COVID-19 lockdown and a weather-induced spike in hydroelectric power production). Adjusted for these effects, GDP growth is estimated to have slowed only slightly in Q2:22, despite the steep hike in inflation. Indeed, headline inflation hit 20-year highs in Q2:22, and would have been even higher had the Government not capped electricity prices. The services sector remained the main growth driver in Q2:22, underpinned by resilient consumption. The latter was sustained by tight labour market conditions (as manifested by strong employment growth, up 4.3% y-o-y in Q2:22), a loose incomes policy and a strong pick-up in remittances (reflecting income from seasonal workers, whose movement was restricted during the pandemic).

Persistently high inflation, together with weakening external demand and a tighter policy mix, should push economic growth lower in the period ahead. The pace of economic expansion is set to moderate further in the period ahead, as stubbornly high inflation (up 8.1% y-o-y in September against 7.4% in June and 2.5% a year ago) would squeeze real incomes. This impact, together with weakening consumer confidence, should weigh on private consumption. Tight labour market conditions, due to persistent labour force shortages (with the latter attributed, *inter alia*, to youth migration and skills mismatches) and the Government's new measures (including a 6.3% and 9.5% hike in the minimum wage and pensions, respectively, in FY:23) should cushion these effects.

At the same time, weaker external demand from the EU, especially Italy -- Albania's main trade partner (absorbing c. 43% of the country's exports) -- which is projected to slide into recession next year -- along with rising input costs should weigh on exports.

Tightening financing conditions would also take a toll. The impact should be mostly felt by the previously overperforming construction sector, which has benefited from double-digit growth in mortgage lending. Indeed, against the backdrop of record-high inflation and stubbornly high current account deficits, the Bank of Albania cannot but tighten further its stance. As a result, we see the key rate at 3.3% by mid-2023, up from 1.0% in mid-2022 and 0.5% at end-2021. On the other hand, following a small fiscal consolidation in FY:22, fiscal policy is set to turn broadly neutral in FY:23.

All said, we expect activity in all economic sectors to be affected markedly, with FY:22 GDP growth projected at 3.0% -- slightly below its long-term potential (of c. 3³/₄%) -- against an outstanding 8.5% in FY:21. Although growth dynamics are set to improve in H2:23, in line with dissipating inflationary pressures and a more favourable global backdrop, FY:23 GDP growth is set to ease further to 1.8% -- the lowest in SEE-5 -- due to a weak carry-over effect (of a mere 0.2 pps from Q4:22 against 1.5 pps from Q4:21).

Downside risks to our forecasts arise from: i) weaker-than-assumed growth in the EU, in the event of a cut-off in Russian gas supplies to Europe; and ii) shortfalls in domestic power generation. Note that Albania's reliance on hydroelectricity (accounting for 98% of total electricity generation) renders the energy sector highly vulnerable to weather conditions.

On a positive note, the long-awaited opening of EU accession negotiations in mid-July should provide an important policy anchor and strengthen the reform drive.



DETAILED MACROECONOMIC DATA

ROMANIA					
	2019	2020	2021	2022f	2023f
Real Sector					
Nominal GDP (EUR million)	223,269	219,004	240,279	290,703	325,294
GDP per capita (EUR)	11,500	11,330	12,432	15,042	16,834
GDP growth (real, %)	4.2	-3.8	6.0	6.9	2.2
Unemployment rate(ILO definition, %, aop)	4.9	6.1	5.6	5.5	5.5
Prices and Banking					
Inflation (% eop)	4.0	2.1	8.2	15.5	7.7
Inflation (% aop)	3.8	2.6	5.0	13.5	10.7
Loans to the Private Sector (% change, eop)	7.0	5.0	14.3		
Customer Deposits (% change, eop)	12.6	15.3	13.7		
Loans to the Private Sector (% of GDP)	24.6	25.9	26.5		
Retail Loans (% of GDP)	13.5	14.2	13.9		
Corporate Loans (% of GDP)	11.1	11.7	12.5		
Customer Deposits (% of GDP)	33.1	38.2	38.9		
Loans to Private Sector (% of Deposits)	74.5	67.8	68.1		
Foreign Currency Loans (% of Total Loans)	32.0	29.7	26.5		
External Accounts					
Merchandise exports (EUR million)	63,066	57,560	70,194	80,573	86,474
Merchandise imports (EUR million)	80,918	76,509	93,317	111,021	118,233
Trade balance (EUR million)	-17,852	-18,949	-23,123	-30,448	-31,759
Trade balance (% of GDP)	-8.0	-8.7	-9.6	-10.5	-9.8
Current account balance (EUR million)	-10,907	-10,900	-17,474	-25,196	25,407
Current account balance (% of GDP)	-4.9	-5.0	-7.3	-8.7	-7.8
Net FDI (EUR million)	4,848	2,960	8,820	10,143	11,157
Net FDI (% of GDP)	2.2	1.4	3.7	3.5	3.4
International reserves (EUR million)	32,926	37,379	40,475	42,422	44,422
International reserves (Months ^a)	4.0	4.9	4.3	3.8	3.7
Public Finance					
Primary balance (% of GDP)	-3.4	-8.2	-5.2	-4.6	-3.8
Fiscal balance (% of GDP)	-4.6	-9.6	-6.8	-6.0	-5.2
Gross public debt ^b (% of GDP)	35.0	46.9	48.5	48.2	49.7
External Debt					
Gross external debt (EUR million)	109,783	126,750	134,617	145,352	155,491
Gross external debt (% of GDP)	49.2	57.9	56.0	50.0	47.8
External debt service (EUR million)	17,442	17,291	16,079	17,000	17,250
External debt service (% of reserves)	53.0	46.3	39.7	40.1	38.8
External debt service (% of exports)	19.4	21.3	16.4	14.9	14.1
Financial Markets					
Policy rate (1-w repo rate, % eop)	2.5	1.5	1.8	7.0	6.3
Policy rate (1-w repo rate, % aop)	2.5	1.8	1.4	4.5	6.8
10-Y Bond Yield (% eop)	4.5	3.1	5.1	8.5	7.8
Exchange rate: EUR (eop)	4,786	4,863	4,946	4,950	5,025
Exchange rate: EUR (aop)	4,743	4,835	4,919	4,933	4,988

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



NORTH MACEDONIA					
	2019	2020	2021	2022f	2023f
Real Sector					
Nominal GDP (EUR million)	11,274	10,657	11,754	13,678	15,309
GDP per capita (EUR)	6,074	5,772	6,399	7,477	8,402
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	18.3	4.0
Inflation (% aop)	0.8	1.2	3.2	13.9	9.3
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	6,518	6,965
Merchandise imports (EUR million)	7,296	6,622	8,371	9,630	10,165
Trade balance (EUR million)	-1,949	-1,805	-2,375	-3,112	-3,201
Trade balance (% of GDP)	-17.3	-16.9	-20.2	-22.8	-20.9
Current account balance (EUR million)	-0,368	-0,366	-0,416	-0,937	-0,814
Current account balance (% of GDP)	-3.3	-3.4	-3.5	-6.8	-5.3
Net FDI (EUR million)	0,363	0,155	0,435	0,522	0,588
Net FDI (% of GDP)	3.2	1.5	3.7	3.8	3.8
International reserves (EUR million)	3,263	3,360	3,665	3,515	3,615
International reserves (Months ^a)	4.6	5.3	4.6	3.8	3.7
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	9,547	10,669	11,329
Gross external debt (% of GDP)	72.3	80.1	81.2	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	102.4
External debt service (% of exports)	35.4	52.7	45.9	38.7	40.4
Financial Markets					
28-d CB bill rate (% eop)	2.3	1.5	1.3	3.8	4.0
28-d CB bill rate (% aop)	2.3	1.6	1.3	2.3	4.0
1-Y T-bill rate ^c (% eop)	0.6	0.4	0.5	2.8	3.0
Exchange rate: EUR (eop)	61.4	61.6	61.6	61.6	61.6
Exchange rate: EUR (aop)	61.4	61.6	61.5	61.6	61.6

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



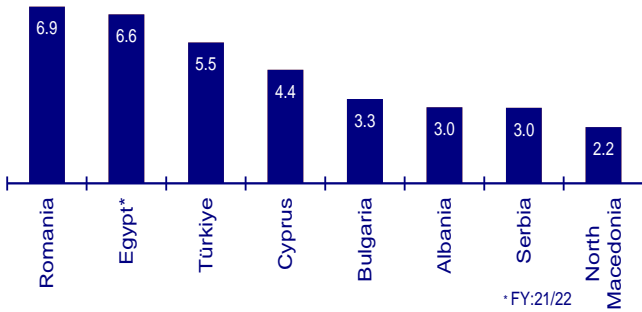
ALBANIA					
	2019	2020	2021	2022f	2023f
Real Sector					
Nominal GDP (EUR million)	13,786	13,319	15,460	17,020	17,877
GDP per capita (EUR)	4,830	4,693	5,404	5,960	6,270
GDP growth (real, %)	2.1	-3.5	8.5	3.0	1.8
Unemployment rate (% aop)	12.0	12.2	12.1	11.7	11.3
Prices and Banking					
Inflation (% eop)	1.1	1.1	3.7	7.5	3.5
Inflation (% aop)	1.4	1.6	2.0	6.7	4.8
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	-25.1
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	-6.5
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	7.2
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	58.4
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	3.3
Policy rate (1-week repo rate, % aop)	1.0	0.6	0.5	1.5	3.3
1-Y T-bill rate ^b (% eop)	1.8	1.8	1.6	4.8	5.0
Exchange rate: EUR (eop)	121.6	123.4	120.6	122.5	123.5
Exchange rate: EUR (aop)	122.7	123.4	122.2	121.5	123.0

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

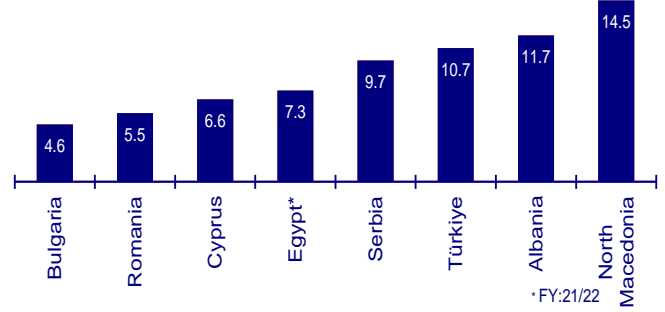


REGIONAL SNAPSHOT: MACROECONOMIC INDICATORS

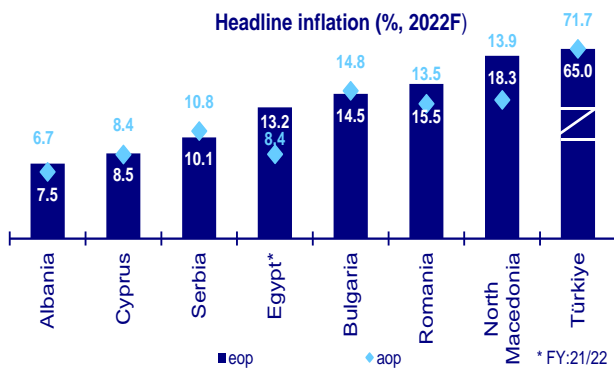
Real GDP Growth (% , 2022F)



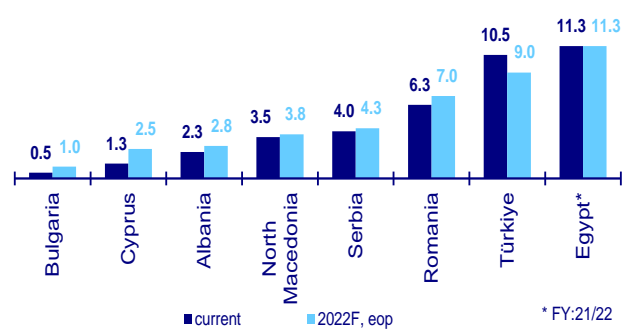
Unemployment (% , 2022F, aop)



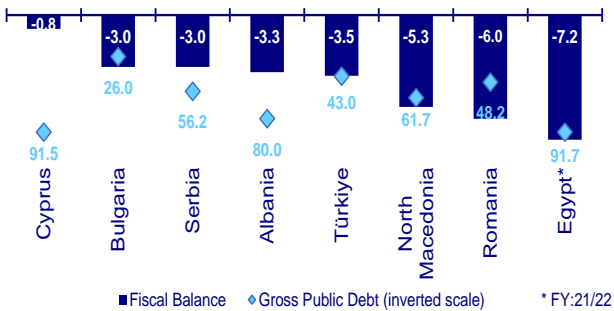
Headline inflation (% , 2022F)



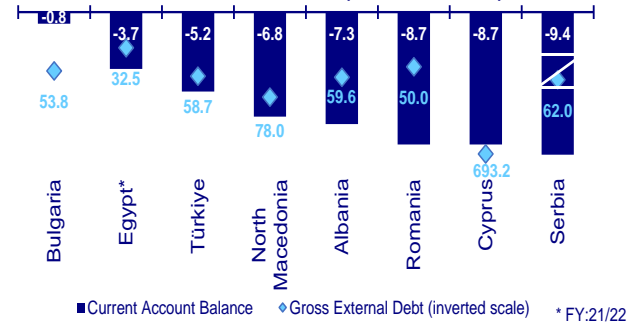
Policy rates (%)



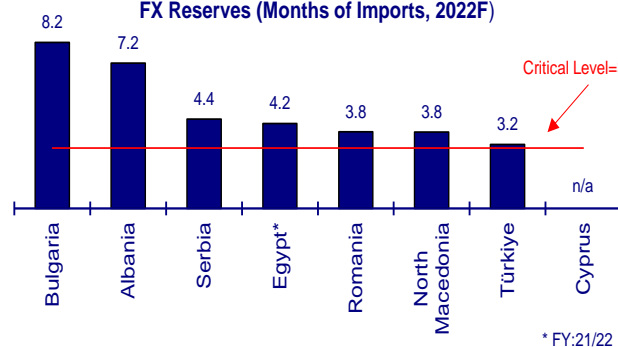
Public Finance (% of GDP, 2022F)



External Accounts (% of GDP, 2022F)



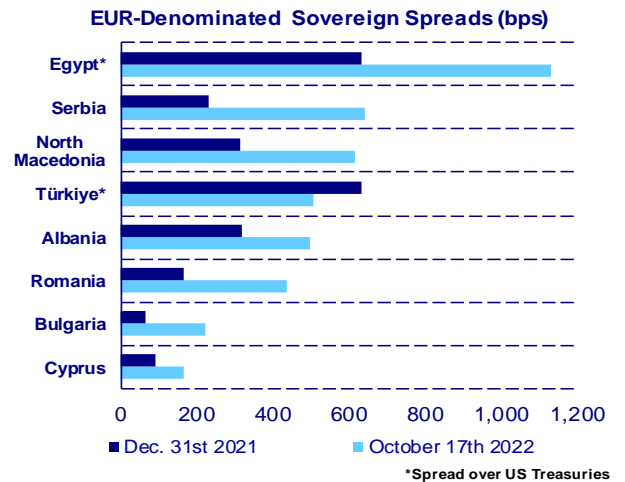
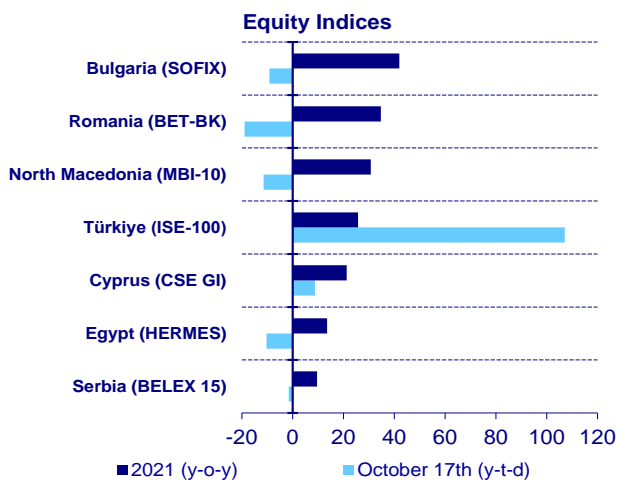
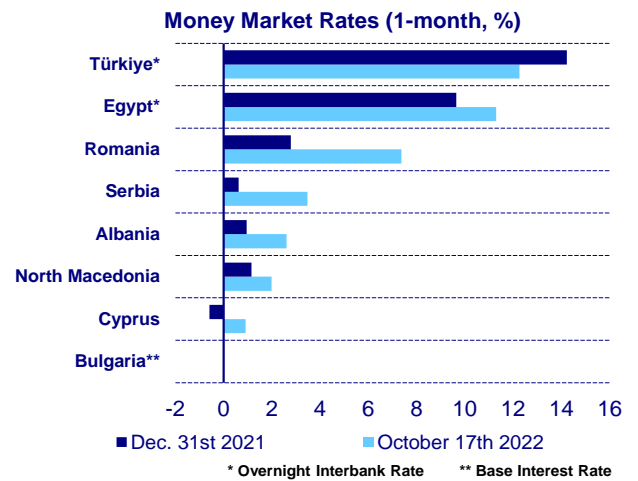
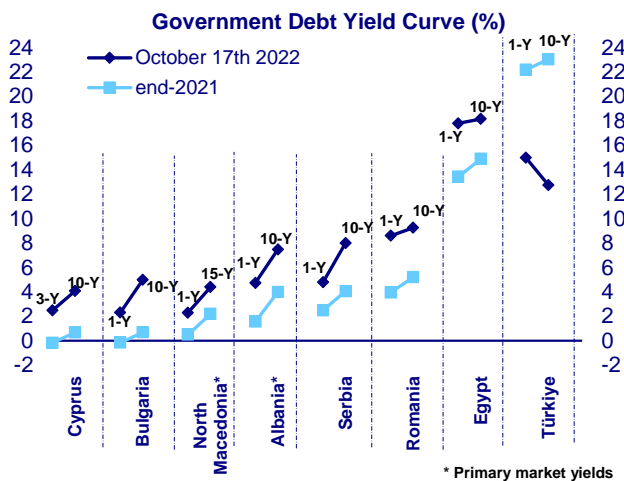
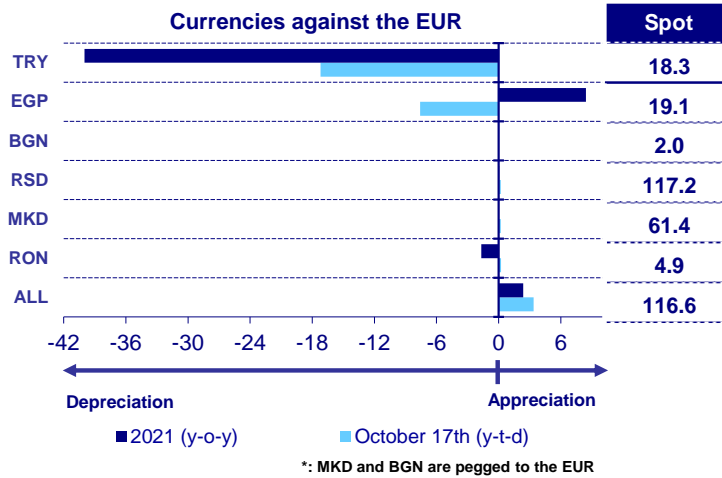
FX Reserves (Months of Imports, 2022F)



Sources: National Sources & NBG estimates



REGIONAL SNAPSHOT: FINANCIAL MARKETS



Sources: Reuters & NBG estimates



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