



COUNTRIES IN FOCUS:

Türkiye & Cyprus

TÜRKIYE 1

The CBRT continues its long way to policy normalization, raising its key rate by another 250 bps to 17.5% (up 900 bps cumulatively since June)

The CBRT's cautious approach to monetary policy tightening is dictated, *inter alia*, by the private sector's high indebtedness

CYPRUS 2

Albeit moderating, due to strong headwinds -- especially rising interest rates -- GDP growth in Cyprus should remain resilient in FY:23, at 3.2%, continuing to outperform the euro area average

The Cypriot tourism sector continues its recovery towards pre-pandemic levels

The continuation of some big infrastructure projects, together with strong RRF-backed investment in non-construction projects, should compensate for softer private consumption in the period ahead

APPENDIX: DETAILED MACROECONOMIC DATA 3

REGIONAL SNAPSHOT: MACROECONOMIC INDICATORS 5

FINANCIAL MARKETS 6

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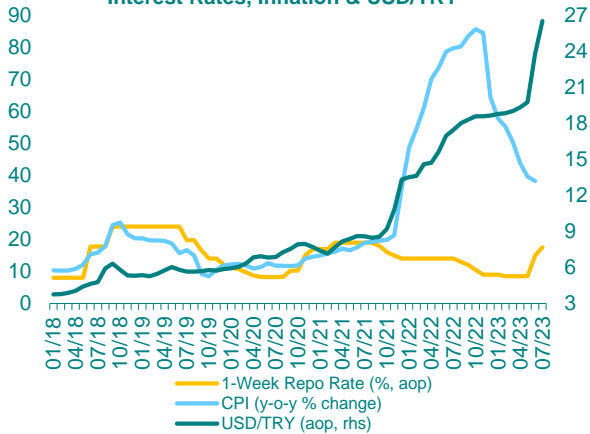
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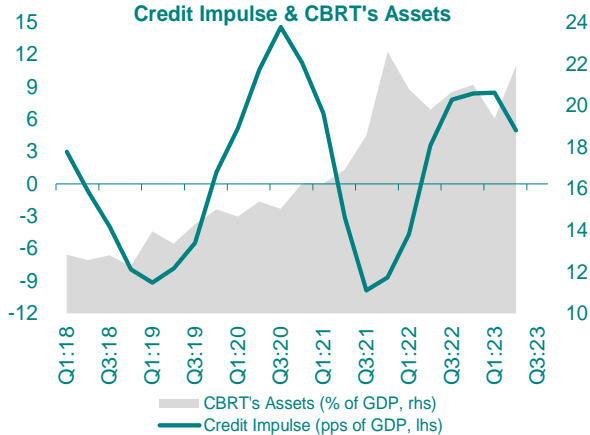
Türkiye

B / B3 / B (S&P / Moody's / Fitch)

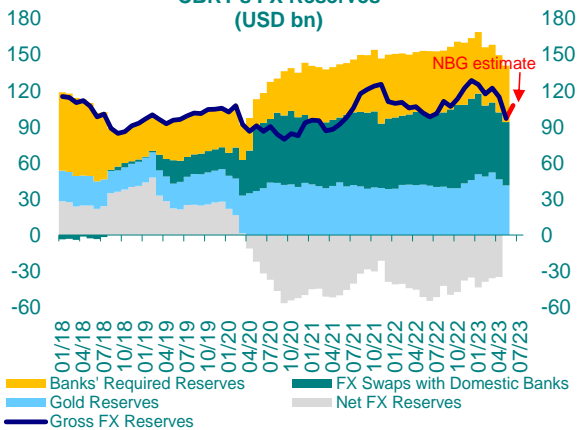
Interest Rates, Inflation & USD/TRY



Credit Impulse & CBRT's Assets



CBRT's FX Reserves (USD bn)



The CBRT continues its long way to policy normalization. In mid-July, the CBRT raised its key rate by another 250 bps to 17.5%, bringing the total hikes since the change of guard at the helm of the CBRT, in June, to 900 bps. Recall that in the wake of his re-election and in a bid to calm markets, which were expecting return to more conventional policies, President Erdoğan appointed former banker in the US, H. G. Erkan, as the CBRT's new Governor -- the 5th since 2019.

The reversal in interest rates has been complemented by tighter monthly growth limits on several loan categories and partial roll-back of macro-prudential regulations stemming dollarization, including cutting the ratio of TRY securities banks must hold against FX deposits and introducing a minimum reserve requirement rate on FX-protected deposits.

Nevertheless, with the policy moves falling short of market expectations, which had been for the policy rate moving faster close to the inflation rate (up 38.2% y-o-y in June), and the CBRT having reportedly stopped FX interventions, the TRY has been continuing to depreciate, hitting a new low of c. 27.0 against the USD, down 25.0% since the Presidential runoff and 30.0% y-t-d.

Considering the deeply negative real *ex-post* policy rate and the size of the monetary stimulus injected into the economy, authorities have a long way to go before Türkiye's imbalances get effectively unwind. Recall that, in light of the structural external deficit (largely stemming from Türkiye's complete reliance on imports to cover its energy needs), the ultra-accommodative monetary policy authorities have been pursuing over the past years has trapped the economy into a vicious cycle of weakening TRY (down 35% against the USD between end-2021 and the May '23 elections and 80% in FY:18-22) and high inflation (up 71.6% in FY:22 and c. 25.0% in FY:18-22), which was, however, has been accompanied by strong GDP growth (up 4.5% in FY:18-22).

Worryingly, the CBRT is short of ammunition to defend the ailing TRY during the adjustment period, as -- despite recent trends -- its net FX reserves remain negative. This means that authorities would have to continue relying on non-market financing flows from Türkiye's partners - including GCC states, especially UAE, which recently pledged to buy Turkish sukuk bonds worth up to USD 8.5bn, and Russia -- to close the external financing gap, at least in the short-term.

Importantly, Türkiye's low gross public debt (c. 32.0% of GDP) provides ample fiscal space to ensure the orderly unwinding of the sizeable monetary stimulus and help minimize the social cost of the adjustment. In this context, authorities are currently proceeding with a mass easing in incomes policy (partially funded by indirect tax hikes), which, nonetheless, could delay further much-needed disinflation.

Leaving aside political considerations (see below), the CBRT's cautious approach to policy normalization should be mainly attributed to its bid to safeguard macro-financial stability. Indeed, in the event of a drastic withdrawal of excess liquidity from the market, the already highly debt-burdened private sector (with a total exposure of c. 185% of GDP, over 40% of which is FX-denominated) would see its debt repayment capacity coming under (further) severe strain, stressing, *inter alia*, banks, given the latter's tight liquidity position (with a loan-to-deposit ratio of 98%).

Looking ahead, we expect the CBRT to continue hiking rates cautiously, while slowly unwinding its (complex) macro-prudential regulations protecting the TRY (but most likely not the FX-protected deposit scheme). As a result, we see the policy rate at 25.0% by end-2023 and remaining at that level by end-2024, although we recognize that visibility remains in poor in the absence of forward guidance, especially given Erdoğan's track record of sudden populist policy shifts. Worryingly, despite Erdoğan's re-election, the political factor is expected to remain at play at least until the March '24 local elections.

	24 July	3-M F	6-M F	12-M F
O/N TLREF (%)	16.1	23.0	25.0	25.0
TRY/USD	26.92	27.90	29.30	30.80
Sov. Spread (2027, bps)	364	380	360	320

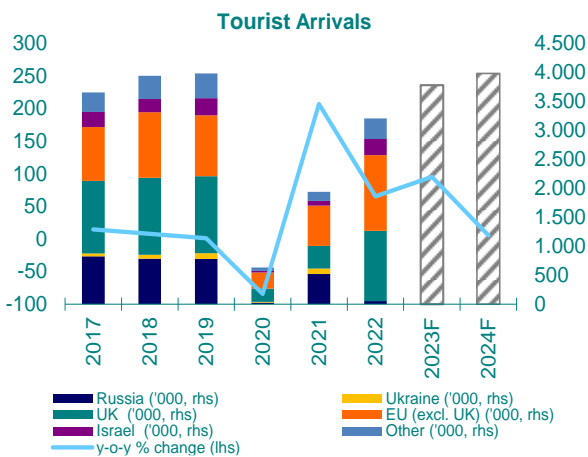
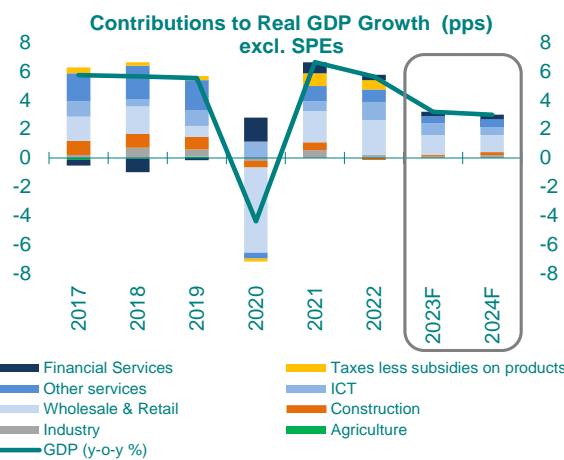
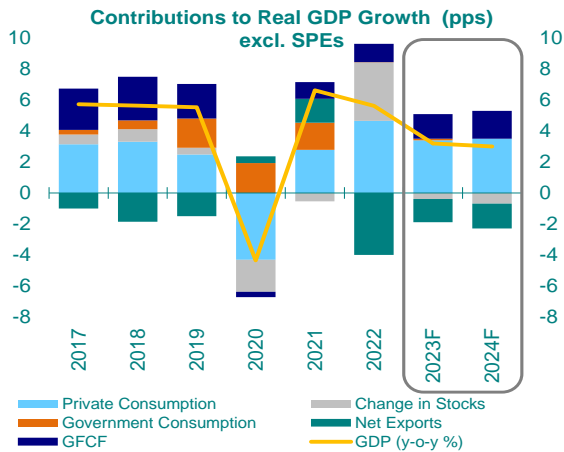
	24 July	1-W %	YTD %	2-Y %
ISE 100	6,695	1.4	21.5	395.4

	2020	2021	2022	2023F	2024F
Real GDP Growth (%)	2.0	11.4	5.6	3.3	2.9
Inflation (eop, %)	14.6	36.1	64.3	54.5	30.0
Cur. Acct. Bal. (% GDP)	-4.4	-0.9	-5.3	-5.6	-4.0
Fiscal Bal. (% GDP)	-3.4	-2.7	-0.9	-4.8	-3.8

Sources: Reuters, CBRT, BDDK, Turkstat & NBG estimates

Cyprus

BBB / Ba1 / BBB (S&P / Moody's / Fitch)



Albeit moderating, due to strong headwinds -- especially rising interest rates -- GDP growth in Cyprus should remain resilient in FY:23, at 3.2%, continuing to outperform the euro area average

Despite weakening global growth, economic expansion in Cyprus should continue to be underpinned by strong (export) growth in tourism and business services (accounting for c. 14.0% and 35.0% of FY:22 GDP, respectively) and their positive spillover to the economy.

Indeed, following a strong rebound in tourism activity in FY:22, which came despite the virtual annihilation of inflows from Russia (accounting for 26.8% of tourists in FY:21), the sector should continue towards full recovery to pre-pandemic levels this year -- growing, however, at a more moderate pace than in FY:22 -- thanks to still strong pent-up demand and authorities' efforts for market diversification. Confirming the favourable outlook, tourist arrivals were up 32% y-o-y in January-May, falling slightly behind the levels seen during the same period in 2019.

At the same time, despite the adverse impact of EU sanctions against Russia, external demand for business (mainly ICT, shipping & financial) services should continue to grow at a solid -- yet slower than in FY:22 -- pace, supported by the expansion of the sector's base. Recall that there has been a massive relocation of foreign (especially Russian, Ukrainian & Belarusian) companies in Cyprus, with more than 1100 firms with 9000 employees having been locally registered during the previous year.

Importantly, investment in non-construction projects is expected to accelerate this year, following the implementation of the RRF Plan (with Cyprus due to receive funds worth 5.0% of its FY:21 GDP in 2021-26). At the same time, strong external demand for real estate and the continuation of some big infrastructure projects (mainly in the areas of energy and tourism) should sustain construction activity in FY:23, largely compensating for softer domestic demand for residences.

On the other hand, private consumption is unlikely to gain much steam in the short-term, in view of rising interest rates (see below), and elevated -- yet gradually easing -- inflation. Private consumption would have been much weaker, had it not been for partial wage indexation (an increase of 4.4% was implemented in January 2023, covering c. 45% of employees) and full indexation of pensions. Note that the labour market has shown resilience, supported by the expansion of labour-intensive services sectors, with the unemployment rate projected to ease further to 6.5% in FY:23 from 6.8% in FY:22, well below pre-pandemic levels.

Fiscal policy should remain neutral in FY:23. Indeed, solid tax revenue growth and the phasing-out of the measures mitigating the impact of high inflation should broadly compensate for stronger-than-nominal GDP growth in the public wage bill and the pick-up in public investment.

All said, we see GDP growth moderating to 3.2% in FY:23 from 5.6% in FY:22, well above the euro area average (up c. 1.0%). Assuming that inflation stabilizes at normal levels in FY:24, we see economic activity gaining momentum, with the underlying growth rate easing, nonetheless, slightly to 3.0%, close to its long-term potential, due to a weaker carry-over effect (projected at 0.9 pps versus 1.5 pps in the previous year).

Worryingly, despite recent deleveraging, private sector's indebtedness remains high (at 248% of GDP at end-2021, well above the euro area average of 144%), posing a strong downside risk to economic outlook, in view of rising interest rates (note that the bulk of debt contracts in Cyprus have variable interest rates). Importantly, however, domestic banks' strong capitalisation and highly liquid positions provide a line of defense against financial stress. Delays in the execution of the country's RRF plan and stickier-than-assumed inflation could also drag overall economic growth lower in the period ahead.

	24 July	3-M F	6-M F	12-M F
1-M EURIBOR (%)	3.5	3.9	3.9	3.6
EUR/USD	1.11	1.10	1.11	1.13
Sov. Spread (2028, bps)	100	100	97	92

	24 July	1-W %	YTD %	2-Y %
CSE 100	117	0.6	30.4	77.0

	2020	2021	2022	2023F	2024F
Real GDP Growth (%)	-4.4	6.6	5.6	3.2	3.0
Inflation (eop, %)	-1.1	4.8	7.9	2.1	2.2
Cur. Acct. Bal. (% GDP)	-10.1	-6.8	-9.1	-8.0	-6.7
Fiscal Bal. (% GDP)	-5.8	-2.0	2.1	2.0	2.2

Sources: Reuters, CYSTAT & NBG estimates

DETAILED MACROECONOMIC DATA

TÜRKİYE					
	2020	2021	2022	2023f	2024f
Real Sector					
Nominal GDP (USD million)	719,168	815,755	905,475	969,188	1,100,398
GDP per capita (USD)	8,601	9,633	10,568	11,182	12,555
GDP growth (real, %)	2.0	11.4	5.6	3.3	2.9
Unemployment rate (% aop)	13.2	12.0	10.5	10.0	10.0
Prices and Banking					
Inflation (% eop)	14.6	36.1	64.3	54.5	30.0
Inflation (% aop)	12.3	19.3	71.6	48.8	41.4
Loans to the Private Sector (% change, eop)	34.8	37.0	54.5		
Customer Deposits (% change, eop)	33.0	51.5	68.0		
Loans to the Private Sector (% of GDP)	70.8	67.6	50.4		
Retail Loans (% of GDP)	16.8	14.5	11.2		
Corporate Loans (% of GDP)	54.1	53.1	39.2		
Customer Deposits (% of GDP)	62.1	65.5	53.1		
Loans to Private Sector (% of Cust. Deposits)	114.1	103.2	94.9		
Foreign Currency Loans (% of Total Loans)	34.2	42.2	32.6		
External Accounts					
Merchandise exports (USD million)	168,378	224,686	252,416	261,842	282,672
Merchandise imports (USD million)	206,252	253,999	342,899	359,689	373,822
Trade balance (USD million)	-37,874	-29,313	-90,483	-97,847	-91,150
Trade balance (% of GDP)	-5.3	-3.6	-10.0	-10.1	-8.3
Current account balance (USD million)	-31,888	-7,232	-48,405	-53,981	-43,467
Current account balance (% of GDP)	-4.4	-0.9	-5.3	-5.6	-4.0
Net FDI (USD million)	4,456	6,874	8,412	9,253	10,641
Net FDI (% of GDP)	0.6	0.8	0.9	1.0	1.0
International reserves (USD million)	93,277	111,181	128,736	125,000	135,800
International reserves (Months ^a)	4.9	4.7	3.3	3.9	4.2
Public Finance					
Primary balance (% of GDP)	-0.8	-0.2	1.1	-2.1	-1.0
Fiscal balance (% of GDP)	-3.4	-2.7	-0.9	-4.8	-3.8
Gross public debt (% of GDP)	39.7	41.8	31.7	33.0	32.5
External Debt					
Gross external debt (USD million)	429,177	437,281	458,699	490,000	520,000
Gross external debt (% of GDP)	59.7	53.6	50.7	50.6	47.3
External debt service (USD million)	70,931	74,311	80,000	85,000	90,000
External debt service (% of reserves)	76.0	66.8	62.1	68.0	66.3
External debt service (% of exports)	37.5	27.6	25.4	26.0	25.5
Financial Markets					
Policy rate (Effective funding rate, % eop)	17.0	14.0	9.0	25.0	25.0
Policy rate (Effective funding rate, % aop)	10.5	17.6	12.6	16.1	25.0
10-Y T-bill rate (% eop)	12.5	23.1	9.9	19.0	17.0
Exchange rate: USD (eop)	7.43	13.32	18.69	29.00	32.00
Exchange rate: USD (aop)	7.02	8.89	16.57	23.80	30.50

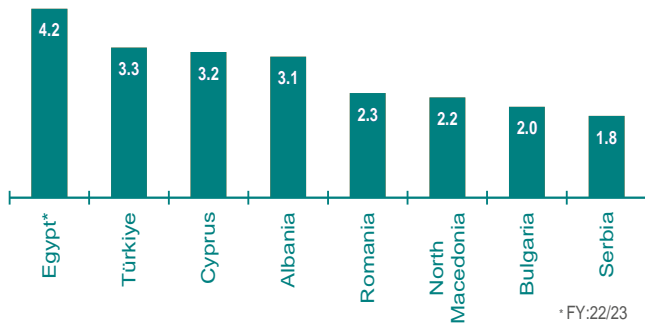
f: NBG forecasts; a: months of imports of GNFS

CYPRUS					
	2020	2021	2022	2023f	2024f
Real Sector					
Nominal GDP (EUR million)	21,896	24,019	27,006	28,714	30,252
GDP per capita (EUR)	24.548	26.677	29.669	31.202	32,548
GDP growth (real, %)	-4.4	6.6	5.6	3.2	3.0
Unemployment rate (% aop)	7.6	7.5	6.8	6.6	6.1
Prices and Banking					
Inflation (% eop)	-1.1	4.8	7.9	2.1	2.2
Inflation (% aop)	-0.6	2.4	8.4	3.0	2.3
Loans to the Private Sector (% change, eop)	-5.6	-5.0	-12.1		
Customer Deposits (% change, eop)	-0.6	5.4	2.8		
Loans to the Private Sector (% of GDP)	132.0	114.3	89.3		
Retail Loans (% of GDP)	61.2	50.9	42.6		
Corporate Loans (% of GDP)	70.8	63.4	46.7		
Customer Deposits (% of GDP)	188.0	180.7	165.3		
Loans to Private Sector (% of Deposits)	70.2	63.2	54.0		
Foreign Currency Loans (% of Total Loans)	---	---	---		
External Accounts					
Merchandise exports (EUR million)	2,969	3,590	4,570	4,527	4,646
Merchandise imports (EUR million)	7,180	7,907	10,454	10,660	10,928
Trade balance (EUR million)	-4,211	-4,318	-5,884	-6,133	-6,282
Trade balance (% of GDP)	-19.2	-18.0	-21.8	-21.4	-20.8
Current account balance (EUR million)	-2,202	-1,638	-2,463	-2,308	-2,038
Current account balance (% of GDP)	-10.1	-6.8	-9.1	-8.0	-6.7
Net FDI (EUR million)	7,454	4,369	8,143	10,382	12,977
Net FDI (% of GDP)	34.0	18.2	30.2	36.2	42.9
International reserves (EUR million)	---	---	---	---	---
International reserves (Months ^a)	---	---	---	---	---
Public Finance					
Primary balance ^b (% of GDP)	-3.7	-0.2	3.6	3.6	3.8
Fiscal balance ^b (% of GDP)	-5.8	-2.0	2.1	2.0	2.2
Gross public debt (% of GDP)	113.8	101.2	86.5	80.5	72.7
External Debt					
Gross external debt (EUR million)	175,543	168,003	180,003	178,003	176,003
Gross external debt (% of GDP)	801.7	699.5	666.5	619.9	581.8
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	2.5	4.0	3.0
Policy rate (ECB refinancing rate, % aop)	0.0	0.0	0.7	3.7	3.6
3-Y T-bill rate (% eop)	-0.1	-0.2	2.6	3.8	3.6
Exchange rate: USD (eop)	1.221	1.137	1.070	1.100	1.140
Exchange rate: USD (aop)	1.142	1.183	1.053	1.093	1.120

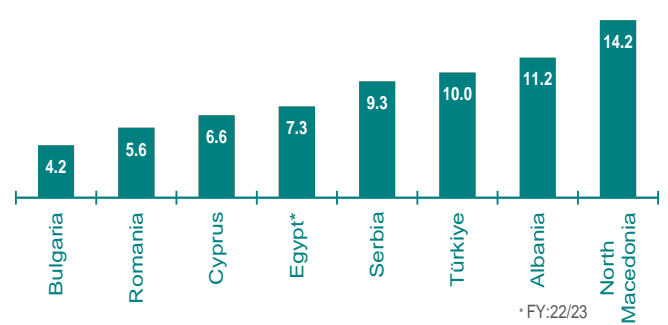
f: NBG forecasts; a: months of imports of GNFS; b: cash basis

REGIONAL SNAPSHOT: MACROECONOMIC INDICATORS

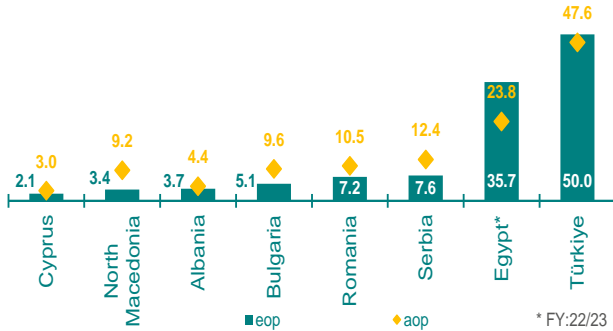
Real GDP Growth (% , 2023F)



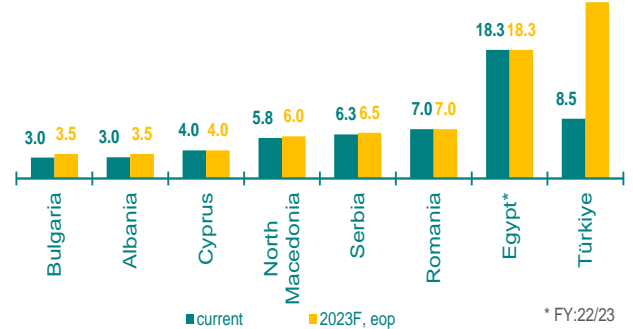
Unemployment (% , 2023F, aop)



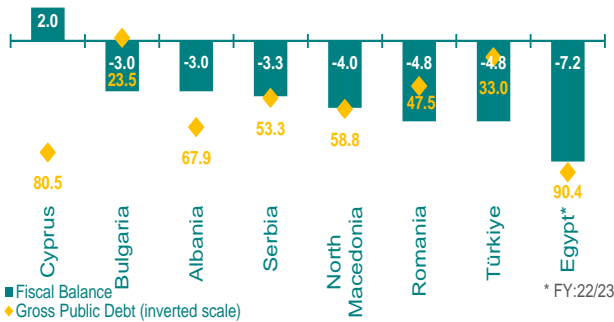
Headline inflation (% , 2023F)



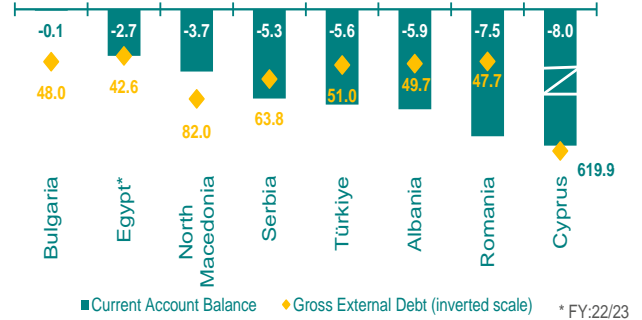
Policy rates (%)



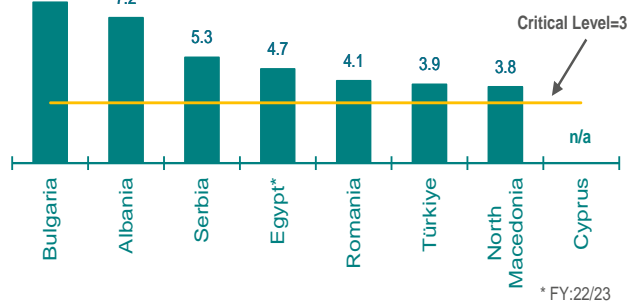
Public Finance (% of GDP, 2023F)



External Accounts (% of GDP, 2023F)

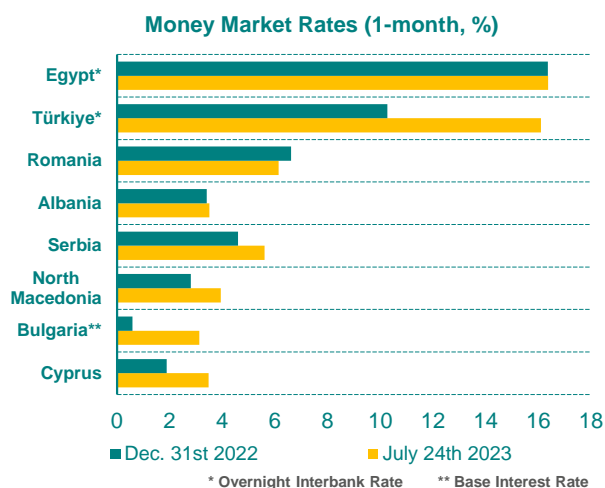
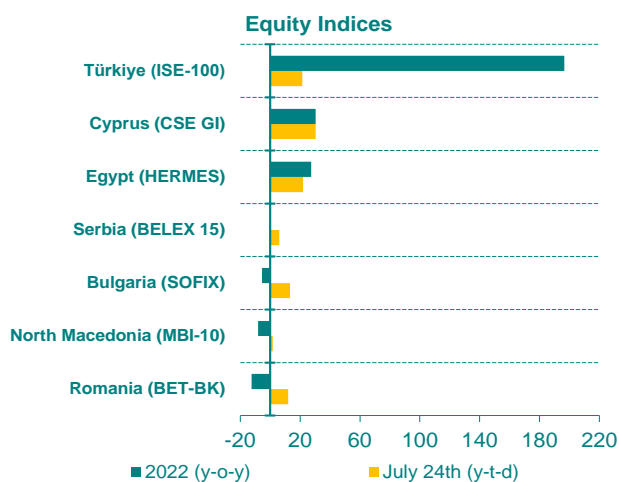
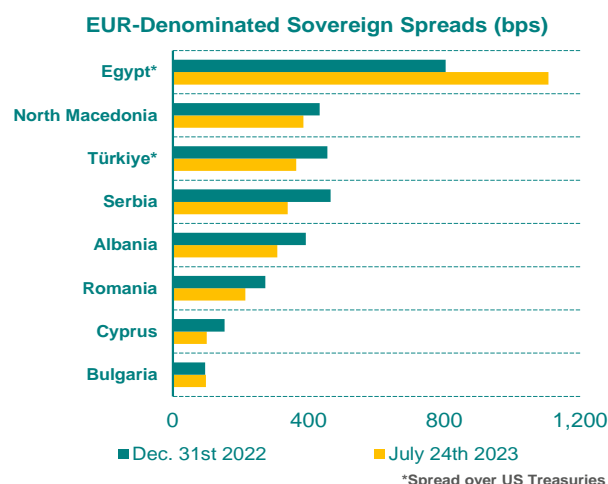
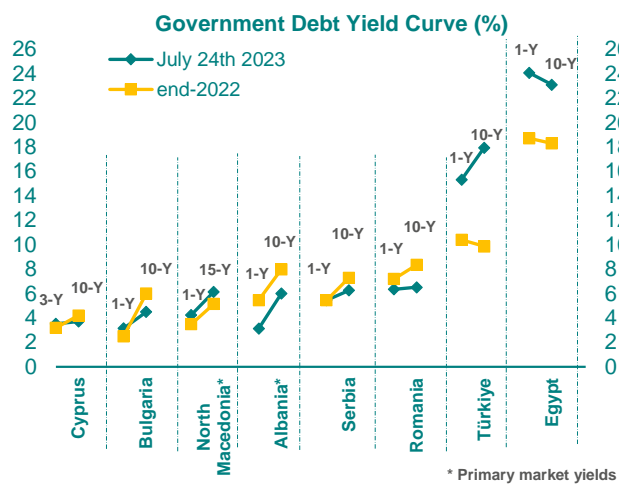
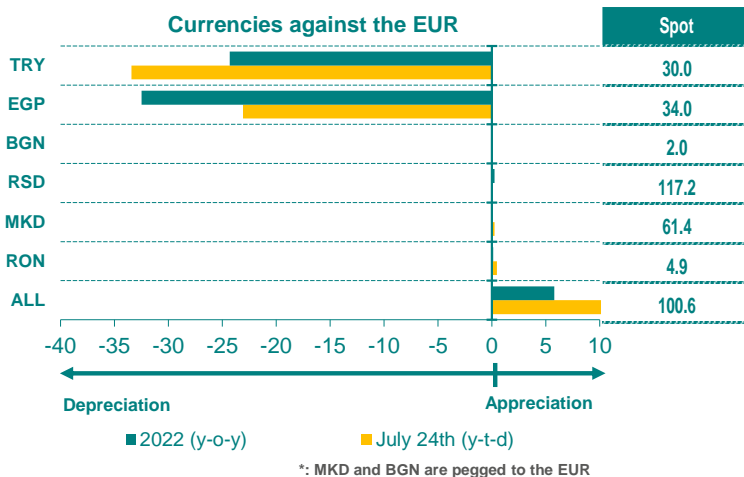


FX Reserves (Months of Imports, 2023F)



Sources: National Sources & NBG estimates

REGIONAL SNAPSHOT: FINANCIAL MARKETS



Sources: Reuters & NBG estimates

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