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

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I. Snapshot

Overview

Macro Picture

- **USA:** Latest economic indicators point to a soft start to Q2, with global weakness weighing on the manufacturing sector
- **EA:** Below-trend growth with persistent industrial weakness and fading global trade growth
- **UK:** Solid Q1 GDP growth on strong inventory build-up; but a likely unwinding could claw back growth in the coming quarters
- **EM:** Economic growth seems to have bottomed out in many EMs
- **CESEE:** Flash GDP Q1 prints reveal region's growth resilience amid EU's economic activity slowdown

Policy Outlook

- **USA:** Fed is expected to keep patient stance; No anticipated rate changes in 2019
- **EA:** TLTRO III details likely to be unveiled in June; ECB ready to adjust all of its instruments; No policy rate hike until end-2020
- **UK**: The BoE is expected to remain in a "wait-and-see" stance awaiting greater Brexit clarity
- **CESEE:** Monetary policies remain broadly accommodative despite the tightening dilemma

Summary

Although the fundamentals of the world economy remain relatively strong, US/China trade frictions and geopolitical tensions have intensified, while the latest economic data have raised worries about the sustainability of the underlying economic recovery. The OECD projects real GDP global growth at 3.2% in 2019 from 3.5% in 2018

Markets

- **FX:** USD remained supported amidst fears for US-China trade war escalation, political uncertainty in the UK and continuously weak EU economic data. However, weak US PMIs data put pressure on the USD, pushing the currency back to April closing levels
- **Rates:** After April's small correction in yields the rally resumed in May as the positive sentiment about the Chinese economy has faded. Both Treasuries and Bunds rose to new YTD highs, driving the corresponding yields and swap rates to multi-month lows. The continuously weak economic data, the trade war escalation and the dovish FED minutes released on the 22-May have been the main reasons behind the rally
- **EM:** The US/China tension affected both Cash and CDS spread driving them wider. We remain cautious on EM spreads despite an abatement in trade war tensions. Valuations remain tight in spite of the sell-off
- **Credit:** Trade war developments moved spreads wider both in US and EUR credit since early May. We remain cautious over the next 1-2 months as the Q1 macro surprise might wane and markets start to be more risk averse again, especially from current relatively tight levels

Key Downside Risks

- **Renewed trade jitters:** US-China trade dispute turns to a full-blown trade war; the US imposes EU auto tariffs
- **Increased EU political uncertainty:** Delay in the formation of consensus in the European Parliament for the appointment of the next European Commission President; renewed confrontation between Italy and the European Commission
- **No-deal Brexit:** The next Conservative Party leader is more open to a no-deal Brexit; the UK House of Commons fails to reach consensus on Brexit by the 31 October deadline and the EU leaders do not agree to delay Brexit further
- **EM sensitivity:** Plethora of EM economies is strongly dependent on the outcome of the global trade war
- **China:** Further policy stimuli may not avert a further GDP growth slowdown

Macro Views

Eurobank

Latest Macroeconomic Developments & Outlook

World Economic Outlook		Although the fundamentals of the world economy remain relatively solid, US/China trade negotiations, which have taken a turn to the worse, intensified geopolitical tensions, as well as the latest economic data, have raised worries about the sustainability of the underlying economic recovery. High-frequency indicators point to weak trade prospects in the months ahead, export orders are at a low level -especially in the euro area and Germany in particular-, and global industrial production growth has recently stalled. On the flipside, the dovish shift from major central banks to a more accommodative stance has led to an easing of financial conditions, while sizeable fiscal easing measures and favorable labor market conditions keep boosting private consumption in the major economies. Overall, the OECD revised downwards its real GDP global growth projection to 3.2% in 2019 from 3.5% in 2018, with main downside risks focusing on a trade conflict escalation, policy uncertainty -including Brexit-related woes- and a failure of policy stimulus to prevent a sharper deceleration in China.
Developed Economies	**US**	Economic indicators point to a rather soft start to Q2. April retail sales fell short of market expectations, while the fall in April industrial production implies that the recent softness in the manufacturing sector cannot be fully attributed to the US government shutdown, but partly reflects weaker global demand, the waning effect of US fiscal stimulus and the lagged effect from past tightening in monetary conditions. Overall, we maintain our real GDP growth projection at 2.4% in 2019 down from 2.9% in 2018.
	Euro Area	Q1 real GDP growth came in stronger than expected at 0.4%QoQ, on the back of resilient domestic demand. Nevertheless, the negative print in March IP creates a negative carry over for Q2 and flash May PMIs suggest that downside risks continue to loom large. Recent developments on the trade front suggest that the euro area may return to sub-trend growth rates after the Q1 economic rebound. Overall, expansion is expected to continue in the medium term, albeit at a lower pace mainly due to fading global trade growth, with 2019 real GDP growth coming in at 1.2% from 1.9% in 2018.
	Periphery	Spain remained the Eurozone's bright star in Q1 2019 with GDP growth rising by 0.7%QoQ, the fastest pace since Q4 2017. Italy came out of recession over the same quarter but heightened political uncertainty constitutes a major risk to its growth outlook. With the outcome of the European Parliament election changing the balance of power within the coalition government in favor of the Eurosceptic League, tensions with the Five Start Movement may increase. In addition, the risk of a renewed confrontation with the European Commission, has increased.
Emerging Economies	**BRICS**	In Brazil, as meagre economic data releases continue and the vital pension reform struggles to be ratified, concerns over the sustainability of the country's economic recovery have increased. Even though Russia's GDP Q1 flash estimate came in at 0.5% YoY, well below market consensus at 1.2% YoY, economic activity gained some steam in April as industrial production data showed. The expected victory of Narendra's Modi right wing coalition in India's parliamentary elections sets the ground for continuity in the welfare reform agenda. China's economy appeared to have lost some momentum in April while the recent resurgence in the trade jitters with the US are expected to weigh further in May's economic performance.
	CESEE	The flash Q1-2019 GDP estimates in the broader CESEE region were a positive surprise, demonstrating the region's resilience to the deteriorating global economic environment. In the vast majority of countries, the statistical services announced flash GDP estimates that were above analysts' expectations, forcing them to revise upwards their full year forecasts.

Global Macro Themes & Implications

Theme	Implications
Inflation expectations in the way of a dovish turn	Despite full-employment conditions, relaxed fiscal policy and the still accommodative monetary policy stance, global inflation has disappointed in recent months. Major central banks struggle with inflation rates below the official target, with Fed officials expressing heightened anxiety about the prospect of persistently below-target inflation negatively affecting inflation expectations. In the US, according to the May FOMC minutes, there was broad agreement among participants that the recent softness in inflation is likely to be transitory, i.e. unexpected large price drops in the apparel category as well as in portfolio management services. Nevertheless, some FOMC members thought that downside risks to inflation have increased, while others expressed worries that long-term inflation expectations might have dropped below the levels that are consistent with the Fed's mandate. Meanwhile, according to a research note by the Fed of St. Louis, a "modernized" version of the Taylor Rule, which takes into account future inflation expectations such as the 5y/5y inflation swap, finds a Fed funds rate target slightly less than 2.0%. This framework suggests that the current fed funds target range of 2.25-2.50% is 'modestly tight'. In the euro area, although – according to the minutes of the April ECB's monetary policy meeting – the Governing Council believes that rising wage growth should lead to higher inflation and that there is still no sign of unanchored inflation expectations, market-based inflation expectations have deteriorated noticeably in recent weeks, with the 5y5y and 2y2y inflation swap both hovering close to all-time lows. Given that the ECB has initiated QE in August 2014 when the 5y5y inflation swap declined to slightly below 2%, markets have recently been speculating about the next monetary policy stimulus as the said inflation swap is currently trading around 1.30%.
Mounting worries over the global growth outlook following recent poor PMI releases across the globe	World economic growth has decelerated significantly over the past year, with the softness observed in the second half of 2018 continuing at the beginning of 2019 on the back of intensified trade war frictions. World trade and private investment growth have weakened abruptly, particularly in Europe and China, while confidence among businesses and households in a number of key economies have levelled off recent highs as heightened policy uncertainty has been offsetting the tentative signs of improvement witnessed in early 2019. Worries over the global growth outlook are mounting, following recent poor PMI releases across the globe. In the Euro area, the Composite PMI index disappointed in May with a mere 0.1p increase to 51.6, above the critical 50 units threshold but still below long-term averages; services PMI declined to 52.5 from 52.8 in April, while manufacturing PMI dipped further into contractionary territory (47.7 from 47.9 in April). According to HIS Markit, at current levels the PMI is pointing to real GDP growth of only 0.2%QoQ in Q2 2019. In the US, the ISM manufacturing index plunged to its lowest level since late 2016 in April, while the ISM non-manufacturing index fell 0.6pts to 55.5 in April, pointing to a rather moderate pace of growth in the services sector. Adding to the above, the Markit 'flash' manufacturing index for the US fell to the lowest in nearly 10 years (50.6 from 52.6 in April), while the respective index for the US services sector marked the lowest level in more than three years. As reported in HIS Markit's release, the recent decline in the Composite 'flash' PMI to its lowest level in three years is historically consistent with a real GDP growth rate of merely 1.2%QoQ saar in May.

Global Macro Themes & Implications

Theme	Implications
Brexit uncertainty to remain elevated in coming weeks	The Conservative Party's heavy defeat in the 2 May local elections, the government's three times failure to get the Withdrawal Agreement through parliament and the collapse in cross-party Brexit talks between the government and the Labour Party, were the drivers behind UK PM Theresa May's decision to resign as Prime Minister. She will step down on 7 June, opening the way for a Conservative Party leadership race starting in the week of 10 June. Depending on the number of candidates, the process for electing a new party leader could require a minimum of around a month, and in most cases, closer to two months. Should this be the case, the new leader could be in place by early July, before the UK parliamentary summer recess in mid-July. While the rules are subject to the discretion of the 1922 Committee, the election for the new party leader is likely to take place in two stages: i) Conservative MPs will go through a series of voting rounds with candidates receiving the fewest votes getting eliminated in each round; ii) When the number of candidates comes down to two, the new leader will be chosen by party members (as opposed to MPs) in a postal ballot. As regards Brexit, there is widespread concern that the new party leader is likely to be significantly more open to the prospect of a hard Brexit than Theresa May. One of the key reasons for such a view is that opinion polls of the Conservative Party membership suggest that around two thirds of party members are in favor of a no deal outcome. In addition, the strong support for the Brexit Party at the European Parliament election has already put pressure on some Conservative leadership candidates to signal their intention to pursue a no-deal Brexit, if needed. However, whoever takes the lead in the Conservative Party, will likely face the same challenges as Theresa May of having to break the Brexit impasse. The indicative votes in March suggest that a majority in the House of Commons is against a no-deal Brexit and will likely use the available tools (i.e., no confidence vote) to prevent such a scenario. A general election could solve the deadlock but, based on recent polls, the Conservatives could risk losing power to Labour. Another way to break the impasse might be a second referendum, but the indicative votes earlier this year showed that the majority of UK lawmakers does not favor that course of action. The other way forward could be a request for another Brexit extension on the basis that the new leadership requires additional time to examine his/her options. It should however be noted, that European Commission President Jean-Claude Juncker said recently that EU leaders will not engage in renegotiations on Theresa May's Withdrawal Agreement, suggesting that a renewed Brexit extension beyond October 30, should not be taken for granted. As a result, Brexit uncertainty remains high and the UK political landscape extremely uncertain.

Global Macro Themes & Implications

Theme	Implications
US-China trade dispute escalates	The US-China trade war unexpectedly intensified in mid-May, with trade negotiations breaking down as key differences between the two sides remain. The US administration raised tariffs to 25% from 10% on more than $200bn Chinese imports, effective from 1 June, and threatened to impose a 25% levy on the remaining c. $325bn imports from China in the coming months. A public hearing on the proposal for further action on Chinese imports will be held on 17 June and the due date for the submission of final comments to the US government is 24 June. In retaliation to the US action, China increased tariffs by 5-25% on $60bn US goods while there is rising speculation that it is considering to also use some new countermeasures as leverage in the trade war, including, reduced exports to the US of rare earths. That group of chemical elements is vital for many US industries and, according to US official data, around 80% of US imported rare earths come from China. Apparently, one of the most important obstacles to a trade deal is the US's demand that certain parts of the agreement be incorporated in Chinese Law to assure enforcement. On its part, China insists that the US should trust that it will fulfil its pledges through administrative and regulatory changes. In addition, the US prefers to keep the tariffs imposed so far on imports from China and to remove them gradually as China meets its commitments under the trade agreement, including intellectual property rights, forced transfer of technology and purchases of US goods. China, on the other hand, requests the one-off removal of those tariffs as a prerequisite for signing a trade agreement. The two trade teams have reportedly agreed to meet again but without determining when. Meanwhile, US President Donald Trump said recently that he would like to meet his Chinese counterpart at the G20 meeting on June 28-29 but nothing is officially confirmed yet. Against this background, market participants are concerned that the renewed escalation in the US/China trade war could be more extended than previously thought, as the latest developments make it hard to see the resolution of the trade dispute any time soon. Though uncertainty is high with regard to how trade talks will evolve, we still think that a trade deal will eventually be reached but not until the economic cost of the trade war to both economies has become clearer, putting pressure on both sides to make mutual concessions.

Macro Themes & Implications in CESEE

Theme	Implications
Flash GDP estimates of Q1-2019: The broader CESEE region remains immune to the deteriorating global economic environment	The flash Q1-2019 GDP estimates in the broader CESEE region were a positive surprise. In the vast majority of countries, the statistical services announced flash GDP estimates that were above analysts' expectations, forcing them to revise upwards their full year forecasts. Despite conventional wisdom suggesting that rising external environment headwinds and the slowdown of their main trade partner Germany would have a detrimental impact on their growth prospects, CEE3 (Poland-Hungary-Slovakia) economies were among the most resilient in the broader CESEE group. The CEE3 economies are leading the pack expanding on average by 4-5% YoY, while the SEE (Bulgaria-Serbia-Cyprus) economies are lagging behind growing on average by 3-3.5%. Meanwhile, both Romania and Turkey were outliers in the SEE pack. Romania accelerated by 1.3% QoQ/5.0% YoY in Q1-2019 above consensus (4.1% YoY). In contrast, high frequency indicators in Turkey point to a bottoming out of economic recession on fiscal stimulus yet it remains to be verified by the official announcement. Although the breakdown of the national accounts is still not available, it is highly likely that once again economic activity received support primarily from domestic demand. In most cases, net exports were a negative contributor, more than in the previous quarters, driven by higher imports mirroring strong domestic demand but also lower exports in response to the deteriorating external environment.
While fears over rising Euroscepticism appear contained in the Euro parliament elections, they keep surging in the heart of the region	Following the completion of the European Parliament (EP) elections, at first glance, the common denominator between the region and the whole EU is the increased turnout in the 2019 elections compared to those in 2014. The participation rate in the EU, rose above 50% for the first time since 1979 when turnout was close to 62% and slid to the historical low of 42.6% in 2014. Participation in the CEE3 countries was above the EU average; the turnout in Poland reached 46% from 24%, in Hungary it stood at 43.4% from 29%, in Romania at 51% from 32.4%, while in the Czech Republic 29% of the voters showed up vs 18.2% back in 2014. However, the political outcome in most of these countries is different compared to that in the EU, as a whole; While the overall results at the EP level point to a continuation of the fundamental realignment of the European politics and the surge of the populistic wave seems to have been contained, the populist ruling parties won the election in Poland, Hungary and the Czech Republic. Romania stands out as a notable exception, as the Socialist ruling party received a smaller share, paying the toll for a domestic scandal over corruption. The Visegrad countries, are in a battle for at least the past 5 years with migration waves mostly from Ukraine to Poland and Syria, Afghanistan and Iraq to Hungary. Apparently, change in the EU's migration policy could be one of the necessary but maybe not sufficient conditions needed for a shift in the political scene in the eastern boarder of the continent.

CESEE Markets Developments & Outlook

Country	CESEE Markets Developments & Outlook
Bulgaria	Bulgarian Eurobond yields dropped across the board during May ranging from 2 bps on the short end of the curve up to 11 bps for the longest tenor, namely that maturing in 2035. Local bond yields closely followed and dropped between 2-6 bps across all tenors. The Bulgarian Ministry of Finance continued its short- to medium-term strategy of decreasing the public debt/GDP levels and held no auctions in May. As a result, Bulgaria remains the EU member with the 3rd lowest Public debt/GDP ratio.
Serbia	By taking a one-month lookback, it is hard to notice changes on the EUR/RSD. The dinar, a currency that has exhibited extreme volatility in the past, looks currently poised to embrace the 118.00 level for good. The appreciating effects on the dinar from the robust FDI flows in the country are defused by the National Bank of Serbia (NBS) that intervenes through Euro purchases in order to keep the pair within a firm range. That said, according to the latest data, FDI flows in Serbia in Q1 2019 have climbed to EUR 1.3bln, when total FDI flows in 2018 accounted for EUR3.5bln, resulting in a 14% rise YoY. Against this backdrop, the NBS counterweighted those inflows through interventions. On the one hand, we have the strong FDI flows, forcing the dinar to strengthen and on the other hand we have the depreciating dynamics stemming from the CA deficit and the interventions from the NBS. The final outcome of these three determinants is a stable dinar towards the euro. Presumably, FDIs will keep their strong pace in 2019 and while the high trade deficit consists of a headwind for the dinar, it appears far more sustainable now than before. Not only Imports' composition indicates that they are employed for investment purposes, but also the imports-to-GDP ratio tends to shrink as the economy continues to grow. Moreover, once investments, in the manufacturing segment, supported by machinery imports, bear fruits, exports will rise and consequently the trade deficit will shrink. The aforementioned rationale bodes well with Serbia's growth expectations as analyzed in the IMF's Spring World Economic Outlook. On top of that, IMF officials, following the Article IV and the completion of the second PCI Review in late May, confirmed that the country is expected to grow by 3.5% YoY and 4% YoY in 2019 and 2020 respectively.

Markets View

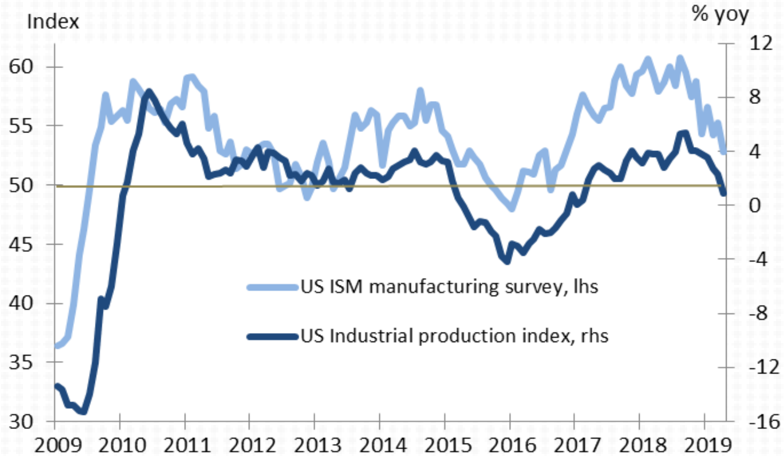
Asset Class	Outlook
Foreign Exchange	**EUR/USD:** With the EU election having a big impact on national politics (probable changes in the political landscape in the UK, Italy, Austria, Greece, etc.), the uncertainty about tariffs implementation and the continuous weakness of the EU economy might further weigh on the common currency and drive the pair in the area of 1.10 - 1.09. **USD/JPY:** The pair continues to face selling pressures and downside risk remains significant amidst uncertainty over the US-Japan trade deal talks. Moreover, the sell-off seen in the Treasury yields across the curve is weighing on USDJPY. **GBP/USD:** GBPUSD is trading under 1.2700 as markets digest the EU elections and see a growing chance of a hard Brexit after Farage's victory. Three days after PM Theresa May announced her intention to step down the election results may only increase the chances of a no deal Brexit. We expect Cable to trade below 1.2600, as the pair is also affected by USD strength. The greenback advances amidst ongoing concerns surrounding the US and China technology and trade disputes.
Rates	**EU:** Optimism over the Chinese economy has faded and meanwhile the data has deteriorated, trade war frictions have escalated, European political risks have risen after elections and Brexit worries have resurfaced. All these factors, in conjunction with anchored inflation expectations and weak EU economy should keep 10yr Bund yields to multi-year lows below 0%. If conditions do not improve soon, ECB may be forced to introduce deposit tiering, hinting that the Central Bank is somewhat doubtful about its medium-term ability to lift interest rates. **US:** Treasury yields across the curve are in multi-month lows, and OIS markets are pricing in more than one 25bp ease in 2019 and more than two full cuts over the next two years. Though rich valuations and long positioning technically suggest risks are tilted bearishly, we do not see a catalyst for higher yields over the near term. Unresolved trade tensions, coupled with soft inflation data, should keep Treasury yields trading around current levels. We remain neutral on duration.
EM hard currency debt	EM spreads both on CDS and Cash started the month tighter but this did not last long. By the end of the first week the market got volatile and ended trading wider due to trade war rhetoric between US and China. President Trump announced that the US would raise tariffs to 25% on $200bn of Chinese exports, with China announcing that it would take “counter measures”. The tensions got calmer by month-end and so the market stabilized. Turkey 5-year CDS closed 70bps wider at 520bps after a volatile month as Erdogan proposed another round of election in Istanbul as he questions the previous result. South Africa had a volatile month in both CDS and cash with the 5-year CDS closing 15bps wider at 202bps. Russia 5-year CDS started the month tighter but following the trade war sentiment it reached 132bps mid-month (from 125bps). Nevertheless, it closed the month unchanged. KSA 5-year CDS closed wider at 93bps from 76bps on volatile oil price action due to deepening trade war fears and the US-Iran tension escalation. Same picture for Aramco which traded wider across the curve. We remain cautious on EM spreads despite an abatement in trade war tensions. Valuations remain tight in spite of the sell-off, and outflows accelerated. Going forward, apart from the trade war, macro data gain in importance again and we focus on Q2 numbers since projections are in general on the softening side.
Corporate credit	USD and EUR credit spreads moved wider since early May on negative trade war developments and a lot of relevant headlines. On the fundamentals front, the Q1 macro environment was supportive, but the overall risk sentiment has started to shift to a more cautious stance, from relatively tight valuations. Financials were weaker on rates moves as well as Autos on tariff threats across US and EUR. Additionally, the semiconductors space was hit by the Huawei ban case. We remain very cautious ahead since both macro risk and political risk might elevate further in Q2 and favour low duration between 3-6 years in EUR. We also see relatively more value in eur snr fins if the deposit tranching theme goes ahead, but this again would mostly be a countermeasure to evident macro/economic weakness.

II. Advanced Economies

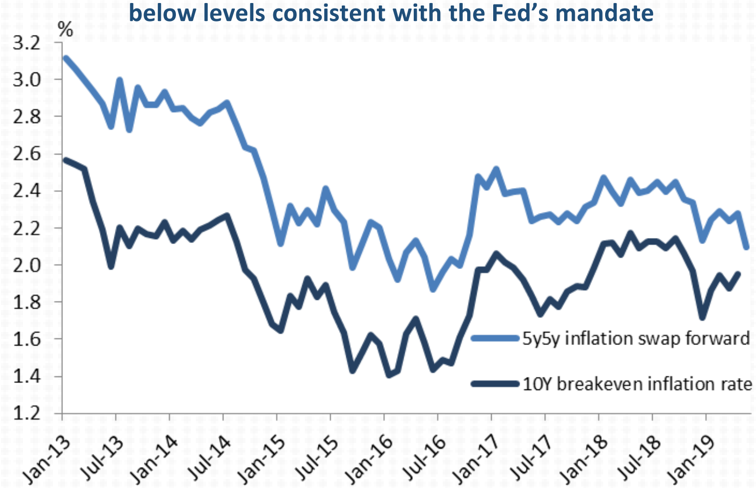
- USA
- Euro Area
    - Germany
    - France
    - Periphery (Italy, Spain, Cyprus)
- UK

USA: Latest economic indicators point to a soft start in Q2, with global weakness weighing on the manufacturing sector

Softness in manufacturing not entirely attributed to one-off factors



Inflation expectations might have dropped below levels consistent with the Fed's mandate



Source: Federal Reserve, ISM, NAHB, Bloomberg, Eurobank Research

Latest Economic Developments

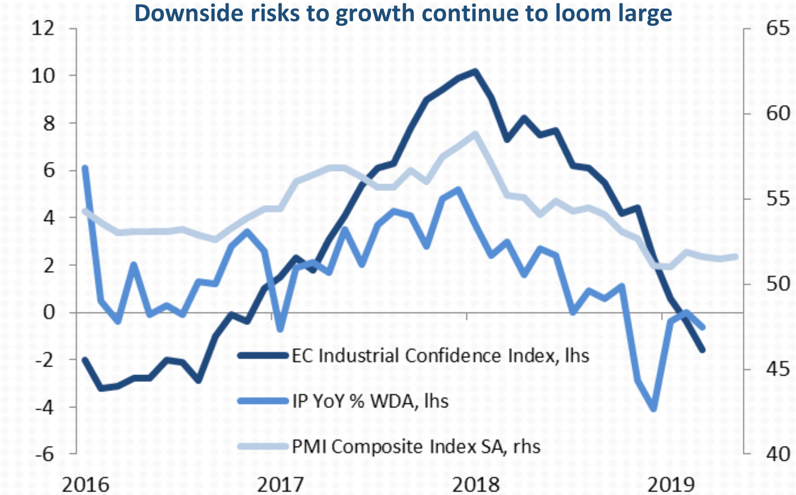
Economic indicators point to a rather soft start in Q2. April retail sales declined by 0.2%MoM falling short of market expectations for a modest increase, with broad-based weakness across categories. Meanwhile, industrial production fell 0.5%MoM in April, from +0.2%MoM in March, with downward revisions for January and February, implying that the recent softness in the manufacturing sector cannot be fully attributed to the US government shutdown, but partly reflects weaker global demand, the waning effect of US fiscal stimulus and the lagged effect from past tightening in monetary conditions. Regarding soft data, the ISM manufacturing index plunged to its lowest level since late 2016 in April, while the ISM non-manufacturing index fell 0.6pts to 55.5, pointing to a rather moderate pace of growth in the services sector. Overall, we maintain our real GDP growth projection at 2.4% in 2019 down from 2.9% in 2018. Strong labor market conditions, rising wages and firm consumer confidence should be supportive for household consumption, although the potential for higher tariffs could add to policy uncertainty and adversely affect business investment.

Central Bank Watch

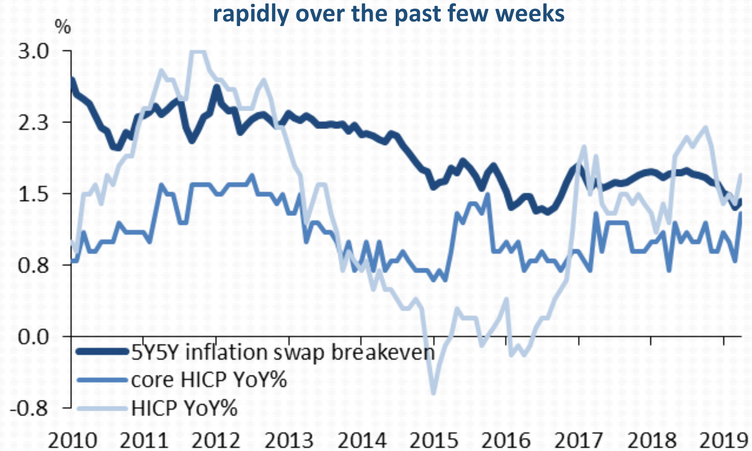
The May FOMC minutes adopted a more optimistic view for the US economic outlook compared to January and March meetings, as participants see incoming data pointing to a pick-up in activity after transitory disruptions at the beginning of the year. With inflation near the Committee's symmetric target of 2.0% and a moderate but sustained economic growth rate, the FOMC members could be patient and keep a wait-and-see monetary policy stance. Nevertheless, the more upbeat economic outlook will probably be tested in upcoming FOMC meetings by recent increased downside risks, i.e. heightened US/China trade tensions, weaker demand and prolonged disinflationary pressures. Our baseline scenario includes no interest rate adjustments at least by the end of 2019, while the fed futures market is currently attaching a probability of slightly above 80% for a 25bp cut in December 2019 vs. ~60% one month earlier.

Euro area: Below-trend growth with persistent industrial weakness and fading global trade growth

Downside risks to growth continue to loom large



Inflation expectations have deteriorated rapidly over the past few weeks



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

Latest Economic Developments

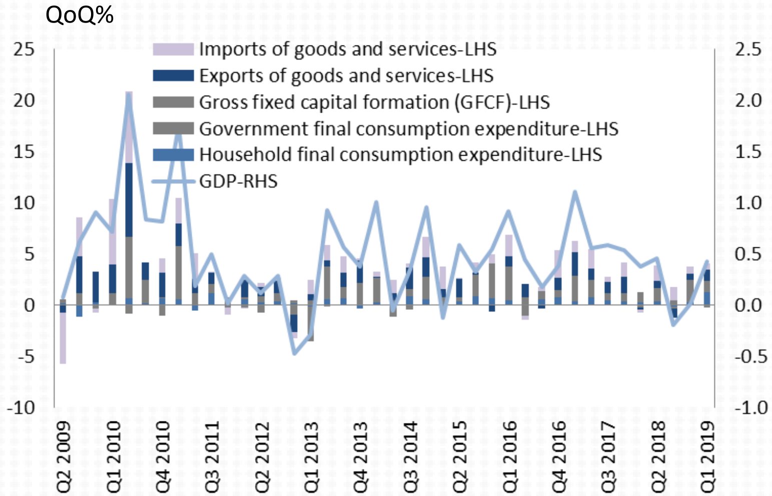
Real GDP growth came in at 0.4%QoQ in Q1, up from 0.2%QoQ in the prior quarter, on the back of resilient domestic demand. Nevertheless, IP slipped 0.3%MoM in March creating a negative carry over for Q2, while flash May PMIs suggest that downside risks continue to loom large. The Composite PMI index stood at 51.6, above the critical 50 units threshold, but still below long-term averages; services PMI declined to 52.5 from 52.8 in April, while manufacturing PMI dipped further into contractionary territory. Adding to the above, recent developments on the trade front suggest that the euro area may return to sub-trend growth rates after the Q1 economic rebound. Indeed, the May Composite PMI is consistent with a real GDP growth rate of approximately 0.2%QoQ. Expansion is expected to continue in the medium term, albeit at a lower pace mainly due to fading global trade growth, with our 2019 real GDP growth projection standing at 1.2% from 1.8% in 2018. Eurozone growth is anticipated to be primarily driven by robust domestic demand supported by accommodative monetary policies, expansionary fiscal policy and rising wage growth. The potential of higher tariffs being imposed by the US on the European auto sector, the possibility of a no-deal Brexit and Italian political risks continue to pose downside risks to our baseline forecast.

Central Bank Watch

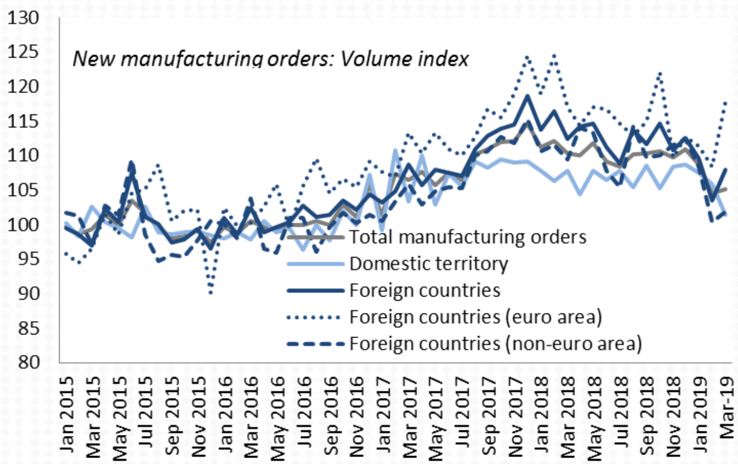
According to the minutes of the ECB's April meeting, interest rates are expected to remain at current record lows "at least through the summer of 2019". However, should the Euro area's macroeconomic conditions deteriorate further, the ECB might delay the first rate hike further, while the possibility of additional policy easing cannot be ruled out. ECB President Mario Draghi stressed that "the Governing Council stands ready to adjust all of its instruments, as appropriate" to meet its price mandate. June looks as the most likely time for the LTRO details to be unveiled, when the ECB will publish its updated staff projections. Potential mitigation measures are not expected before September, when key risks for the euro area regarding potential auto tariffs, US/China trade frictions and Brexit woes will have probably become clearer.

Germany: Economic growth rebounds in Q1 supported by domestic demand; slowdown likely in Q2

Q1 GDP rebounds; domestic demand the major growth driver



Manufacturing orders do not bode well for Q2 2019



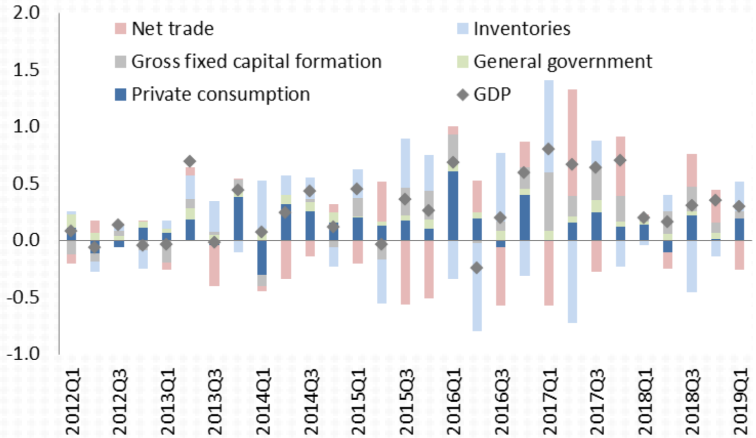
Source: Federal Statistical Office (Destatis), Eurobank Research

Latest Economic Developments

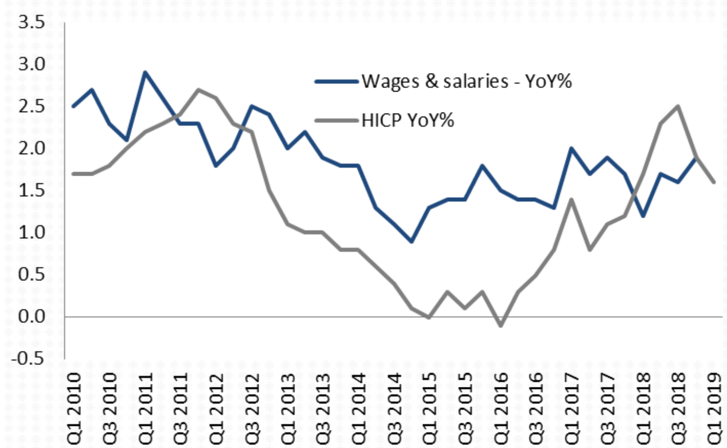
Germany's GDP —adjusted for calendar and seasonal effects—grew by 0.4%QoQ in Q1 2019, the first positive quarterly growth rate after stagnation in Q4 2018 and a 0.2%QoQ contraction in Q3 2018. The main growth driver was domestic demand, spurred by increased private consumption and investment spending. Supported by tight labor market conditions (unemployment rate at 3.2% in March, the lowest since German reunification), positive wage developments (3.2% increase in public sector workers' pay effective from 1 January 2019 followed by an additional 4.8% rise in 2020-2021) and an expansionary fiscal package for this year (estimated at c. €25bn or 0.8% of GDP), private consumption accelerated by 1.2%QoQ from 0.3%QOQ in Q4 2018. Fixed investment growth also gained momentum, rising by 1.1%QoQ vs. 0.8%QoQ a quarter earlier. Among sub-components, the main boost came from construction investment due to unusually mild weather, growing by a two-year high of 1.9%OoQ. In spite of the solid Q1 GDP growth, the German economy is not yet out of the woods. Positive one-off effects that lifted construction activity in Q1 may disappear in Q2, depressing economic growth. Furthermore, new orders in the manufacturing sector fell by around 4.0%QoQ in Q1 after a 0.7%QoQ rise in Q4 2018, while the March figure puts the Q2 carry-over at -0.9%QoQ, pointing to further industrial weakness ahead. Against this background, the prospect of less dynamic economic growth or even stagnation in Q2 cannot be ruled out. Looking ahead, a further pick-up from Q1 lows in the manufacturing PMI indicators for output, orders book and export sales in May, leaves some hope for a moderate turnaround in H2 2019. However, risks remain skewed to the downside, especially as US/China trade tensions flared up again recently, uncertainty on additional US tariffs on EU auto imports remains elevated as President Donald Trump has postponed his decision until November and the latest UK political developments are fueling worries over a no-deal Brexit scenario. Nevertheless, the better start into the year, allows us to stick to our 2019 annual GDP growth forecast for Germany at 0.8%.

France: Private consumption rebounds in Q1 2019 mainly supported by Emmanuel Macron's fiscal measures

Total domestic demand rebounds in Q1 GDP 2019 mainly on firmer private consumption



Stronger wage growth and low inflation support private consumption



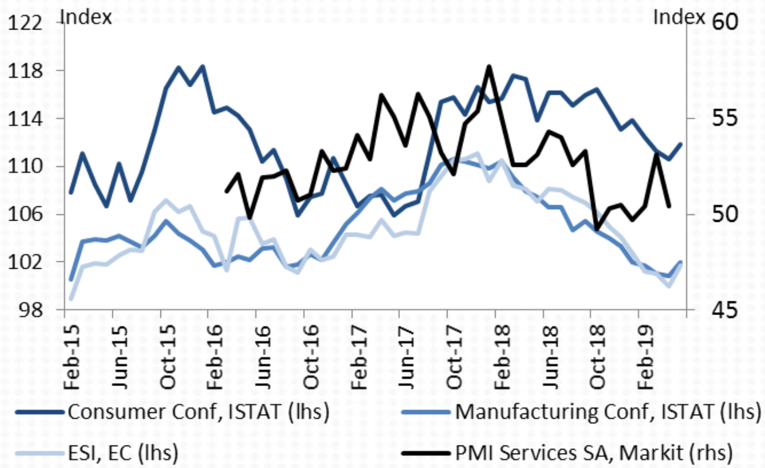
Source: INSEE, Eurostat, Bloomberg, Eurobank Research

Latest Economic/Political Developments

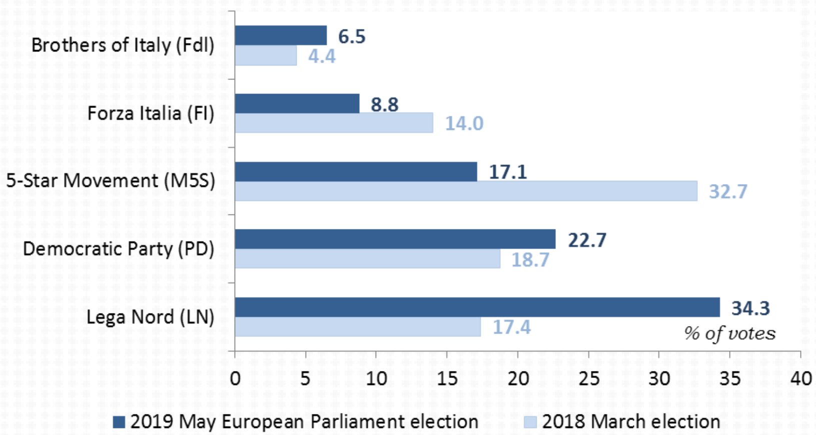
France's Q1 2019 GDP grew by 0.3%QoQ for the third quarter in a row, taking the annual rate up to 1.1% from 1.0% in Q4 2018. Business investment remained supported, rising by 0.5%QoQ, a tad higher from 0.4%QoQ in the prior quarter and adding 0.1pp to GDP growth. Net exports contributed negatively by 0.3pp. Exports rose by just 0.1%QoQ, while imports grew by a hefty 0.9%QoQ with this negative surprise being, however, completely offset by a 0.3pp contribution of stock building. Total domestic demand rebounded, rising by 0.2pp to 0.3%QoQ and added 0.2pp to GDP growth, spurred by private consumption. Mainly supported by households' increased purchasing power on the back of President Emmanuel Macron's fiscal measures in response to the "gilets jaunes" movement, private consumption, which has traditionally been the main growth driver, rose by 0.4%QoQ after 0.0% in Q4 2018. Reflecting improved purchasing power, the INSEE consumer confidence improved in May by 0.3pp to 99, approaching its long-term average of 100 for the first time in a year. The French President has announced two rounds of fiscal reforms aiming at increasing purchasing power (December 2018 & April 2019), most notably new tax cuts, amounting to around €17bn (or c. 0.7% of GDP) that will be implemented in 2019 and 2020. The Banque de France estimates that the first batch of reforms (c. €11bn) could boost purchasing power by 0.7% this year, while, combined with lower inflation and positive labor market conditions, the overall increase should be 2.1%, the highest since 2007. The unemployment rate declined by 0.1pp to a ten-year low of 8.4% in Q1 2019, wage growth reached 1.9% in Q4 2018, the highest pace in more than a year while, HICP, which averaged 1.2%YoY in the first four months of the year, is projected to drop to 1.3%YoY in 2019 after hitting a six-year high of 2.1%YoY in 2018. Barring another episode of social unrest and/or further deterioration on the external sector – Brexit, US/China trade war, US tariffs on the European auto sector— that could weigh on purchasing power, private consumption is expected to remain the main growth driver, with GDP growing by 0.3/0.4%QoQ by end-2019 and 1.2%YoY for the year.

Italy: Positive growth signs in Q1, but downside risks to the outlook prevail

Encouraging signs in early 2019, but downside risks prevail



Salvini's triumph in the May European elections increases risks for escalating tensions with the EC



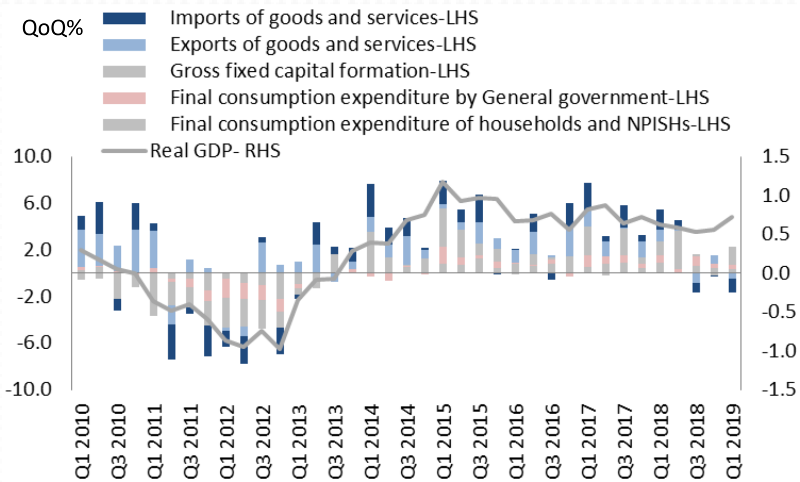
Source: Italy MEF, Eurobank Research

Latest Economic & Political Developments

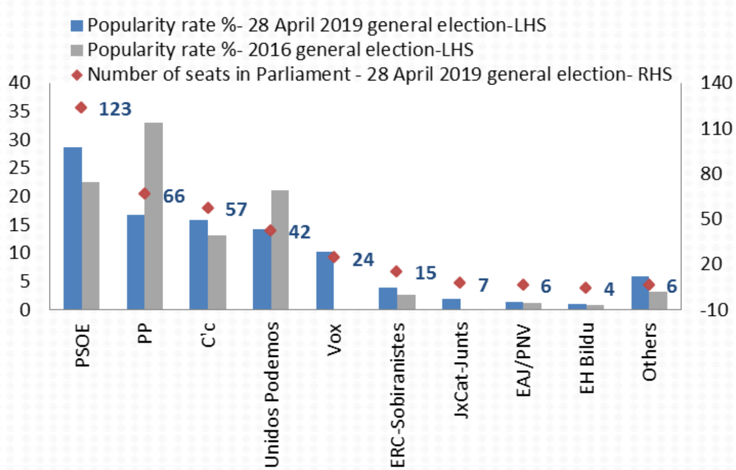
The Italian economy exited from technical recession in Q1 2019, with real GDP expanding by 0.2%QoQ after a negative print of -0.1%QoQ in Q4 2018. The quarterly rise was in fact the best reading in a year, reflecting growing production in the industrial, agricultural and services sectors. Nevertheless, preliminary data (final national accounts data to be released on 31 May) indicated that domestic demand contributed negatively to growth, while external demand made a positive contribution. Meanwhile, industrial production declined by 0.9%MoM in March, following two consecutive monthly increases of 2.7% cumulatively, while the Composite PMI slipped back into recessionary territory in April to 49.5 from 51.5 in March. Given the mixed growth picture in Italy, the encouraging signs in Q1 do not alter our 2019 GDP forecast of 0.2% from 0.9% in 2018, as the drivers behind the weakness in domestic demand are not yet known. Heightened political uncertainty constitutes a downside risk to the outlook of the Italian economy, as the European Commission is reportedly considering to propose a disciplinary procedure for Italy over its failure to rein in public debt, as part of the EU's regular budgetary process, most likely on June 5. Matteo Salvini's triumph in the 26 May European elections adds fuel to the fire, as he is already demanding greater fiscal flexibility so as to prioritize additional fiscal easing measures such as tax cuts and increased infrastructure spending. The League (L) secured 34.3% of votes, c.17pp above the respective votes of the 2018 general election, while 5SM received only 17.1%, c. 16% below the outcome of March 2018 general election. Although snap elections are not our baseline scenario as neither of the two ruling parties would have a strong incentive to disrupt the current government coalition, there are heightened risks that tensions with the European Commission are going to escalate ahead of the 2020 Budget season, as the League seems determined to push for its fiscal expansion plan contrary to the EU's fiscal and economic rules.

Spain: Positive momentum carried over into Q1 2019; Coalition talks likely to take long

Spanish economy remained the Eurozone's bright star in Q1 2019



28 April snap general election yielded a more fragmented Congress



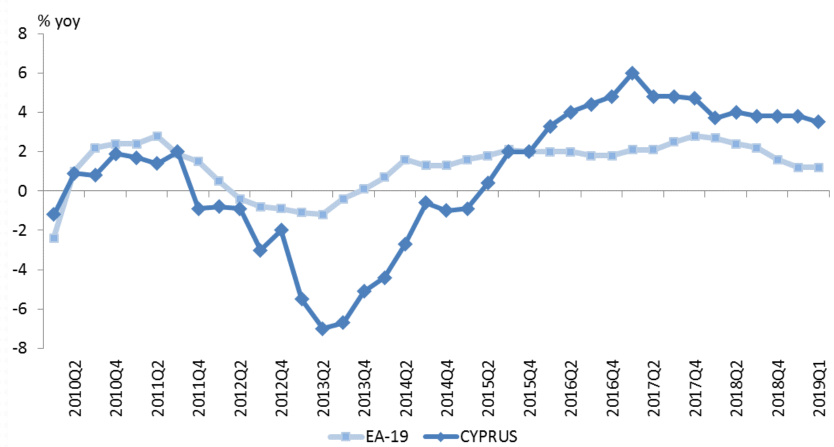
Source: INE, Spain's Ministry of Interior, Eurobank Research

Latest Economic/Political Developments

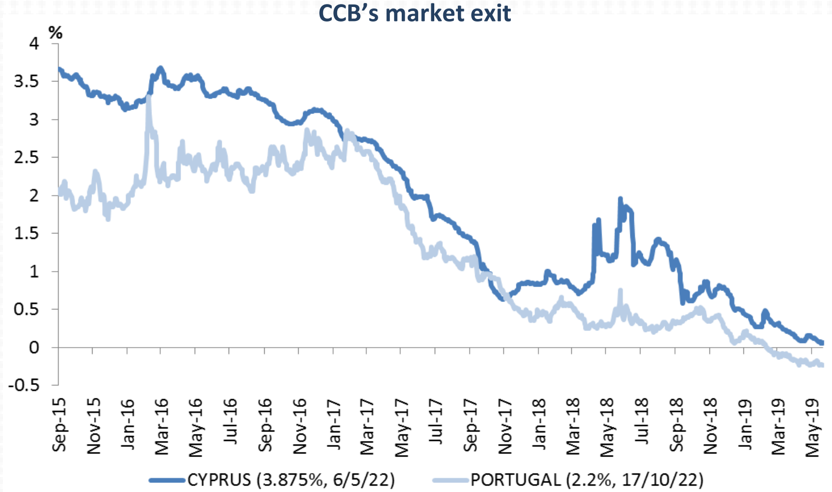
Spain remained the Eurozone's bright star in Q1 2019 with GDP growth rising by 0.7%QoQ, the fastest pace since Q4 2017, from 0.6%QoQ in Q4 2018. Both domestic demand and net exports contributed positively. Gross fixed capital formation increased by a solid 1.5%QoQ on the back of a strong rebound in machinery and equipment investment following a 0.2%QoQ contraction in the prior quarter. Private consumption slowed, albeit modestly, growing by 0.3%QoQ compared to 0.4%QoQ in Q4 2018, while general government spending expanded by 0.4%QoQ for the second quarter in a row. Exports contracted 0.5%QoQ, while imports fell by a greater extent of 1.1%QoQ, the biggest drop since Q4 2012. For the remainder of the year, the economy is expected to continue growing by a healthy pace, albeit more moderately than last year, amid the maturing business cycle. Domestic demand, and particularly private consumption, is anticipated to remain a key growth driver, supported by continued solid employment growth, moderate inflation and some recent social policy measures including an increase in the minimum wage, pensions and public sector wages. Business investment is also expected to retain a positive momentum favored by low financing costs. However, in an environment of slowing global growth, net trade is likely to be a drag on economic activity this year, contrary to what happened in the last two years. Overall, FY-2019 GDP growth is likely to slow to 2.1% from 2.6% in 2018, remaining though above our projection for c. 1.0% euro zone annual average. Thanks to strong economic growth and decreasing debt servicing costs, the general government deficit as a percentage of GDP is projected to decline for the seventh consecutive year in 2019 to 2.3% from 2.6% in 2018 following a peak of 10.5% in 2012. On the political front, the 28 April snap general election yielded a more fragmented Congress. The incumbent Socialist Party (PSOE) won the largest share of votes but fell short of a majority, while a far-right party, VOX, entered parliament for the first time in the country's democratic history. Coalition talks are set to take long, especially if Catalan separatist parties are to participate in the new government.

Cyprus: The flash GDP estimate of Q1-2019 is an illustration that soft landing has started

Cyprus turn-around growth story has been impressive so far



Cypriot medium term bond yields have improved in recent months after CCB's market exit



Source: Eurobank Research, National Authorities, Bloomberg

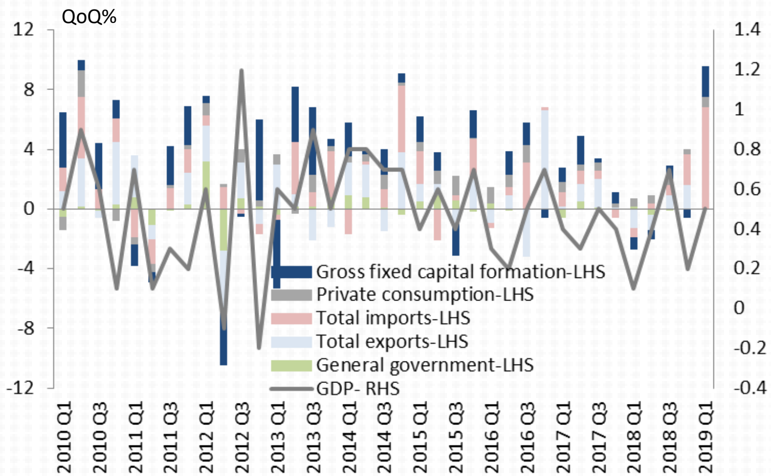
Latest Political & Economic Developments

The flash estimate of Q1-2019 confirmed that economic activity has embarked on a decelerating path. Real GDP remained flat at 1.0% on a quarterly basis bringing the annual rate of expansion at 3.5% YoY in Q4-2018 on a seasonally adjusted basis compared to 3.8% YoY in Q4-2018 & Q3-2018 vs. 3.5% YoY in Q4-2017. Domestic demand is expected to have had the lion's share in the GDP growth reading of Q1, while net exports are most likely to have come under pressure echoing the deterioration in the world economic environment.

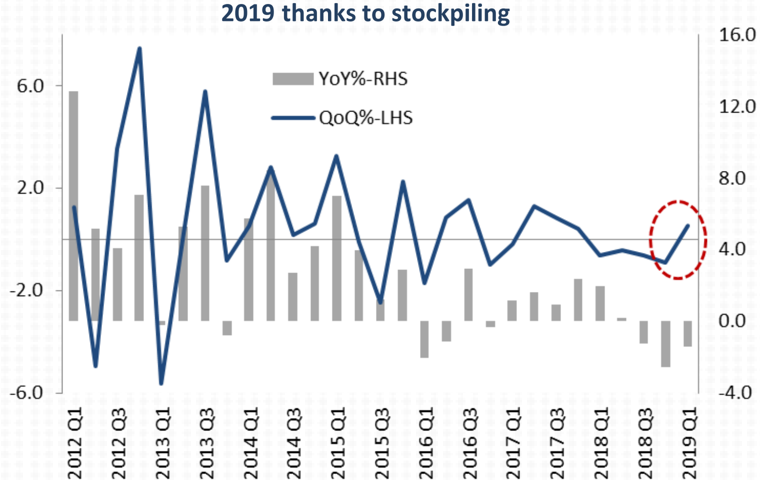
Looking ahead, the growth trajectory suggests that the soft landing we penciled in all previous analyses has already started. Real GDP expanded by 3.9% in 2018 compared to 4.2% in 2017, 4.8% in 2016 and only 2.0% in 2015. The growth dynamics are expected to remain relatively strong- yet still lower than last year- at 3.3% in 2019 driven primarily again by buoyant foreign-funded investments and solid private consumption. However, there is an increasing number of downside external and internal environment risks to our forecast. The external risks stem from the slowing Euro area growth performance, a potentially hard Brexit and the challenges posed for the tourism sector, one of the key export industries of the Cypriot economy. Those stem from lower tourism arrivals not only from a less favorable external environment but also as a result of the increasing competition from the re-opening of neighbor markets, where safety concerns are abating and the bankruptcy of some air-carriers servicing the island. The internal risks are concentrated around the systemic financial risks posed by the still large amount of NPEs and high private sector indebtedness. Decisive government action on the resolution of the Cyprus Co-operative Bank (CCB) allowed for an important – but one-off – decline in the NPEs ratio from 40% to the much lower 30%. However, NPEs remain in the broader economy despite their removal from the banking system's balance sheet.

UK: Solid Q1 GDP growth on strong inventory build-up; but a likely unwinding could claw back growth in the coming quarters

Q1 2019 GDP growth accelerates on strong inventory build-up



Business investment broke out of its technical recession in Q1 2019 thanks to stockpiling



Source: ONS, Eurobank Research

Latest Economic Developments

According to the ONS' first estimate, real Q1 2019 GDP expanded by 0.5%QoQ, accelerating from 0.2%QoQ in Q4 2018. On the output side, growth in the services sector slowed to 0.3%QoQ from 0.5%QoQ in the prior quarter (0.3pp contribution) and construction accelerated to 1.0%QoQ from -0.5%QoQ thanks to warmer weather (0.1pp contribution). Interestingly, there was a noticeable pick-up of 1.4%QoQ in production (0.2pp contribution) compared to a 0.8%OoQ contraction a quarter earlier, boosted by a 2.2%QoQ rise in manufacturing output, the fastest rate since Q3 1999, as UK manufacturers increased production to build inventories and meet orders amid fears over potential Brexit-related supply disruptions ahead of the initial scheduled Brexit date on 29 March 2019. On the expenditure side, Q1 GDP growth was driven by household consumption, government spending and gross capital formation. Private consumption grew by a two-year high of 0.7%QoQ (0.4pp contribution), supported by a record 76.1% employment rate and a decade wage growth high of 3.5%YoY recorded in the first two months of the year before declining modestly to 3.2%YoY in March. Government consumption grew by 1.4%QoQ, a tad higher from 1.3%QoQ in Q4 2018 (0.2pp contribution), while gross fixed capital formation rose by 2.1%QoQ after contracting 0.6%QoQ in Q4 2018 (0.3pp contribution), with business investment increasing 0.5%QoQ and halting a four-quarter declining trend, but still down 1.4%YoY. Net exports contributed negatively by a hefty 2.2pp with exports remaining unchanged and imports rising by 6.8%QoQ, the highest pace since Q3 2007, as UK firms imported supplies ahead of the original Brexit deadline. Looking ahead, economic activity is expected to slow down in the coming quarters on the back of a possible unwinding of inventories following a six-month extension to Brexit. The latest escalation in US/China trade tensions and mounting UK political uncertainty ahead of a Conservative leadership challenge, as the new PM is likely to be more open to no-deal Brexit than Theresa May, are also likely to weigh on future output. Q2 GDP is expected to slow to 0.2%QoQ, while we stick to our annual growth forecast of 1.2% for 2019.

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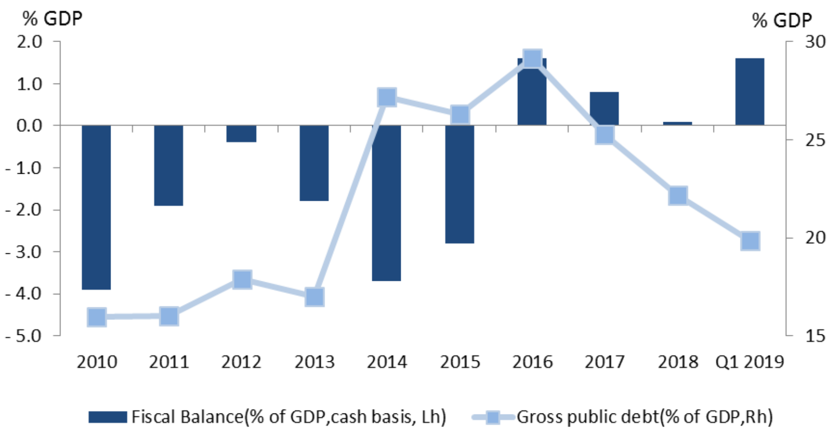
III. Selected CESEE economies

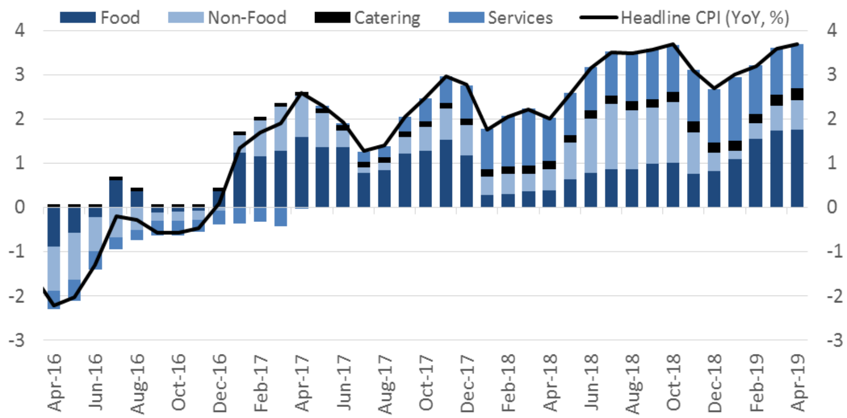
- Bulgaria
- Serbia
- Turkey

Bulgaria: Economic activity accelerated in Q1-2019 in defiance of an unfavorable world economic environment

Bulgaria's fiscal position is sound



Inflation has rebounded in recent months on higher food prices



Source: Eurobank Research, National Authorities

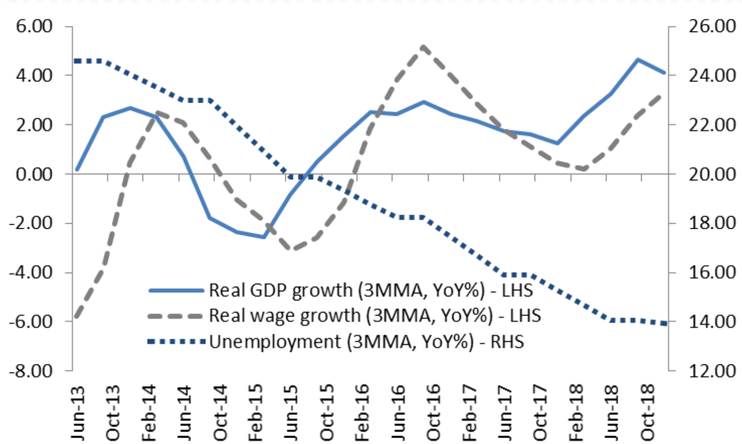
Latest Political & Economic Developments

Economic activity accelerated in Q1-2019 in defiance of an unfavorable world economic environment. According to the flash estimate, real GDP growth accelerated to 1.1% QoQ/3.5% YoY in Q1-2019 up from 0.8% QoQ/3.2% YoY in Q4-2018 and 0.7% QoQ/3.1% YoY in Q3-2018. As usual, there will be another estimate of the national accounts data published at a later stage and there will most probably be huge revisions and reallocations within the components of the individual growth drivers. As things stand, net exports appeared to have made a very strong contribution against an unfavorable external backdrop (exports: 1.8% QoQ/+5.1% YoY vs imports: -0.6% QoQ/+1.7% YoY). Second, final consumption had a smaller than in previous quarters positive contribution (0.3% QoQ/3.5% YoY in Q1-2019 vs -0.1% QoQ/5.0% YoY in Q4-2018), which is counter-intuitive given the improvement in the labor market and consumer sentiment. Third, investments appeared to be losing momentum in Q1-2019 despite wide expectations for the opposite (0.2% QoQ/2.6% YoY in Q1-2019 vs. 2.8% QoQ/6.6% YoY in Q4-2018). In a nutshell, the second estimate will allow for safer conclusions.

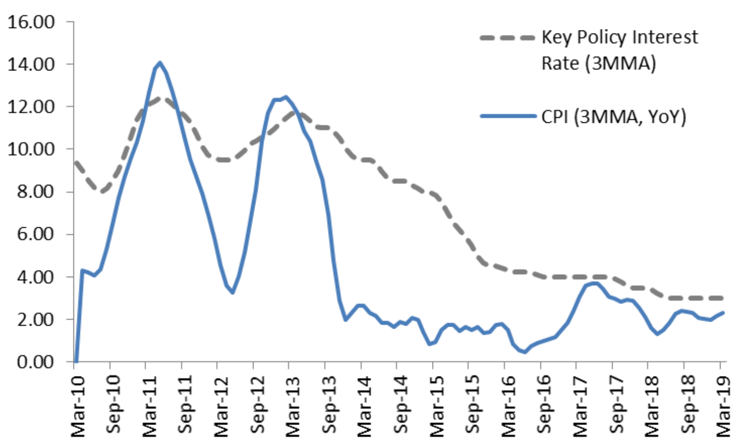
In our view, solid growth momentum continues in 2019- our forecast stands at 3.5% currently-on sound domestic demand dynamics. Private consumption will be in the driver's seat, receiving support from a tighter labor market, relatively low energy prices, convergence of wages towards EU average, a vibrant manufacturing sector despite the increasing world trade tensions and increased tourism flows. Investment, especially public investment which has not been impressive in the last two years, will receive a boost from improved EU funds absorption. With the end of the programming period 2014-2020 approaching, the government will need to step up spending for a number of mature projects. Moreover, domestic credit conditions have turned more growth supportive. Credit activity expanded by 7.8% in March not very far from 8.7% YoY in February, which was the highest rate since June 2009. The March reading is favorably compared to 7.7% in 2018, 4.7% in 2017 vs. only 1.5% in 2016, and -1.2% in 2015.

Serbia: Modest GDP growth in 2019 amid global trade headwinds

Modest GDP growth and firm labor market…



…amid price stability and firm interest rate environment



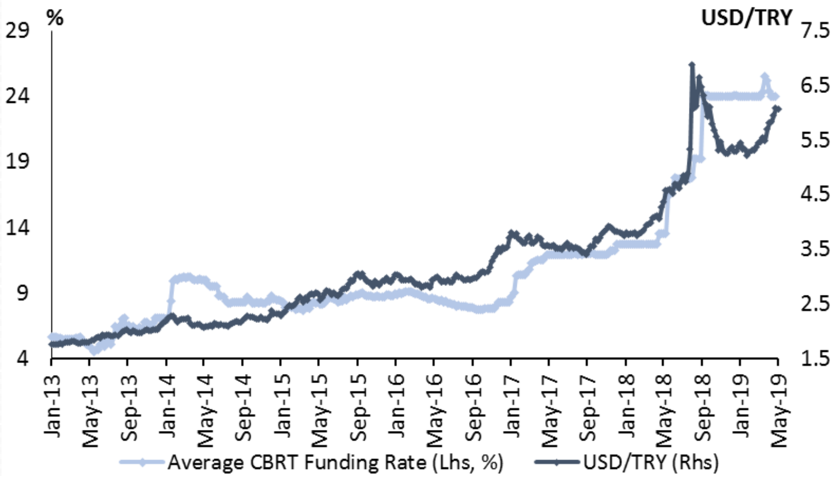
Source: Bloomberg, Eurobank Research

Latest Economic Developments

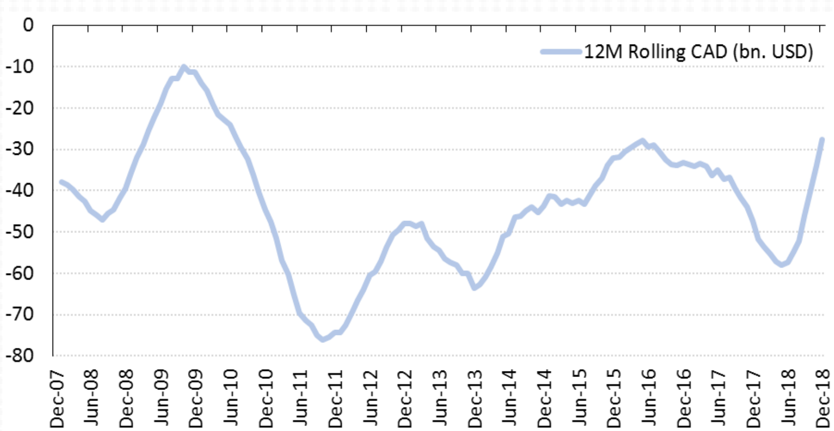
Following a strong performance in FY 2018 in terms of GDP growth (4.3%YoY), the economy is expected to slow down this year, taking into account the lukewarm flash Q1-2019 GDP growth print (2.3%YoY vs market consensus at 3.0%YoY) along with high frequency indicators released in Q1 2019. In detail, retail sales grew by 9.5%YoY in March vs 10.8%YoY in February, while industrial production fell in Q1 due to a protracted feebleness in the energy and the mining sectors. Private consumption is expected to remain the key growth determinant, supported by increases in real wages and pensions while investments are expected to play a pivotal role as well, with the Serbian Government having recently declared that it intends to spend EUR5.2bn (12% of projected GDP) in 2019 and EUR3.5bn (8% of projected GDP) in 2020 on infrastructure projects, under the Belt and Road initiative. There are some concerns on whether exports will maintain their robustness due to a weaker outlook for the EU, which is its main trade partner. That said, within Q1-2019, the trade and current account deficit has been modestly widening, still it is substantially covered by the FDI flows, though to a lesser extent compared to the last five years. In the above context, the European Commission in the Spring forecast trimmed its projection for Serbia's GDP growth in 2019 to 3.1%YoY from 3.8%YoY in the Autumn forecast, considering that risks, stemming from geopolitical and regional tensions, are tilted to the downside for the current year but the economy will pick up pace in 2020, broadly based on improved net exports. The IMF, in the Spring World Economic Outlook, and the EBRD, in the Regional Economic Prospects, both released recently, kept their view for 2019 GDP growth stable at 3.5%YoY. Moreover, following the 2019 Article IV Consultation and the Second Review under the Policy Coordination Instrument (PCI) completion in the previous week, the IMF stated that even though many key reforms have been implemented, still a plethora of reforms to strengthen the resilience of the economy remains at stake, as risks to the near-term growth outlook appear tilted to the downside.

Turkey: Renewed lira depreciation pressures increase the disinflation process downside risks

Turkish Lira under renewed depreciation pressures in May



Macroeconomic imbalances have been unwinding rapidly in 2018



Source: Eurobank Research, National Authorities, Bloomberg

Latest Political & Economic Developments

Headline inflation declined to 19.5% YoY in April down from 19.7%YoY in March compared to 20.3%YoY in December coming significantly below analysts' consensus expectations (Actual: +1.7%MoM vs Bloomberg: +2.4%MoM). Despite the monthly decline (-3.7% MoM) of the volatile fruit & vegetables component, food & non-alcoholic beverages prices (+1.4%MoM/+31.9%YoY in April) were still the main contributor (7.3ppts on an annual basis). Rising world energy prices, renewed domestic currency depreciation pressures, tax hikes in tobacco products and seasonality were also reflected in the groups of furnishing & household equipment (2.7%MoM/27.6%YoY), miscellaneous goods and services (1.9%MoM/27.5%YoY), health (0.5%MoM/19.8%YoY), hotels, cafes and restaurants (1.1%MoM/19.6%YoY) and alcoholic beverages & tobacco (6.8% MoM/9.7%YoY) prices.

Headline inflation has retreated from its historic highs in recent months ending at 20.3%YoY in Dec down from 21.6%YoY in Nov and 25.2%YoY in Oct. Despite lira depreciation pressures, core inflation (which excludes food, alcohol, tobacco, energy and gold prices) eased further to 16.3%YoY in April vs. 17.5%YoY in March down from 19.5%YoY in Dec vs. 20.7%YoY in Nov. Looking ahead, weak domestic demand dynamics and favorable base-effects in the food prices segment are expected to support the disinflation process in the 2H-2019. On the other hand, markets' concerns over the predictability & efficiency of the government policy and renewed tensions with the US due to the S-400 missile purchases from Russia coupled with investors' concerns over the Central Bank independence have put the lira under pressure again, thus increasing the disinflation process downside risks. The Turkish lira traded at 6.14/$ at the time of the writing –comfortably above the 6.00/$ threshold-and close to an eight month low, on media reports that the Ministry of Defense stated that Turkey was preparing for potential U.S. sanctions over its purchase of the S-400 missile defense systems.

IV. Special Focus:
The May 2019 European Parliament election

The May 2019 European Parliament election

The May 2019 European Parliament election yields a more fragmented parliament with important political repercussions at the individual country level

The May 2019 European election resulted in a more fragmented parliament, which will probably make policy-making more complex in the coming years as broader cross-party compromises will be required. As was expected from polling data, **the traditional centrist parties lost their overall majority for the first time since the introduction of the European elections in 1979.** The centre-right European People's Party (EPP) remained the largest party but its vote share was lower than in the last election in 2014, gaining 178 seats in the 751-seat European Parliament vs. 217 previously. The centre-left Progressive Alliance of Socialists & Democrats (S&P), which also suffered significant losses, trailed behind gaining 153 seats compared to 187 in 2014. But the loss of the majority for the long-standing alliance between the EPP and the S&P did not translate into a material shift in the balance towards Eurosceptic parties. **Anti-EU parties increased their support to 175 seats from 197 in 2014, but fell short of the one third of the seats that some polls had suggested they would gain,** a threshold that could have important implications for the function of the EU. Instead, the increased turnout and the reduced support for centrist parties appear to have benefited the Liberals (ALDE) and Greens, which gained 37 and 17 more seats, respectively, compared to 2014, totaling 105 and 69 MPs. **Overall, pro-EU groupings form a majority in the European parliament**. But with neither centrist parties nor left-leaning parties securing an outright majority, **reaching consensus on key issues will become harder and negotiations between groupings may be tense and lengthy, at a time when the European economy faces a number of headwinds**, including slowing global growth, a no-deal Brexit scenario and a possible escalation in trade tensions with the US. **Admittedly, the fragmented European Parliament will have significant implications on the EU policy agenda**, including, the appointment of key figures for Europe's top jobs that will become vacant later this year (the next Presidents of the EU Commission, the EU Council and the ECB). **In addition, the outcome of the European Parliament elections could have important political repercussions at the individual country level, especially for Italy, the UK and Germany.**

In **Italy**, the popular support for eurosceptic League almost doubled from the last general election in 2018 (up c. 17pps to 34.3%), while the anti-establishment Five Star Movement (5SM) faced a heavy defeat and dropped to third place (17.1% vs. 32.2% at the 2018 general election). With Matteo Salvini's League becoming Italy's largest party and changing the balance of power within the government coalition with 5SM, tensions between the two parties may increase. Indeed, the election outcome could provide the incentive to Mario Salvini to request a reshuffle within the current coalition in favour of his party and/or renegotiation of the government policy in order to prioritize the League's flagship policy measures. Should this be the case, a renewed confrontation with the European Commission in early June, in the context of the presentation of the country-specific recommendations, is possible. All the more so, given Mario Salvini's recent comments over his intention to break EU fiscal rules, if needed. In addition, the prospect of Matteo Salvini wanting to capitalize on its increased support to trigger new elections later this year (subject to approval of the Italian President) cannot be ruled out.

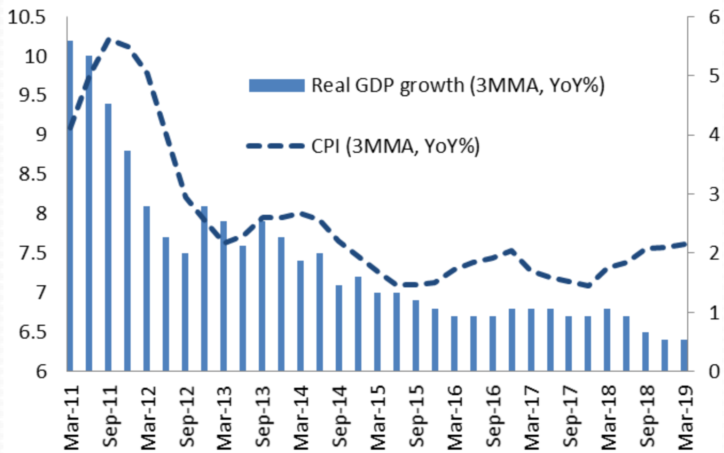
In the **UK**, the clear victory of the Brexit Party suggests that many Leave voters favor a no-deal Brexit. The above, combined with the sharp losses of the Conservative Party in both the European election and the 2 May local election, increase the likelihood the new Tory leader to be more open to the prospect of no-deal Brexit, diminishing scope for a softer Brexit deal.

In **Germany**, the biggest loser in the European election was the center-left Social Democrats party (SPD), the junior partner in the "grand coalition" with CDU/CSU. SPD almost halved its share and came third, losing 11 seats. The poor performance of the party in the European election and the disappointing result in the Bremen regional election (held on the same day) where SPD lost its status as the largest party for the first time in 73 years, do not bode well for the stability of Germany's "grand coalition". A trigger for a likely fall of the current coalition could come later this year, when SPD is scheduled to carry out a mid-term review of the coalition government.

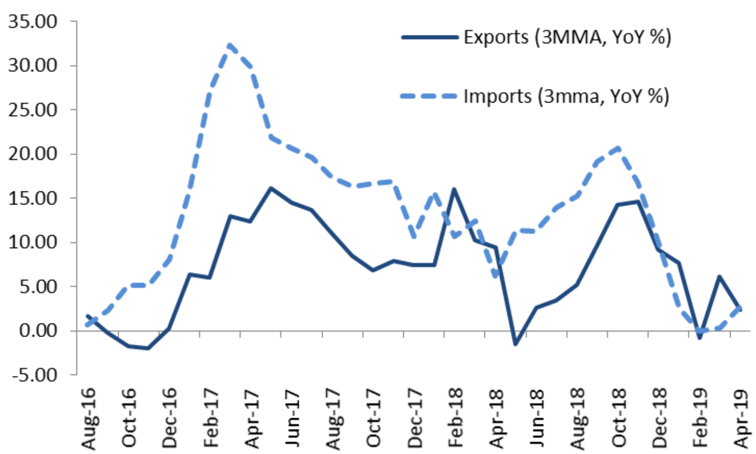
IV. Special Focus:
China's arsenal to confront with the US
in the trade battle

China's arsenal to confront with the US in the trade battle

Within the past 10 years GDP growth is gradually losing steam



Trade activity is shrinking amid trade conflicts with the US



Source: Eurobank Research, National Authorities

Latest Political & Economic Developments

Following the favorable Q1 GDP growth reading at 6.4%YoY and a plethora of positive frequent data for March, China's economy appeared to have lost some steam in April. The PMI manufacturing index moved lower to 50.2 from 50.8, IP growth slid to 5.4%YoY compared to 8.5%YoY, retail sales dropped to 7.2%YoY from 8.7%YoY and fixed assets investments retreated to 6.1%YoY vs 6.3%YoY in March. At the same time, US/China trade talks stumbled just before entering into what was supposed to be the last round of negotiations. According to US officials, the reason for the turn of events was China's denial to incorporate into Chinese law commitments agreed in previous stages of negotiations. On the contrary, Chinese Vice Premier Liu He tabulated as the issues that prevent both countries from sealing a deal the removal of all tariffs, the realistic amount of imports purchased by China and a more balanced agreement both in terms of language and a check-and-balance mechanism. Following the moratorium of negotiations, the US increased the tariff imposed to USD200bn imports from 10%, imposed in September 2018, to 25% on May 10, China retaliated right after by stating that the tariff rate on imports worth USD60bn will be increased from 10% up to 25% on June 1 and the US responded with the signature of an executive order that effectively bans Chinese companies, among which Huawei and ZTE, from selling equipment to US companies and consumers. The Chinese government has taken a sterner stance against the US pressure and for the time being, it, still, has ample room to adopt additional measures in order to ring fence the economy from further widening in the trade negotiations gap. On the monetary side, credit conditions may be kept loose so as for the private business sector to have substantial access to local debt capital markets. However, the monetary arsenal will be handled cautiously so as to protect the CNY from substantially devaluating against other currencies and particularly the USD. On the fiscal front, even though tax exemptions primarily to industries hit by the escalation of tariffs can be supported, they will be handled prudently as it is strategically important to save policy resources in fear of additional tariffs threat on Chinese products worth USD300bn.

V. 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)		
	2018	2019f	2020f	2018	2019f	2020f	2018	2019f	2020f	2018	2019f	2020f	2018	2019f	2020f
World	3.6	3.3	3.5	3.6	3.3	3.3									
Advanced Economies															
USA	2.9	2.4	2.0	2.4	2.0	2.2	3.9	3.7	3.6	-2.4	-2.5	-2.9	-3.8	-4.5	-4.5
Eurozone	1.9	1.2	1.4	1.8	1.3	1.5	8.2	7.6	7.4	3.0	2.9	2.8	-0.6	-1.0	-1.0
Germany	1.4	0.8	1.4	1.9	1.5	1.6	3.4	3.2	3.2	7.3	6.4	6.2	1.7	1.0	0.8
France	1.5	1.2	1.4	2.1	1.3	1.5	9.1	8.8	8.6	-0.3	-0.5	-0.3	-2.5	-3.2	-2.5
Periphery															
Cyprus	3.9	3.3	3.0	0.8	1.0	1.5	8.4	7.5	7.0	-7.0	-7.5	-7.0	2.9	3.0	2.6
Greece	1.9	1.9	2.0	0.8	0.9	1.3	19.3	17.8	16.5	-2.9	-2.6	-2.4	1.1	0.5	-0.1
Italy	0.9	0.2	0.7	1.3	1.0	1.0	10.6	10.6	10.5	2.6	2.9	2.6	-2.1	-2.7	-3.0
Portugal	2.1	1.6	1.5	1.2	1.0	1.5	7.0	6.4	6.2	-0.6	-0.2	-0.2	-0.5	-0.4	-0.2
Spain	2.6	2.1	1.9	1.7	1.3	1.6	15.3	13.9	12.8	0.9	0.9	0.9	-2.5	-2.2	-2.0
UK	1.4	1.2	1.5	2.5	1.9	2.0	4.1	4.2	4.1	-3.9	-3.5	-3.4	-1.5	-1.5	-1.3
Japan	0.8	0.7	0.5	1.0	0.9	1.2	2.4	2.4	2.4	3.5	3.5	3.5	-3.2	-2.8	-2.1
Emerging Economies															
BRICs															
Brazil	1.1	1.8	2.5	3.7	3.9	4.0	12.3	11.8	10.8	-0.8	-1.3	-1.7	-7.3	-6.6	-6.2
China	6.6	6.3	6.0	2.1	2.2	2.3	3.8	4.0	4.0	0.4	0.1	0.0	-2.2	-4.2	-4.2
India	7.2	7.0	7.2	4.0	3.4	3.8		*NA*		-2.2	-2.2	-2.2	-3.6	-3.4	-3.4
Russia	2.3	1.4	1.7	2.9	4.9	4.0	4.8	4.8	4.8	7.0	5.7	4.2	2.6	1.9	1.3
CESEE															
Bulgaria	3.1	3.5	2.8	2.7	2.8	2.5	5.2	5.3	5.7	4.6	1.0	1.0	0.1	-0.5	0.0
Romania	4.1	3.8	3.5	4.7	4.0	3.5	4.2	3.9	4.2	-4.7	-5.0	-5.2	-2.9	-3.4	-4.7
Serbia	4.3	3.3	3.8	2.0	2.6	2.8	12.7	11.0	9.0	-5.2	-6.0	-5.5	0.6	-0.5	-0.5
Turkey	3.3	-1.5	2.5	16.3	16.0	13.0	10.9	13.0	12.5	-3.6	-1.5	-2.0	-2.1	-3.0	-2.5

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

Eurobank Fixed Income Forecasts

	2019				2020
	Current (as of 29 May)	June	September	December	March
USA					
Fed Funds Rate	2.25-2.50%	2.25-2.50%	2.25-2.50%	2.25-2.50%	2.25-2.50%
1 m Libor	2.43%	2.47%	2.50%	2.55%	2.54%
3m Libor	2.52%	2.56%	2.59%	2.64%	2.63%
2yr Notes	2.08%	2.39%	2.46%	2.52%	2.53%
10 yr Bonds	2.24%	2.59%	2.66%	2.73%	2.76%
Eurozone					
Refi Rate	0.00%	0.00%	0.00%	0.00%	0.05%
3m Euribor	-0.32%	-0.32%	-0.32%	-0.31%	-0.27%
2yr Bunds	-0.65%	-0.54%	-0.52%	-0.47%	-0.43%
10yr Bunds	-0.17%	0.15%	0.22%	0.28%	0.36%
UK					
Repo Rate	0.75%	0.75%	0.75%	0.85%	0.90%
3m	79.00%	0.84%	0.87%	9.50%	1.02%
10-yr Gilt	0.91%	1.34%	1.39%	1.49%	1.48%
Switzerland					
3m Libor Target	0.73%	0.73%	0.74%	0.75%	0.74%
10-yr Bond	-0.47%	-0.44%	-0.41%	-0.37%	-0.33%

Source: Bloomberg (market implied forecasts)

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VI. Disclaimer

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