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GLOBAL & REGIONAL MONTHLY

Following a broad-based and synchronized global deceleration over the past 18 months, there have lately been some tentative signs that the world economy may be bottoming out. Alongside the moderation of global policy uncertainty, major central banks have signaled that monetary policy will likely remain accommodative for an extended period amid subdued inflationary pressures and downside risks to the growth outlook

Macro Picture

USA: Diminished recessionary risks, but economic growth has decelerated to trend

EA: The economy fails to gain speed in December

UK: Weaker-than-expected October GDP growth bodes poorly for Q4

EM: Tentative signs of global growth stabilization and a trade truce between the US and China foster EM's economic growth

CESEE: The broader region's growth performance, albeit increasingly heterogeneous among individual economies, depends on domestic demand's resilience

Markets

FX: Low volatility, range-bound trading remains, but increased risk for a break higher in EURUSD and USDJPY

Rates: Recovery in European periphery, risk-on sentiment, core rates mildly higher. US curve bear flattened despite a "low for longer" Fed rhetoric

EM: EM credit had a strong performance with LatAm outperforming. CBs and risk sentiment remain the key drivers. Idiosyncratic stories driven by social unrest

Credit: Rally in spreads post UK election results and US-China tariffs roll back. Market to finish the year at the tights

Policy Outlook

USA: On hold in the foreseeable future

EA: Unchanged policy, focusing on strategic review and maintaining an easing bias

UK: BoE likely to cut rates in early 2020 in case of increased fears over a cliff-edge Brexit

CESEE: Limited room for more expansive fiscal & monetary policies in a more challenging 2020

Key Downside Risks

Renewed escalation of trade tensions: Threats of tariff reinstatement

Resurgent Brexit uncertainties: Uncertainty regarding the length of the transition period and the future UK/EU trade arrangement

EM & China sensitivity: A setback in the US/China trade deal to weigh on investors' sentiment

Themes in this issue

Trip notes: 13th Commerzbank Emerging Markets Macro Conference in Dubai

US/China **trade uncertainty** to remain elevated

Rising **no-trade deal Brexit** woes

CESEE region: **Domestic demand** driven growth resilience, albeit increasingly **heterogeneous**

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December 2019

Contents

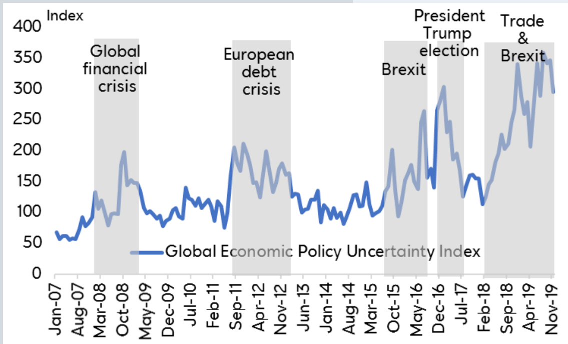
Macro Views

Latest Macroeconomic Developments & Outlook

World Economic Outlook

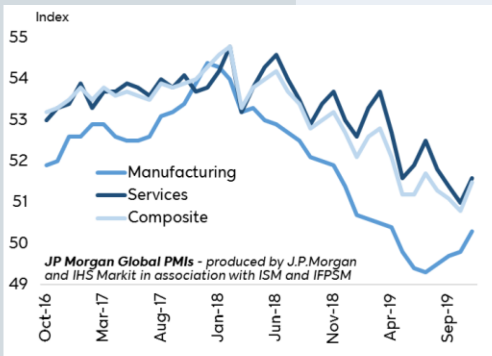
Following a broad-based and synchronized global deceleration over the past 18 months, there have lately been some tentative signs that the world economy may be bottoming out. After falling from late-2017 through mid-2019, the global manufacturing PMI has risen for four consecutive months, posting a seven-month high of 50.3 in November from 49.8 in the prior month and moving back above the 50.0 threshold that distinguishes expansion from contraction for the first time since April. New orders – the key forward-looking subcomponent of the PMI – improved for the first time in seven months, mirroring companies' willingness to raise output further. At the same time, the global services PMI advanced for the first time since July 2019 to a four-month high of 51.6 (Figure 1). It seems that two prominent downside risks that have weighed on household and business sentiment have faded over the last few days. On the one hand, the US have signed off on a "Phase One" trade deal with China, while the US Congress and the White House seem to have reached an agreement on the USMCA trade deal, reducing worries about US/China as well as NAFTA and US-Mexican-Canadian trade relations. On the other hand, the result of the UK general election was a large Conservative majority, giving PM Johnson the mandate to deliver on his intention 'to get Brexit done' and pass by 31 January the Withdrawal Agreement negotiated in October. As a result, the Global Economic Policy Uncertainty Index has declined to ca. 296 pts in November 2019 from a historical high of ca. 348 in the prior month, while it is expected to moderate further in the coming months following the positive developments on the Brexit and trade-related front (Figure 2). Alongside the moderation of global policy uncertainty, major central banks have signaled that monetary policy will likely remain accommodative for an extended period amid subdued inflationary pressures and downside risks to the growth outlook. Overall, we expect global GDP growth to ease to around 3.0% in 2019 from 3.6% in 2018, and to maintain a similar pace in 2020.

Figure 1: Global Uncertainty has receded; expected to moderate further



Source: Davis, Steven J., 2016. "An Index of Global Economic Policy Uncertainty," Macroeconomic Review (October), Eurobank Research

Figure 2: Global Manufacturing PMI re-enters the expansion zone



Source: Refinitiv Datastream, Eurobank Research

Developed Economies

US: Although the heightened trade-related uncertainty, the fading positive effect of fiscal measures as well as Fed's past rate hikes have certainly slowed growth momentum, latest economic indicators seem to have diminished the risk of a US recession. The Atlanta Fed's GDPNowcast model upgraded its real Q4 GDP growth forecast by 0.5pp to 2.0%QoQ saar, with strength in consumer demand more than offsetting subdued business investment and weak external demand. We maintain our GDP growth forecast at 2.3% for 2019 and 1.8% for 2020, as weakness in manufacturing and ex-US global growth take their toll on underlying growth momentum, on top of a waning effect from expansionary fiscal policies.

Euro area: Mirroring a broad-based contraction in production but consistent with a softening of the ongoing manufacturing contraction, IP fell by 0.5%MoM in October, with the quarterly carry-over in Q4 increasing to -0.4%QoQ from -0.8%QoQ in Q3. Nevertheless, the flash December PMIs suggested that the EA economy failed to pick up momentum. We maintain our 2019 real GDP growth forecast at 1.1% down from 1.8% in 2018, with the overall balance of risks titled to the downside. Weak economic prospects, coupled with a monetary stance that already is very expansionary, calls for additional fiscal stimulus, but any such measures are expected to be rather moderate and gradual.

Periphery: With a bounce in domestic demand partially offsetting the negative contribution from net exports, Italy and Spain, the two biggest southern European peripheral economies posted a quarterly GDP growth rate in Q3 unchanged compared to that in the prior quarter (0.1%QoQ and 0.4%QoQ, respectively). However, in annual terms, underlying growth momentum is clearly slowing, with Q1-Q3 2019 average falling to 0.1% in Italy and 2.1% in Spain vs. 0.9% and 2.4%, respectively, in the respective period of last year. Looking ahead, sentiment surveys and hard data pertaining to Q4 suggest that underlying growth momentum continues slowing in both countries with domestic political uncertainty adding to growth fears as the risk of snap elections (in both countries) cannot be ruled out entirely.

Emerging Economies

BRICs: The BRICS met in Brazil in mid-November under the banner of "Economic Growth for an Innovative Future" and an agenda of low key issues such as strengthening cooperation in science, technology, innovation and enhancing cooperation in the digital economy. The countries in question are moving on different economic growth paths with China and India both recording economic growth rates above 6.5% YoY for the past five years and Russia and Brazil lagging behind substantially, posting GDP growth rates just above 1.5% YoY and 1.0% in the past two years as they are still recovering from the FY 2015 recession. On the economic data front, Brazil's GDP growth accelerated to 1.0% YoY in Q2 2019 compared to a 0.5% YoY in Q1 2019. There has been a clear improvement in business sentiment as both manufacturing and services

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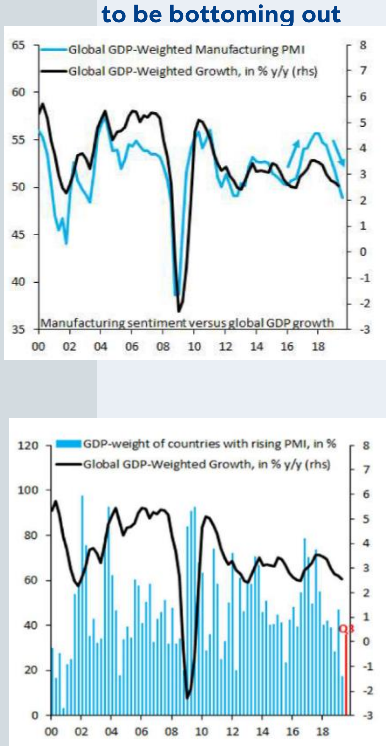
PMI prints have climbed over 50.0 since the end of July. However, political developments lure attention following the release of former President Luiz Inacio Lula da Silva from prison and the investigation into one of Bolsonaro's sons for embezzling public funds. In India, economic growth has continued decelerating in Q2 2019, after Q1 GDP growth print of 5.8% YoY, which is a 6-year low. Finally, in Russia, the flash Q3 GDP economic growth estimate came in at 1.7% YoY, up from 0.9% YoY in Q2 and 0.5% YoY in Q1. At the monetary policy meeting held last week, the Central Bank cut the key policy rate by 25 bps to 6.25%, which is the lowest level since 2014. This was the fifth rate cut since June with monetary easing phasing in at a time of declining inflationary pressures (3.5% YoY in October, with average inflation in 2019 so far standing at 4.6%).

CESEE: Third quarter second GDP estimates for the broader CESEE region indicate that these economies' performance remains resilient and domestic demand driven, albeit increasingly heterogeneous, against a turbulent international economic environment. CESEE economies outperformed, in terms of GDP growth, core-euro area economies for yet another quarter in Q3-2019. Yet, this outperformance is becoming less pronounced and less visible as we heading into a more challenging 2020.

Special Topic: Trip notes - Key points from 13th Commerzbank Emerging Markets Macro Conference in Dubai (November 13th-14th)

In mid-November, we traveled to Dubai where we attended the 13th Commerzbank Emerging Markets Macro Conference titled "Order in the Disorder: Have markets got used to geopolitical volatility?" The present note is a short analysis of the key themes and main points of the presentations at the conference

Figure 3 & 4: Global manufacturing in recession, but seems to be bottoming out

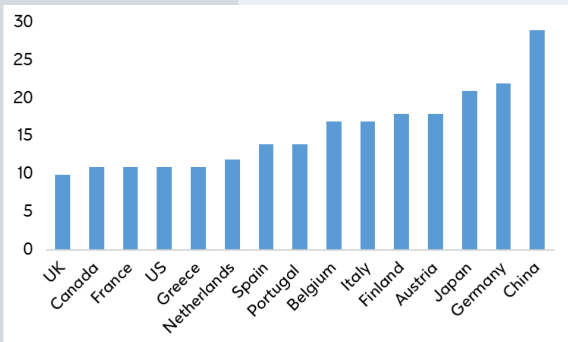


Source: IIF, 13th Commerzbank Emerging Markets Macro Conference

Global Economic Prospects

- Although the global manufacturing sector has been in recessionary territory during the past 6 months, the pace of decline in the global manufacturing sector seems to have slowed lately, with tentative signs of a stabilization in manufacturing sentiment mainly driven by developed markets' economies (Figure 3 & 4). Service sector output is expected to hold up relatively well in the US, with no significant adverse spillovers from the ongoing manufacturing weakness.
- The fiscal stimulus in the US will likely abate, and the Fed's earlier tightening as well as uncertainty about the trade conflicts will increasingly slow economic growth. Nevertheless, fears of a US economy recession based on the argument of decelerating manufacturing activity are overblown. US companies have stocked a lot of inventories in the recent past, and they now seem to be on a destocking phase. Nevertheless, there are some first positive signs that the inventory correction is nearing an end. In the euro area, weaker global demand has dampened growth notably. In the case of Germany, an economy in a gray area between meagre growth and recession where manufacturing has a relatively high share in economic activity, fears for a protracted slowdown are more justified. Indeed, according to the latest data, manufacturing in Germany equaled ca. 22% of gross value in Q1 2019, double the respective figure in the US during the same period (Figure 5).
- The trade war between the US and China, which has resulted in several rounds of retaliatory tariffs since mid-2018, has taken its toll on China's economic outlook. Nevertheless, the overall export picture in China is relatively fine, with China's export values remaining unchanged in the period

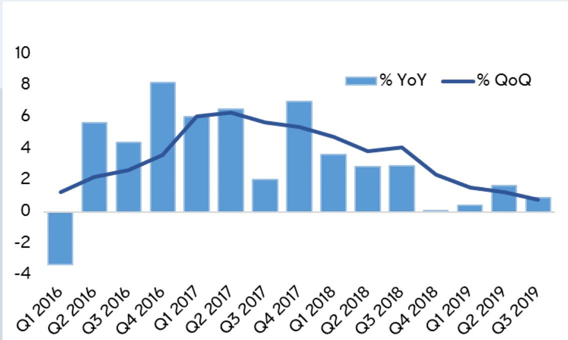
Figure 5: Manufacturing as % of gross value added (as of Q1 2019)



Source: National Sources, Eurobank Research

January-August 2019 compared to January-August 2018. Global trade growth has decelerated significantly, averaging around 7.0% during 1992-2007 compared to an average of merely 2.3% over the past 10 years. More recently, trade volume growth (goods and services) stalled at the end of 2018 and remained rather subdued in the first nine months of 2019. Near-term trade prospects remain soft with heightened protectionist risks, although the ongoing slowdown is nothing like the slowdown in 2015/16 (Figure 6).

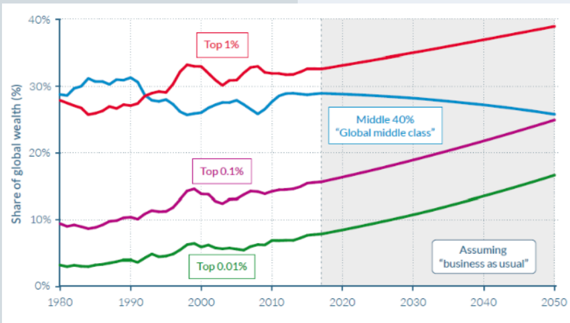
Figure 6: World trade growth



Source: OECD, Eurobank Research

- Income inequality is at the highest level since the 20-30s, fueled by easy credit and quantitative easing (Figure 7). The latter, combined with the deceleration in the GDP per capita growth – a trend more pronounced in the advanced economies – has led to the rise of populism and nationalism worldwide, and is not confined to Europe (Brexit, Trump, Europe, TPP, UNESCO, UNHCR, Paris Accord, Iran deal, NAFTA, NATO). This trend is likely to stay for a much longer period of time than we would expect.
- In response to moderating global growth and subdued inflationary pressures partly due to past globalization and the digitalization, major central banks have embarked on a monetary easing cycle in 2019. The Fed has cumulatively cut its policy rates by 75bps so far in 2019, with markets only pricing in one Fed cut by end-2020. Nevertheless, increasing economic risks, low inflation, and political pressure could prompt the Fed to cut interest rates further, exerting a downward pressure to the 10y Treasury yield over the course of 2020. In the euro area, following the ECB's comprehensive stimulus package delivered in September, declining growth forecasts and core inflation fluctuating around 1.2% as well as the southern countries' insistence on a loose monetary policy argue in favor of a further rate cut by the ECB as well as an increase in the volume of net asset purchases in spring 2020. Meanwhile, most Asian central banks have been cutting rates following the Fed's and ECB's further easing cuts and deteriorating growth prospects. Due to rate cut expectations, the 10y German government bond yield could tend to recede for the time being.

Figure 7: Global wealth inequality, 1980-2050 China, Europe and the US



Source: World Inequality Report 2018, wir2018.wid.world, 13th Commerzbank Emerging Markets Macro Conference

Emerging Markets

- **IIF overview**: According to Mr. Robin Brooks, the trade war is a struggle over growth and a structural headwind for EMs that may lead to a big re-rating of fair values. Although the trajectory of USD vs. G10 currencies index is a non-story since its rise in 2014-2015, the trajectory of USD vs EM has been and will remain the big story. The IIF US dollar indices ex-China (indexed to 100 in August 2011, when the US dollar hit a post-crisis low) has depreciated by approximately 60% (as of October2019). The question is whether the weakness of EM currencies vs. USD is a trend to continue in the longer term or its dynamics are exhausted and EM assets are now a buy opportunity. Elevated trade tensions may be the trigger for a realignment of EM FX fair values. Large devaluations are not producing a big pick-up in export volumes. The export volumes in a number of EM Latin America economies (such as Brazil, Argentina, Colombia and Chile) have declined despite REER depreciation in December2013 - June2019. Trade tensions are making current account adjustment harder. In the previous balance of payment devaluation episodes in EMs, the pick-up in trade volumes after the devaluation episodes has been faster, when compared to the recent examples of Turkey and Argentina. A decade of easy G-3 monetary policy has resulted in over positioning in EM assets, while big valuation losses in EMs' holdings (for example Argentina) means that contagion risks for other assets classes are high.
- **US-China trade war implications:** According to Mr. Charlie Lay, the US-China trade war is more than just a bilateral trade deficit issue. The so-called "phase one" trade deal would remove a tail risk temporarily but the sensitive issues of unfair trade practices, forced technology transfers, geopolitics and security consideration will be harder to address. This means that regardless of whether or not President Trump is re-elected in 2020, trade tensions with China will most probably persist. The US-China trade war could actually be a "Sputnik" moment for both the US and China. For the US, it could act as a spurt to innovation but also end a forty-year period of international policy engagement. For China, it could serve as an impetus to introduce reforms, spur rural and urban revitalization and speed up tech know-how and self-sufficiency. Ironically, it could also lead to action in line with US demands, such as improving intellectual property protection.
- **China:** China's economy achieved a tremendous growth of 9.5% on average in the previous 39 years (1980-2018). The initial opening up of the economy in the 80s-90s plus the WTO accession in 2001 gave a boost to growth dynamics. However, growth in the post-2009 period in the aftermath of the international financial crisis has been financed by the accumulation of debt. The growth achievements came at the expense of huge environmental, social costs (migration from rural areas to cities) and rising inequality and was made possible by low interest rates and low-cost labor. The authorities are now pursuing a transition to a more consumption oriented growth model by increasing the share of private consumption as a percentage of GDP. However, this shift will be more difficult to materialize if authorities continue propping up inefficient and loss-making state-owned enterprises at the expense of the private sector. The private sector is an important stakeholder as it owns 70% of the patents and accounts for 80% of urban employment. Reforming loss making state-owned enterprises is part of the deleveraging strategy. Low interest rates subsidize borrowers at the expense of savers. Low wages are subsidizing producers at the expense of labor workers. A weak FX currency rate is subsidizing exporters at the expense of importers. The solution is to

transfer wealth to the household sector, which will translate in higher interest rates, higher wages and a more stable currency. "China will grow old before it gets rich": Addressing unfavorable demographics is another point of attention. In China, the labor force participation rate peaked in 2015 when GDP/capita was just US$10,000. This is unfavorably compared to the paradigm of Japan, when labor force participation peaked in 1995 with three times higher GDP/capita than that of China. The Chinese economy was already slowing before the trade war in 2018, with private consumption, retail sales and industrial production slowing. Policy stimulus has been restrained thus far, but authorities are preparing the firepower to address economic slowdown if needed. There is some room for further fiscal stimulus through tax cuts, although tax rates are already fairly low and tax revenue stands at 18% of GDP, very low in comparison to the OECD average of 34%. Monetary stimulus is also relatively restrained and available through RRR cuts aiming to increase credit to the private sector. Finally, authorities are building up special purpose bonds to finance infrastructure spending. In that direction, local governments have brought forward bond issuances (by September 2019 bond issuances had reached CNY2.2tn).

Global Macro Themes & Implications

US/China agreement on Phase One trade deal reached, but trade uncertainty likely to remain elevated

After a one-and-half years of trade war escalation, the US and China reached an agreement on a long-waited Phase One trade deal on 13 December. Among others, the said deal contains the rollback on part of the existing tariffs as well as commitments by China to increase purchases of US agricultural goods and services, to better protect intellectual rights, to end its long-standing practice of pressuring foreign companies to transfer technology to Chinese companies as a condition for obtaining market access and to improve access to China's financial services market for foreign companies.

Undoubtedly, the said deal is an important step towards a comprehensive US/China trade deal in the future, underpinning business confidence and, ultimately, implying a better global growth outlook. But it is probably not enough to eliminate trade policy uncertainty and fully restore business confidence. The magnitude of the tariff rollbacks appears to be smaller than expected (planned December tariffs on $156bn worth of Chinese imports were removed but tariffs on $120bn of Chinese imports were only halved to 7.5%, while 25% tariffs on $250bn of Chinese imports remain in place). Furthermore, a renewed escalation in the US/China trade dispute and the threat of tariff reinstatement cannot be ruled out completely, taking into account the challenges China will likely have to address to implement properly the Phase One deal. Among others, China is requested to make substantial additional purchases of US goods (mostly agricultural goods, seafood products and energy products) and services in the coming two years, at a time it faces a number of domestic headwinds.

Regarding the trade deal timeline, the Phase One deal is expected to be signed in early January in Washington D.C. with an intention, according to US President's remarks, for negotiations on the second phase (which will involve bigger structural issues including subsidies for Chinse state-owned enterprises) to begin soon after the deal comes into effect (30 days after the signing), rather than waiting until after the US November 2020 elections. Nevertheless, a delay is likely considering that Chinese officials stated that the start of the second phase of the negotiations will hinge upon the implementation of the Phase One deal agreement, a remark that probably stems from concerns that the deal may trigger domestic political and economic pressures. Consequently, uncertainties around the US/China trade relations are likely to remain elevated in the coming months and tensions will likely erupt anew as the bar for an agreement on a comprehensive trade deal seems to be much higher.

Market excitement about UK Conservatives' landslide victory likely to give way to uncertainty related to the risk of a no-trade deal Brexit

Under the leadership of Boris Johnson, the Conservatives won a comfortable majority in the 12 December UK general election, securing 43.6% of the vote, the highest popularity rate by any party since 1979. On the view that all of the elected Conservative MPs have signed up to Boris Johnson's Brexit deal as part of the election campaign, the Tories' landslide victory brought some near-term clarity on Brexit, pushing the GBP sharply higher across the board. Under the terms of the said deal, the ratification of the relevant bill would allow the UK to leave the EU by the end of January 2020 and enter as of 1 February into a so-called transition period that would allow the country to maintain privileges and obligations as if it were an EU member state (such as the single market, customs union access, and free movement of people) but losing representation (and voting rights) in European institutions (such as the European Parliament, the EU Council and the Commission). During this period, the UK and the EU will begin negotiating a full free trade agreement with a view to reaching a deal by 31 December 2020, when the transition period is scheduled to expire. If by end-June 2020 the negotiations have not proceeded quickly enough to allow for an agreement on the long-term UK/EU economic relationship by the deadline, the UK could request an extension that will need to be agreed with the EU. Such an extension can be requested once and cannot last for more than two years.

The Conservative manifesto makes clear that the party does not intend to extend the transition period beyond 31 December 2020. However, finalizing and ratifying a comprehensive trade deal within just 11 months seems highly ambitious given that trade negotiations typically take a number of years to be reached (the EU-Canada free trade agreement required seven years). Therefore, the risk of a no-deal exit at the end of 2020 cannot be ruled out completely. Should this be the case, the UK would face a no-trade deal cliff edge, whereby it would transition into standard WTO rules that are generally much less favourable than existing trade arrangements. This means that the risk of a disorderly Brexit that prevailed in 2019 could likely give way to some degree of uncertainty related to the risk of a no-trade deal with negative repercussions for business sentiment and economic activity over the coming months.

Macro Themes & Implications in CESEE

Q3-2019 second GDP estimates for the broader CESEE region indicate that these economies' performance remains resilient and domestic demand driven albeit increasingly heterogeneous, against an increasingly challenging international economic environment in 2020

Q3-2019 second GDP estimates, released in early December, carried no major revisions. The CESEE region outperformed, in terms of GDP growth, core-Euroarea economies for yet another quarter and we expect this to be the case also in the last quarter of the year. Once again, growth was primarily driven by domestic demand in most cases. From a geographical point of view, CEE3 (Poland-Hungary-Slovakia) economies are leading the pack in the broader CESEE group growing on average by 4-5% on expansionary fiscal and monetary policies, while the SEE (Bulgaria-Serbia-Romania-Turkey) economies are lagging behind. Moreover, when analyzing country performance in the latter group, heterogeneity prevails. Romania, an outlier in our previous analyses, slowed abruptly to 3.2% YoY in Q3-2019, sharply down from 4.3% YoY in Q2-2019 and 4.9% YoY in Q1-2019, paying the price for its excessive expansionary and largely inconsistent fiscal and monetary policies. In contrast, Bulgaria slipped to 3.7% YoY in Q3 vs. 3.8% YoY and 3.9% YoY in Q2 visibly outperforming revised official forecasts underpinned by solid final consumption dynamics. Serbia has accelerated to 4.8% YoY in Q3, up from a mediocre performance of 2.7% YoY and 2.9% YoY in Q1 & Q2 respectively. Turkey, an underperformer in recent quarters, registered its first positive – on an annual basis –reading in a year in Q3-2019 (0.4% QoQ/0.9% YoY in Q3).

Yet, in contrast to the previous years, the CESEE region's GDP over-performance is becoming less pronounced and less visible and even more heterogeneous within individual group of economies, heading into the likely more challenging year 2020. Having passed their cyclical peak, GDP growth dynamics in the regional economies are expected to slow in most cases on weaker net exports and domestic demand dynamics. Net exports are expected to come under more pressure in a less friendly global economic environment due to persisting trade tensions. At the same time, domestic demand will remain the key source of growth. However, it is not expected to make a higher contribution, as households' and corporates' incomes growth decelerates, and the room for domestic fiscal & monetary policy responses becomes more limited. Although each case is different and uncertainties high, improved EU funds absorption – a pivotal factor behind public investment if used wisely – plus healthy credit expansion can make a positive difference in each individual country's output performance next year.

CESEE Markets Developments & Outlook

Bulgaria

Bulgarian Eurobond yields rose across the board, ranging between 7-13 bps, with the 2027 and 2028 paper yields gaining 12 and 13 bps respectively. Local yields, on the other hand, registered modest gains of 2-4 bps across all maturities. The Ministry of Finance did not hold any bond auctions this month, as the yearly debt ceiling set by the Ministry was reached. Standard and Poor's recently upgraded Bulgaria's sovereign rating by a notch, from BBB- to BBB stable, citing the consistent budget surplus and low public debt/GDP levels as the primary drivers of the decision. Recently, the Ministry of Finance distributed the year-end budget surplus of EUR 0.7M to large infrastructure projects, aiming to increase productivity and support the domestic economy. The Ministry noted also that the budget target forecast for the next two years does not foresee a year-end surplus, taking into account the late cycle stage of the economy and the overall global economic uncertainties.

Serbia

Overall, so far in 2019, the dinar has managed to scoop only 0.6% against the euro, as the National Bank of Serbia (NBS) has stated publicly several times that "excessive currency movements in either way is what the NBS strictly opposes". Daily FX interventions have remained the main tool of protecting the dinar from over-appreciating. Throughout the year, the NBS has bought EUR2.7bn from local commercial banks. Moreover, it has stepped-in on several occasions as a seller of the hard currency for EUR390mn. In retrospect, there was room for the dinar to strengthen, but interventions of the NBS prevented such an outcome.

Meanwhile, government bond yields developments have been driven by the overall positive macroeconomic data that has been coming out, namely strong GDP growth, anchored inflation and impressive FDIs. On a year-to-date basis, the government bond yield curve has shifted significantly lower on both ends of the curve with the flattening of the curve being more pronounced during the summer. In general terms, the long end of the curve fell 180 basis points while the short end was trimmed ca 126 basis points, trading currently around 3.1% and 1.7%, respectively.

Markets View

Foreign Exchange

EURUSD: The pair is trading close to its 200 day moving average (1.1153) that we have flagged as a major resistance, and a close above would open the way for a move towards 1.1250 and 1.1450. With the Brexit uncertainty out of the way at least in the near term and the Fed decisively dovish, support for the EUR versus the USD is increasing. We will still play the 1.08 – 1.12 range but with a tight stop on the upside given recent developments.

GBPUSD: The expected breakout higher materialized post the UK elections with the pair reaching a high of 1.3514. Given the quick move we expect some consolidation now between 1.30 and 1.35 ahead of the 31 January exit and the long process of negotiating a trade deal with the EU (to be completed by December 2020).

USDJPY: The 108.00 – 109.50 persisted in December with the risk-on sentiment pushing the pair towards the upper end (high 109.71). We still see any rally towards 109-110 as corrective and would be sellers of the pair, but the risk of a breakout higher is increasing, so we use tight stops. A weekly close above 109.75 would mark a break of this year's downtrend and would be clearly bullish.

Rates

EU: Lagarde's first ECB meeting indicated that monetary policy will remain unchanged for the months ahead, if not longer. German yields are closing the month slightly higher with the curve steeper. Economic numbers and market sentiment will remain the key drivers in the near term. The periphery outperformed with Greece and Italy at the forefront, while Spain has been the obvious laggard. Overall we see room for further increase in core yields and compression in the Periphery but do not expect any major moves.

US: The wide range of November (1.70%-2.0%) persisted in December as well on the back of a dovish Fed on one side and positive economic and market-related news on the other side. The market seems to have priced all good news so far and, therefore, we have a preference to the long side across the Treasury curve into Q1 with equities and credit at multi-year highs/tights. We expect the short end to outperform as the Fed is clearly in a low-for-longer stance.

Emerging Markets credit

EM credit performed very well in December boosted by the dovish Fed and ECB but mostly by the US/China

"Phase One" trade agreement and the push back of further tariffs. LatAm reversed part of its recent underperformance versus EMEA and Asia. The spreads of EMBI+ tightened by 15bps to 292bps (close to the 2018 tights of 288bps). We see global CB policies, a continuation of trade wars and protests on the back of social unrest as the key drivers of EM spreads/total returns for 2020. The hunt for yield and benign economic numbers will remain supportive for the asset class. We remain tactical buyers of any widening.

Corporate credit

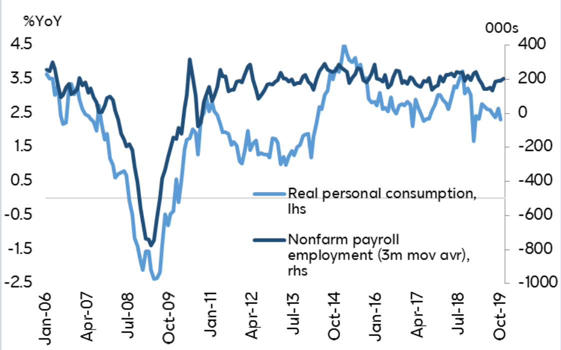
Nothing like December 2018 for global credit. UK election results and trade war related "agreement" between the US and China were the end-of-year gifts to the markets with USD, EUR and GBP credit spreads tightening close to or beyond this years' lowest levels. Overall cash outperformed structured credit and lower rated credits outperformed higher rated ones in both IG and HY with credit spread curves bull steepening mildly as the primary market slowed down. The Fed and ECB provided further support with dovish commentaries and especially in IG the play now is more rates than credit. We remain defensive in our outlook for the credit market, especially post the tightening into year-end as the market seems to have priced all good news. It is the time to lighten positioning further and put on some cheap hedges via CDS options into Q1 2020.

US

Diminished recessionary risks, but economic growth has decelerated to trend

The second real GDP growth estimate for Q3 came in 0.2pp higher at 2.1%QoQ saar, the second near-trend growth release in a row following a quarterly average of ca. 2.7% in 2017 and 2018. Although the heightened trade-related uncertainty, the fading positive effect of fiscal measures and Fed's past rate hikes have certainly slowed the growth momentum, latest economic indicators seem point to a diminished risk of a US recession. November nonfarm payrolls surpassed market expectations (+266k) with upward revisions to prior two months, boosting the three-month moving average payroll increase to 205k from 189k in October. In addition, the labor force participation rate currently stands close to its highest level since the summer of 2013 (averaging at 63.2% over the past 4 months), pointing to further gains in personal income and spending. Following the November employment report, the Atlanta Fed's GDPNowcast model upgraded on December 6 its real Q4 GDP growth forecast by 0.5pp to 2.0%QoQ saar, with strong consumer demand (particularly in services) – supported by accommodative financial conditions – more than offsetting subdued business investment and weak external demand. Nevertheless, we maintain our GDP growth forecast at 2.3% for 2019 and 1.8% for 2020, as weakness in manufacturing and ex-US global growth take their toll on the underlying growth momentum, on top of a waning effect from expansionary fiscal policies.

Figure 8: Strong labor market conditions bode well for personal income and spending



Source: Federal Reserve, Eurobank Research

Table 1: FOMC Economic projections, December 2019

	Median* (percent)				
USA	2019	2020	2021	2022	Longer run
Real GDP change	**2.2**	**2.0**	**1.9**	**1.8**	**1.9**
Sept projection	2.2	2.0	1.9	1.8	1.9
Unempl rate	**3.6**	**3.5**	**3.6**	**3.7**	**4.1**
Sept projection	3.7	3.7	3.8	3.9	4.2
PCE inflation	**1.5**	**1.9**	**2.0**	**2.0**	**2.0**
Sept projection	1.5	1.9	2.0	2.0	2.0
Core PCE	**1.6**	**1.9**	**2.0**	**2.0**	
Sept projection	1.8	1.9	2.0	2.0	
Fed Funds Rate	**1.6**	**1.6**	**1.9**	**2.1**	**2.5**
Sept projection	1.9	1.9	2.1	2.4	2.5

Source: Federal Reserve, Eurobank Research

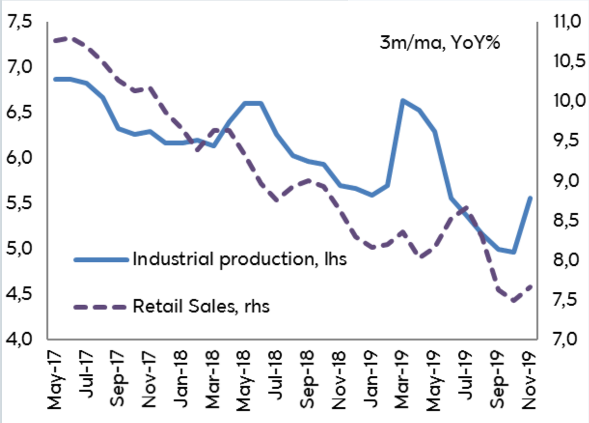
As broadly expected, the Fed kept the fed funds rate stable at 1.50-1.75% at its December meeting following three cuts in a row earlier this year. The post-meeting statement stated that "the current stance of monetary policy is appropriate", while Chairman Jerome Powell highlighted that given the below-target inflation and the remaining slack in the labor market, only a "persistent" and "significant" increase in inflation would justify higher policy rates. In line with the "dots", we expect the Fed to remain on hold in the foreseeable future (13 out of 17 FOM members expect the target range to remain stable throughout 2020) barring "a material reassessment of the outlook".

China

Stability and risk control are set as top policy priorities for 2020

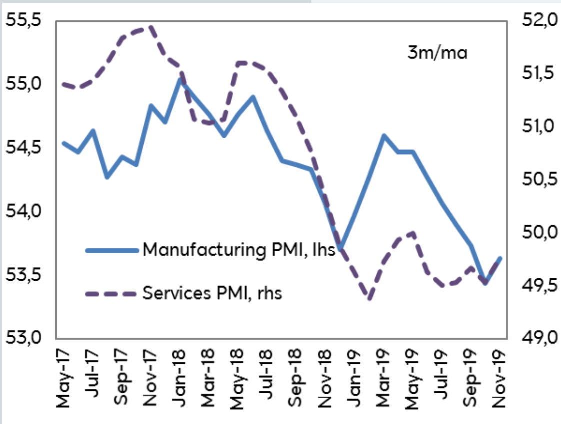
On December 10-12 the Central Economic Work Conference (CEWC) was held in Beijing. Traditionally, the CEWC prepares the ground for the setting of economic targets such as the GDP and the CPI, which are later announced at the National People's Congress (NPC). Risk control and overall stability were considered as top policy priorities for 2020 with stabilisation required in the areas of employment, finance, trade, foreign and domestic investments along with market expectations regarding the country's overall outlook. The conference clearly acknowledged the downward pressure on the economy, coming from both global and domestic sides. As a result, the economic growth target for 2020, which is expected to be announced in the coming NPC next March, is anticipated "around 6%", lower compared to 2019's targeted range between 6% and 6.5%, which, albeit marginally, appears achievable, given that the Q4 reading is expected around 6%. The generic character of the set priority in the conference, namely overall stability, leaves enough room for maneuvers to policy makers in the year ahead. Fiscal policy will remain proactive while the mandate for the monetary policy is prudency with liquidity remaining ample. The phase one trade deal with the US reached last week contributes to the stability goal and is regarded as a deterrent against economic growth slowdown. At first glance, it will assist in stabilising China's external demand in 2020. Furthermore, it will reduce the uncertainty around US tariffs that delayed business decisions of domestic and foreign companies operating in China. Hard data as of November point to an improvement in China's economy. Industrial production accelerated to 6.2% from 4.7% and retail sales growth came in at 8% YoY from 7.2% YoY in October. Moreover, both Caixin and the official manufacturing PMI rebounded above 50 in November, with the official index standing above 50 only for the second time in 2019. Consequently, contrary to the view that the economy may slow further in 2020, the chances of a bottoming out in 2020 are increasing.

Figure 9: IP and Retail sales recovering in November



Source: Bloomberg, Eurobank Research

Figure 10: PMI gauges on a recovery path



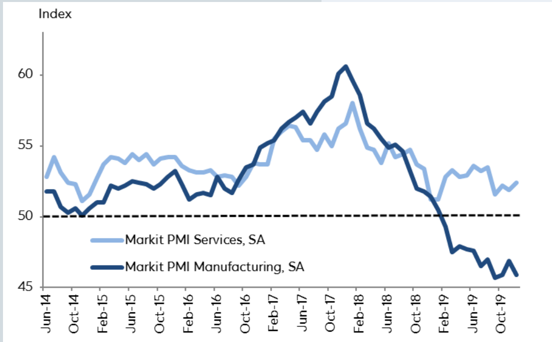
Source: Bloomberg, Eurobank Research

Euro area

The economy fails to gain speed in December

Mirroring a broad-based contraction in production and consistent with a softening of the ongoing manufacturing contraction, IP fell by 0.5%MoM in October, with the carry-over in Q4 increasing to -0.4%QoQ from -0.8%QoQ in Q3. Nevertheless, the flash December PMIs suggested that the EA economy failed to pick up momentum, with the manufacturing recession deepening further to a 2-month low of 45.9 pts from 46.9 in November, not far from September's multi-year low of 45.7. On the contrary, the service sector showed signs of resilience, with the respective index increasing to a 4-month high of 52.4 pts from 51.9 in the prior month. Overall, the December Composite PMI remained unchanged at 50.6 pts, pointing to a Q4 real GDP growth rate of just 0.1%, down from 0.2% in Q3.[1] With the euro area economy expected to end the year on a weak note, we maintain our 2019 real GDP growth forecast at 1.1% down from 1.8% in 2018, with the overall balance of risks tilted to the downside. Weak economic prospects, coupled with an already very expansionary monetary stance, calls for additional fiscal stimulus, but any such measures are expected to be rather moderate and gradual.

Figure 11: Output rises at the weakest pace since H2 2013



Source: IHS Markit, Bloomberg, Eurobank Research

On the monetary front, the ECB kept its policy unchanged at the December meeting, the first under Christine Lagarde's presidency. With no major changes to the introductory statement, the ECB highlighted signs of stabilization in growth, albeit at weak levels, a mild increase in underlying inflation and somewhat less pronounced downside risks. Changes to the ECB staff macroeconomic projections were relatively small compared to September (see Table 2), while strong emphasis was placed on the strategic review expected to start in January and be completed by end-2010. The strategy review framework has to be agreed to within the Governing Council as well as with some external stakeholders. Overall, we keep our call for unchanged monetary policy for the coming quarters, with the ECB maintaining an easing bias while continuing QE.

Table 2: ECB staff/Eurosystem macro midpoint projections, December 2019

ECB projections (%)	2019	2020	2021	2022
GDP growth	**1.2**	**1.1**	**1.4**	**1.4**
Sept projection	1.1	1.2	1.4	
HICP inflation	**1.2**	**1.1**	**1.4**	**1.6**
Sept projection	1.2	1.0	1.5	
Core inflation	**1.0**	**1.3**	**1.4**	**1.6**
Sept projection	1.1	1.2	1.5	
Wage growth	**2.1**	**2.1**	**2.3**	**2.5**
Sept projection	2.2	2.3	2.4	

Source: ECB. Eurobank Research

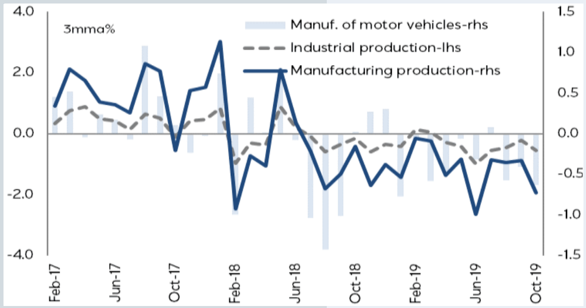
[1] For more details see the HIS Markit PMI's press release https://www.markiteconomics.com/Public/Home/PressRelease/744e10d0074244fd8f007451da9de4f8

Germany

Industrial production still mired into recession

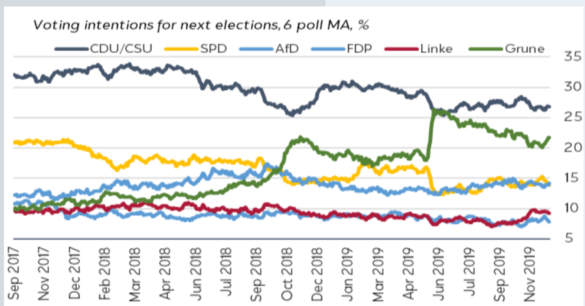
Germany's industrial production unexpectedly dropped by 1.7%MoM in October, the biggest decline in the last six months and the second-strongest drop in the last one and a half years, following a 0.6%MoM decrease in the prior month. The October drop took the Q4 carry-over at -1.9%QoQ vs. -1.2%QoQ in Q3, indicating that industrial production will likely drag on GDP growth in the last three months of the year. Looking at the main sub-sectors, construction contracted -2.8%MoM along with manufacturing which shrunk 1.6%MoM on the back of a sharp decline in the auto sector production (-5.6%MoM), while energy increased further (+2.3%MoM), limiting the October decline in industrial production. Industrial production data are at odds with certain major business surveys, which suggest that domestic industrial downturn has probably reached a trough and should be moderating in the coming months amid expectations for some improvement in business sentiment, especially after the US and China reached an agreement on a long-waited Phase One trade deal. Indicatively, the Ifo business climate index edged up in November for the second time in the last three months (95.0) and the ZEW indicator rose more than expected in December reaching the highest level since February 2018 (10.7). Meanwhile, domestic demand, especially in the form of private consumer expenditures, remains on a solid footing, supporting the view that the economy will likely continue to grow at a slow pace of 0.1%QoQ in the coming quarters and fears over a potential crunch are probably exaggerated. The unemployment rate hit a fresh record low of 2.8% in Q3 (domestic concept), gross wages and salaries were up by 4.2%YoY over the same period and households' disposable income rose by 3.4%YoY compared to an average 2.6%YoY in Q1 2019. On the domestic political scene, the SPD's party convention (6-8 December) formally approved the outcome of the membership vote on the new leadership duo of Saskia Esken and Norbert Walter-Borjans who had been openly critical of the current grand coalition. However, warding off fears over an imminent "GroKo" collapse, the SPD delegates rejected a motion for an immediate exit from the government and instead gave the new leadership the mandate to reopen discussions with coalition partners CDU/CSU on a package of policy issues, as a working basis for continuing the government coalition.

Figure 12: IP still mired into recession



Source: Federal Statistical Office (Destatis), Eurobank Research

Figure 13: SDP appetite for snap elections is certainly low given the party's weak performance in recent polls



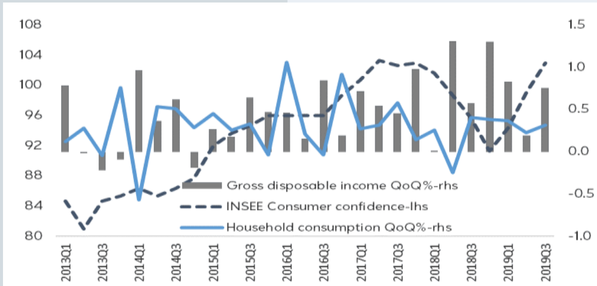
Source: Press, Eurobank Research

France

Expected Q4 GDP growth resilience to ongoing pension reform strikes

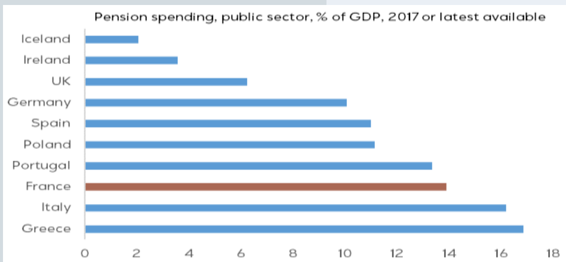
French household goods consumption rose by 0.2%MoM in October (volume terms), following a 0.3%MoM decline in the prior month, thanks to a 0.3%MoM improvement in engineered goods consumption and a 0.2%MoM gain in manufactured goods that offset a 1.5%MoM drop in energy. The modest October rise took the Q4 carry-over at 0.0%QoQ compared to 0.4%QoQ in Q3, suggesting that household consumption may slow in Q4 from a final growth rate of 0.4%QoQ in Q3 (revised up by 0.1pp from 0.3%QoQ flash estimate). The open-ended nationwide strike that started on 5 December with more than 800,000 workers from a wide range of professionals, demonstrating against the government's proposed reform of the pension system, is another source of concern for France's economic growth performance in the last quarter of this year. The proposed reform primarily aims to replace the existing 42 special pension schemes that provide public and private sectors with a number of privileges such as eligibility for early retirement and higher pension benefits, with a single, universal, points-based system aiming to improve fairness and transparency (according to the OECD, France's current pension system, in terms of public spending as a percentage of GDP stands at 14%, among the highest in the EU). Though it may be difficult for household spending to match the Q3 pace of growth, it is likely to eventually prove resilient thanks to positive disposable income fundamentals (+0.8QoQ in Q3) and a further increase in INSEE consumer sentiment in November (a near twelve-year high of 106 and above the long-term average of 100 for the sixth month in a row). Further supporting our view for an unchanged GDP growth rate of 0.3%QoQ in Q4 and 1.2% for the full year 2019, industrial production rose in October for the second consecutive month (0.4%MoM), taking the Q4 carry-over at 0.3%QoQ vs. -1.1%QoQ in Q3, indicating that the Q4 industrial drag is likely to be more limited, especially after the US and China reached an agreement on a Phase One trade deal, offering some breathing space to companies that have been hit with the threat of higher tariffs.

Figure 14: Q4 household consumption likely to prove resilient to ongoing pension reform strikes



Source: National Institute of Statistics and Economic Studies (INSEE), Eurobank Research

Figure 15: The cost of France's pension system, in terms of public spending as % of GDP, is one of the highest in the EU



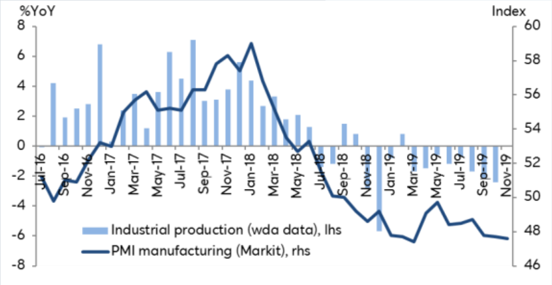
Source: OECD, Eurobank Research

Italy

Despite receding political uncertainty, growth is unlikely to recover much from stagnation

Industrial production fell by -0.3%MoM in October for the second consecutive month, with a sharp contraction in energy production (-1.9%MoM) and a more modest decline in manufacturing (-0.3%MoM). The October print took the negative Q4 carry-over to -0.4%QoQ, not far from -0.5%QoQ in Q3, pointing to further deterioration in output growth in the last quarter of the year. Meanwhile, the November PMI manufacturing index fell by 0.1 to 47.6 pts, marking the fourteenth monthly deterioration in a row and actually at the fastest pace since March. Furthermore, business confidence towards year-ahead output moderated to its lowest level since December 2012 amid heightened worries over softer global demand. Italian business activity also registered a weak performance in November, with the respective PMI index (based on a single question asking respondents to report on the actual change in business activity at their companies compared to one month ago) falling by -1.8 to 50.4pts to signal the weakest expansion in output across the service sector since May. Moreover, the Composite Output Index declined to 49.6pts in November from 50.8 in October, reporting the first decline (albeit marginal) in Italian private sector output since May. [2] Overall, economic activity is unlikely to recover much from stagnation, with our 2019 real GDP growth forecast at 0.2% from 0.7% in 2018, with the significant deceleration of global growth and the downturn in the industrial cycle weighing on overall growth.

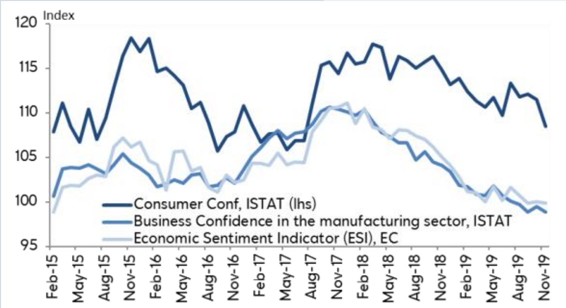
Figure 16: Further contraction in industrial output in Q4



Source: Bloomberg, Eurobank Research

On the political front, our baseline case is for the M5S-PD coalition to stay in place through 2020, but tensions within the government are likely to remain high. The risk of snap elections cannot be ruled out, given that the M5S and the PD will need to handle 7 regional elections in H1 2020 and a new electoral law. Meanwhile, Lega's popularity is back at its peak level of ~35%, having already managed to increase the regions it controls from 3 to 12 over the past two years.

Figure 17: Consumer and business confidence have deteriorated



Source: EC, IHS Markit, Bloomberg, Eurobank Research

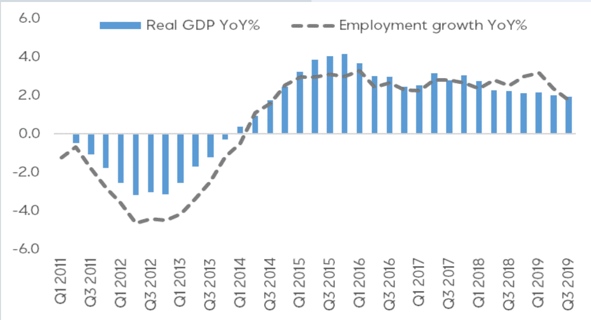
[2] For more details see the HIS Markit PMI's press release https://www.markiteconomics.com/Public/Home/PressRelease/73e440b1e5e744b3bfdc9ef9ef19ac51, https://www.markiteconomics.com/Public/Home/PressRelease/789d5000ec2c4dcf8c911cdf987761b2

Spain

Still in political deadlock amidst slowing growth momentum

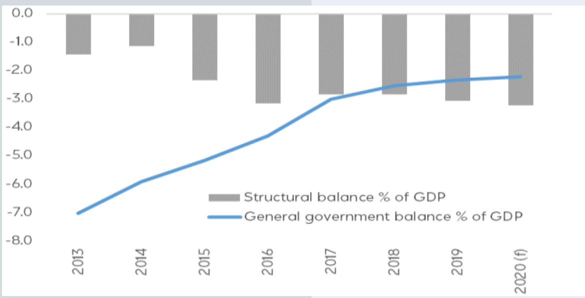
The newly elected Congress convened in early December but it remains uncertain whether caretaker PM Pedro Sanchez of the incumbent centre-left Socialist Workers' Party (PSOE) will secure enough support to form a government following the inconclusive outcome of the 10 November general election. The socialist leader has already reached a preliminary agreement with the left-wing Unidas Podemos, but further support is required, as the two parties control 155 MPs cumulatively, short of the required majority in the 350-seat Parliament. To sum up, political deadlock remains and new elections cannot be ruled out. Political developments have broadly failed to be a hindrance for the Spanish economy in the past four years, with GDP growing by a 3.0% average in the 2015-2018 period. But in light of slowing global trade growth as the world economy weakens, a prolonged impasse appears to start hurting domestic economic activity. Q3 GDP grew by 2.0%YoY for the second quarter in a row, down from 2.2%YoY in Q1, mainly due to the external sector, while recent data indicate risks for some further slowdown in Q4. Indicatively, retail sales lost traction in October decelerating to 2.4%YoY vs. 3.6%YoY in September and a 3.9%YoY average in Q3, as softer employment growth (partly reflecting the delayed effect of the 22% increase in the minimum wage in January 2019) and prolonged political uncertainty appear to restrain private consumption. Industrial production dropped by 1.3%YoY in October, the first decline in the last seven months, while the Markit PMI manufacturing remained below the 50-threshold (47.5) for the sixth consecutive month. As a result, we expect GDP growth to moderate to 1.9% in 2019 vs. 2.4% in 2018 and then further towards potential growth of 1.5% in 2020, with Spain remaining among the top performers in the Euro area, in spite of the anticipated deceleration. On the fiscal front, the EU Commission warned in its latest economic forecast that Spain is running a pro-cyclical fiscal policy and the structural deficit is projected to increase in 2020 for the second consecutive year to -3.2% of GDP, the highest in the Euro area. But, complying with the EU fiscal rules (0.65% of GDP structural adjustment required for 2019 and 2020) may not be an easy task for the new government, especially if Unidas Podemos, which has been calling for further fiscal loosening, becomes one of the coalition partners.

Figure 18: Real GDP and employment growth have moderated



Source: National Statistics Institute (INE), Eurobank Research

Figure 19: Spain expected to record the highest 2020 structural deficit in the EA



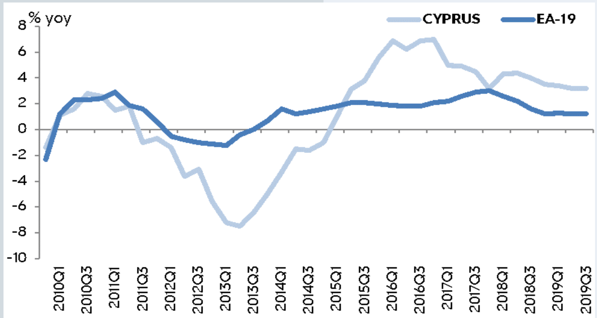
Source: AMECO, Eurobank Research

Cyprus

Third quarter revised GDP estimate paves the way for softer economic activity readings in 2020

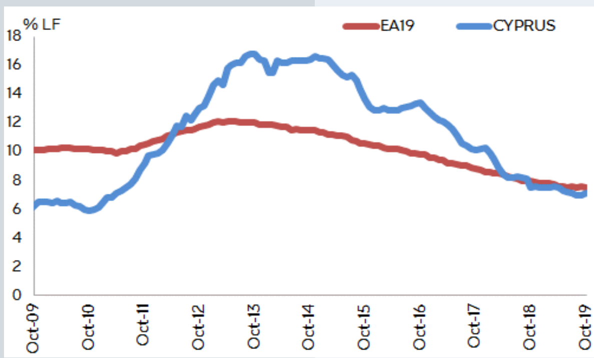
In a widely unexpected move, the second CYSTAT estimate of Q3-2019 added 0.3ppts to the flash. On a seasonally adjusted basis, real GDP expanded by 0.4% QoQ/3.4% YoY in Q3-2019 compared to 1.0% QoQ/3.2% YoY in Q2-2019 (up from 0.7% QoQ/3.1% YoY previously) and 1.4% QoQ/3.4% YoY in Q1-2019 (up from 0.7% QoQ/3.3% YoY previously). Factoring in the revised estimate of Q3, the year-to-Q3 GDP growth performance stands at 3.3% in line with our long-expressed views, down from 4.2% in 2018 and 4.4% in 2017. Although the reading was significantly revised, it doesn't change our view that the soft landing of the economy to more sustainable levels, a view that we penciled in previous analyses as well, has already started and will be more visible next year. At the moment, economic activity is still supported by sustained sentiment improvement, tightened labour market conditions, record-high tourist arrivals (despite the Thomas Cook bankruptcy), further property market recovery, the impact from fiscal relaxation and the accelleration of public consumption plus a stream of ongoing residential and tourism infrastructure construction projects underpinned by the program "citizenship by investment", which has helped to attract foreign investment in the real estate sector. High profile cases of program misuse have necessitated government amendments aiming to make the program more targeted and trustworthy in response to EU institutions' criticism that the transparency of the program should be bolstered. At the same time, concerns for the prospects of this activity in the future remain and are anticipated to become more pronounced next year. Final consumption dynamics (0.0% QoQ/5.3% YoY vs. 1.8% QoQ/6.3% Yo) made a 4.4ppts contribution to GDP growth in Q3-2019. Investment spending, at constant prices, was higher on an annual basis (-0.1% QoQ/+8.9% YoY) in Q3-2019. However, the negative inventories performance resulted in gross capital formation having a negative contribution (-4.4ppts) to GDP growth. Finally, net exports' contribution was positive (+3.4ppts in Q3-2019 vs. -5.8ppts in Q2-2019). That was the combined effect from both exports expanding by +6.4% QoQ/1.6% YoY, and imports dropping by -3.0% QoQ/-3.0% YoY.

Figure 20: Cyprus' turn-around growth story has been impressive so far



Source: CYSTAT, Eurostat, Eurobank Research

Figure 21: Unemployment in Cyprus now stands below Euroarea



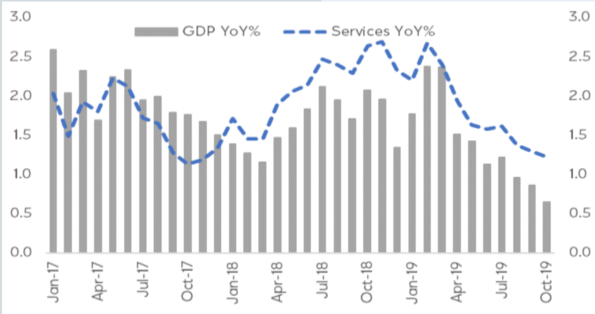
Source: Bloomberg, Eurobank Research

UK

Weaker-than-expected October GDP growth bodes poorly for Q4

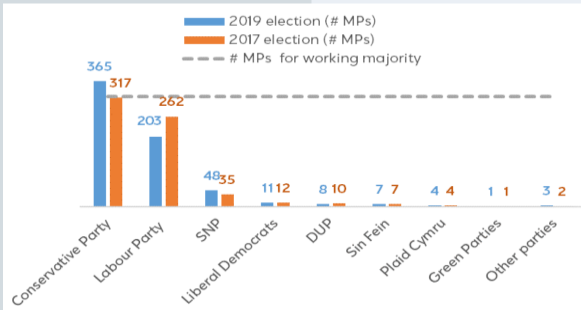
UK monthly GDP for October came in weaker-than-expected with a 0.0%MoM print following two consecutive monthly declines. The Q4 carryover stands at 0.0%QoQ, indicating that the BoE's forecast for 0.2%QoQ GDP growth may prove optimistic. Manufacturing output grew by 0.1%MoM, the first positive figure in the last four months, probably boosted by temporary stockpiling ahead of the 31 October Brexit deadline (as was also the case in Jan-Mar 2019 ahead of the initial Brexit deadline). In annual terms, manufacturing output contracted by a pace of c. 1.5% for the third consecutive month, with the respective index having dropped back to mid-2017 levels, weighed down by Brexit-related uncertainty, supply chains' reallocation by EU manufacturers to avoid potential future disruption and reduced export demand on the back of weaker global growth. With respect to the services sector, the main growth engine of the UK economy, output grew by 0.2%MoM in October and was the only positive contributor to GDP growth, probably also favored by temporary stockpiling. But in annual terms, growth in services has been steadily declining after peaking at 2.7% in February to stand in October slightly above 1.0%. The volatile construction component was the main driver behind the disappointing October GDP print, contracting by the highest pace in near two years of 2.1%MoM on the back of an unusually high number of rainy days. Although part of the October fall in construction is likely to be reverted in the coming months due to improved weather conditions, risks seem skewed to the downside and a renewed contraction of GDP growth in Q4 cannot be ruled out, if upcoming data verify the view that the October boost to both manufacturing and services was driven by temporary stockpiling. For the full year 2019, we see GDP growth averaging c. 1.0% and remaining below the BoE's potential rate of 1.5% in 2020, as risks of a no-trade-deal are likely to remain elevated, if, in line with the Conservative manifesto, PM Boris Johnson does not request an extension to the transition period scheduled to expire at the end of December 2020.

Figure 22: Services, the growth engine of the UK economy, has slowed significantly this year



Source: Office for National Statistics (ONS), Eurobank Research

Figure 23: Conservatives won a big victory at the 12 December 2019 general election



Source: Press reports, Eurobank Research

Bulgaria

Improving macroeconomic fundamentals shield Bulgaria's short- to medium-term trajectory against a turbulent international economic environment.

On seasonally and calendar adjusted terms, real GDP expanded by 0.8% QoQ/3.7% YoY in Q3-2019 com-pared to 0.9% QoQ/3.8% YoY in Q2-2019 vs. 1.1% QoQ/3.9% YoY in Q1-2019, bringing the year-to-September performance at 3.8% YoY vs. 3.1% YoY in 9M-2018. Domestic demand was very supportive to-wards GDP growth accelera-tion throughout the outgoing year. Final consumption accelerated to 5.4% YoY in 9M-2019 up from 5.2% YoY in 9M-2018 and 3.9% YoY in 9M-2017, making a hefty contribution of 4.2ppts in the 9M-2019 reading vs. 4.0ppts in the 9M-2018. Gross fixed capital formation advanced by only 1.5% YoY in 9M-2019 making a contribution of only 0.3ppts, falling short of expectations, visibly lower than 5.7% YoY in 9M-2018 (down from 1.1ppts contribution in 9M-2018). Although some of the government expenditure is traditionally skewed to the last quarter of the year, this will most probably not suffice for the full-year performance to reach 1.9% YoY, as the Ministry of Finance projected in autumn. Exports volume remained virtually flat at 0.3% YoY in 9M-2019 vs. 0.6% YoY in 9M-2018 down from 6.7% YoY in 9M-2017. Imports also remained subdued at 0.7% YoY in 9M-2019 vs. 5.1% YoY in 9M-2018 down from 7.5% YoY in 9M-2017. As a result, net ex-ports' contribution to GDP growth became less negative in the first nine months of the year (-0.3ppts in 9M-2019 vs. -3.0ppts in 9M-2018). Overall, GDP growth is expected to have expanded briskly by 3.7% in FY2019 up from 3.1% in FY2018, more than three times higher than the expected EA-19 average. In our view, robust growth performance is expected to continue in 2020 – albeit at a slower pace given the rise of external risks. Thus, our full-year forecast stands at 3.2%, driven by sound domestic demand dynamics. The solid growth momentum has not escaped notice of the rating agencies. Standard and Poor's raised the long-term sovereign rating of the country by one notch to BBB from BBB- with a positive outlook in early December. The rating agency cited the resilient economic performance of the country without building macroeconomic imbalances as the main driver behind its decision. At the same time, it acknowledged that the country's fiscal and external balance sheets are strong, and progress on entering the ERM II steadfast.

Figure 24: Bulgaria's fiscal position is sound

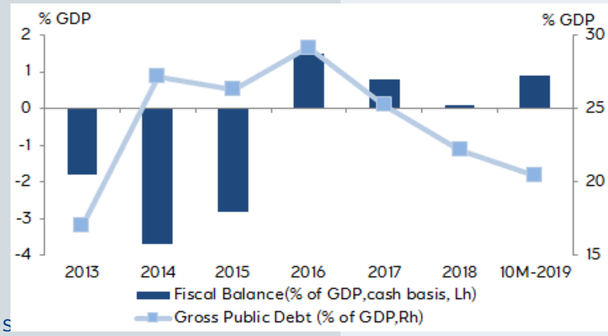


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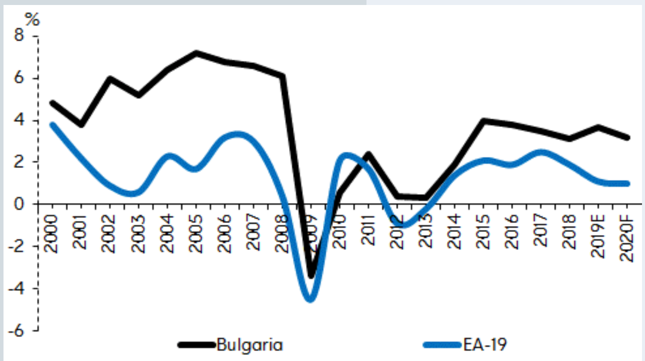
Figure 25: The GDP growth of Bulgaria has been three times higher than Euro area in 2019-2020



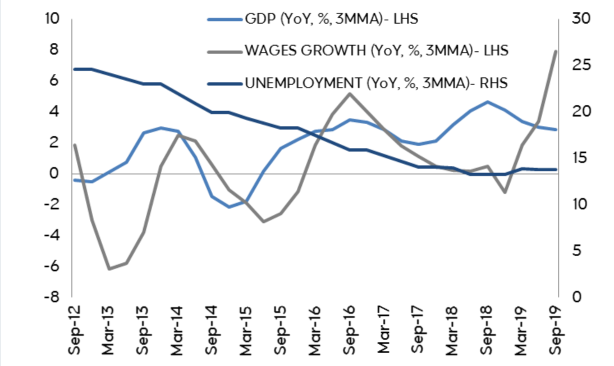
Source: National Authorities, Eurobank Research

Serbia

Robust investments- driven economic growth and subdued inflationary pressures

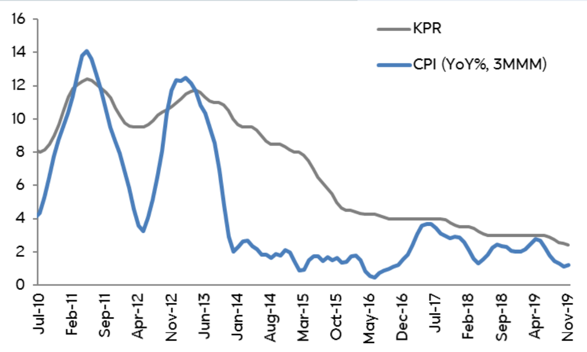
Real GDP growth came in at 4.8% YoY in Q3 2019 compared to 2.9% YoY and 2.7% YoY in Q1 and Q2 respectively. On the expenditure side, economic growth was primarily led by fixed investments, increased by 17.3% YoY and contributing almost 75% to this quarter's headline economic growth. Private consumption remained robust while the negative contribution of net exports to growth decreased in Q3 on the back of improved exports. Despite the weak growth of the Euroarea, economic performance rebounded in Q3. The strong growth reading contributed, among other reasons, to the country's long-term sovereign credit rating upgrade by the Standard and Poor's rating agency to BB+ from BB. The agency based its rationale on the country's resilient exports and the investment-driven economic growth, amid challenging external circumstances. It also noted that Serbia has succeeded in reducing macroeconomic imbalances: net public debt has gone down, net FDI has exceeded current account deficits supporting external deleveraging and price and financial stability has been enhanced. S&P forecasts that GDP growth will accelerate to 3.9% in 2020 from 3.6% in 2019, noting that solid domestic demand, including a benign investment outlook, should help the economy surpass the lingering weakness in Europe. This month's monetary policy meeting had no surprises with the key policy rate remaining unchanged at 2.25%. Along with the monetary policy decision, it also adopted a Memorandum on Inflation Targets until 2022, according to which the inflation target will remain unchanged at 3%±1.5pps until the end of 2022. In its rationale, the NBS Executive Board said that external developments still warrant caution as the international financial and commodity markets are primarily influenced by the uncertainty surrounding the trade policies of the world's leading economies and the slowdown in global growth. Finally, inflation accelerated to 1.5% YoY in November from a record low of 1.0% YoY in October. The upward pressure on the headline CPI came mostly from food and non-alcoholic beverage prices.

Figure 26: Solid economic growth and labor market



Source: Bloomberg, Eurobank Research

Figure 27: Monetary easing amid subdued inflationary pressures



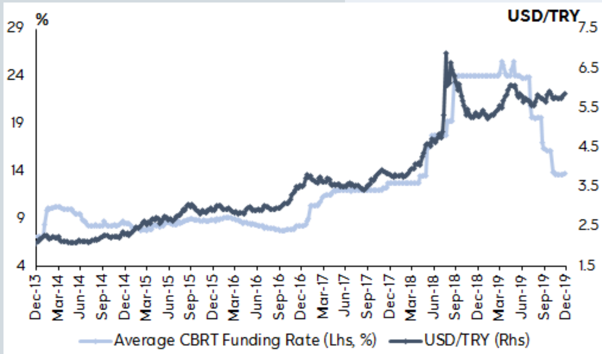
Source: Bloomberg, Eurobank Research

Turkey

First positive national accounts reading on an annual basis in a year

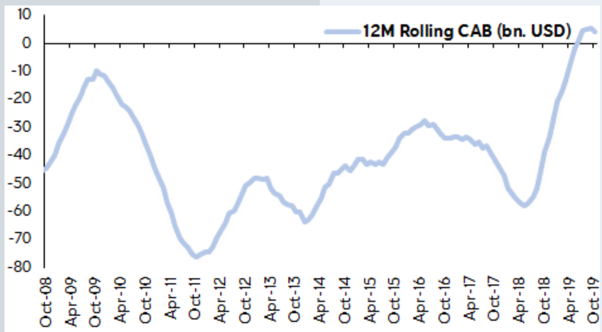
GDP growth registered its first positive – on an annual basis – reading in a year in Q3-2019. Having exited from a technical recession in Q2, real GDP expanded by 0.9% YoY in Q3 close to the market consensus (Bloomberg: 1.1% YoY) up from -1.6% YoY in Q2 and -2.3% YoY in Q1. On a seasonally and calendar adjusted terms, GDP expanded modestly by 0.4% QoQ in Q3-2019, albeit slowing from 1.7% QoQ and 1.0% QoQ in Q2 and Q1 respectively. Fiscal, credit and monetary stimulus pushed the economy further out of technical recession. Consumption, both private and public, was the main contributor to GDP growth, investments remained a drag on growth, while net exports' contribution turned negative after five quarters. On a continuous positive trend, private consumption expanded by 1.5% YoY switching from three consecutive negative rates (-7.7% YoY in Q4-2018, -4.9% YoY in Q1-2019, -1% YoY in Q2-2019). Public consumption (7.0% YoY, 0.9ppts) driven by the ongoing fiscal expansion also boosted growth. Net exports subtracted 0.2ppts to the print, mirroring the combined effect of exports moderation by 5.1% YoY in Q3 (down from 8.1% YoY in Q2) as a result of weaker markets and the expansion of imports by 7.6% YoY in Q3 (up from -17.0% YoY in Q2) mirroring some improvement in domestic demand conditions. Following four quarters of large contractions, gross fixed capital formation (-22.1% YoY, -3.5ppts) remained a drag on growth. The flat quarterly investments' performance, the lower cost of lending and the prospect of a rebound in capital flows create some optimism for a botomming out in the near term. On top, strong inventories building (+2.8ppts) averted a deeper contraction for investments. Meanwhile, the Central Bank of Turkey (CBRT) cut its KPR, the 1-week repo rate, by 200bps from 14.0% to 12.0% in mid-December. The outcome was slightly deeper than the market consensus of 150bps, bringing the cumulative easing since July to 1,200bps. The weaker than anticipated inflation (November: 10.6% YoY below the year-end inflation CBRT projection of 12%), improved agents' expectations and a relatively stable lira are among the main drivers behind the Central Bank's decision. Provided that inflation remains on this trajectory, further front-loaded cuts by CBRT cannot be ruled out in the beginning of 2020.

Figure 28: Central Bank slashed interest rates by 1000bps in the last three policy meetings



Source: Bloomberg, Eurobank Research

Figure 29: Macroeconomic imbalances have been unwinding rapidly in 2018-19



Source: National Authorities, Eurobank Research

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	3.0	3.0	3.6	3.1	3.1									
Advanced Economies															
USA	2.9	2.3	1.8	2.5	1.8	2.0	3.9	3.7	3.7	-2.4	-2.5	-2.6	-3.8	-4.5	-4.5
Eurozone	1.9	1.1	1.0	1.8	1.2	1.2	8.2	7.6	7.5	2.9	2.6	2.5	-0.5	-1.0	-1.0
Germany	1.5	0.4	1.0	1.9	1.3	1.2	3.4	3.2	3.4	7.6	7.0	6.8	1.9	1.2	0.6
France	1.7	1.2	1.2	2.1	1.3	1.3	9.1	8.5	8.3	-0.6	-0.4	-0.5	-2.5	-3.1	-2.2
Periphery															
Cyprus	3.9	3.3	2.9	0.8	0.9	1.3	8.4	7.2	6.0	-4.4	-7.2	-6.5	3.4	3.8	2.7
Greece	1.9	1.9	2.0	0.8	0.6	0.7	19.3	17.4	16.0	-2.8	-2.1	-2.2	1.0	1.2	1.2
Italy	0.8	0.2	0.5	1.3	0.7	0.9	10.6	10.3	10.3	2.5	2.8	2.9	-2.1	-2.0	-2.5
Portugal	2.4	2.0	1.7	1.2	0.3	1.1	7.0	6.3	6.0	0.1	-0.4	-0.7	-0.4	-0.1	0.0
Spain	2.4	1.9	1.5	1.7	0.9	1.1	15.3	13.9	13.3	1.9	2.4	2.5	-2.5	-2.3	-2.2
UK	1.4	1.1	1.2	2.5	1.8	2.0	4.0	3.8	4.0	-4.3	-4.3	-4.2	-2.3	-2.2	-2.4
Japan	0.8	0.9	0.4	1.0	0.8	1.0	2.4	2.4	2.4	3.5	3.3	3.3	-3.2	-3.0	-2.2
Emerging Economies															
BRICs															
Brazil	1.1	1.0	2.0	3.7	3.6	3.8	12.3	11.9	11.1	-2.2	-1.7	-2.0	-7.3	-6.3	-5.8
China	6.6	6.1	5.9	2.1	2.6	2.6	3.8	4.0	4.0	0.4	1.0	1.8	-4.1	-4.5	-4.8
India	7.2	6.0	5.6	4.0	3.4	3.9		*NA*		-2.0	-1.8	-1.9	-3.4	-3.6	-3.5
Russia	2.3	1.1	1.6	2.9	4.5	3.5	4.8	4.6	4.5	7.0	5.0	3.9	2.6	2.1	1.3
CESEE															
Bulgaria	3.1	3.7	3.2	2.6	2.5	2.3	5.2	4.4	4.1	5.4	5.2	4.1	0.1	-2.0	0.0
Romania	4.0	4.1	3.6	4.6	4.0	3.5	4.2	3.9	4.2	-4.4	-5.2	-5.9	-5.0	-3.6	-4.4
Serbia	4.4	3.5	3.7	2.0	2.0	2.1	12.7	11.0	10.5	-5.2	-6.0	-5.5	0.6	-0.5	-0.5
Turkey	3.3	-0.5	2.5	16.3	15.0	13.0	10.9	13.0	12.5	-3.6	0.5	-1.0	-2.1	-3.0	-2.3

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

Eurobank Fixed Income Forecasts

	Current	March 2020	June 2020	September 2020	December 2020
USA					
Fed Funds Rate	1.50-1.75%	1.42-1.65%	1.34-1.60%	1.32-155%	1.31-1.55%
1 m Libor	1.76%	1.66%	1.61%	1.60%	1.59%
3m Libor	1.90%	1.79%	1.74%	1.73%	1.72%
2yr Notes	1.62%	1.60%	1.61%	1.62%	1.64%
10 yr Bonds	1.87%	1.81%	1.86%	1.91%	1.93%
Eurozone					
Refi Rate	0.00%	0.00%	0.00%	0.00%	0.00%
3m Euribor	-0.40%	-0.45%	-0.47%	-0.47%	-0.47%
2yr Bunds	-0.64%	-0.71%	-0.69%	-0.68%	-0.67%
10yr Bunds	-0.29%	-0.50%	-0.47%	-0.44%	-0.38%
UK					
Repo Rate	0.75%	0.75%	0.75%	0.75%	0.75%
3m	0.79%	0.79%	0.74%	0.76%	0.82%
10-yr Gilt	0.75%	0.77%	0.81%	0.88%	0.95%
Switzerland					
3m Libor Target	-0.71%	-0.80%	-0.80%	-0.80%	-0.81%
10-yr Bond	-0.59%	-0.70%	-0.67%	-0.64%	-0.58%

Source: Bloomberg (market implied forecasts)

Eurobank

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