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Regional analysis
Interest rate forecasts

Interest rates rising until mid of 2023

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Highlights

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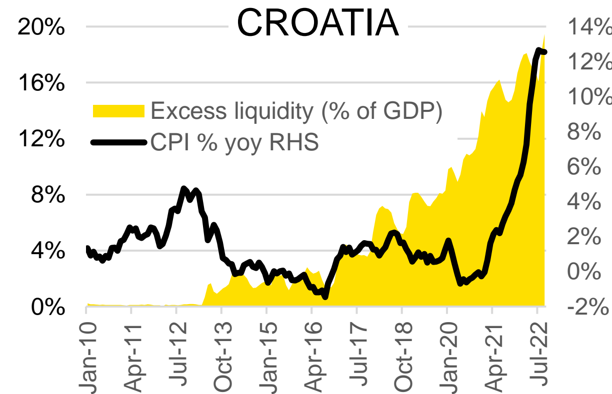
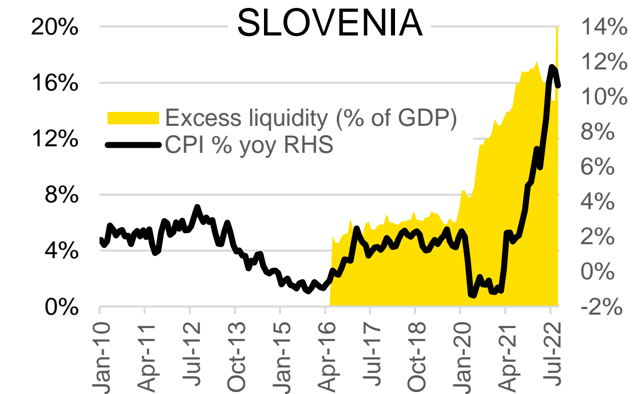
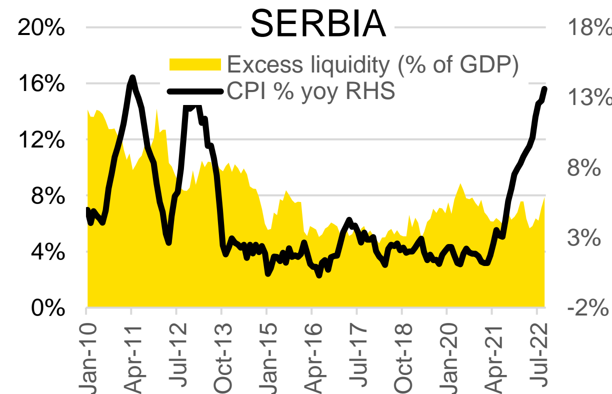
The central banks are in the midst of policy tightening, with consumer inflation speed-up showing only limited (if any) signs of abating. We are examining the trajectory and presenting **forecasts for the key interest rates until end of 2023**.

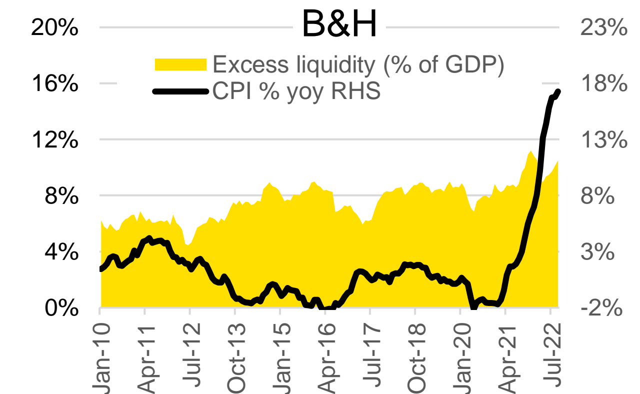
During most of 2010s, the central banks have spent most of the time **printing money**, with the global peers largely concentrated on bond purchase programs, while the regional monetary authorities focused on creating the local currency money via exchanges of foreign currency receipts from the sovereigns' foreign bond issuances. The mentioned time period was highlighted by economic growth calling for monetary support, low inflation, post Global Financial Crisis debt de-deleveraging in many cases (e.g. large parts of the Eurozone, Croatia in the region etc.) and sporadic turbulences by specific scenarios (e.g. the Eurozone public debt crisis in 2012). The final piece of the puzzle was the key central banks' „do whatever is needed" motion to battle the market crisis created by the COVID-19 outbreak.

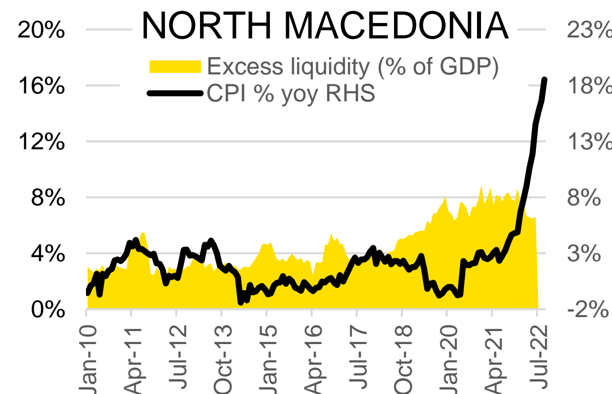
During the past decade, interest rates were on a more or less one-way downward path, reflecting low or negative regulatory interest rates and excess liquidity in the financial systems at historical highs. In this respect, **the Eurozone excess liquidity has grown to 4.7 trEUR**, representing an increase of 45x since end of 2010. When placed against the Eurozone's GDP, the excess liquidity shapes a share of massive 38%, hence being yet another evidence of the magnitude of the ECB's policy relaxation during the past ten years. **In the Adria region**, we have seen **excess liquidity increases** as well, with the biggest moves in **Croatia (206x since end-2010) and Slovenia (7x** – series starting from mid-2016), however in neither of those two countries is the latest excess liquidity running at even half of the relative to GDP figure as in the Eurozone. Although following the similar monetary relaxation profile, the excess liquidity creation in the rest of Adria region was quite more limited, if any at all, reflecting different setups of monetary policy and their respective limitations (notably B&H with the currency board). The common flavour was inflation, which was running at low single-digits in most of the times, with sporadic slips into negative area as well.











source: local central banks

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Transmission mechanism in pulling the private sector interest rates lower was eventually effective. Aside from the local central banks' liquidity creation via FC conversions, this has **also reflected relaxation in mandatory reserves**, but most importantly **value clause effects of the EUR rates** in the local banking systems. **Lending interest rates are already showing sings of bottoming out**, more due to interest rate links with Euribor but also as the banks are starting to price in the economic slowdown effects and increased mid-term uncertainty.

Aside from the central bank policy moves, the trajectory of interest rates has also reflected the **lending activity developments**. **Adria region** countries displayed **mixed performance in generating new loans**, notably with **Croatia and Slovenia in massive deleveraging** over a 10 year period as shown by reduction in the loan-to-GDP ratio. The mentioned moves have reflected the local banking systems cleaning from poor quality loans as well as the private sector abandoning some of the past traditional business moves where the local corporate sector was overburdened by debt. The rest of Adria region countries have started the path at a lower base, with no major need for restructuring and thus loan-to-GDP remaining stable or with a small increase. Another element standing behind the private sector's interest rate downward movements is the loan-to-deposit ratio which fell in all cases as the growth in deposits has outplayed the rise in loan stock. Such movement came on the heels of growing household wealth (supporting higher savings) amid real disposable income increase, poorer demand for loans and people in the region traditionaly opting much for bank deposits rather than investing much of their saved money into riskier assets. Looking ahead, we see a convergence potential of Adria region's loan-to-GDP ratios towards the Western EU levels, where the named indicators are higher (Germany 83%, Austria 92%, France and Spain +100%) given higher economic development – this will provide some footing for the interest rates.

The 2010s were also highlighted by the EU bank regulation ramp-up arising from the Basel III standards, notably with the LCR and NSFR ratios. Banks' liquidity is now kept much higher than before, which also stands behind the elevated amount of excess liquidity in the system and will for sure provide some support from falling much lower in the near term.

Average interest rates on distributed loans

	Loan segment	31.12.2012	31.12.2015	31.3.2022	30.9.2022
Croatia	Corporate	6.00%	5.04%	2.26%	2.33%
	Household	7.63%	6.70%	4.46%	4.22%
Slovenia	Corporate	5.58%	3.30%	1.95%	2.39%
	Household	6.19%	5.38%	3.42%	3.53%
Serbia	Corporate	8.75%	5.24%	2.83%	3.86%
	Household	12.06%	10.04%	6.59%	7.46%
B&H*	Corporate	8.73%	5.82%	3.59%	3.85%
	Household	8.15%	7.44%	5.42%	5.17%
North Macedonia	Corporate	6.40%	5.24%	3.31%	3.45%
	Household	8.74%	4.84%	4.84%	5.57%

*presents new business loans, other countries display total business average interest rates

source: local central banks

		31.12.2012	31.12.2015	31.3.2022	30.9.2022
Croatia	loan-to-GDP ratio	84.97%	79.76%	66.18%	70.39%
Slovenia		98.93%	63.35%	66.35%	67.23%
Serbia		58.80%	58.29%	60.92%	62.81%
B&H		59.27%	59.00%	56.93%	58.54%
North Macedonia		47.50%	50.98%	54.89%	57.01%

		31.12.2012	31.12.2015	31.3.2022	30.9.2022
Croatia	loan-to-deposit ratio	125.23%	106.78%	78.16%	74.29%
Slovenia		92.09%	79.21%	83.43%	83.06%
Serbia		144.62%	133.36%	111.52%	109.68%
B&H		116.64%	102.03%	79.23%	76.16%
North Macedonia		90.77%	93.56%	87.30%	87.94%

Outlook

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We see interest rates on the money market **going further up**, with the private sector interest rates following suit. These are **the key arguments** behind our view:

1) **ECB** – we see the **Eurozone's monetary authority hiking the rates by additional 75bps**, 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. Announcements of the ECB going into quantitative tightening i.e. selling previously purchased bonds will be the key event to watch for the complete picture of the ECB's policy tightening, with the first messages likely to arrive in the next monetary policy meeting in December 2022;
2) **NBS** – we see **Serbian central bank hiking rates by an extra 100bps over course of next six months** with inflation to peak only during 4Q22-1Q23 and ongoing spillovers from the headline inflation onto the core 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;
3) **NBRNM** – we see **NBRNM hiking rates by an additional 100bps in the next six months** amid an ongoing fight against persistently high inflation and need to safeguard the stability of the EUR/MKD dirty float regime. Instability of the global financial markets is another negative element to watch for in this respect. A positive catalyst is the newly arranged deal with the IMF worth 530 mEUR, which will alleviate pressures on the FX reserves.

We displayed our interest rate forecasts for the upcoming quarters in the table on the right.

End of quarter values	current	4Q 2022	1Q 2023	2Q 2023	3Q 2023	4Q 2023
ECB main refi rate (%)	2.00	2.50	2.75	2.75	2.75	2.75
Euribor 3M (%)	1.82	2.40	2.75	2.75	2.75	2.75
Euribor 6M (%)	2.34	2.90	3.00	3.00	3.00	3.00
NBS policy rate (%)	4.50	5.00	5.50	5.50	5.50	5.50
Belibor 3M (%)	4.34	4.85	5.35	5.35	5.35	5.35
Belibor 6M (%)	4.49	5.00	5.50	5.50	5.50	5.50
NBRNM policy rate (%)	4.25	4.75	5.25	5.25	5.25	5.25

The displayed money market rates do have direct impact on the private sector lending interest rates, especially in existing loans with variable interest rates. However, we still think that, especially for the new loan business, banks will somewhat curb the upside pressures on the final interest rates thanks to the remaining sizeable excess liquidity in the system. Also in that direction is the fact that we see weakening demand for loans and resultantly slower loan generation growth amid weakening domestic demand in the upcoming quarters.

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