Eurobank Research
https://www.eurobank.gr/en/group/economic-research
Research@eurobank.gr

Global Macro Themes & Market Implications for the EA Periphery and the CESEE

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Contributing Authors:
Olga Kosma, Research Economist
Paraskevi Petropoulou, Senior Economist
Ioannis Gkionis, Senior Economist
Galatia Phoka, Research Economist

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I. Snapshot

Overview

Macro Picture

- **USA:** Among the fastest growing advanced economies, with fiscal loosening supporting the recovery
- **EA:** High-frequency indicators point to a moderation in activity growth
- **UK:** Growth to remain lackluster as robust global growth offsets the drag from Brexit uncertainty and subdued real consumer spending growth
- **EM:** Growth momentum remains strong as recovery in Russia and Brazil picks up pace; modest deceleration in India and China
- **CESEE**: Region close to or past cyclical peak

Policy Outlook

- **USA:** As expected, Fed hiked rates by 25bps to 1.50%-1.75% in March. Risk probably skewed towards a total of four hikes in 2018
- **EA:** Gradual normalization process to continue, with QE likely ending by end-2018. No interest rate hike expected before H1 2019.
- **UK:** Increased risk for a May rate hike on higher wage growth and inflation persistently above BoE target
- **CESEE:** Different inflation paths allow for divergent monetary policies across the region

Summary

Leading indicators suggest that the global economy has probably started to loose some momentum, pointing to moderation rather than a sharp deterioration. Price pressures remain well contained, leaving scope for just a gradual withdrawal of monetary policy. Mounting fears over a global trade war due to escalating US/China trade tensions

Markets

- **FX:** EUR/USD seems to has established a range between 1.22 and 1.25 with little impetus seen for the established status quo to change in the near term.
- **Government bonds:** US and EU rates have moved sharply lower on geopolitical jitters, fears over rising protectionism and a slowdown of global growth.
- **EM:** EM spreads widened further in March, reflecting the increase in volatility and uncertainty about developed markets rates and the potential of a US-China trade war.
- **Credit:** Credit spreads widened in March and it is the first time in a while that credit is actually feeling weak along with other risk assets. Cash underperformed structured credit on ETF outflows.

Key Risks

- **Global trade war:** Reciprocal tariffs escalate into a full-blown trade war with material negative repercussions to the global economy
- **Higher than expected rise in inflation:** Steeper path of monetary policy tightening
- **Persistent surge in volatility:** Significantly tighter financial conditions push the global economy into a downturn
- **Sharper than expected slowdown in China:** Investment continues to slow on deleveraging measures in SOEs while fiscal policy remains tight
- **Heightened euro area political jitters:** Protracted political uncertainty in Italy

Macro Views

Latest Macroeconomic Developments & Outlook

World Economic Outlook		The synchronized and broad based cyclical upturn is set to continue in 2018, benefitting from stronger investment, the rebound in global trade and improving labor market conditions. Nevertheless, business sentiment surveys point to a possible easing in the global manufacturing cycle, suggesting that the current economic cycle has probably passed its peak. New corporate and personal income reductions and spending increases in the US as well as the likelihood of additional fiscal stimulus in Germany, bode well for the global growth outlook. Inflation pressures remain relatively low, although there is scope for a gradual acceleration. Overall, global GDP growth is expected to accelerate to 3.9% in 2018 and 2019 from 3.7% in 2017, with the main downside risks stemming from the potential of a full-blown trade war.
Developed Economies	**US**	Slower personal spending in the first two months of the year is largely attributed to the surge in durable consumption witnessed late last year due to a series of large hurricanes in August and September. Overall, the significant fiscal stimulus, including the US Tax Cuts and Jobs Act and the decision of Congress to raise spending limits over the next two years, is set to provide a short-term boost to US real growth, expected at 2.8% in 2018 and 2.5% in 2019.
	Euro Area	High frequency indicators in the first three months of the year suggest that strong economic growth momentum built in H2 17 will likely fade gradually in 2018 albeit still supporting economic activity. Overall, we expect Euro area GDP to grow by 2.5% and 2.2% in 2018 and 2019 respectively with both monetary and fiscal policies supporting the recovery. Risks seem broadly balanced with protectionist US trade policy, probably the biggest threat to the Euro area's prosperity.
	Periphery	Favored by strong global growth and the ECB's ongoing accommodative monetary policy stance, periphery euro area economies' growth momentum remains strong, even though leading indicators suggest that the recovery has probably started to lose some shine. However, political jitters prevail. In Italy , the consultation process of forming a new government –expected to start on April 4- is likely to take a few months while in Spain, Catalonia still does not have a government and Article 155 is in place with spillover effects on national politics.
Emerging Economies	**BRICS**	Economic slowdown towards 6.5% from 6.9% in 2017 is anticipated this year in China, as last year's main drivers (property and infrastructure activities) are seen softening this year, while the government is focusing on containing financial risks. Tariffs imposed by the US on Chinese imports are broadly anticipated to have a rather limited impact. Signs of further economic recovery are being visible in Russia and Brazil in 2018, while growth seems is penciled in to remain strong in India despite some deceleration.
	CESEE	The economies of the broader region are about to or have already passed their cyclical peak. The exemption of EU from the US trade tariffs on steel and aluminum puts a cap on the direct consequences on the region's trade relationships and limits them down to non EU members (Russia, Turkey and Ukraine). The rising trend of headline and core inflation is uneven across the region allowing for divergent regional Central Bank monetary policies.

Global Macro Themes & Implications

Theme	Implications
The US administration's trade tariffs raises fears of a tit-for-tat retaliation, escalating into a global trade war	In retaliation for China's intellectual property practices following an investigation under Section 301 of the 1974 US Trade Act, the US administration unveiled a detailed list of Chinese imports worth $50bn that could be subject to a 25% tax. The duties will be implemented in June at the earliest while the matter is still subject to public hearings. In response to the above, China threated to increase tariffs on 106 US products including soybeans and airplanes which are the two biggest US export groups to China. This followed China's decision a few days earlier to impose tariffs up to 25% on 128 US goods in response to the US duties on imports of aluminum and steel the US administration announced in early March. Meanwhile, the US President has threatened to pull the US out of NAFTA —which went into effect in 1994— unless a fair deal is reached in negotiations with Mexico and Canada. The US President has also threatened to raise tariffs on EU-made cars and other export groups unless the EU reduces its tariffs, for example on cars and/or European countries spend more on defense expenditure. As things stand, China and the EU seems focusing on keeping their reciprocal tariffs proportional but what happens next, will likely depend on whether the US President pushes ahead with his tariff plans. Undoubtedly, imposition of tariffs and other trade barriers by the US, raises the risk of a trade war in the form of a broad-based tariff response, rolling back foreign investment or/and limiting imports, with material negative repercussions to the global economy.
Synchronized and broad-based global upturn set to continue in 2018, but current economic cycle has probably passed its peak	The synchronized and broad based cyclical upturn is set to continue in 2018, benefitting from stronger investment, the rebound in global trade and improving labor market conditions. Nevertheless, business sentiment surveys point to an easing in the global manufacturing cycle, suggesting that the current economic cycle has probably passed its peak. Real economic activity growth has likely peaked in the Euro area and Japan, while EMs are expected to accelerate marginally as recovery in Russia and Brazil picks up pace. Downside risks mainly stem from the potential of a full-blown trade war.
March FOMC meeting: The Committee gets increasingly confident on US growth outlook but the median 2018 dot continues to imply three rate hikes	As expected, the FOMC decided unanimously at its March FOMC meeting to raise the target range by 25bps to 1.50%-1.75%, the sixth move in this cycle. In the accompanying statement, the Fed acknowledged a stronger US economic outlook and reiterated its confidence that inflation on a 12-m basis will stabilize around the 2% target over the medium-term. Along these lines, the updated Summary of Economic Projections revealed a higher real GDP growth forecast for 2018 and 2019 by 0.2pp and 0.3pp respectively to 2.7% and 2.4%, reflecting the expected impact from the combination of tax cuts and additional government spending through FY2020. Core PCE inflation forecast for 2018 was left unchanged at 1.9% but for both 2019 and 2020 was revised higher by 0.1pp to 2.1% for each year. The median funds rate (the "dots") for 2018 remained at 2.1%, implying three rate hikes, while the median funds rate for 2019 and 2020 rose to 2.9% (implying three hikes) and 3.4% (implying two hikes) respectively, from 2.7% and 3.1% in December. Given that the number of Fed officials favoring four rate hikes in 2018 doubled to six, risks are probably skewed towards a total of four hikes, especially in case wage growth starts gaining traction in a tight labor market and/or core PCE accelerates towards the upper boundary of the 1.3%-1.9% range that prevails over the last six years.

Global Macro Themes & Implications

Theme	Implications
The ECB takes another small step towards a policy exit but President Mario Draghi downplays the move	At its March monetary policy meeting, the ECB decided unanimously to omit from the accompanying policy statement the explicit pledge that had been in place since 2016 suggesting that the Central Bank stands ready to increase the volume of monthly asset purchases should the euro area outlook or financial conditions become less favorable. Although the ECB President tried to downplay the change in the forward guidance, it does however mark another small step towards the phasing-out of net asset purchases by the end of 2018. We expect that the ECB will likely provide, no earlier than June/July, a plan to taper its asset purchases to zero in the last three months of 2018, trying to prevent a further EUR appreciation and an unwarranted tightening of financial conditions. The key driver for the first interest rate hike will be the future path of core inflation and wage growth, so we do not envisage a hike before Q1 2019, at the earliest, as inflationary pressures are expected to remain subdued by year-end.
23/24 March European Council declares agreement on Brexit transition terms; increased optimism for a soft Brexit	Marking a significant step forward in the Brexit negotiation process, the 23/24 European Council declared full agreement on Brexit transition terms. The transition period will run for 21 months until 31 December 2020 giving the UK space to come in full agreement with the EU on the terms of future relationship, in particular on trade. Both parties also agreed on the issue of EU citizens' rights in the period following the UK's departure from the EU on 29 March 2019 and the role of the Court of Justice of the European Union. On the thorny Irish border issue, they agreed in principle on the so-called EU backstop solution that envisions Northern Ireland to effectively remain aligned to EU regulation after Brexit unless another solution is found that will prevent a hard border between Norther Ireland and Ireland. Though main obstacles still remain to be addressed before a Brexit deal can be concluded, including the Irish border issue, the joint agreement on Brexit transition terms reduces worries over a 2019 cliff edge scenario, bodes well for the UK's near-term growth outlook as it prevents businesses from activating contingency plans and supports optimism for a soft Brexit.

Macro Themes & Implications in CESEE

Theme	Implications
Trade wars: The risk of an escalation could have meaningful consequences on the growth prospects for the broader CESEE region	After having the best year in the post-Lehman brothers period in 2017, the economies of the broader CESEE region have found them-selves in a less favorable external environment in Q1-18. Currently, the exemption of EU from the US trade tariffs on steel and aluminum puts a cap on the direct consequences on the region's trade relationships and limits it down to non EU members (Russia, Turkey and Ukraine). Yet, the risk of an escalation in trade wars could put more pressure on world trade having more meaningful consequences on the growth prospects of the small open economies in the CESEE region.
Private spending revival will most likely extend in 2018	Private consumption is expected to make a key-yet smaller than last year-contribution to GDP growth as real disposable incomes are expected to continue rising at a lower rate than last year reflecting reflecting the higher inflation and the moderation of wage growth against the backdrop of further labor market tightening, loose financial conditions, sustained consumer sentiment gains.
Investments performance is key to a more balanced growth path in the medium term	The rise of investments is crucial for the regional medium term growth prospects. In order for this to happen, private sector will need to invest more to increase their production capacity given that utilization rates are already at comparably high levels. EU funds absorption, which has failed to impress in the past year for a number of reasons, is expected to accelerate providing a boost to public investments.
Different inflation paths allow for divergent regional Central Banks monetary policies	The outlook looks more challenging from a policymaking point of view, as lax monetary policies from both major and regional central banks have embarked on a normalization course which is expected to unfold fully in 2018. Yet, the rising trend of core and headline inflation metrics is uneven across the region allowing for different degrees of freedom in the respective Central Banks' monetary policies. The majority of Central Banks in the region maintain their cautiously accommodative stance. From that point of view, the Central Bank of Serbia (NBS) cut interest rates further to 3.25% in mid-March. On the other hand, Romania is an outlier. NBR has already delivered 2 hikes of 25bps in the first two months of the year bringing the KPR at 2.25% given the inflation (expectations) jump and is expected to deliver two at least two more in the next months.

CESEE Markets Developments & Outlook

Country	CESEE Markets Developments & Outlook
Bulgaria	• Bulgarian local-currency bonds have been well supported since the beginning of 2018. The yield curve experienced some modest steepening, with that of 7 years maturity exhibiting a rise of a little over 2bps, while those of 3 and 4 year tenors marginally declined in March, by ca 3 and 4 bps respectively. The Bulgarian Ministry of Finance continued its recent policy and did not hold any auctions in March, while also not providing any indications of an offering in April. • Meanwhile, Eurobond yields fell in March across the board, with shorter maturities such as 2023 and 2024 falling by 10 and 9 bps, respectively. Longer maturities registered more modest drops with the 2027 and 2028 yield tightening by 1.2 and 0.9 bps, while the yield on the longest maturity bond, the 2035, was the only security to increase, by 5 bps in March. All in all, we believe that Bulgarian credit spreads remain tight and valuations continue to be stretched. Hence, we prefer to remain neutral and not enter any new positions.
Serbia	• The EUR/RSD has remained bound within a tight range of 118.00-118.60 since the start of the year. The pair's apparent stability so far in 2018 has been supported by repeated interventions in the FX market by the National Bank of Serbia (NBS). As part of its managed floating exchange rate regime, the Central Bank intervenes in the FX market when it considers appropriate "in order to limit excessive daily oscillations in the foreign exchange market, contain threats to financial and price stability and safeguard an adequate level of foreign exchange reserves". In that respect, it has bought a total amount of €595mn since February 19 to halt the dinar's upside momentum. This practice will most likely continue in the weeks ahead, with the EUR/RSD remaining within a tight range. In that confined space, we remain bullish on further expansion of the Serbian economy, which provides us with enough convictions to favor selling rallies of the EUR/RSD. Moreover, NBS is unlikely to stand against some fundamentally backed trend appreciation in the long-run. Yet, a fast pace of dinar gains may trigger a more dovish policy shift (although its already stretched) given the recent weak inflation readings. • In the FI space we prefer staying at the short end of the yield curve (up to 1Y) as there is still not a clear picture over how a policy shift in the Eurozone, will affect Serbian bonds. The absence of any hedging instruments for local currency sovereign debt also supports this view. Progress towards EU accession will considerably mitigate negative effects of higher global rates. In addition, further success in terms of clearing NPL's, reducing public debt and reforming SOEs (State-Owned Enterprises) could also cap any move higher in Serbian yields as a result of deteriorating external conditions.

The Trader's View

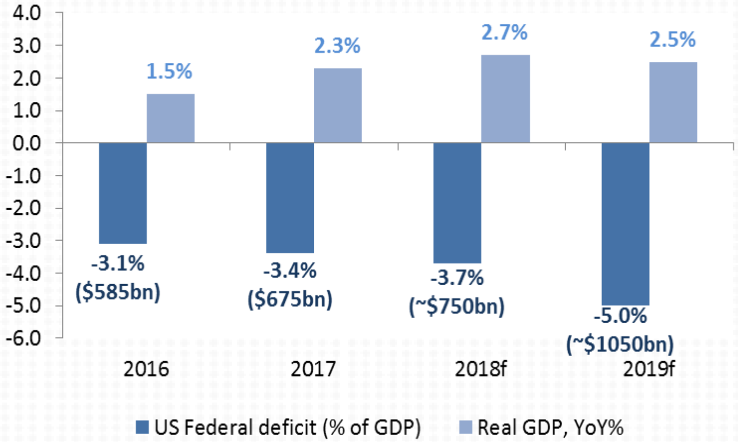
Asset Class	Outlook
Foreign Exchange	**EUR/USD**: The USD found some support on relatively stronger US economic indicators and tighter financial conditions. The shaky risk environment due to trade war talks has seen the pair range trade between 1.22 and 1.25 with no real catalyst at the moment to drive a break either way. **USD/JPY**: USD/JPY moved in a relative tight range closing the month almost unchanged at 106.28. The Tankan survey was a slight disappointment with the dip in Japanese business sentiment partly due to a stronger JPY, although solid but not spectacular growth continues. BOJ's Kuroda has been talking again about normalisation, noting there are internal discussions over an eventual stimulus exit, but markets continue to take these comments in their stride. Prices aren't hitting 2.0% any time soon but such rhetoric is helping keep a lid on the pair at 107.00/30. Although Tokyo stands a good chance of keeping out of possible trade wars an escalation in tensions between the US and China cannot be good for risk and should intermittently lend itself to a safe haven bid for the Yen. **GBP/USD**: An agreement reached between the EU and the UK for the transition period has given a new leg higher to GBP although general USD weakness remains the primary driver. On balance bias remains bullish on renewed hopes over a smooth Brexit and a BoE May18 rate hike now priced in, with a probability of 80%, strong support is expected in the 55-DMA at 1.3985/1.3990.
Government Bonds	**US:** Markets have started to worry about a global growth slowdown. Real GDP growth in the major advanced economies surprised to the downside in Q4 2017 and is on track for another soft reading in Q1. President Trump announced more tariffs and financial conditions have tightened. US 10yr rates broke below the crucial support of 2.80% as risk off sentiment prevailed. Strong support exists between 2.65% and 2.70%. Fed delivered on its hike but the lack of a dot signaling a 4th hike in 2018 disappointed markets with USTs starting April on a cautious note and a flatter curve (2s/10s at 30bps hitting multiyear lows). **EU:** The March ECB meeting was a non event with EUR rates lower as the 10yr Bund yield is now hovering around 0.50%, which is a strong support, losing 16bps in the last month. The pace at which inflation has been rising looks to be slowing, as economic data have increasingly surprised to the downside and EUR has strengthened. Trade wars, and the vulnerability of the German economy to them, are showing up on markets radar while the lack of free float (less than 10% for German bonds) and the demand for core bonds coming from the stickiest of investors means long-end yields are capped at lower levels.
EM hard currency debt	EM external debt spreads widened again in March but in a contained fashion, affected by the increased volatility in developed markets rates and the general risk off sentiment. Heightened geopolitical and global policy risks, as well as record new supply in Q1, all weighed on spreads. Fundamentals remain supportive but volatility, that we expect to persist, tends to lead to outflows from EM external debt funds, although these have not materialized yet. Going forward the key risk is the potential trade war between the US and China and its effects particularly on manufacturing oriented EM economies. Overall we remain of the view that valuations in EM remain rich and we prefer to conserve our firing power for significantly wider levels.
Corporate credit	Corporate credit spreads (IG and HY) continued their widening trend in March in line with the general market risk off sentiment. Cash underperformed synthetics on significant ETF outflows. ECB is still supportive of EUR credit, hence the overall outperformance versus USD in the recent sell off. European total returns were also supported by the rally in rates. Another driver for the USD underperformance has been the significant increase in USD funding costs. The March ECB meeting did not give any real hints as to the future path of the QE, with markets are now expecting June to be the turning point in policy guidance. High yield has significantly decompressed versus investment grade, while increased volatility is expected to persist (as well as further spread widening). We still favor shorter duration credit given our cautious view and the approaching end of the current credit cycle (global policy adjustment, increased geopolitical risks). We continue to find attractive at current yield levels the USD corporate credit short end (up to 5 years).

II. Advanced Economies

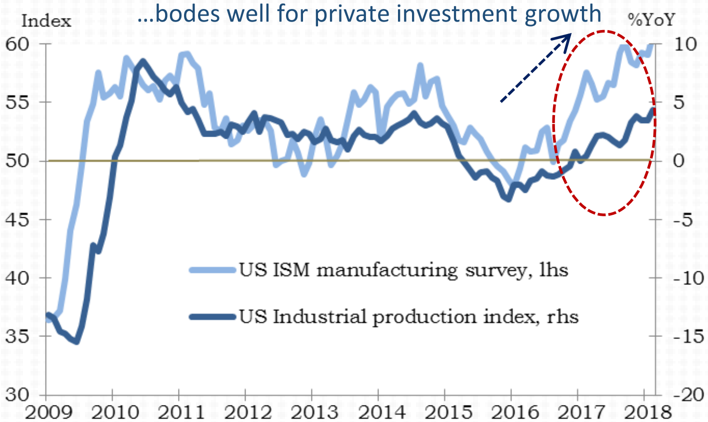
- USA
- Euro Area
  - ❖ Periphery (Italy, Spain, Portugal, Cyprus)
- UK

USA: Among the fastest growing advanced economies, with fiscal loosening supporting the recovery

US: "Tax Cut and Jobs Act" & "Bipartisan Budget Act"
tailwind for growth but headwind for public finances



US: Strong momentum in the manufacturing sector…
…bodes well for private investment growth



Source: Bloomberg, Federal Reserve, Eurobank Research

Latest Economic Developments

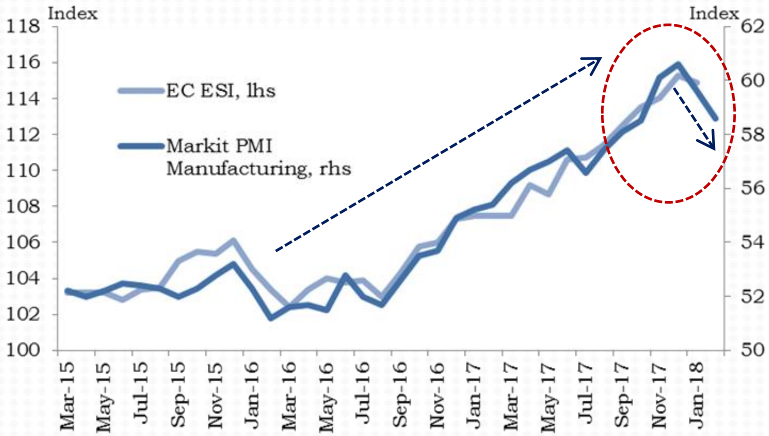
According to the BEA's third estimate, US Q4 GDP growth was revised higher by four-tenths to 2.9%QoQ saar, with a 20bps upward revision in personal consumption being the major driver. Although corporate profits numbers declined by 0.1%QoQ in Q4 following two straight quarters of growth, the decline appeared to be driven by a drop in financials with non-financial corporate profits still standing firm. Slower personal spending in the first two months of the year is probably largely attributed to the surge in durable consumption witnessed late last year due to a series of disruptive hurricanes in August and September. On the flipside, durable goods orders came in stronger than expected in February, pointing to higher equipment investment in Q1. Overall, the significant fiscal stimulus, including the US Tax Cuts and Jobs Act and the decision of Congress to raise spending limits over the next two years, is set to provide a short-term boost to US real growth, expected at 2.8% in 2018 and 2.5% in 2019.

Central Bank Watch

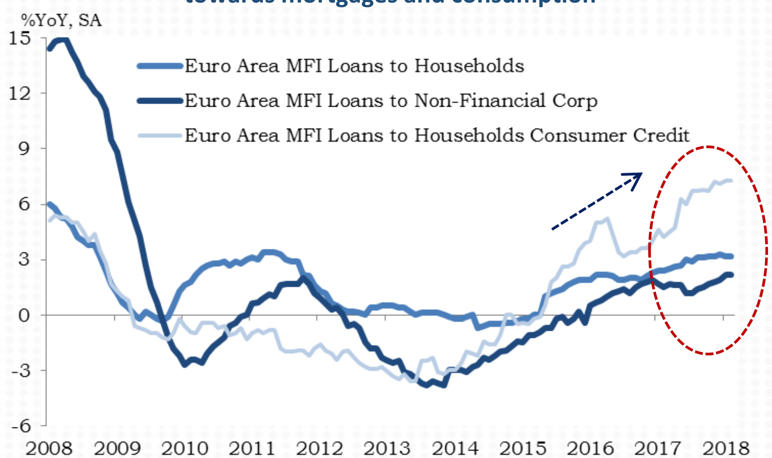
As expected, the FOMC decided unanimously at its March FOMC meeting to raise the target range by 25bps to 1.50%-1.75%. In the accompanying statement, the Fed acknowledged a stronger US economic outlook and reiterated its confidence that inflation on a 12-m basis will stabilize around the 2% target over the medium-term. Along these lines, the updated Summary of Economic Projections revealed a higher real GDP growth forecast for 2018 and 2019 by 0.2pp and 0.3pp respectively to 2.7% and 2.4%, reflecting the expected impact from the combination of tax cuts and additional government spending through FY2020. Core PCE inflation forecast for 2018 was left unchanged at 1.9% but for both 2019 and 2020 was revised higher by 0.1pp to 2.1% for each year. The median funds rate (the "dots") for 2018 remained at 2.1%, implying three rate hikes, while the median funds rate for 2019 and 2020 rose to 2.9% (implying 3 hikes) and 3.4% (implying 2 hikes) respectively, from 2.7% and 3.1% in Dec. Given that the number of Fed officials favoring four rate hikes in 2018 doubled to six, risk is probably skewed towards a total of four hikes this year.

Euro area: High-frequency indicators point to a moderation in activity growth

EA: Cyclically strong, although some signs of softness emerge on past EUR appreciation



EA: Private sector lending on a strong footing but tilted towards mortgages and consumption



Source: ECB, EC, Eurostat, Markit, Bloomberg, Eurobank Research

Latest Economic Developments

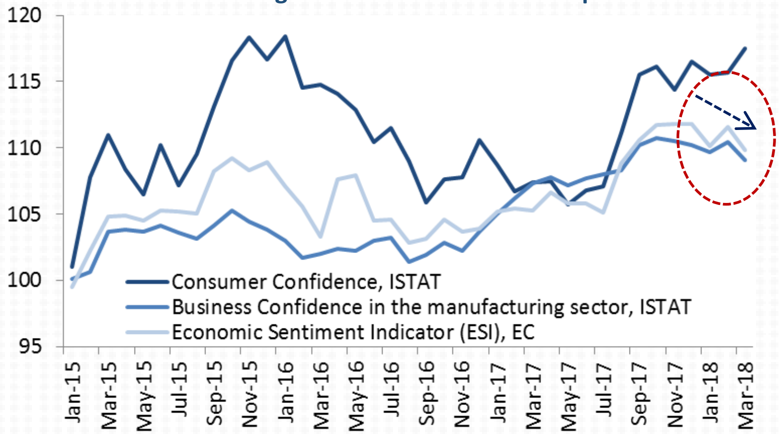
High frequency indicators in the first three months of the year suggest that strong economic growth momentum built in H2 17 will likely fade gradually in 2018 albeit still supporting economic activity. Euro area industrial production contracted in January (-1.0%MoM), with its annual rate of growth decelerating to 2.7%YoY after finishing 2017 at a multi-year high of 5.3%. Meanwhile, March “flash” PMI manufacturing index surprised to the downside, falling to a 13month low of 55.3, pointing to a moderation in activity growth across euro area economies. Overall, we expect Euro area GDP to grow by 2.5% and 2.2% in 2018 and 2019 respectively, with both monetary and fiscal policies supporting the recovery. Risks seem broadly balanced with protectionist US trade policy, probably the biggest threat to the Euro area’s prosperity. Although the US have announced the exemption of tariffs on EU steel and aluminum exports until May 1, 2018, the Euro area that is relatively highly exposed to external trade would be severely hit if EU-US trade frictions escalate and US tariffs are imposed on other EU sectors.

Central Bank Watch

At its March monetary policy meeting, the ECB decided unanimously to omit from the accompanying policy statement the explicit pledge that had been in place since 2016 suggesting that the Central Bank stands ready to increase the volume of monthly asset purchases, should the euro area outlook or financial conditions become less favorable. Although the ECB President tried to downplay the change in the forward guidance, it does however mark another small step towards the phasing-out of net asset purchases by the end of 2018. We expect that the ECB will likely provide, no earlier than June/July, a plan to taper its asset purchases to zero in the last three months of 2018, trying to prevent a further EUR appreciation and an unwarranted tightening of financial conditions. The key driver for the first interest rate hike will be the future path of core inflation and wage growth, so we do not envisage a hike before Q1 2019, at the earliest, as inflationary pressures are expected to remain subdued by year-end.

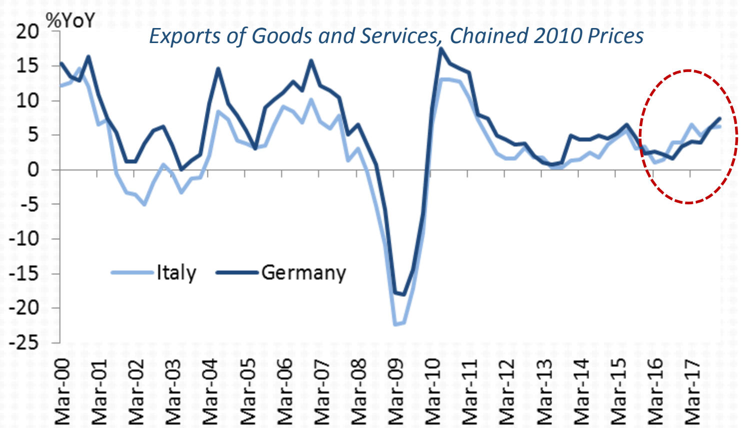
Italy: Political uncertainty prevails following the inconclusive March election

Certain leading indicators off their recent peaks



Italian exports increasing at rates similar to Germany…

…capitalizing on the synchronized and broad-based global upturn



Source: ISTAT, European Commission (EC), Bloomberg, Eurostat, Eurobank Research

Latest Economic Developments

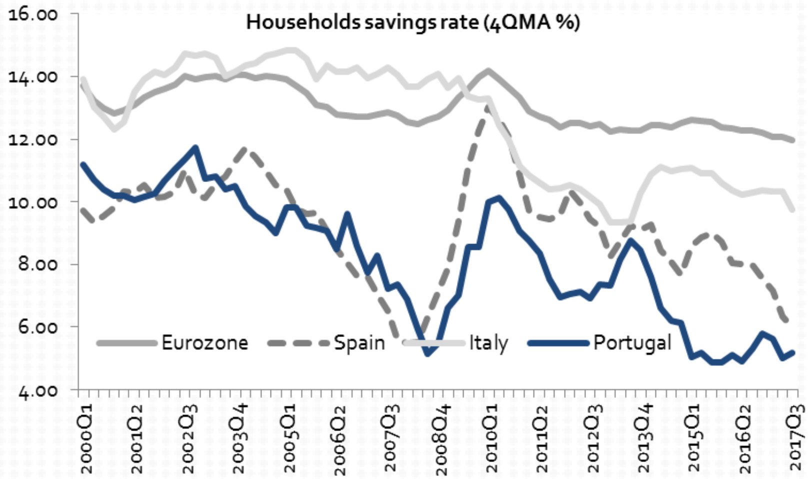
Although Q4 real GDP reported its weakest pace of growth in a year (+0.3%QoQ), overall growth for the whole of 2017 came in at 1.5%, the strongest over the past 10 years. Though private consumption, one of the major pillars of growth softened to 1.3% in 2017 from its recent peak of 1.9%YoY in 2015, exports more than doubled their pace of growth to 5.2%YoY from 2.6%YoY in 2016, capitalizing on the synchronized and broad-based global upturn. Looking ahead, real GDP is expected to decelerate marginally to 1.4% in 2018 and 1.2% in 2019, as -despite promised tax cuts and public spending increases by almost all major political parties- there is no available space for fiscal expansion as the expected end of the ECB's QE later this year could lead to a rise in Italy's borrowing costs.

Italian politics update

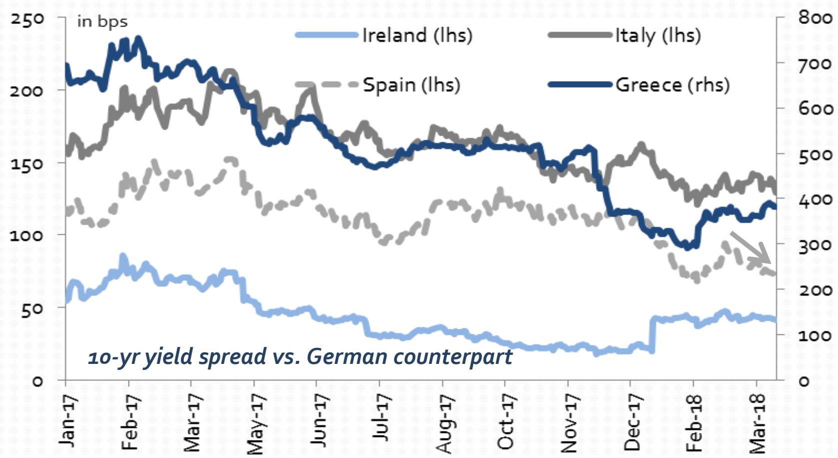
Following the inconclusive outcome of the 4 March election, the centre-right coalition [formed by Lega (L), Forza Italia (FI) and Fratelli di Italia (FdI)] and the M5S struck a deal, resulting in the election of the presidents of the Lower and the Upper House on March 24, i.e. Roberto Fico (from M5S) and Elisabetta Casellati (from FI), respectively. President Sergio Mattarella is expected to start the process of forming a new government on April 4 but the odds are that the consultation process will likely take several weeks, especially as elections in Molise (22 April) and Friuli Venezia Giulia (29 April) are looming. A mixed government backed by both traditional and anti-establishment political parties remains our baseline scenario. Nevertheless, the possibility of a M5S-Lega populist governing alliance has also increased following Di Maio and Salnivi's cooperation in the elections of the speakers of the two chambers of parliament, although it remains difficult to materialize given that Lega may not be willing to ruin his traditional alliance with centre-right parties. A government of national unity involving almost all political parties could also be a potential outcome, while new elections in the short-term, in case government building consultations between political parties fail, cannot be entirely ruled out.

Spain: Solid expansion continues but momentum has slightly weakened

Spain's gross savings rate among the lowest in the euro area



Spain among the main performers in the EMU sovereign space in recent weeks



Source: Eurostat, Bloomberg, Eurobank Research

Latest Developments

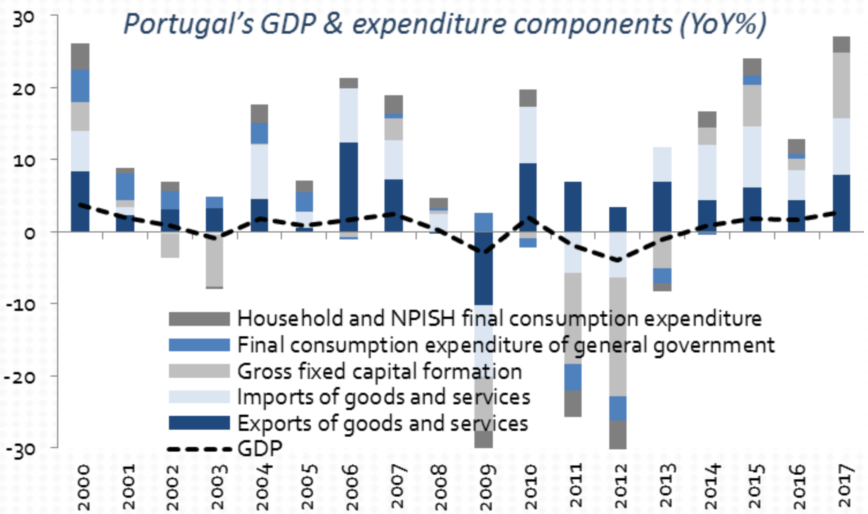
After Spain's GDP grew by 3.1% in 2017, above the euro area average for the third consecutive year, business surveys for the first few months of this year point to continued healthy growth, albeit at a slowing pace. The European Commission's economic sentiment index fell in March for the second month in a row coming in at a seven-month low of 109.0 and the Markit PMI manufacturing index slipped by 1.2 points to 54.8 in March with the output component falling to the lowest since August. Meanwhile, the pace of job creation has eased in recent months supporting the view that private consumption —the country's main engine of growth— is likely to lose some momentum this year, especially in case households are not willing to further push down their savings rate. Meanwhile, S&P followed a similar move by Fitch in January, raising in late March its rating for Spain firmly into single A territory, citing expectations that economic growth will outpace that of the euro area average over 2018-2021 and that the government's budget deficit will continue to shrink. In reaction to the above and favored by prevailing ECB accommodative monetary policy stance, Spain has been among the main outperformers in the EMU sovereign space in recent weeks.

Catalonian Politics Update

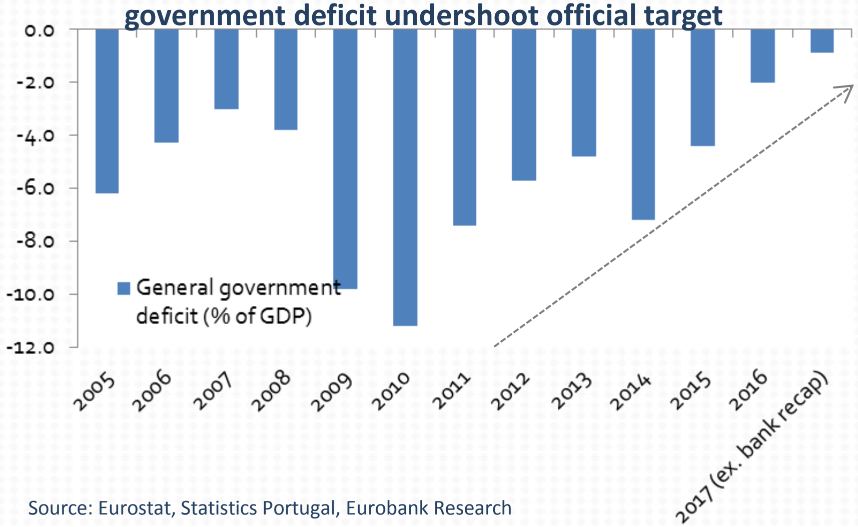
More than three months after the 21 December 2017 election, pro-independence parties that secured a majority of seats in the regional parliament have not yet agreed on a viable government (if no government is formed by May 22, new elections in the region will have to be held in July). The arrest of former First Minister Carles Puigdemont in Germany on March 25 did not help to break the political deadlock in the region. As a result, Catalonia does not have a government and Article 155 is in place with spillover effects on national politics. Spain has been left without a budget for 2018 as the minority government led by the Popular Party lacks the necessary support in parliament. Whereas Cuidadanos has signaled that it may cast a positive vote, the Basque Nationalist Party (PNV) has warned that it is unwilling to support the 2018 budget for as long as Article 155 is in place.

Portugal: Economic recovery continues at a healthy pace

Portugal's 2017 strong performance likely to carry over into 2018



Ex. bank recapitalization, 2017 general government deficit undershoot official target



Source: Eurostat, Statistics Portugal, Eurobank Research

Latest Economic Developments

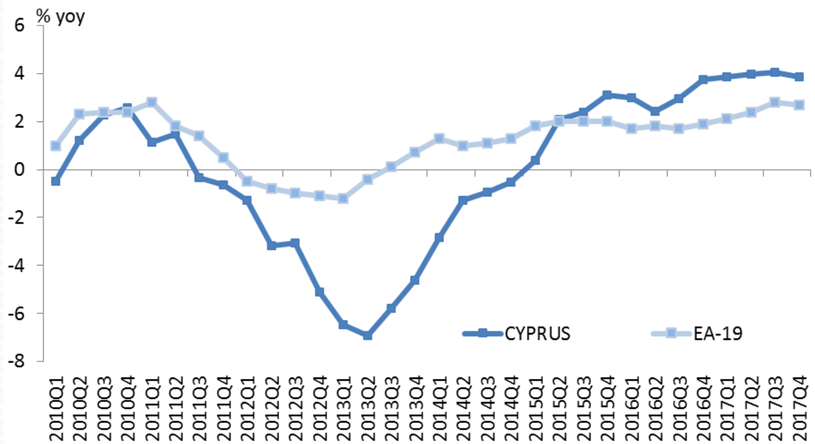
Available data for Q1 2018 suggests that last year's stellar performance has carried over into 2018. Industrial production growth gained steam in January rising by 2.5%YoY, the highest among euro area member states. In a similar positive tone, with 2011-2014 debt crisis firmly behind it, the real estate boom continued in January with production in construction gaining 3.0%YoY, the second highest in a year. Economic sentiment index fell in March for the fourth month in a row coming at 112.7, remaining though not too far from November's 17½ year peak of 115.1. Reflecting strong economic sentiment, real retail trade rose by 5.3%YoY in January, matching November's six-month high pace of growth on the back of strong domestic demand mainly thanks to the rapid erosion of the slack in the labour market. The unemployment rate remained in a downward trend in February for the 17th consecutive month falling below 8.0% for the first time since mid 2004 to 7.8%. Strong economic performance has been accompanied by strong fiscal performance with budget deficit –excluding the effect of the recapitalisation process of Caixa Geral de Depositos- falling in 2017 at 0.9% of GDP, undershooting the official target of 0.5% of GDP. Acknowledging the positive evolution of the economy and the government's steps to reduce structural imbalances, the European Commission removed in early March Portugal from its list of countries with excessive economic imbalances. In terms of debt supply, following last year's credit rating upgrades by S&P and Fitch that restored the nation's investment grade status, Portugal continued to obtain negative rates in short term debt auctions. It also returned to the very long term financing in mid-March (10-yr & 27-yr debt) paying the lowest interest ever.

Debt & bank jitters constitute Portugal's key medium-term downside risks

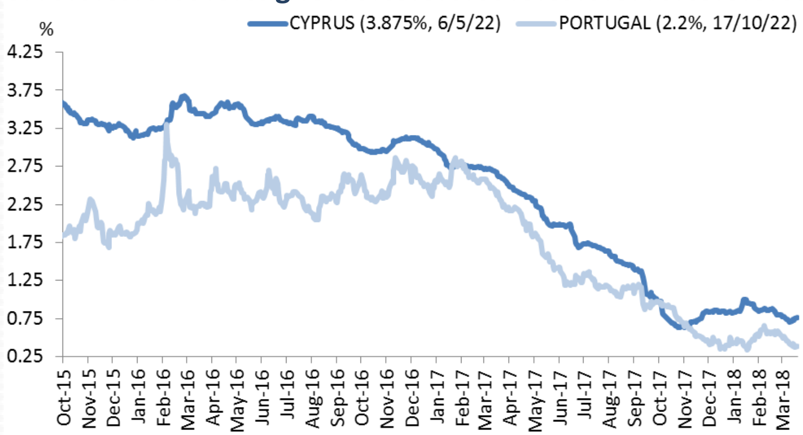
Portugal's high level of general government and private debt, constitutes key risks for adverse side effects on economic recovery medium-term. Challenges also remain for the banking sector mainly due to the elevated level of non-performing loans, weak asset quality, low profitability and contained capital buffers.

Cyprus: The highest post-Lehman GDP growth rate in 2017

Cyprus turn-around growth story has been impressive so far



Cypriot medium term bond yields trading above those of Portugal since mid-November



Source: Eurobank Research, National Authorities, Bloomberg

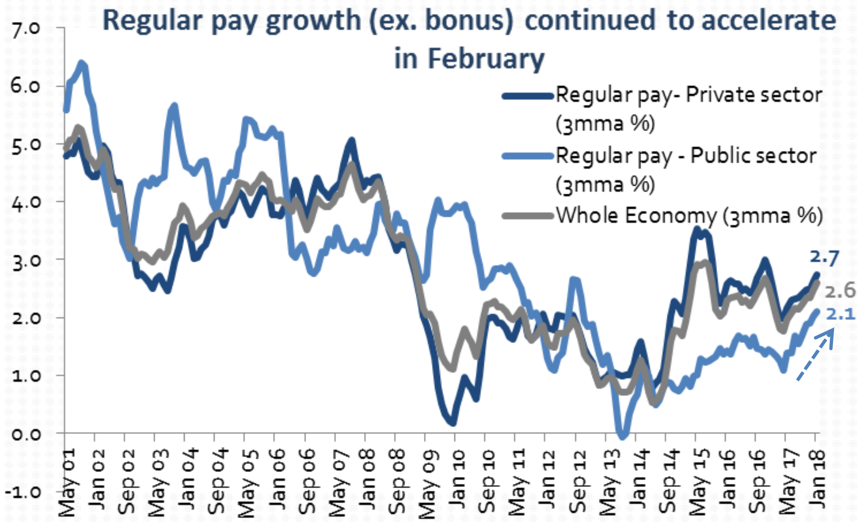
Latest Political & Economic Developments

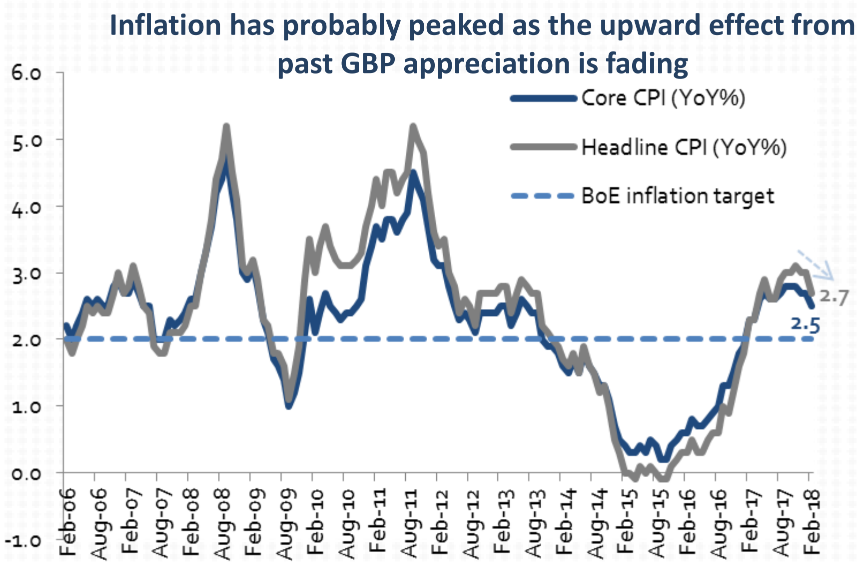
According to the second estimate release, real GDP on a seasonally adjusted basis expanded by 3.8% YoY in Q4-2017 bringing the full year performance at 3.9% in 2017-the highest growth rate in the post-Lehman period-up from 3.4% in 2016 and 2% in 2015. The consumption rebound continued throughout 2017, making a total contribution of 3.3ppts to growth. Private consumption accelerated to 4.2% YoY in 2017 up from 3.3% YoY in 2016. Public consumption expanded by 2.7% YoY in 2017 switching from -0.3% YoY in 2016, making a positive contribution for the first time since 2011. Investment spending expanded by 27.8% YoY in 2017 on top of 35.0% YoY in 2016, thereby having the largest positive contribution to GDP growth (5.1ppts in 2017 vs. 4.9ppts in 2016). Investments received support from all segments (construction 24.9% YoY, machinery & equipment 40.9%, transport equipment 20.2%). As a result, investments to GDP ratio climbed to 20.4% in 2017-close to the EA19 average-up from 16.8% in 2016 and only 12.3% in 2014, 13.2% in 2013 and a pre-crisis high at 28.9% in 2008. Higher imports of transportation equipment weighed heavily on the imports side (10.1% YoY), so that with the small deceleration of exports (3.4% YoY in 2017 vs. 4.0% YoY in 2016) resulted in net exports having a negative contribution of -4.5ppts in 2017 (vs. -1.7 ppts in 2016).

Risks & Challenges

Given that no party enjoys absolute parliamentary majority, the new President will have to achieve concessions from other parties in the 56-seat parliament in order to pass legislation. The ruling right-wing DHSY controls only 18 seats while DHKO can no longer be counted as a government partner which explains at large the lower re-election approval rate of President Anastasiades. This is not very reassuring given that there is a number of important pending structural reforms in the areas of privatizations, public and health sectors, while addressing the challenges of a still high bad loans stock (NPEs ratio at 43.7% in November 2017) in order to avoid backtracking on the economy.

UK: The economy on a steady but slow course in early 2018





Source: ONS, Eurobank Research

Latest Economic Developments

According to the most recent data, the UK economy kept on its steady but slow course in the early months of 2018. The Markit/CIPS manufacturing PMI came in largely unchanged in March (55.1) but Q1 2018 average declined to a one-year low, suggesting that the underlying momentum has weakened. Consumer confidence fell by one point in February to -10 mainly due to ongoing concerns about sluggish household income and expectations of higher BoE interest rates. Fragile consumer confidence took a toll on housing market activity with Nationwide, one of the biggest UK mortgage lenders, reporting a drop in house prices in March for the second month in a row. Retail sales rebounded 0.8%mom in February following two months of weakness but on an annual basis the subdued trend remained in place as sales continued to grow by 1.5%. On a positive note, the unemployment rate unexpectedly fell from 4.4% to a record low of 4.3% in the three months to January and the 3-month average of regular pay growth continued to accelerate rising from 2.5%YoY to 2.6%YoY, the highest since end 2016. For the whole of 2018, UK GDP is projected to grow modesty at around 1.5%, a relative laggard among G7 developed economies, as robust global growth should offset the drag from Brexit uncertainty and continued subdued real consumer spending growth.

Central Bank Watch

The BoE kept the Bank Rate on hold at 0.50% at the March 21 meeting while the overall tone of the accompanying statement implicitly validated market expectations for a 25bps May rate hike. Providing further support to the prevailing view of higher BoE rates in the foreseeable future, regular pay growth accelerated in February for the second month running and inflation, while declining from last November's six-year high of 3.1%YoY, remained in February well above the BoE's 2.0% inflation target. Adding to the above, although certain issues remained unresolved, the EU and the UK reached a technical agreement at the March 22/23 EU Council on the broad terms of the transition period and the guidelines for the ensuing negotiations on the future relationship, marking a significant step forward in the Brexit negotiation process.

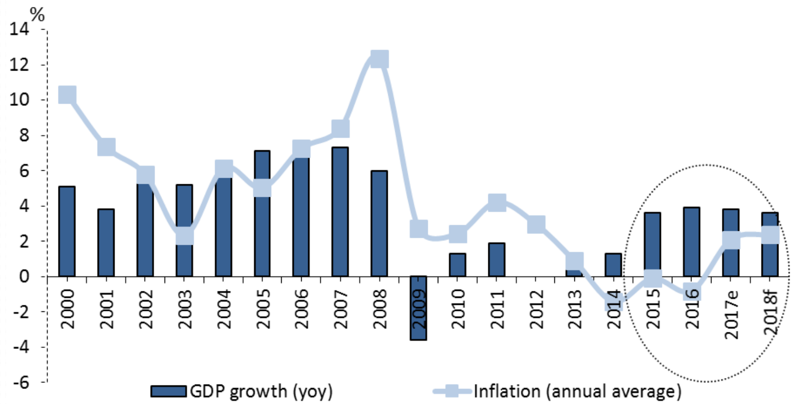
III. Selected CESEE economies

- Bulgaria
- Romania
- Serbia

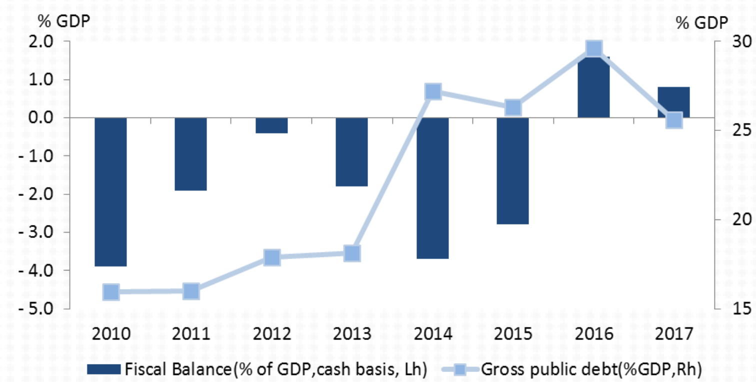
Bulgaria: Investments performance will be key to a more balanced growth path in 2018

Eurobank

Growth dynamics are set to remain strong in 2018



Bulgaria's fiscal position is sound and fulfills the nominal criteria for Euroarea entry



Source: Eurobank Research, National Authorities

Latest Economic Developments

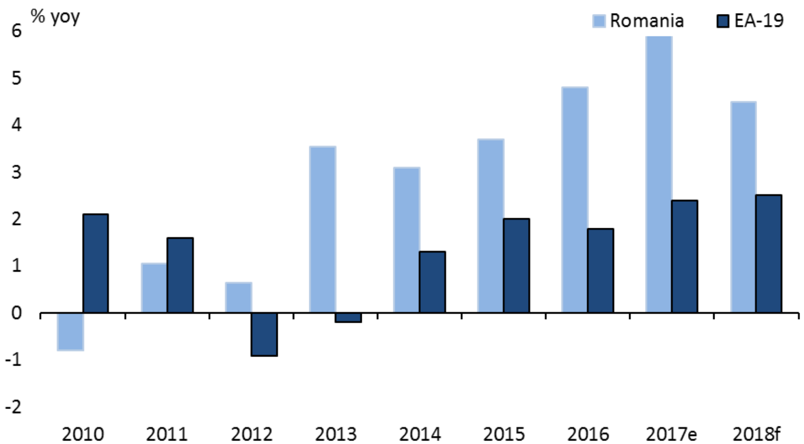
According to the second estimate, real GDP growth slowed to 3.5% YoY in Q4-2017 down from 3.9% YoY in Q3-2017 on the back of the quarterly performance of investments (+0.2% QoQ) and net exports (exports:-1.0% QoQ & imports:+4.4% QoQ). Having expanded by 3.6% YoY in 2017, Bulgaria is now expected to register another year of strong-above potential-growth in 2018. The economy is expected to benefit from further labor market improvement, accelerating credit activity dynamics, a more expansionary fiscal policy stance, a vibrant export oriented manufacturing sector and an emerging tourism destination. The economy is operating at or close to full employment (the relevant % of companies reportedly confronted with labor scarcity in the EU survey has climbed to 40% in Q4-2017 up from only 13% in Q4-2013). Fiscal policy is expected to be more growth-supportive provided that budget execution aligns with the 1% of GDP deficit target in 2018 vs. a 0.8% surplus in 2017. Credit to the non-government sector accelerated to 4.8% YoY in 2017 vs. only 1.5% YoY in 2016. With capacity utilization standing at an all-time high, private companies will need to invest more in order to strengthen their productive capacity. Finally, investments are going to receive support from improved EU funds absorption.

Risks & Challenges

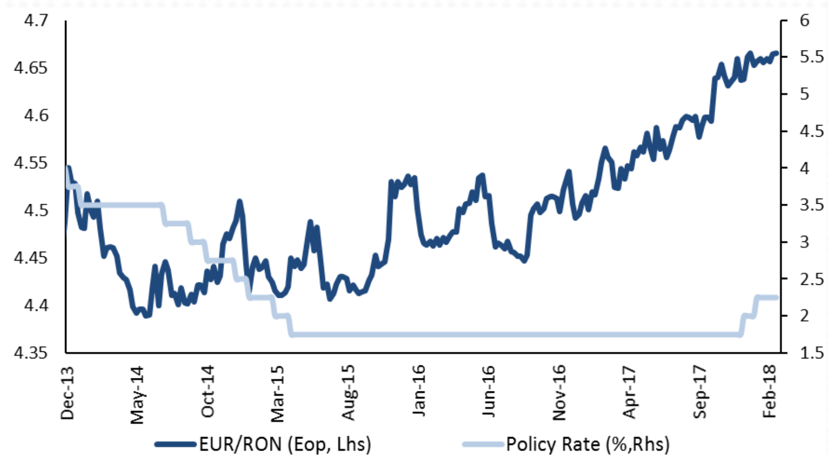
Currently, Bulgaria fulfills most of the nominal convergence criteria for Euroarea entry. Real convergence criteria are not satisfied, although officially these are not part of the evaluation procedure. The living standards and productivity are the lowest in EU-28. The country is still subject to the Co-operation and Verification mechanism, which was set up in 2007 to monitor progress in the fields of judicial reform, corruption and organized crime. Factoring in the fast GDP growth trajectory in 2015-2018, GDP per capita in PPS terms will have only climbed to 50% in 2018. Finally, IMF in its latest Article IV report sees GDP growth moderating to 2.75% over the medium, reflecting capacity constraints and unfavorable demographics.

Romania: Inflation at the highest level of the last five years

Romania has been growing faster than EA-19 in 2013-2018



NBR hiked the KPR by another 25bps in February 2018



Source: Eurobank Research, National Authorities, Bloomberg

Latest Economic Developments

Consumer prices jumped to +4.7% YoY in February up from 4.3% YoY in January, in line with Bloomberg consensus. The monthly jump was mainly driven by higher non-food prices (+0.1% MoM/+6.3% YoY) reflecting the new regulated price increase for energy tariffs (as of Jan 2018) plus base effects from the phasing out of last year's VAT rate cut. On top, food prices continued rising (+0.6% MoM/+3.7% YoY) reflecting the upward trend of volatile fruits and vegetables. The reading on an annual basis is the highest in the last 5 years, so that headline inflation has now penetrated the upper bound of the NBR's target interval (2.5+1%). The adjusted Core CPI (excluding administered and volatile prices, alcohol and tobacco) advanced further to 2.9% YoY in February, the highest level since August 2013, in an illustration of underlying demand side pressures.

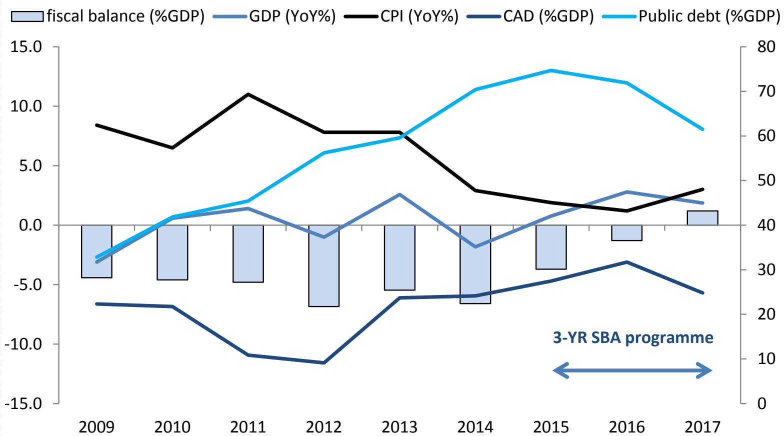
Real GDP slowed down to 7.0% YoY in Q4-2017 down from 8.5% YoY in Q3-2017 bringing the FY performance at 7.0%, a new post crisis high up from 4.8% in 2016. Growth is largely driven by private consumption, financed by an overly expansionary fiscal policy, and leads to a revival of macroeconomic imbalances (CAD17: -3.5% of GDP). A sharp slowdown to 4.5% is on the cards in 2018 reflecting the impact of higher inflation on real disposable incomes, a front-loaded monetary policy and the need for a more conservative fiscal policy.

Risks & Challenges

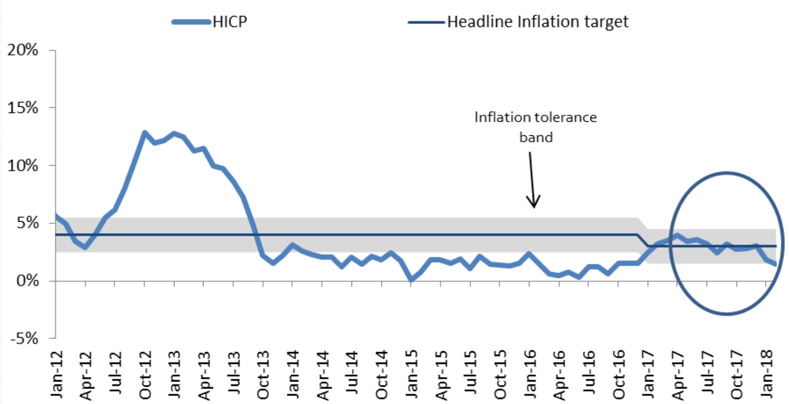
Risks are centered around the impact of current pro-cyclical and pro-consumption expansionary fiscal policies on the medium-term prospects. Running sizeable fiscal deficits coupled with low public investment spending is exacerbating inflationary pressures undermining not only the competitiveness and the growth potential of the country but also its ability to withstand an external shock. To make things worse, the tensions within the ruling PSD party threaten political stability and have a negative impact on the consistency and efficiency of implemented policies.

Serbia: PCI deal with the IMF likely to be signed by mid-year

Macro fundamentals improve in the SBA period



Inflation pressures remain subdued



Source: Eurobank Research, National Authorities

Latest Economic & Political Developments

Discussions about a new economic reform program with the IMF started in March, following the successful conclusion of the $1.32bn 3-year SBA in late February. The Fund confirmed that such a deal would likely entail the form of the non-financing Policy Coordination Instrument (PCI). The government has already demonstrated in the three years under the SBA its own-financing capability, having treated the previous programme as precautionary. Such a deal suggests continuation of reforms and provides a valuable policy anchor going forward. The mission is scheduled to return to Serbia in May to finalize the terms of such a deal. As recently noted by Prime Minister Ana Brnabic a package is expected to be signed by mid-year and is seen focusing on economic growth.

Central Bank Watch

The MPC cut the key policy rate by 25bps to a new low of 3.25% in March following stable rates in the prior four meetings. The decision was taken amid low inflation pressures and was aimed at supporting domestic credit and economic growth. The dinar's recent appreciation to 3 ½ year highs just below 118.00/€ and weak inflation figures, had somewhat stirred market talk for a rate cut in March, albeit the median forecast was for stable interest rates. Headline CPI slid to a 1-½-year low of 1.5%YoY in February on base effects and touched the lower bound of the 3.0±1.5% target band, a range held since late 2016. Additionally, the corresponding core index came in at 1.3%YoY, 0.1ppts above January's life-time low, confirming that inflationary pressures remain subdued. Nonetheless, the current monetary easing cycle is close to reaching or has reached its bottom as lower CPI readings have been primarily driven by one-off factors, with a move higher seen later in the year as domestic demand dynamics improve further, labour market conditions remain tight and some fiscal loosening takes place in 2018. The pace of monetary policy normalization by major CBs and movements in global oil and food prices will also be key to future MPC decisions.

IV. Eurobank Forecasts

Eurobank Macro Forecasts

	Real GDP (YoY%)			CPI (YoY%, avg)			Unemployment rate (% of total labor force)			Current Account (% of GDP)			General Budget Balance (% of GDP)		
	2017	2018f	2019f	2017	2018f	2019f	2017	2018f	2019f	2017	2018f	2019f	2017	2018f	2019f
World	3.7	3.9	3.9	3.1	3.3	3.3									
Advanced Economies															
USA	2.3	2.8	2.5	2.1	2.3	2.2	4.4	3.9	3.5	-2.4	-2.6	-2.8	-5.0	-5.5	-6.5
Eurozone	2.3	2.5	2.2	1.5	1.5	1.4	9.1	8.4	7.9	3.4	3.0	2.9	-1.1	-0.9	-0.8
Germany	2.5	2.7	2.1	1.7	1.6	1.6	3.8	3.5	3.2	7.9	7.5	7.2	0.9	1.0	1.1
France	1.8	2.2	1.9	1.2	1.5	1.4	9.5	9.3	8.9	-3.0	-2.8	-2.6	-2.9	-2.8	-2.7
Periphery															
Cyprus	3.9	3.9	3.5	0.7	1.0	1.5	11.1	10.0	9.3	-6.7	-6.2	-6.5	1.9	1.3	1.4
Greece	1.4	2.2	2.2	1.1	1.0	1.2	21.6	20.0	18.5	-0.8	-0.1	-0.1	-0.6	0.6	0.8
Italy	1.5	1.4	1.2	1.3	1.1	1.3	11.2	10.9	10.5	2.9	2.6	2.4	-2.1	-1.8	-1.8
Portugal	2.7	2.1	1.9	1.6	1.4	1.4	9.0	8.0	7.5	0.4	0.7	0.5	-1.4	-1.2	-1.2
Spain	3.1	2.8	2.3	2.0	1.7	1.3	17.2	15.0	13.5	1.7	1.3	1.0	-3.1	-2.4	-2.0
UK	1.8	1.5	1.2	2.7	2.5	2.3	4.4	4.5	4.5	-4.1	-4.3	-4.1	-2.7	-2.4	-1.7
Japan	1.6	1.3	1.1	0.5	1.0	1.0	2.8	2.7	2.7	4.0	3.9	3.8	-5.0	-4.2	-4.0
Emerging Economies															
BRICs															
Brazil	1.0	2.2	2.5	3.5	4.0	4.2	12.9	11.8	11.0	-0.5	-1.5	-1.8	-8.9	-7.5	-6.8
China	6.9	6.6	6.3	1.6	2.5	2.5	3.9	4.0	4.0	1.3	1.3	1.2	-3.7	-2.6	-2.5
India	7.1	6.6	7.4	3.3	3.7	4.5		*NA*		-1.4	-1.5	-1.6	-3.5	-3.5	-3.3
Russia	1.5	1.8	1.7	3.7	3.4	4.0	5.2	5.1	5.0	2.2	3.0	2.5	-1.7	-0.8	-0.5
CESEE															
Bulgaria	3.6	3.7	3.5	2.1	2.4	2.7	6.3	6.0	5.7	5.0	4.5	4.0	0.8	-1.0	-0.5
Romania	7.0	4.5	4.0	1.3	4.5	3.0	4.9	4.8	4.7	-3.5	-4.0	-4.5	-3.0	-3.5	-4.0
Serbia	1.9	3.0	3.2	3.2	3.0	3.2	12.5	11.5	11.0	-5.7	-5.3	-5.2	0.5	-0.6	-0.5
Turkey	7.0	4.2	4.0	11.1	10.0	9.0	10.9	10.6	10.5	-5.2	-5.1	-5.0	-2.1	-2.3	-2.3

Source: EU Commission, IMF, OECD, Bloomberg, Eurobank Research

Eurobank Fixed Income Forecasts

	2018				2019
	Current	June	September	December	March
USA					
Fed Funds Rate	1.50-1.75%	1.75 -2.00%	1.75-2.00%	2.00-2.25%	2.00-2.25%
1 m Libor	1.88%	2.02%	2.03%	2.30%	2.37%
3m Libor	2.31%	2.29%	2.40%	2.50%	2.58%
2yr Notes	2.26%	2.37%	2.45%	2.50%	2.56%
10 yr Bonds	2.75%	2.79%	2.83%	2.90%	2.95%
Eurozone					
Refi Rate	0.00%	0.00%	0.00%	0.00%	0.00%
3m Euribor	-0.33%	-0.32%	-0.31%	-0.29%	-0.25%
2yr Bunds	-0.60%	-0.52%	-0.47%	-0.40%	-0.36%
10yr Bunds	0.51%	0.58%	0.63%	0.70%	0.75%
UK					
Repo Rate	0.50%	0.75%	0.75%	1.00%	1.00%
3m	0.72%	0.94%	1.00%	1.09%	1.16%
10-yr Gilt	1.35%	1.45%	1.50%	1.52%	1.57%
Switzerland					
3m Libor Target	-0.75%	-0.75%	-0.71%	-0.67%	-0.61%
10-yr Bond	0.06%	0.10%	0.12%	0.18%	0.21%

Source: Bloomberg (market implied forecasts)

Eurobank Research & Trading Teams

Economic Analysis & Financial Markets Research

Research@eurobank.gr

Dr. Tassos Anastasatos: Group Chief Economist
tanastasatos@eurobank.gr, + 30 210 33 71 178

Anna Dimitriadou: Economic Analyst
andimitriadou@eurobank.gr, + 30 210 37 18 793

Ioannis Gkionis: Senior Economist
igkionis@eurobank.gr + 30 210 33 71 225

Stylianos Gogos: Economic Analyst
sgogos@eurobank.gr + 30 210 33 71 226

Olga Kosma: Research Economist
okosma@eurobank.gr + 30 210 33 71 227

Paraskevi Petropoulou: Senior Economist
ppetropoulou@eurobank.gr, + 30 210 37 18 991

Galatia Phoka: Research Economist
gphoka@eurobank.gr, + 30 210 37 18 922

Theodoros Stamatiou: Senior Economist
tstamatiou@eurobank.gr, + 30 210 33 71 228

Global Markets Trading Team

Global_Markets_Trading@eurobank.gr

FX & Derivatives

Stavros Daliakopoulos (Head), Maria Katrantzi, Dimitris Stamoulis, Nassos Assimakopoulos

FX_TRADING@eurobank.gr, DERIVS_TRADING@eurobank.gr

Credit, EM & Sovereigns

Magdalini Papadimatou (Head), Lambros Demertzoglou, Kostas Theodoropoulos, Andreas Lake, Konstantinos Livitsanos

SOV_TRADING@eurobank.gr, EM_CORP_TRADING@eurobank.gr

Costas Katsileros: Head of Global Markets Trading
ckatsileros@eurobank.gr + 30 210 37 18 764

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