Bloomberg Adria

Adria Region Macro Quarterly 1Q 2023

Economic Winter Blues

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Slovenia

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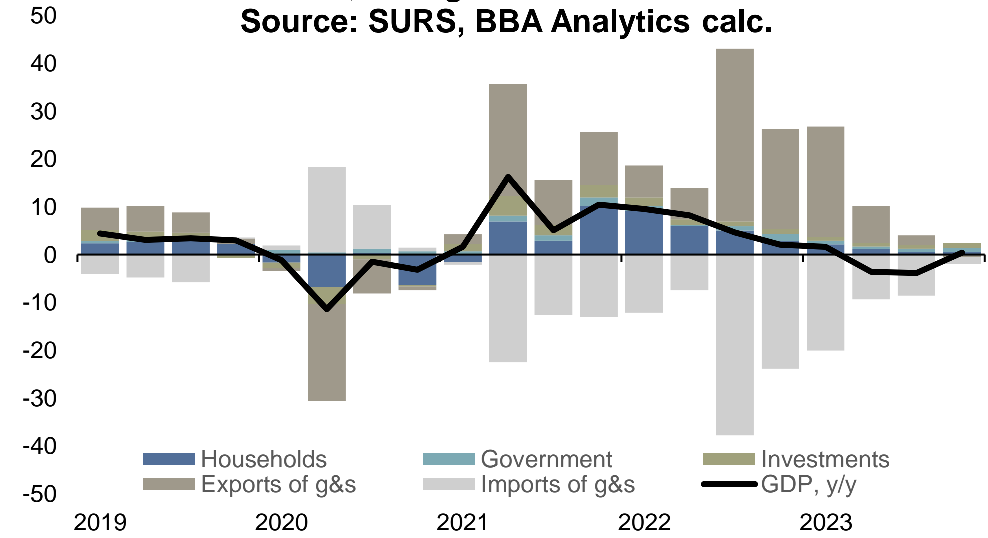
	2019	2020	2021	2022E	2023F	2024F
GDP real growth (%)	3.5	-4.3	8.2	6.1	-1.3	4.2
GDP current prices (EUR mln)	48,533	47,021	52,208	60,504	64,410	69,851
GDP per capita (EUR)	23,233	22,361	24,770	28,689	30,541	33,121
CPI (%, annual average)	1.7	-0.3	2.1	9.3	8.5	4.2
CPI (%, end-of-year)	2.0	-1.2	5.1	11.2	6.4	2.6
Unemployment rate (%, ILO)	4.5	5.0	4.8	4.2	4.4	4.1
Employment growth (% annual average)	2.5	-0.6	1.3	2.4	1.1	2.0
Imports of goods (EUR mln)	30,701	27,289	34,373	43,190	48,392	49,897
Exports of goods (EUR mln)	31,999	29,622	35,255	44,299	49,634	51,177
EUR/USD (average)	1.12	1.14	1.18	1.05	1.04	1.08
EUR/USD (end-of-year)	1.12	1.22	1.14	1.02	1.07	1.10
3M Euribor (average)	-0.36	-0.43	-0.55	0.25	2.75	2.00
10Y EUR swap rate (average)	0.26	-0.14	0.05	1.87	2.91	2.41



Economic activity

- GDP growth in 2022 seen at 6.1% yoy, based primarily on strong household consumption and exporting prospects, while **for 2023 we expect GDP declining by 1.3% yoy**, amid base effect, deteriorated foreign demand and inflationary-impacted household consumption.
- Even though energy crisis seems weaker than firstly anticipated, primarily as supply remains stable (but costly), full scale of cost burden to households should emerge as soon as Spring 2023. Given the falling real incomes, even wage hikes (driven by tight labour market and governments' wage increase for its public sector workers) won't offset dwindling personal consumption. Lower economic activity of the country's main trading partners, at the same time, will influence the exporting part of the economy (demand for high-technology products more so than the rest), thus heavily impacting overall GDP movement (as the country is an exporting powerhouse, if we compare it to region's peers) and in all should present a stronger shock to the economy versus govts' effort to offset that with an aid worth ca 2% of GDP.
- Based on rebounding effect, **in 2024 we see GDP growing by 4.2% yoy**, as both domestic and foreign demand gradually recover.

Inflation

- We see average inflation (HICP) rate in 2022 at 9.3% yoy, driven by soaring energy and food prices, while **in 2023 we project inflationary pressures to slightly soften to 8.5%**. Main reasoning behind for our upward revision (since last quarterly report) regarding 2023 inflation are double-digit producer price levels throughout this year, which we see materialising in some form to consumer prices' growth in 2023, followed by wage hike pressures from both public and private sector (giving the tight labour market) and unresolved energy (and thus inter-connected food component) situation at both supply and cost-terms.
- **In 2024, we see average inflation rate at 4.2% yoy**, impacted by dampened demand (monetary actions making stronger impact) and base factors, with 2% mark only showing somewhere around 2025.

Slovenia

Monetary and fiscal policy

- We see the Eurozone's monetary authority hiking the rates to 2.75% (ECB's main refi rate), with the hiking cycle likely to end in 1H 2023. The reason for further policy tightening lies in the need to contain the mid-term inflation expectations, with the CPI inflation expected to fall within the medium target of below 2% only in 2025. The ECB will be looking for the developments on the banking system's excess liquidity, with the EMU banks likely to pay back up to 1.8 trEUR out of TLTROs in January-2023. This is important for the sake of stability of the EMU financial system, especially if there is resurgence in fragmentation fears. A full blown quantitative tightening will likely be one of major policy moves in the next months, favouring our view on more increases in interest rates.
- On the fiscal front, the government is amending the structure of personal income tax rates, raising the level of non-taxed amount and hiking the tax rate for the high earners. In 2023, we assume the fiscal deficit north of 5% of GDP due to increased public spending to curb negative effects from high inflation on private sector spending. Weakening economic activity will be another element driving the budget gap higher. Observing the gross public financing needs, Slovenia seems to be strongly positioned, with the cash buffer covering for more than the public financing needs (fiscal gap plus maturing debt) in 2023.

FX and interest rates

- EUR/USD will see more volatility going into 1H 2023 mostly on the resolving of interest rate differential game between the ECB and the Fed, with the latter looking for an earlier reversal from high interest rates than the former. Also, global investors are looking deeply into re-opening of China. Another important element is that most of positive drivers for the USD strength are already heavily priced in and we see them gaining more footing only in case of an abrupt deterioration in global sentiment (not our base scenario though). Finally, with the view gradually shifting from inflation towards growth prospects, we see this being relatively more supportive for the EUR as most of economic weakness anticipation is priced in and it historically provided better risk/reward profile when cyclical elements (e.g. economic activity) were in focus.
- On interest rates outlook, we forecast the 3M Euribor rising slightly beyond 2.5% in the next couple of months, tracking fully the ECB's tightening. Excess liquidity in the EMU system is reducing quickly, with banks repaying TLTROs, however we nevertheless expect that in the local systems there will remain enough non-engaged liquidity to prevent a much more pronounced increase in interest rates. Demand for loans will be also affected by the general weakening of economic activity, hence alleviating some upside pressures from the interest rates. On the long term rates, we see upside pressures there as well, with a general deterioration in credit quality globally in 2023 largely behind. Still, better rated issuers such as Slovenia will be less affected.

Croatia

	2019	2020	2021	2022E	2023F	2024F
GDP real growth (%)	3.4	-8.6	13.1	5.8	-0.4	2.0
GDP current prices (EUR mln)	55,677	50,461	58,287	68,329	73,766	78,326
GDP per capita (EUR)	13,696	12,467	14,989	17,572	18,970	20,143
CPI (%, annual average)	0.8	0.0	2.7	10.7	8.6	4.1
CPI (%, end-of-year)	1.3	-0.3	5.2	13.4	5.7	2.7
Unemployment rate (%, ILO)	6.7	7.6	7.7	7.0	7.3	7.0
Employment growth (% annual average)	2.3	-1.2	2.2	2.4	1.2	2.0
Imports of goods (EUR mln)	23,312	20,856	26,254	36,633	38,149	40,093
Exports of goods (EUR mln)	12,817	12,013	15,609	21,689	22,554	23,704
EUR/USD (average)	1.12	1.14	1.18	1.05	1.04	1.08
EUR/USD (end-of-year)	1.12	1.22	1.14	1.02	1.07	1.10
3M Euribor (average)	-0.36	-0.43	-0.55	0.25	2.75	2.00
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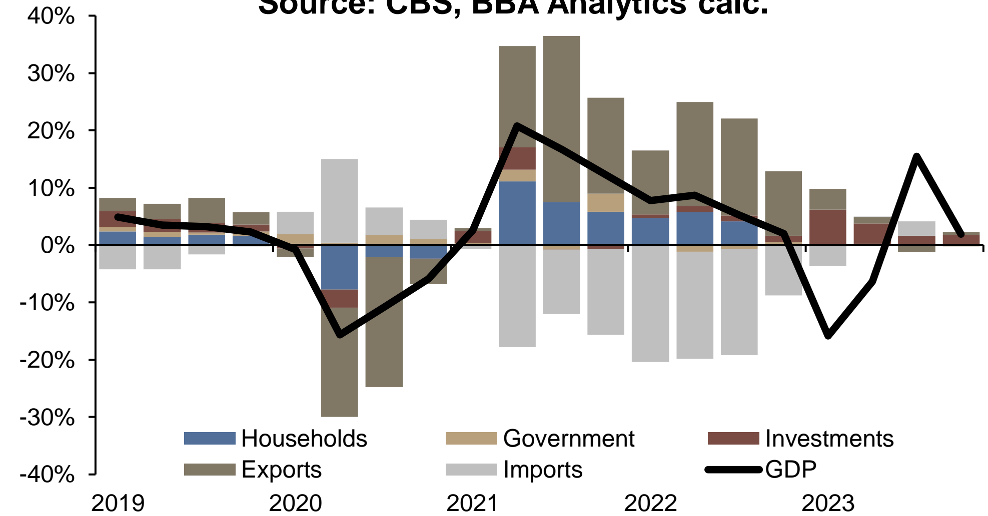


Economic activity

- After estimated 5.8% yoy growth in 2022, we see **GDP in 2023 to mildly decrease by 0.4% yoy**, strongly influenced by hampered personal consumption prospects. As the inflationary-bitten personal disposable incomes take a hit, energy costs will continue to burden households, especially as heating seasons ends in Spring 2023 and administratively regulated energy prices unfreeze to market (read: higher) levels. On the other hand, investments in 2023 are seen higher, driven by more stable (versus regional peers) costs of financing – a result of eurozone entry, relatively stable public finances and high EU funding amount (which will add greatly to overall economic activity, if at least historical average absorption rate is achieved). Even though recessionary environment looms, employment growth is expected to remain in the green, as post-pandemic labour demand haven't fully recovered and some of the largest sectors in the overall economy are expected to fence off any stronger economic slowdown (tourism, for example, as the sector is seen contributing positively to headline growth, unlike export of goods, for which we expect to decline as major trading partners' demand fade). **For 2024, we expect GDP to rebound to +2.0% yoy**.

Inflation

- Inflationary pressures intensified in the latter part of 2022, thus prompting a slight upward revision of 2022 average since our last quarterly report, i.e., to 10.7% yoy. Usual stubborn inflation drivers this year remain food/energy, with the 2H2022 additional factor coming from somewhat hotter foreign demand (due to strong tourist season), that added fuel to the inflationary fire. Ample demand should continue at least for 1H2023, supported by wage hikes in the public sector and higher minimum wage/tight labour market, while base effects and recessionary surrounding should ultimately influence **the average 2023 inflation rate to soften to 8.6%.** Negative risks in 2023 stem from still high producer prices' level, implying spare capacity in consumer prices' growth, while additional unknown is geopolitical situation.
- Humble economic outlook and thus lower demand should prompt **inflation to more than double-down in 2024, which we see at 4.1%.**

Croatia

Monetary and fiscal policy

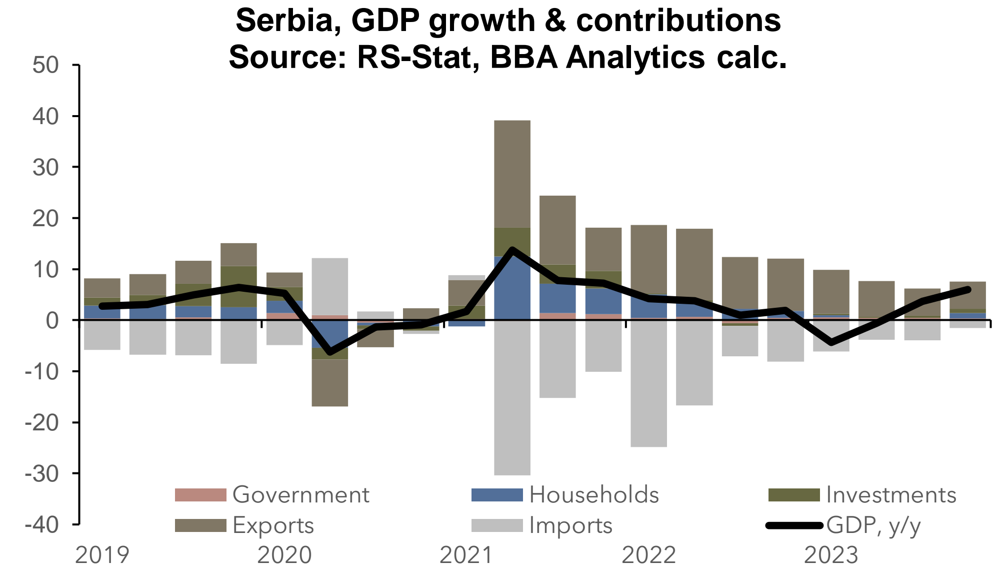
- We see the Eurozone's monetary authority hiking the rates to 2.75% (ECB's main refi rate), with the hiking cycle likely to end in 1H 2023. The reason for further policy tightening lies in the need to contain the mid-term inflation expectations, with the CPI inflation expected to fall within the medium target of below 2% only in 2025. The ECB will be looking for the developments on the banking system's excess liquidity, with the EMU banks likely to pay back up to 1.8 trEUR out of TLTROs in January-2023. This is important for the sake of stability of the EMU financial system, especially if there is resurgence in fragmentation fears. A full blown quantitative tightening will likely be one of major policy moves in the next months, favouring our view on more increases in interest rates.
- Fiscal gap will widen in 2023 on the back of weaker economic activity and the absence of major budget moves. We think the highlight for public finance is Croatia's widest gap between the overall refinancing needs and the current cash buffer. We see this as the Croatia government counting on the local investors to cover for the domestic debt maturity (6% of GDP in 2023), with local pension funds and banks traditionally delivering strong interest for domestic debt issuance. The rest of Croatia financing needs we see coverable by foreign bond issuance, but potentially at higher price than in case of bigger cash buffer.

FX and interest rates

- EUR/USD will see more volatility in 1H 2023 mostly on the resolving of interest rate differential game between the ECB and the Fed, with the latter looking for an earlier reversal from high interest rates than the former. Also, global investors are looking deeply into re-opening of China. Another important element is that most of positive drivers for the USD strength are already heavily priced in and we see them gaining more footing only in case of an abrupt deterioration in global sentiment (not our base scenario though). Finally, with the view gradually shifting from inflation towards growth prospects, we see this being relatively more supportive for the EUR as most of economic weakness anticipation is priced in and it historically provided better risk/reward profile when cyclical elements (e.g. economic activity) were in focus.
- On interest rates outlook, we forecast the 3M Euribor rising slightly beyond 2.5% in the next couple of months, tracking fully the ECB's tightening. Despite reduction of excess liquidity in the EMU system, we expect that in the local system there will remain enough non-engaged liquidity to prevent a much more pronounced increase in interest rates in the private sector lending. Demand for loans will be also affected by the general weakening of economic activity, hence alleviating some upside pressures from the interest rates. On the long term rates, we see upside pressures there as well, with a general deterioration in credit quality globally in 2023. Croatia will still see benefits from the EMU membership, however we do not expect stronger performance than Slovenia given also Croatia's material gross refinancing need.

Serbia

	2019	2020	2021	2022E	2023F	2024F
GDP real growth (%)	4.3	-0.9	7.5	2.6	1.3	3.5
GDP current prices (EUR mln)	46,005	46,815	53,329	61,098	68,559	74,490
GDP per capita (EUR)	6,624	6,786	7,803	8,940	10,032	10,899
CPI (%, annual average)	1.9	1.8	4.0	11.6	10.7	4.9
CPI (%, end-of-year)	2.1	1.3	7.9	14.2	6.4	4.2
Unemployment rate (%, ILO)	10.5	9.1	11.1	9.1	8.9	8.6
Employment growth (% annual average)	2.0	1.9	2.6	1.2	1.2	1.4
Imports of goods (EUR mln)	22,103	21,347	26,802	34,303	37,839	39,549
Exports of goods (EUR mln)	16,506	16,353	21,224	27,322	31,337	33,468
EUR/RSD (average)	117.86	117.58	117.57	117.47	117.68	117.88
EUR/RSD (end-of-year)	117.59	117.57	117.58	117.32	117.80	118.00
6M Belibor (average)	2.65	1.37	1.08	2.74	5.50	5.00
5Y RSD govt rate (average)	3.50	2.77	2.63	6.28	8.50	8.00



Economic activity

- **Real GDP growth** will slow to **1.3% in 2023**, with a **combination of weakening in both foreign and domestic demand** behind. Domestic demand will feel the brunt of persistently high inflation, hitting on all spending categories. Households are thereby affected by aggravation in real disposable income and costlier borrowing, with hefty labour market one of few elements to act supportively. Investments will be under pressure of more expensive funding as well as uncertainties in mid-term investment return calculations courtesy of the mentioned upside inflation surprises. Situation at the main EMU trading partners is looking somewhat more stable than assumed before, mainly thanks to less concerns about the energy availability for industry users, however foreign demand weakening will materialize even more in the upcoming quarters as a result of monetary tightening and the remaining outlook concerns.
- In 2024 we see GDP growth gaining more pace on assumed recovery in personal spending and stronger investments on clearer prospects for monetary policy i.e. availability and price of capital going forward.

Inflation

- HICP inflation rate will peak around the turn of the year, followed by a gradual reduction in yoy inflation rates in the rest of next year. For **2023** as a whole, we forecast the **average inflation rate of 10.7%**, hence just a small reduction to the 2022 average figure. The next year's inflation profile will reflect high base effects, lower commodity prices and weakening in domestic demand. The monetary tightening will do it's part as well, especially the imported element from the ECB's tightening.
- Despite a downtrend building in the upcoming quarters, inflation will nevertheless be on a slow path downwards and we forecast the annual average at around 5% in 2024 i.e. being a way above of the recent years' profile.

Serbia

Monetary and fiscal policy

- We see Serbian central bank hiking rates to 5.50% during next few months with inflation to peak only during 4Q22-1Q23 and ongoing spillovers from the past energy and food price hikes onto the core inflation categories. The ECB's policy tightening will also generate some transmission into the local financial system given the magnitude of the euroization in Serbian economy. The (imported) weakening of economic activity will curb the NBS' tightening need as it will contain inflation to some extent. The ongoing volatility of the global financial markets is a clear negative for the local monetary policy as it will create pressure on the stability of the central bank's foreign exchange reserves, although it must be mentioned that sizeable foreign capital inflows in the recent months have provided some manoeuvring space to the NBS. Arranging a Stand-By deal with the IMF is another positive element as it will clear away part of the worries about the public refinancing capacity.
- Aside from the widening in fiscal gap largely as a result of weakening economic activity, we estimate the 2023 gross public refinancing needs (i.e. fiscal deficit plus maturing debt) at just above 10% of GDP. This is not the highest within the region, with Croatia and Hungary seeing even higher refunding needs, and the government carries a relatively healthy cash buffer of just above 7% of GDP. The negotiated IMF deal worth 2.4 bnEUR will help to overcome the remaining gap in funding needs.

FX and interest rates

- EUR/RSD will trade in the tight range till the end of 2022 and through 2023. The dinar is supported by strong foreign capital inflows incl. effects of the new 2.4 bnEUR worth Stand-By deal with the IMF plus the NBS tightening and the recent stabilization in the global financial markets. However, the next year will be highlighted by more instability on the global markets front and the RSD could still be sporadically under depreciation pressures as a result. The NBS managed to increase the FX reserves to a record 17.3 bnEUR, covering for five months of goods & services imports.

- On the interest rates, we see them higher in 2023 amid ongoing fight against persistently high inflation and ongoing geopolitical concerns. Aside from the central bank tightening, cost of money also rises on the back of the expected deterioration in credit quality world wide, which will be felt in the local system as well. The latter effect will not only influence the short term RSD rates, but the long term also. Serbia is there under pressure of widening spreads, which are traditionally more under pressure for lower rated issuers.

Bosnia and Herzegovina

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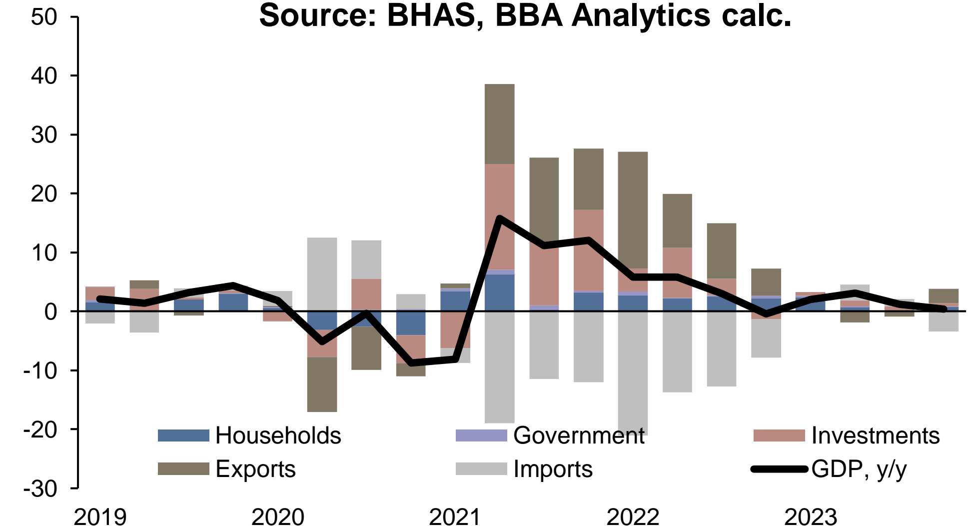
	2019	2020	2021	2022E	2023F	2024F
GDP real growth (%)	2.8	-3.2	7.6	3.5	1.7	2.0
GDP current prices (EUR mln)	18,675	18,124	20,412	24,130	27,219	29,221
GDP per capita (EUR)	5,350	5,216	5,874	6,944	7,833	8,409
CPI (%, annual average)	0.6	-1.1	2.0	14.2	10.9	5.3
CPI (%, end-of-year)	0.3	-1.6	6.3	16.8	7.3	4.4
Unemployment rate (%, ILO)		15.9	17.4	15.4	15.2	14.8
Employment growth (% annual average)	2.3	-1.0	1.3	2.0	1.8	2.0
Imports of goods & services (EUR mln)	19,494	16,645	21,084	29,054	30,465	32,218
Exports of goods & services (EUR mln)	14,328	11,870	16,485	22,972	24,094	25,481
EUR/USD (average)	1.12	1.14	1.18	1.05	1.04	1.08
EUR/USD (end-of-year)	1.12	1.22	1.14	1.02	1.07	1.10
3M Euribor (average)	-0.36	-0.43	-0.55	0.25	2.75	2.00
10Y EUR swap rate (average)	0.26	-0.14	0.05	1.87	2.91	2.41



Economic activity

- GDP growth in 2022 is expected at 3.5% yoy, driven by ample investment expenditure and strong exporting growth, as the country benefits from strong economic activity of its main foreign trade partners. Conversely, heavy foreign demand slowdown should influence the two previously mentioned categories, forcing them into red, and, along with milder household consumption (energy/food driven inflation bites personal incomes), result with a **1.7% GDP growth in 2023.**
- We see future growth prospects generally tilted upwards, as we see the successful government forming in the making on the Federation of B-H and national level encouraging to reforms on all levels, thus aiding positively on the economy. Additionally, political tensions should ease and also the country has pending EU candidacy status (possible announcement somewhere in December), which should materialise in higher investments/lower financing costs through pre-accession funds.
- **In 2024, we see GDP growth at +2.0% yoy**, amid rebounding investment/exporting and household consumption strengthens.

Inflation

- Our upward revised inflation estimates suggest 2022 average rate at 14.2% yoy, as the lack of more significant government support (in one part because 2022 was an election year) for consumers aided negatively to soaring food and energy prices that are impacting households. **For 2023, we see inflation at around 10.9% yoy**, bearing in mind frozen energy prices on a local levels, that will make a full impact once unfrozen come Spring 2023, while at the same time the country is being highly dependent on foreign energy imports and producer prices are still sky-high (suggesting spare capacity available to fuel consumer prices' growth).
- On a positive side, base effects will support inflation slowdown in 2023, but more so will newly agreed government forming at both entity and national levels, which should support stronger and meaningful government aid to inflationary-burden economy. **In 2024, we see inflation at 5.3% yoy.**

Bosnia and Herzegovina

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Monetary and fiscal policy

- We do not expect a change in the monetary policy setup, with the Central Bank of Bosnia and Herzegovina moving sticking to the Currency Board Arrangement (CBA). The stability of the EUR/BAM is perceived as resistant to the short term fluctuations, with the CBBH FX reserves at above 8 bnEUR i.e. up by 1% yoy. According to the IMF change proposals targeting better stability of the currency board, the CBBH is restructuring the FX reserves lately by selling gold assets. Despite somewhat better profile in the recent weeks, the 2023 will be highlighted by more volatility in the global capital markets, which maintains a dose of uncertainty for the FX reserve stability going forward. Still, we see the B-H's political situation upgrades and gaining the EU candidacy status as giving some positive views in the eyes of the IMF, which will also spill over onto the perception of the currency board stability.
- On public finances, forming the government levels will lead to changes in the fiscal outcome, whereby we see some widening in the fiscal deficit for 2023. This alongside the maturing debt profile shapes the gross refinancing needs at a relatively small sub-4% (as a share of GDP) level, which alongside the government's cash buffer at just above 2% of GDP is an element suggesting no major change in the public financing costs.

FX and interest rates

- The EUR/BAM stability will remain in place going forward, according to our view.
- Interest rates will rise further in 2023 on the back of imported monetary tightening i.e. effects of ECB's monetary squeeze and bearing in mind the magnitude of the euroization of the local financial system. Additional element for higher financing costs would be the assumed deterioration in credit quality courtesy of weakening economic activity.. However, slowdown in economic growth would still curb the demand for loans by the private sector and alleviate some of the upside pressures to interest rates in the local banking system.

North Macedonia

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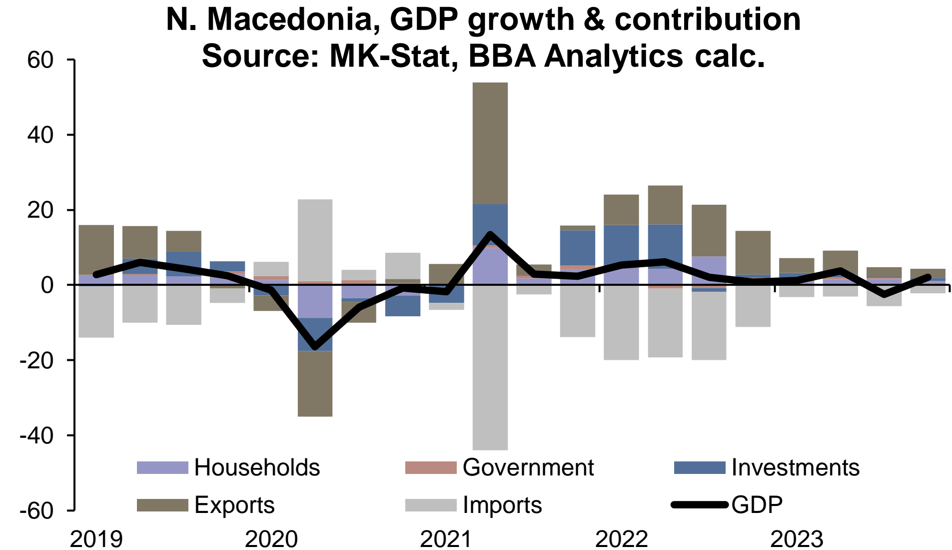
	2019	2020	2021	2022E	2023F	2024F
GDP real growth (%)	3.9	-6.1	4.0	3.4	1.1	2.6
GDP current prices (EUR mln)	11,261	10,635	11,735	13,853	15,842	17,115
GDP per capita (EUR)	5,423	5,132	5,662	6,684	7,644	8,258
CPI (%, annual average)	0.7	1.2	3.4	14.1	13.1	5.3
CPI (%, end-of-year)	-0.2	3.1	4.9	19.4	8.1	3.9
Unemployment rate (%, ILO)	17.3	16.4	15.7	15.0	15.0	14.6
Employment growth (% annual average)	5.1	-0.3	0.0	0.5*	0.2*	1.0*
Imports of goods (EUR mln)	8,578	7,647	9,609	12,679	13,944	14,996
Exports of goods (EUR mln)	7,028	6,269	7,737	10,081	11,245	12,123
EUR/MKD (average)	61.51	61.67	61.63	61.62	61.60	61.60
EUR/MKD (end-of-year)	61.49	61.69	61.63	61.58	61.58	61.58

*methodology change due to Census 2021



Economic activity

- We forecast slower **real GDP growth in 2023 at 1.1%**, keeping the same forecast figure as in the previous edition of our quarterly macro outlook. The main drivers of economic activity slowdown are private sector spending, with both household expenditure and corporate investments under pressure of upside inflation surprises. Capex is not only hit by costlier funding, but also by elevated mid-term uncertainty for general economic outlook courtesy of lengthy fight against inflation as well as geopolitical concerns. Foreign trade is another element, with exports under pressure of weakening growth dynamics at the major trading partners. Personal spending will be somewhat supported by personal income tax at a flat rate of 10%, however high inflation would still weigh on the spending profile. Upside surprises to inflation would be perceived as a negative element, however we see positive risks in case of a quick resolution to the existing geopolitical concerns.
- In 2024, we assume economic growth to gain more momentum on assumed strengthening in foreign trade and improving environment for investments as inflation reduces.

Inflation

- Inflation rate is expected to peak during 4Q22-1Q23, with a gradual reduction towards high single-digit figures by the end of 2023. Aside from high base effects, we see the reductions in global commodity prices and pull effects of demand weakening as the key reasons behind inflation slowdown. The government’s response to elevated costs of living was lacklustre by now, which we interpret as if it is expected to see how the winter months will affect the economy before some state assistance is distributed between the household and corporate sector afterwards. In all and given the upside surprises in the inflation rate in recent months, we now expect the **average inflation rate at just above 13% for 2023.**
- Inflation will stay high in historical terms in the next years and we do not see the annual average rates much below 4% at least before 2025.

Monetary and fiscal policy

- We expect the NBRNM to hike the reference rate to 5.25% until end of 1Q 2023 latest and this in order to fight persistently high inflation. This would still shape the total gap against the headline inflation rate of +10 percentage points, which we read – similarly as with many other central banks – that the NBRNM would be betting on some help to come from weakening demand to pull the overall inflation rate down. The central bank's policy rate changes we see in combination with up until now relatively stable foreign exchange reserves, which gives some support to the central bank that there is no need for an more pronounced policy rate hikes. Indeed, the NBRNM is likely – as many other central banks overlooking the economic areas with high euroization – to receive additional help in tightening monetary conditions from the ECB's rate hikes, which feeds into higher interest rates for FX-linked loans in the local economy as well. The final element going in favour of the NBRNM's actions is the approved IMF package of 530 mEUR, which will also alleviate some pressures from the FX reserves.
- Slowdown in economic activity will push the fiscal gap higher in 2023, which alongside the maturing debt profile shapes the gross public financing needs at just below 9% of GDP in the next year. The government's current cash buffer is around 6% of GDP, and we think that the government will receive the support to cover the remaining financing needs via market or bilateral borrowing from the IMF-approved deal.

FX and interest rates

- The EUR/MKD will remain in a relatively narrow area at least through 2023, with the NBRNM managing to keep the FX rate in the so-called dirty float regime as the weakening foreign demand effects into the stability of FX reserves are (partly) offset by the IMF-approved Stand-By arrangement.
- The ongoing fight against high inflation will keep interest rates under upside pressure during 2023. The important element in the next year is the deterioration in credit quality, which we see materializing from the weakening of economic activity and pushing interest rates even higher than just implied (in)directly by monetary tightening. The North Macedonian government is relatively good (but not ideally!) positioned to cover the gross public financing needs in 2023, which we see at just below 9% of GDP being partly covered by the government's existing cash buffer of almost 6% of GDP. The remaining gap will give some reasoning for investors to ask for higher return. The final result will be further increase in the interest rates towards the private sector.

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