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GLOBAL & REGIONAL MONTHLY

The reduced likelihood of a no-deal Brexit and optimism that the US and China will likely seal a preliminary "phase one" trade deal in the near future have improved risk sentiment further in November. Although the pace of decline in the global manufacturing sector seems to have slowed recently, there are tentative signs that the protracted manufacturing weakness may be spilling over to services

Macro Picture

USA: Economic momentum moderates after having peaked in Q1

EA: Services no longer insusceptible to the industrial slump

UK: Technical recession avoided in Q3 but underlying growth momentum is slowing

EM: Structural headwinds for EM economies

CESEE: The broader region's performance remained resilient in Q3 albeit increasingly heterogeneous

Markets

FX: Low volatility range-bound trading was the mood of the month as we approach year-end. Only a surprise in the UK elections or US-China negotiations seem to be able to change that

Rates: European periphery saw significant increase in yields/spreads despite the restart of QE by the ECB on profit taking. US yields followed accordingly. Expect range bound trading into year end

EM: EM credit remains in a sweet spot, despite growth issues, as global monetary easing is boosting the appeal of the asset class on the back of hunt for yield. Differentiation between HY and IG

Credit: Busy primary market with spreads moderately wider and HY underperforming. Dispersion between names, ratings and currency continuing to increase

Policy Outlook

USA: On hold at least through mid-2020

EA: "Wait and see" mode, focusing on strategic review and calls for looser fiscal policy

UK: MPC adopts a more cautious tone, leaving the door open for lower rates in the foreseeable future if growth outlook deteriorates further

CESEE: Expansive fiscal and monetary policies underpin the region's over-performance

Key Downside Risks

Escalation of trade war: Renewed tensions in the US-China trade dispute; the US proceeds with a 25% tariff on imported automobiles

Increased no-deal Brexit woes: The UK December election yields a hung government/ the Brexit Party participates in a Tory-led coalition government

EM sensitivity: Elevated trade tensions and US dollar strength against EM currencies increase the risk of macro fall-outs

China: Struggling to strike the optimum economic policy mix response

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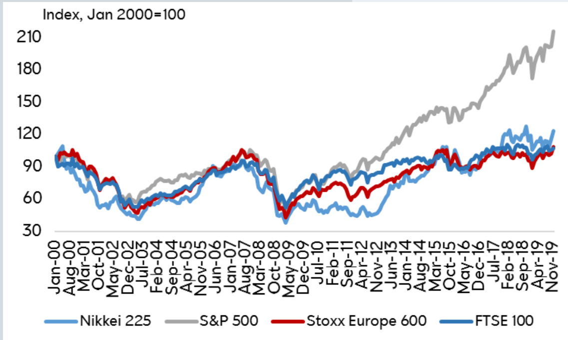
World Economic Outlook

The reduced likelihood of a no-deal Brexit and optimism that the US and China will likely seal a preliminary "phase one" trade deal in the near future have improved risk sentiment further, with US equity markets at fresh record highs (Figure 1). Meanwhile, the pace of decline in the global manufacturing sector seems to have slowed in November, with tentative signs of a stabilization in manufacturing sentiment mainly driven by developed markets economies. Nevertheless, incoming data suggest that although service sector output has held up for much of the year thanks to a steady consumer spending growth, the steep ongoing manufacturing weakness may be spilling over to services, notably via slower employment growth. Hence, a further period of industrial weakness would intensify the downturn in hiring intentions and working hours already underway in several countries, exerting downward pressure on household incomes and spending, and the demand for services. Overall, there is little evidence of any decisive upturn in the global economy, with increasing signs that the cyclical downturn is becoming entrenched. The global economic slowdown, coupled with persistent below-target inflation has prompted major central banks to ease monetary policy, repeat calls for looser fiscal policies and communicate their readiness to act if the outlook were to deteriorate further.

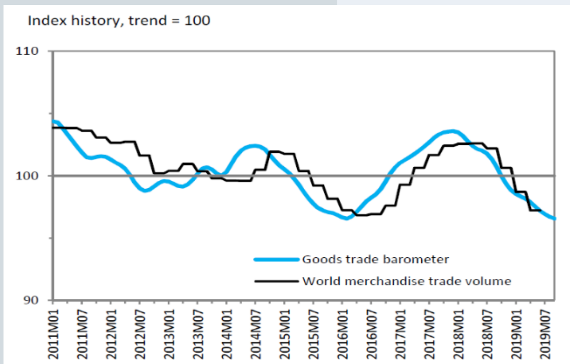
Figure 1: Improved risk sentiment led global equities to fresh highs in November



Source: Refinitiv Datastream. Eurobank Research

Global GDP growth has eased to around 3.0% this year from 3.5% in 2018, with a broad-based slowdown in both advanced and emerging-market economies, and is projected to remain at a similar pace in 2020-21 on persistently high policy uncertainty and weak trade and investment. Indeed, global trade growth has stalled, while the latest WTO quarterly trade volume statistics reveal that global merchandise trade growth decelerated to 0.2%YoY in Q2 2019, compared with 3.5%YoY in the same quarter of last year, and

Figure 2: Goods trade barometer suggests world trade to remain below trend in Q4



Source: WTO

has probably remained below trend in H2 2019. In particular, WTO's latest Goods Trade Barometer[1] improved slightly to 96.6 in September from 95.7 registered in August, but it remains well below the baseline value of 100 for the index, signaling below average growth. For the whole 2019, WTO economists downgraded their trade growth expectations to 1.2%, down from the 2.6% forecast in April, on the back of a substantial deceleration to economic growth, increased tariffs and Brexit-related uncertainty.

Developed Economies

US: Although private final demand has capitalized on lower interest rates, with interest-intensive segments of the economy helping to offset much of the external weakness, incoming data suggest that economic momentum is moderating after having peaked in Q1 2019. Overall, we expect growth to decelerate to 2.3% and 1.8% in 2019 and 2020, respectively, from 2.9% in 2018, as the manufacturing slowdown weighs on investment and the effect from expansionary fiscal policies gradually dissipates. Trade policy uncertainty and adverse external conditions create downside risks that may lead to sub-par growth rates in the quarters ahead.

Euro area: Flash November PMIs suggest that the economy remained close to stagnant for a third successive month, with signs of a stabilization in manufacturing sentiment. Nevertheless, the protracted manufacturing recession seems to be spilling over to services. With the euro area economy likely to end the year on a weak note, 2019 real GDP growth should probably average around 1.1% down from 1.9% in 2018, the slowest pace of expansion since the recession that followed the sovereign-debt crisis. The euro area economy should continue to expand modestly around 1.0% in 2020, on the assumption that prevailing headwinds from the external environment continue to weigh on exports and investment activity.

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% and 0.4%QoQ, respectively). However, sentiment surveys pertaining to Q4 suggest that underlying momentum is either slowing (Spain) or continues to be sluggish (Italy). Taking into account that the Markit Composite output index for November rose in both Germany and France (by 0.3pt and by 0.1pt respectively), the 0.3pt drop in the respective EA average figure implies that Spain may account for a significant part of that decline on the back of escalating tensions in Catalonia and the inconclusive outcome of the 10 November national election. Overall, both countries' economic outlook crucially hinges on future domestic political developments.

[1] Like its counterpart for services, the Goods Trade Barometer aims to gauge momentum and identify turning points in global trade growth. As such, it complements trade statistics and forecasts from the WTO and other organizations. Readings of 100 indicate growth in line with medium-term trends; readings greater than 100 suggest above-trend growth, while those below 100 indicate below-trend growth.

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Emerging Economies

BRICs: Brazil's GDP growth accelerated to 1.0% YoY in Q2 19 compared to a 0.5% YoY in Q1 19. There has been a clear improvement in business sentiment as both manufacturing and services 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 most probably continued decelerating in Q2 - 2019, after Q1's GDP growth print of 5.8% YoY, which is a 6-year low. Moreover, despite the ambitious reforming agenda of India's Prime Minister, Narendra Modi, Moody's downgraded its sovereign rating outlook from stable to negative in early November, citing increasing risks that the country's economic growth will remain "materially lower than in the past". 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 in late October, Central Bank cut the key policy rate by 50 bps to 6.50%, at the lowest level since 2014. This was the fourth rate cut since June with monetary easing phasing in at a time of declining inflationary pressures (3.8% YoY in October, with average inflation in 2019 so far standing at 4.7%).

CESEE: Third quarter flash GDP estimates for the broader CESEE region indicate that these economies' performance remains resilient, albeit increasingly heterogeneous, against a deteriorating 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 and less pronounced and visible as we are approaching the end of the year and heading into 2020.

Special Topic: Trip notes-fact findings from our recent trip to Sofia (November 21st-22nd)

Earlier this month, we traveled to Sofia where we met with high-level officials from the Finance Ministry, the IMF, think tanks as well as market participants from the domestic financial sector. The present note is a first attempt to offer our readers a brief overview of current conditions in the domestic economy, the state of play with respect to ERM2 entry and the long-term challenges Bulgaria will be confronted with in the future.

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

In contrast to its regional peers, the outgoing year has been a year of GDP growth acceleration for Bulgaria. Bulgaria is expected to have expanded briskly by 3.5% in FY2019- more than three times higher than euro area average-up from 3.1% in FY2018, outperforming initial international organizations' forecasts. The GDP growth outperformance of the outgoing year is rooted in the solid domestic demand dynamics which have been fueled by tighter than ever before labor market conditions and improved business and consumer sentiment plus a better than expected net exports outcome. The latter is expected to turn more negative in 2020, reflecting the weakness of the main trade partners of Bulgaria and trade tensions worldwide, weighing on next year's growth prospects. The unemployment rate has reached a historical low- and wages are rising rapidly amid increasing skill shortages. On the positive side, EU funds absorption-a pivotal factor behind public investment-is also expected to rise further from the current levels of 43% as the 2014-2020 programming period is coming to an end. The impact of EU funds is about to become more pronounced as well. According to the Ministry of Finance calculations, the GDP level of 2019 is 5.5% higher than without the impact of EU funds, up from 4.0% in 2018 and only 2.1% in 2017. In addition, credit expansion is going to make an additional positive contribution to economic activity. According to the latest data, credit activity expanded by 7.3% YoY in October compared to 7.1% YoY in September still close to 8.4% YoY at the end of 2018. The readings are favorably compared to 4.7% in 2017 vs. only 1.5% YoY in 2016, up from -1.2% YoY in 2015. The rebound of credit activity is among those key drivers behind GDP growth acceleration in 2017-2019 and is expected to extend into 2020 as well.

Bulgaria's metrics are healthy and sound, but long-term challenges are slowly becoming more visible

Having stick to a series of prudent policies for several years, Bulgaria has accomplished to maintain its fiscal metrics healthy and sound. As a result, given that the country has been running a general government surplus in ESA2010 terms in the last three years, public indebtness ratios have remained at very low levels. Even accounting for the military equipment provision expenditures, the general government in cash terms will run a small deficit of -2% in FY2019 switching from a 0.1% surplus in FY2018, but in ESA2010 terms is expected to run a negligible surplus of 0.05% of GDP.

Accordingly, after years of deleveraging, the external position has also improved markedly. Bulgaria has been running either a balanced current account or a surplus since 2013. The current account surplus climbed to 8.2% of GDP in September 2019 up from 5.0% a year earlier and 3.5% in 2017. Thus, the gross external debt has come down to 57.8% in September 2019, down from 61.5% a year earlier, 65.4% in December 2017 and 96.9% in December 2010.

The main long term challenge of the country is to translate the GDP growth over performance into sustained and inclusive growth and convergence with other EU countries. Bulgaria's per capita income is only half of the EU average and income inequality is higher than EU average. Among those elements of a strategy to achieve, that should be strengthening the quality of institutions. Although some progress has been made in the respective area, which is partially acknowledged by the latest EU reports, the country still ranks very in the relevant World Bank and WEF reports from that point of view.

ERM2 entry is insight and most probable than ever, but timely euro area entry is not guaranteed

The government has made solid progress in the ERM2 entry requirements application checklist. The checklist has been a part of a roadmap agreed with EU institutions and ECB following Bulgaria's official request to establish close co-operation with the ECB on July 2018 as part of its endorsed strategy to simultaneously join the ERM2 mechanism and the Banking Union. Provided that the capital shortfalls identified in the AQR & stress test for two domestic banks are satisfied, that would pave the way for swift ERM2 entry by April 2020. Yet, qualifying for ERM2 entry and staying for a minimum of two years fulfills one of the criteria for euro area entry. Furthermore, Bulgaria also fulfils the rest of the nominal convergence criteria at the moment. However, it is common knowledge and understanding, that Bulgaria's prospective application to euro area in the future will be additionally evaluated under the spectrum of real convergence criteria. Although the latter are not part of the Maastricht Treaty, they have been included in the list of commitments, on a case by case basis, prospective candidates will have to fulfil. Thus, the challenge for Bulgaria will be to accelerate its real convergence process towards euro area, or alternatively to stay for a prolonged period of time in ERM2.

Global Macro Themes & Implications

State of US/China trade talks increasingly uncertain

Nearly six weeks after the US and China reached an agreement on the outline of a mini trade deal that US President Donald Trump called a "Phase One Trade Deal", the two sides are still struggling to strike a preliminary agreement. Undoubtedly, certain issues remain open. These include, inter alia, the US's unwillingness to roll back the increased tariffs that were imposed on Chinese imports during the 16-month long trade war, a key demand according to China's state media in order for the latter to consent to a Phase One deal. In addition, China reportedly does not want to commit to a specific amount of agricultural purchases from the US, an issue that is, however, of paramount importance to the US President ahead of the November 2020 presidential election. Complicating trade talks further, the US President signed into law congressional legislation aimed at supporting the Hong Kong protesters and requiring certification of Hong Kong's autonomy, with Chinese officials making it clear that China "firmly" opposes that action and is ready to retaliate.

Nevertheless, the continuation of trade talks, in spite of prevailing contentious issues, counts as a positive and suggests that a preliminary deal by the end of the year cannot be ruled out completely although more time may be needed meaning that the completion of the phase one deal could slide into next year. Against this background, a key issue for markets in the coming weeks will be whether new higher US tariffs on around $160bn of Chinese imports will go into effect on 15 December, as has already been scheduled, or will be postponed as a gesture of goodwill on behalf of the US. Bear in mind that such a tariff hike could have more pronounced effects on households than in previous rounds, as it would hit consumer items including electronic devices, mainly laptops and cell phones.

To sum up, though our main view is that the two sides will eventually reach a deal in the not too distant future as the Chinese economy is losing momentum and the US President is heading into an election year, a renewed escalation in the US/China trade dispute via another round of US tariff increases or China's retaliation measures over US Hong Kong rights law cannot be ruled out.

12 December UK general election: Conservatives continue to enjoy a comfortable majority

With just less than three weeks to go until the 12 December UK snap general election, opinion polls continue to show that Conservatives enjoy a comfortable lead of c. 10-12 points over the Labour party, which is polling around 30%. The election campaign of the Conservative Party is built around the terms of the PM Boris Johnson's Brexit deal, who has pledged to bring the deal for a vote to parliament before Christmas and get it ratified by the current 31 January Brexit deadline. Such a development would reduce near-term uncertainty and downside risks stemming from domestic politics. In addition, the Tories' manifesto rules out any extension of the Brexit transition period past end-December 2020 and suggests that the UK should negotiate a new trading relationship with the EU by then or else exit the EU without a deal. The Conservative Party also pledged no new taxes. Tories aim to prioritize spending on health, education, safety and infrastructure and plan a total of £23.5bn in “sensible” tax cuts and day-to-day spending by the FY 2023/24. According to the accompanying costings document, annual current spending would rise by £3bn compared with more than £80bn for the Labour Party, which intends to finance its plans through tax cuts on the wealthy and on companies for an equal amount. The Labour Party also vowed to negotiate a better Brexit deal with the EU within six months and put it to public vote, suggesting that, under a Labour-led government, another Brexit extension would be required beyond end-January 2020.

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Macro Themes & Implications in CESEE

Third quarter flash GDP estimates for the broader CESEE region indicate that these economies' performance remains resilient, albeit increasingly heterogeneous, against a deteriorating international economic environment.

Third quarter flash GDP estimates conveyed overall a relatively positive macroeconomic picture for the economies of the broader CESEE region amid a deteriorating international economic environment. The CESEE region outperformed, in terms of GDP growth, core-euro area economies for yet another quarter in Q3-2019. Yet, this outperformance is becoming less and less pronounced and visible as we heading into 2020. As things stand, even though in some cases flash GDP estimates came out better than consensus expectations, it would be fair to say that we are fully in line with our earlier stipulated full-year forecasts for the economies of our focus. 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 remain among the most resilient in the broader CESEE group on expansionary fiscal and monetary policies. In particular, the CEE3 economies are leading the pack expanding on average by 4-5% YoY, while the SEE (Bulgaria-Serbia-Romania) economies are lagging behind. However, when analyzing country performance in the latter group we diagnosed increased heterogeneity. 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 outperforming visibly initial official forecasts supported by better than expected net exports. According to anecdotal evidence, even Serbia has accelerated to 3.5% YoY in Q3, up from a mediocre performance of 2.7% YoY and 2.9% YoY in Q1 & Q2 respectively.

The accession in the Eurozone for the six remaining CESEE countries turns out to be a two gear journey

Among the 13 countries that joined the EU between 2004 and 2013, seven have so far joined the euro area (EA) while the rest have undertaken the commitment to join with no specific deadline. The latter six countries have currently different exchange rate regimes, ranging from a rigid currency board in Bulgaria (with the lev pegged to the German mark since 1997 and then to the euro since 1999), a managed exchange rate in Croatia, to freely-floating exchange rates in the Czech Republic, Hungary, Poland and Romania. Bulgaria in July 2018 and Croatia one year later officially expressed their intentions to join the EA. The rising question for these two countries is whether they will remain committed to prudent macroeconomic policies in order to achieve EA entry. We point out that, from a macroeconomic perspective, both countries are, on a typical level, well prepared for their entrance. In Bulgaria, the government has made good progress in addressing the ERM2 roadmap requirements. However, addressing the AQR findings, modest equity increases in two domestic banks are still pending. Croatia fulfils all criteria apart from that concerning the exchange rate stability, which, however, according to the Prime Minister Mr. Plenkovic's recent statements, is about to be pursued, following the country's official bid to enter the ERM II last July. For the other 4 countries with free floating currencies, the entry in the EA, at the time of writing, seems more of a political than an economic decision. Once the political will is in place and accessing the EA becomes a strategic and national priority for each country, we anticipate the appropriate policy mix that will allow these countries to fully meet the nominal criteria for accession.

CESEE Markets Developments & Outlook

Bulgaria

Bulgarian Eurobond yields rose across the board, ranging between 7-13 bps, with the 2028 paper yields gaining 13 bps over the month. Local yields on the other hand, registered modest drops of 1-3 bps across all maturities. The Ministry of Finance did not hold any bond auctions this month, as the annual debt ceiling target set by the Ministry was reached. However, the 2020 budget plan was published, forecasting EUR 1bn of new debt to be raised by the local market, which is twice the amount budgeted in 2019.

Serbia

The National Bank of Serbia (NBS) proceeded with another round of easing by cutting the key policy rate to 2.25% from 2.5% in early November. The decision was backed by further weakening of inflationary pressures. According to the latest inflation report, CPI moved towards the lower part of the 1.5% - 3.5% target band as we approach the end of the year with the latest reading showing only 1.1% YoY in September and 1% YoY in October. The broad perception over further global economic slowdown also contributed to the decision.

Despite the recent cut, the dinar hasn't been under pressure lately. The EUR/RSD continues to trade in a quite narrow range, heavily restricted by NBS interventions. Regarding the latest intervention, the NBS carried it out in two steps, indicating clearly that shortfalls in hard currency in the local market could occur in both the supply and demand sides. That being the case, as year-end approaches, the market will not be one-sided as it was during June and July, when the NBS was intervening on the buying side.

On the sovereign papers front, the planned auction schedule for 2019 is fully completed and the absence of government bonds issuances is expected to offer some relief to the appreciating dinar. On the other hand, stronger corporate demand for hard currency (especially import of gas) at this period of time will act as counterweight. In a nutshell, less interference with minor volumes of interventions by the NBS and an overall stable EUR/RSD cross are anticipated till the end of the year. Finally, the steepening of the yield curve continues with the biggest drop marked on the 10 year government bond (28 bps lower compared to one month earlier) while the belly of the curve (3-5 year) remains almost unchanged with the short-end capturing a 6 bps drop.

Markets View

Foreign Exchange

EURUSD: With the EU economy continuing to underwhelm and a more positive outlook for a US-China trade agreement the EUR lost ground vs the USD this month but continued to trade within the past six months wide range (1.08 - 1.12). The medium term bear trend remains intact and targets 1.08, despite the fact that real rate differentials between the EU and the US keep decreasing. We are still sellers of any rally towards the 1.12. 1.08 area, if reached, should provide a medium term bottom.

GBPUSD: The pair consolidated in the 1.26/1.30 range ahead of the UK elections in December. With the no deal Brexit now priced at a 5% probability, and the Tories leading by c. 13% in the polls, the path of least resistance seems the resolution of the bullish triangle to the upside targeting 1.35. A Labour majority would cause some downside but we doubt it will extend below 1.25 given the potential of an even softer Brexit or a 2nd referendum.

USDJPY: Traded in a tight range in November (108.00 – 109.50) with a mildly bullish bias given the risk on sentiment this month. We still see any rally towards 109-110 as corrective and would be sellers of the pair. Nevertheless, we no longer see the lows of the year (104.46) tested by year-end as the JPYs funding currency and safe haven appeal seem to be diminishing.

Rates

EU: The increase in yields that started in October continued in November, despite the restart of QE by the ECB, with significant widening of the periphery versus Germany. Spain and Portugal notably decoupled from core after a long time while Italy and Greece gave back some of their larger year to date gains. The reasons cited start from profit taking towards year-end, political situation in Spain and Italy, ECB tiering as well as comment on the potential banking union in the EU with a change in sovereign RWAs. Bund yields reached a high of -0.24% before settling at -0.34%. We expect them to trade in a wide range (-0.20% to -0.60%) and we would be buyers of EU peripheral bonds into year-end versus core as we expect the compression trade to start again. A flattening of curves is also expected.

US: Another volatile month in yields on the back of contradicting headlines about a potential trade agreement between China and the US. 10yr Treasuries traded between 1.67% and 1.97% (1.75% at the time of writing). Economic numbers have been mixed and Fed commentary generally dovish. The market priced out rate cuts pretty quickly in its recent move and we would trade against this as we expect more rate cuts in 2020. Although now we do not expect the year's lows to be revisited by year-end, we still see lower yields from current levels. After the recent bull flattening, further bull steepening is expected as the Fed remains lower for longer.

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Emerging Markets credit

Flows into emerging market (EM) credit have plateaued in the past few months as EM equity and local currencies have seen a pick up. Spreads were mixed in November with the EMBI+ rallying to YTD low of 308 before retracing to a wide of 329, but still at the lows of the year (started the year at 434). Total returns have remained flat as moves in rates have tended to offset moves in spreads since September. These moves do not reflect the significant dispersion between the HY and IG names or between geographical regions as LatAm has significantly underperformed while Asia and EMEA have held well. Trade wars and monetary policy remain the main drivers of spreads on a macro level, while idiosyncratic stories have caused the largest single name moves (Argentina, Ecuador, Lebanon, Chile). Flows are expected to drop into year-end and no major moves should take place so carry remains king. We remain tactical buyers on any widening.

Corporate credit

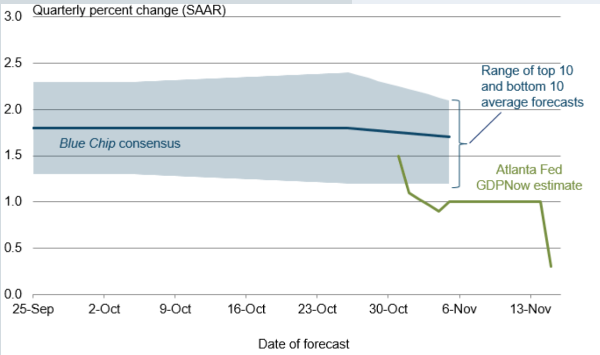
November proved to be one of the busiest months of the year in the primary market causing IG cash spreads to finish marginally wider while HY underperformed both in EU and US. In EU IG higher rated names performed better while the Auto and Bank sectors were the noticeable underperformers. In the US higher rated names were weak with AAA/AA closing 5-7bps wider with Energy and Technology the worst performers sector wise. HY curves bear flattened in both EU and US with CCC decompressing further from B and being now wider YTD. TMT was the sector hit the most in the space. Overall, we remain defensive in our outlook for the credit market and prefer IG over HY on both sides of the Atlantic, as we expect moderate widening into year-end. Once again we stress the rising number of idiosyncratic stories in the HY space. In the IG space, we prefer the 7-10 year tenor as funding levels make shorter dated investments unattractive.

US

Economic momentum moderates towards a soft landing after having peaked in Q1

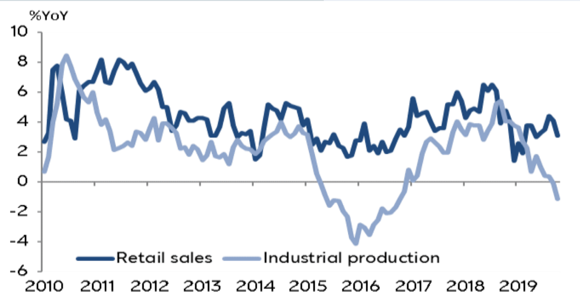
Although private final demand has capitalized on lower interest rates, with interest-intensive segments of the economy helping to offset much of the external weakness, incoming data suggest that economic momentum is moderating after having peaked in Q1 2019. US industrial production fell 0.8%MoM in October following an upwards revised 0.3% decline in September. Even accounting for the negative effect of the GM strike, overall production remains relatively soft as weak external demand and trade-related uncertainty weigh on durable manufacturing. Furthermore, core retail sales rebounded in October (+0.3%MoM) but this increase was offset by downward revisions to August and September data, pointing to a slowing pace of consumption growth. It should be noted that the Atlanta Fed's GDPNowcast model has downgraded on November 15 its real Q4 GDP growth forecast to just 0.3%QoQ saar, down from 1.0% on November 8 following retail trade and industrial production releases, with Q4 real personal consumption expenditures growth currently expected at 1.7%QoQ from 2.1% and Q4 real gross private domestic investment growth forecasted at -4.4% from -2.3%, previously. Overall, we expect growth to decelerate to 2.3% and 1.8% in 2019 and 2020, respectively, from 2.9% in 2018, as the manufacturing slowdown weighs on investment and the effect from expansionary fiscal policies gradually dissipates. Trade policy uncertainty and adverse external conditions create downside risks that may lead to sub-par growth rates in the quarters ahead.

Figure 3: Evolution of Atlanta Fed GDPNow real GDP estimate for Q4 2019



Source: Federal Reserve Bank of Atlanta

Figure 4: IP in contractionary territory, core retail sales broadly flat



Source: Bloomberg, Eurobank Research

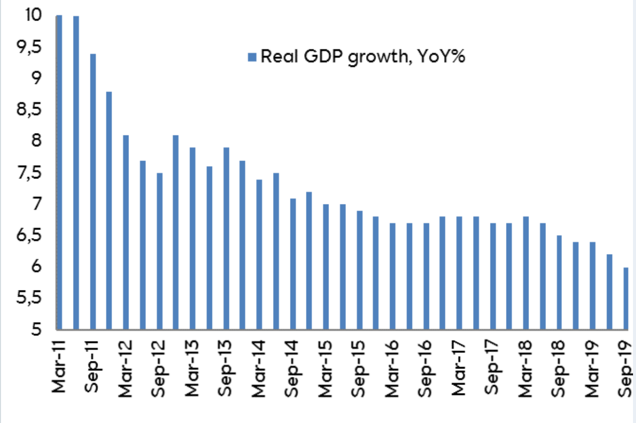
After delivering its third rate cut of the current cycle, the Fed is expected to stay on hold in the months ahead provided there is no deterioration in the economic outlook or/and the external environment. Adding to the above, the futures market has already removed any pricing of another cut until mid-2020, with the odds for a December rate cut currently around zero. In line with Fed Chair Jerome Powell's congressional testimony in mid-November, we think that there doesn't seem to be a high probability for making a move anytime soon, as inflation is well contained and the domestic economy is still relatively strong.

China

In search of the optimum policy mix so as to bolster economic growth

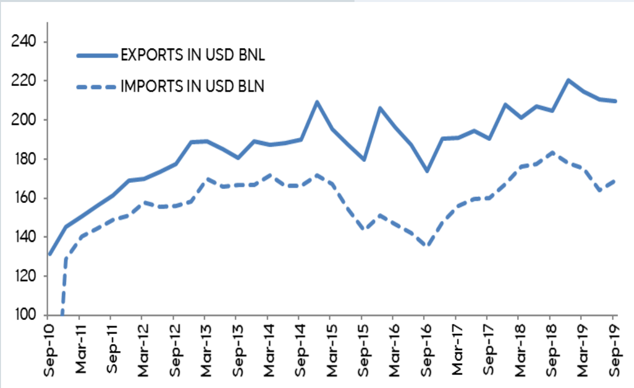
In response to the evident growth slowdown in the past ten years along with the US import tariffs in flux for the past 18 months, China has intensified the fiscal policy stimulus measures, given the existing constraints on the monetary policy front. The People's Bank of China (PBoC) delivered a 5bps cut on the 1 year Medium term Lending Facility (MLF) rate in November, but such a rate move is probably deemed modest and restricted, taking into account, inter alia, i. the surging inflation (3.7%YoY in October and 2.6% YoY on average so far in 2019), mainly attributed to higher pork prices on the back of African Swine Fever related supply shortages and ii. the priority to tame the levels of indebtedness primarily on the corporate side. As such, China has emphasized fiscal loosening by means of VAT, personal income and corporate tax cuts, as well as wider general government deficits and extended issuance of local government bonds. Regarding the first three quarters of 2019, fiscal measures may have prevented economic growth from slowing further (6.0% YoY in Q3 vs 6.2%YoY and 6.4%YoY in Q2 and Q1 respectively) but there are specific reasons that undermined the effectiveness of the measures. We consider among those with the most significant impact, the growing uncertainty in consumption and investment decisions, imposed by the US tariffs on Chinese imports, along with the high level of debt held by a sizeable number of local governments that undermined their decisiveness when conducting fiscal policy. Taking into account the above, China is at a crossroads regarding the optimum policy mix so as to restrain economic growth from slowing further and to exploit in a sustainable manner the country's productivity factors. Apart from some cautious Required Reserve Ratio (RRR) cuts anticipated, it is infrastructure spending that will presumably have a dominant position in terms of growth driving, not only in efforts to boost the economy's productivity, but also because local governments have bond issuance proceeds to deploy, following the bonds spree from January till June amounting to ca CNY 1.5 tn or 1.5% of GDP.

Figure 5: Decelerating economic growth in the last 10 years



Source: Bloomberg, Eurobank Research

Figure 6: China's trade activity appears contained



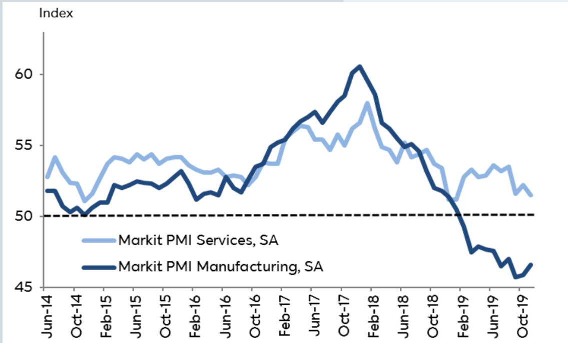
Source: Bloomberg, Eurobank Research

Euro area

Signs of protracted manufacturing recession spreading further into services

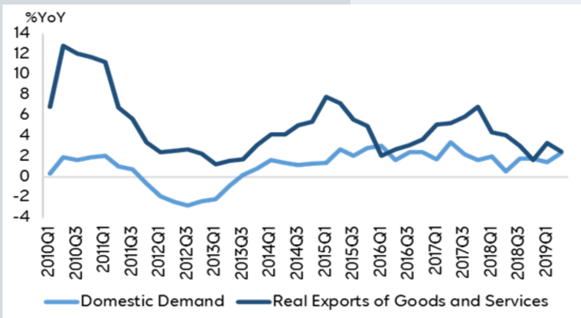
Providing tentative evidence of a slower pace of manufacturing contraction, IP increased modestly by 0.1%MoM in September, with the quarterly carry-over in Q4 turning mildly positive at 0.2% (from -0.9%QoQ in Q3). Adding to the above, the flash November PMIs pointed to a manufacturing stabilization, with the respective index rising 0.7pt to 46.6. Nevertheless, the services output index fell 0.8pt to a ten-month low of 51.5, suggesting that the steep ongoing manufacturing decline is seemingly spreading further into services. Overall, the November Composite PMI fell 0.3pt to 50.3 to signal the second-smallest expansion of output across manufacturing and services since the current upturn began in July 2013, pointing to a Q4 real GDP growth rate of just 0.1%, down from 0.2% in Q3. [2] With the euro area economy likely to end the year on a weak note, 2019 real GDP growth should probably average around 1.1% down from 1.9% in 2018, the slowest pace of expansion since the recession that followed the sovereign-debt crisis. The euro area economy should continue to expand modestly around 1.0% in 2020, on the assumption that prevailing headwinds from the external environment continue to weigh on exports and investment activity. On the monetary front, following the end of ECB President Mario Draghi's eight-year tenure and the appointment of former-IMF head Christine Lagarde, the monetary policy stance is expected to remain highly accommodative for an extended period of time amid weak growth fundamentals and subdued inflationary pressures. In her first speech on monetary policy, President Christine Lagarde highlighted the need for fiscal policies to play a dominant role near the effective lower bound of interest rates, with a call for "a new European policy mix" that includes a strategic review of monetary policy "due to begin in the near future", adding that the ECB is continuously monitoring the side effects of its policies. In our view, the ECB will likely adopt a "wait and see" mode in the coming months, focusing on the strategic review and repeating calls for looser fiscal policy.

Figure 7: Signs of manufacturing stabilization, but services seem no longer immune to industrial weakness



Source: IHS Markit, Bloomberg, Eurobank Research

Figure 8: External demand has weighed on the EA economic growth



Source: Eurostat. Eurobank Research

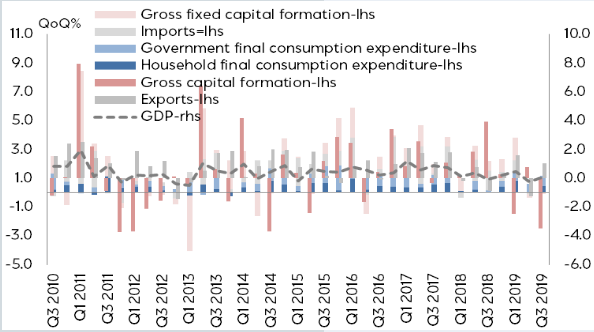
[2] For more details see the HIS Markit PMI's press release https://www.markiteconomics.com/Public/Home/PressRelease/91044e6e6026458b9728162fbcd59345

Germany

Technical recession narrowly avoided but sluggishness likely to prevail

The German economy managed to narrowly avoid technical recession in Q3 as GDP posted meager growth of 0.1%QoQ following a slightly downward revised figure of -0.2%QoQ in Q2. The expenditure details showed that private consumption (+0.4%QoQ) and government spending (+0.8%QoQ) were the key GDP growth drivers, while net exports also contributed positively (exports +1.0%QoQ vs. imports +0.1%QoQ). Gross fixed capital formation contracted (-0.1%QoQ), albeit by a slower pace compared to Q2 (-0.3%QoQ), held up by construction (+1.2%QoQ). The drag on Q3 GDP growth came entirely from inventory changes, as gross capital formation contracted by the highest pace in five years (-3.5%QoQ), a development that would be supportive for economic growth in subsequent quarters. In spite of meager GDP growth and still subdued manufacturing orders (-4.8%YoY on average in January-September), solid wage increases (+4.8%QoQ in Q2, close to a 10-yr peak of 5.0%QoQ marked in Q3 2018) and the recent bottoming out in major forward-looking indicators suggests that fears over a potential crunch are probably exaggerated and, instead, the economy will likely remain on the path of slow expansion. The flash Markit Composite PMI improved in November for the second consecutive month (+0.3pt at 49.2) supported by a further recovery in manufacturing sector sentiment (+1.7pts at 43.8), while services sector sentiment remained broadly unchanged at three-year lows (-0.3pts at 51.3), suggesting that the spillovers from the manufacturing recession into the broader economy remain limited so far. The IFO business climate index, albeit still close to historically low levels, improved modestly in November for the second time in the last three months (95.0) and the ZEW indicator of economic sentiment improved substantially over the same month, but still in negative territory (-2.1). The better than expected Q3 GDP growth figure and the relatively improved Q4 economic activity outlook support our view for 2019 GDP growth at 0.5%, while the 2020 growth outlook crucially hinges on the global trade outlook due to the economy's large manufacturing sector and its relatively high exposure to global trade (Figure 10).

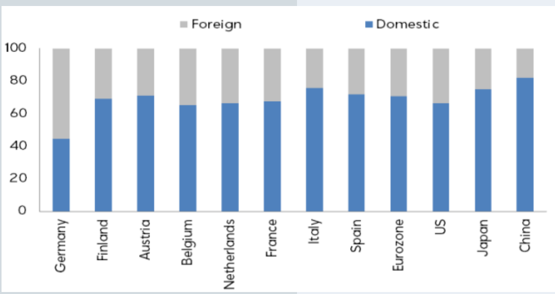
Figure 9: Germany narrowly avoids technical recession in Q3



Source: Federal Statistical Office (Destatis), Eurobank Research

Figure 10: Germany's manufacturing sector highly exposed to international trade

(% of each country's manufacturing value added that goes into servicing domestic and foreign demand)



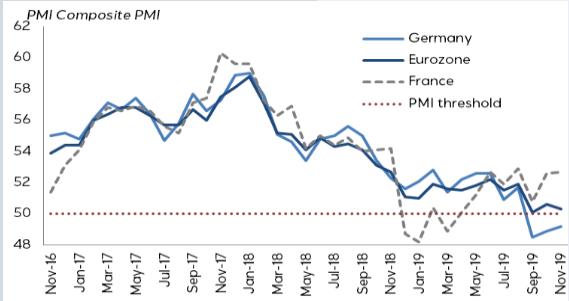
Source: OECD, Eurobank Research

France

Healthy momentum continues, outperforming most of its largest EA peers

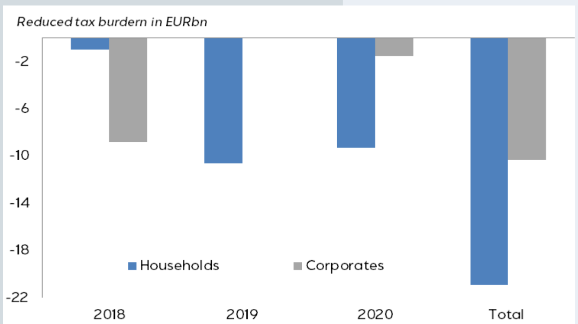
France's economic activity retained a firm tone in Q3, with GDP expanding by 0.3%QoQ for the third quarter in a row, broadly in line with the average pace in H1 2019 (1.2YoY%). Private consumption was the main growth driver, rebounding 0.3%QoQ vs. 0.2%QoQ in Q2 and contributing 0.2ppt to Q3 GDP growth, favored by the announced household tax cuts estimated at c. €21bn for 2018-2020 (Figure 12). Furthermore, labor market conditions continue to improve (the unemployment rate increased in Q3 by 0.1pt at 8.6%, after a 0.2pt fall to an over ten-year low in Q2, but still 0.5pt below the level of the same quarter in the prior year), inflation pressures remains subdued (1.1%YoY average CPI in the period January-October vs 1.6%YoY in 2018) and the INSEE consumer confidence index has been on a rising trend in recent months (at 104 in October for the second month in a row, above its long-term average of 100 for the fifth month in a row after having plunged to four-year lows late last year at the height of the yellow vests movement). On the flip side, gross fixed capital formation slowed to +0.9%QoQ in Q3 following a two-year peak of 1.2%QoQ in the prior quarter on stagnant private investment, while net trade had a negative contribution (-0.4ppt vs. 0ppt in Q2) as, consistent with the improved domestic demand momentum, imports bounced by 1.4%QoQ (vs. -0.3%QoQ in Q2), outpacing the 0.3%QoQ pace of exports growth. Looking ahead, sentiment surveys pertaining to Q4 suggest that the French economy retains a broadly steady pace of expansion, continuing to outperform most of its largest EA peers. The INSEE business climate index came in at 105 in November, not far from June's 106 one-year peak and still above its long-term average of 100. Furthermore, the flash PMI composite index improved in November for the second month in a row (+0.1pt to a three-month high of 52.7) boosted by a hefty 0.9pt gain in manufacturing PMI at a five-month peak of 51.6. For the first two months of Q4, the average composite PMI stood at 52.7, 0.8pt up from Q3 and at the highest level since Q3 2018, supporting our view for resilient GDP growth against the challenging external backdrop. Overall, we retain our expectations for an average growth rate of 1.2% in 2019, with France likely to outperform the EA for the first time since 2013.

Figure 11: France's economy retains healthy momentum



Source: Bloomberg, Eurobank Research

Figure 12: The 2020 Budget contains new measures mostly in favor of households



Source: France's 2020 draft Budget, Eurobank Research

Italy

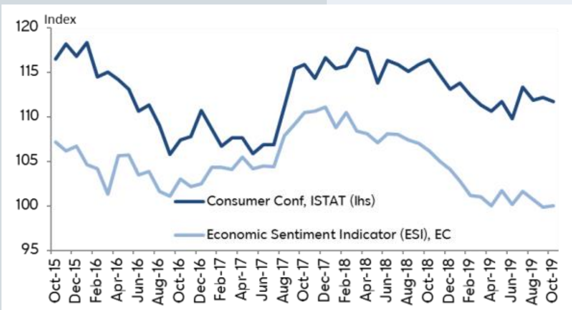
On top of its structural problems, the economy is highly dependent on the global slowdown

Following the preliminary estimate of real GDP growth reading in Q3, which marked the fourth consecutive quarter that the Italian economy grew by 0.1%QoQ, high-frequency indicators point to a similar growth pattern at the outset of Q4. Adding to the October PMI manufacturing release which revealed that conditions in the sector deteriorated at their fastest pace since March, IHS Markit business confidence plunged to a seven-year low in October (the net balance of Italian firms expecting an increase is actually the lowest since October 2012), with optimism regarding future activity, employment and profitability falling from the previous survey in June. Nevertheless, Italian service sector activity has held up reasonably well, rising in October at its fastest pace since March, with new order growth the most-marked in seven months. [3] Overall, the October PMI surveys remain consistent with GDP growing at a slight pace of around 0.1%QoQ in Q4, with firms' expectations of output over the coming year decelerating compared to the prior month due to heightened concerns over the underlying health of the Italian economy. Apart from the cyclical weakness that is largely attributed to weak foreign demand, Italy has the lowest potential growth rate among the large euro area countries (~0.5% of GDP) amid weak productivity growth coupled with a declining working-age population. Our 2019 real GDP growth forecast currently stands at 0.2% from 0.7% in 2018, with weak global trade that weighs on the manufacturing sector partially offsetting the positive impact from substantial easing in financial conditions to domestic demand. Household spending is expected to be moderately supported by a labor tax cut in 2020, with an overall fiscal easing of ca. 0.2% of GDP. Although political uncertainty has recently declined and budget tensions should be less confrontational compared to 2018, political developments are expected to remain a key theme in the Italian economic outlook.

Figure 13: Business sentiment on a downward trend

Source: Refinitiv Datastream, Eurobank Research

Figure 14: Households' assessments of current and future economic conditions have deteriorated



Source: EC, IHS Markit, Bloomberg, Eurobank Research

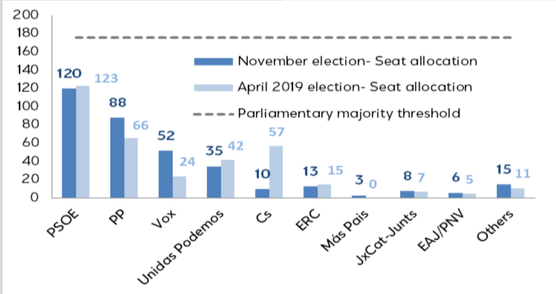
[3] For more details see the HIS Markit PMI's press release https://www.markiteconomics.com/Public/Home/PressRelease/905aea3dcb0d4e2b940986658e1144ba, https://www.markiteconomics.com/Public/Home/PressRelease/96902d3571b24915ac3dad3b50c607ed

Spain

Prolonged political uncertainty amidst weaker growth momentum

As expected, the 10 November general election, the second one this year and the fourth in the last four years, failed to break Spain's political deadlock. Instead, it resulted in a more fragmented political landscape, making things more complicated in terms of government formation. The incumbent centre-left PSOE came first but fell short of reaching a parliamentary majority, while the increased support of right-wing parties at the expense of centrist parties, which reflects voters' anger about Catalan separatism, reduces the spectrum of possible ruling coalitions that could ensure policy stability and carry out the needed structural reforms. As things stand, the most likely scenario seems to be a PSOE-led coalition government with left-wing Unidas Podemos, after the recent announcement by the PSOE leader Pedro Sanchez that the two parties reached a preliminary deal. The two parties control 155 MPs cumulatively, short of the required 176 majority in the 350-seat Parliament. Therefore, active participation of regional nationalist parties or abstention from the investiture vote in Parliament will be required for the formation of a government. However, such a coalition could be perceived as market unfriendly on the view that Unidas Podemos may demand certain concessions in exchange for supporting a PSOE-led coalition government, including looser fiscal policy and a roll-back of structural reforms. In any case, we have to wait until mid-December when the Parliament will hold the first confidence vote to know with certainty whether a PSOE-led government with Unidas Podemos can be formed.

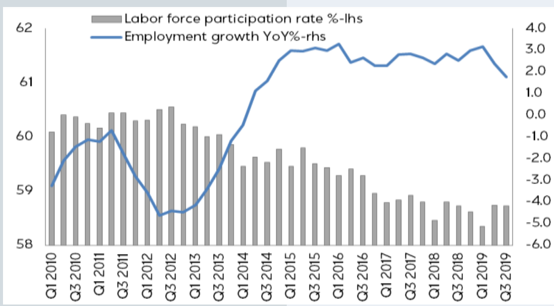
Figure 15: 10 November election resulted in another hung parliament



Source: Local Press, Eurobank Research

Worryingly, prolonged political uncertainty comes against the backdrop of slowing economic activity following the National Statistics Institute's recent downward revision of GDP growth between 2016 and mid-2019. By component, the main factor behind this revision was private consumption as, in reaction to increased external headwinds and in spite of supportive wage growth, consumers modified their spending decisions to shore up precautionary savings. In addition, employment growth —the main engine of growth so far— is losing momentum, manufacturing PMIs remained stuck in contractionary territory in October for the fifth consecutive month and the vital tourism sector is slowing. So, we have revised slightly downwards our 2019 GDP growth forecast to 1.9% (0.1 pp lower), while, for 2020, we now see GDP growth at 1.5% (0.2pp lower).

Figure 16: Employment growth is losing momentum



Source: INE, Eurobank Research

Eurobank

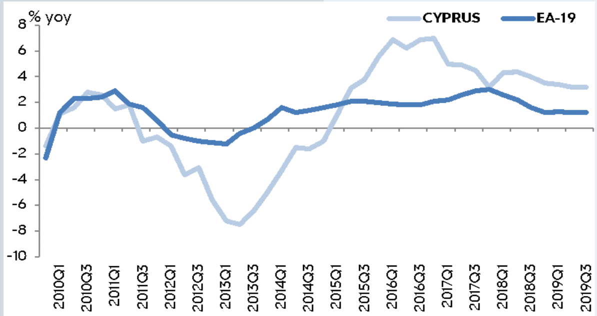
Eurobank Research

Cyprus

The flash GDP estimate of Q3 validates our expectations for a performance of over 3% in FY2019

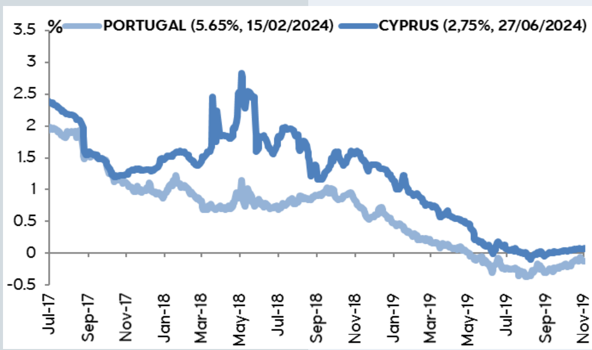
According to the flash estimate, real GDP slowed to 0.7% QoQ/3.0% YoY in Q3-2019 on a seasonally adjusted basis compared to 0.7% QoQ/3.1% YoY in Q2-2019 and 1.4% QoQ/3.3% YoY in Q1-2019. Although the components are not known yet, domestic demand is expected to have had the lion's share in the GDP Q3 growth reading for yet another quarter. Final consumption dynamics were underpinned by a number of factors, namely: sustained sentiment improvement (the average ESI index in Q3 was still close to multi-month highs), tightening labor market conditions (unemployment down to 6.8% in Q3-2019 compared to 8.1% in Q3-2018, now standing below EA-19 levels), further property market stabilization (the residential property price index (RPPI) increased by 0.7% QoQ/2.7% YoY in Q1-2019 vs. 0.9% QoQ/2.5% YoY in Q4-2018), the impact from the fiscal relaxation after the graduation from the economic adjustment programme and the acceleration of public consumption (the average expansion rate climbed to 12.5% YoY between Q4-2018 and H1-2019 up from 3.6% YoY in the previous five quarters). Based on the most recent construction data (the total value of building permits issued in H1-2019 increased by 115.9%YoY) and real estate activity, we anticipate that investments receiving support from the stream of ongoing residential and tourism infrastructure construction projects made a strong contribution in Q3 as well. Yet, the amendments to the program "citizenship through inward investment" have raised concerns for the future prospects of this activity. Looking ahead, the growth trajectory suggests that the soft landing we penciled in all previous analyses is in full force. On the positive side, factoring in the growth performance of the first three quarters, we anticipate the FY2019 GDP growth performance to be more or less in line with our initial forecast of 3.3% formulated in the beginning of this year, above that of euro area for a fifth consecutive year. On the negative side, this performance is the lowest reading since 2015, visibly lower than the CYSTAT revised estimates of 4.1% in FY2018 (up from 3.9% previously) compared to 4.4% in FY2017 (down from 4.5% previously), 6.7% in 2016 (up from 4.8% previously) and 3.4% in 2015 (vs. only 2.0% previously).

Figure 17: Cyprus' turn-around growth story has been impressive so far



Source: CYSTAT, Eurostat, Eurobank Research

Figure 18: Cypriot medium term bond yields have improved further in recent months



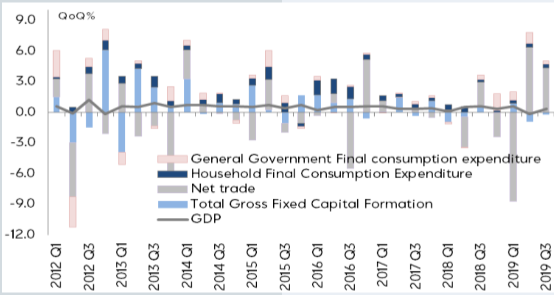
Source: Bloomberg, Eurobank Research

UK

Technical recession avoided in Q3 but underlying growth momentum is slowing

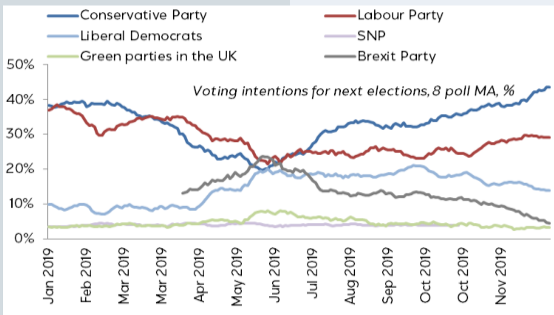
Following a 0.2%QoQ contraction in Q2 GDP, the UK avoided entering a technical recession in Q3 thanks to resilient private consumption. Q3 GDP grew by 0.3%QoQ on the back of a 0.3%MoM gain in July's GDP growth, while growth in the following two months, August and September, contracted by -0.2%MoM and -0.1%MoM, respectively. The Q3 GDP print left growth for the first three quarters of this year averaging 0.2%QoQ, while in annual terms, the economy grew by 1.0%, the weakest pace since Q1 2010 vs. an average pace of 1.7% in H1 2019. The expenditure breakdown showed that private consumption grew by +0.4%QoQ for the second quarter on the back of supportive wage growth contributing 0.25pp to Q3 GDP growth. Both government consumption and net trade also made a positive contribution (0.06pp and 1.22pp respectively) that was partially offset by gross capital formation (-1.24pp) which contracted for the second quarter in a row (-0.2%QoQ), while business investment was flat, continuing its recent subdued performance. With the latest PMIs suggesting risks of GDP contraction in Q4 as the PMI composite index fell further below 50 in November, GDP growth is expected to average 1.1% in 2019 and remain below the BoE's estimated potential of 1.5% in the coming year, weighed down by market uncertainty related to the UK's future trading relationship with the EU. The above projections are based on the assumption of a Conservative majority outcome at the 12 December general election (Figure 20) and the swift ratification of the UK PM Boris Johnson's Withdrawal Agreement by the House of Commons, leaving the UK on course to exit the EU by the end of January 2020. Downside risks mainly stem from an inconclusive election outcome that could potentially result to prolonged Brexit-related uncertainty, keeping annualized growth rates below 1.0%YoY. Under such a scenario, the BoE warned at its last monetary policy meeting on 5 November that the next rate move is likely to be down to reinforce the expected recovery in GDP growth and inflation. Policy-makers voted 7-2 to keep interest rates unchanged but two MPC members dissented to vote for a 25bps rate cut —the first split vote since June 2018 and the first votes for looser monetary policy since 2016— citing continued uncertainty and weaker labor market dynamics. Though the overall BoE tone sounded more cautious, the Central Bank left all options on the table for the future path of interest rates, noting that, if risks do not materialize, some gradual and limited tightening may be needed to keep inflation sustainably at the target.

Figure 19: Technical recession avoided in Q3



Source: ONS, Eurobank Research

Figure 20: Conservatives continue to enjoy a lead in recent nationwide polls



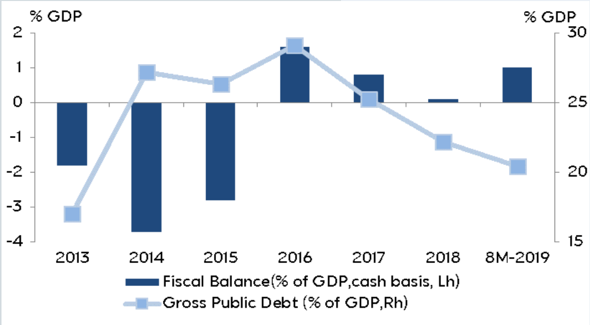
Source: Press reports, Eurobank Research

Bulgaria

Faster real convergence supported by ERM II accession and EU funds absorption

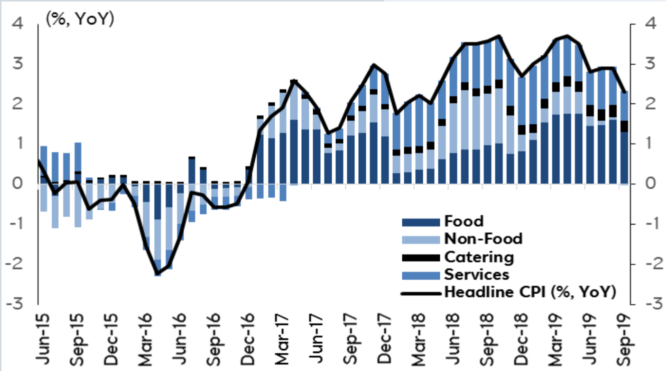
While flash Q3 GDP growth prints in the region reveal that some steam has evaporated, GDP growth in Bulgaria, albeit a tad weaker compared to the previous quarter, exceeded consensus expectations of 3.5% YoY and came in at 3.7% YoY, broadly driven by consumption and to a lesser extent by investments and net exports. We anticipate the final print for 2019 at 3.5% YoY with some deceleration in 2020 while the European Commission in its autumn outlook forecasts 2019 GDP growth a tad higher, i.e. 3.6% YoY. Taking into account the cemented fiscal discipline, mirrored in the approved by the European Commission and ratified by the Parliament 2020 budget, and the solid economic growth, what appears as strategic priority for the country is the accession in the Exchange Rate Mechanism (ERM II) and the Banking Union as a first step towards Euro adoption. Following Bulgaria's official bid to enter the preparatory corridor for the Euro back in July 2018, the Asset Quality Review (AQR) in six domestic banks, mandated by the ECB, was completed one year later necessitating modest capital injections (Common Equity Tier 1) in two of them. Assuming that the equity requirements will be satisfied within Q1 2020, Bulgaria could be accepted within Q2, as the Minister of Finance, Vladislav Goranov stated in late October. A constant challenge for Bulgaria since its accession in the EU back in 2007 remains the allocation and absorption of EU funds. The absorption rate within the Multiannual Financial Framework (MFF) for the period 2014 – 2020 so far stands at ca 45%, which is close to the EU average and it is expected to increase as we approach the expiry of the current MFF. Regarding the budget for period 2021-2027, the discussions at EU level will resume in the next European Council meeting in December 2019 and there is strong evidence that Bulgaria will receive relatively more funds under the next MFF, compared to the current amount, on the back of required infrastructure investments so as for the country to converge faster on real terms towards the EU27 average (currently standing ~50% of EU28 GDP/Capita average in PPP terms).

Figure 21: Bulgaria's fiscal position is sound



Source: National Authorities. Eurobank Research

Figure 22: Inflation trending lower in recent months on lower services' prices



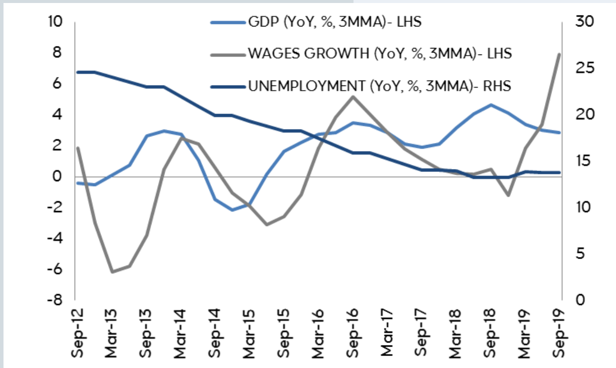
Source: National Authorities, Eurobank Research

Serbia

Economic growth losing steam ahead of parliamentary elections

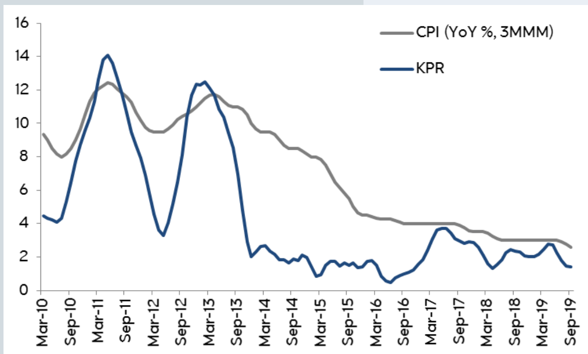
Following the two consecutive cuts in July and August by 50 bps cumulatively, the National Bank of Serbia (NBS) proceeded with an additional interest rate cut of 25 bps in November, setting the key policy rate at 2.25%. The NBS delivered the additional cut grasping the dovish stance of major central banks, namely, additional quantitative easing measures announced by the ECB in September and interest rate cut by the Fed in October. The key driver of the accommodative stance of the NBS throughout H2 2019 is primarily the appreciation pressures on the domestic currency. The EUR/RSD rate has been ranging modestly since January from 116.25 to 118.32 underpinned by substantial NBS interventions in the FX market. To this effect, the NBS has carried out EUR 2.3bn net purchases so far. The NBS has been able to adopt a more accommodative monetary stance up to date due to subdued inflationary pressures in the economy. The headline inflation is standing at 1.1% YoY, according to October's print while its year-to-date average is close to 1.9% YoY with our forecast for the whole year not exceeding 2.0%. As such, while in H1 2019 GDP growth stood at 2.8% YoY, we anticipate an upturn close to 3.2% YoY in H2 so as for the full year to close above 3.0%. Apart from the interest rate cuts so far, we also anticipate expansionary social policy to unfold and boost private consumption, ahead of the upcoming parliamentary elections in spring 2020. Real wages growth continues (+10.7% YoY in September from +9.6% YoY on average so far in 2019, compared to 3.4% YoY on average in 2018), setting the ground for the ruling right wing coalition to retain the majority, despite the threat of boycott by the Alliance for Serbia, a newly shaped catch all political force, ranking second with around 10-15% of the votes.

Figure 23: Solid economic growth and labor market



Source: Bloomberg, Eurobank Research

Figure 24: Monetary easing amid subdued inflationary pressures



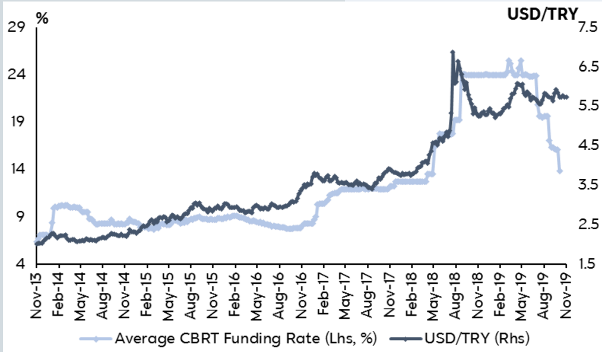
Source: Bloomberg, Eurobank Research

Turkey

Macroeconomic environment improves further on the back of stimulus measures

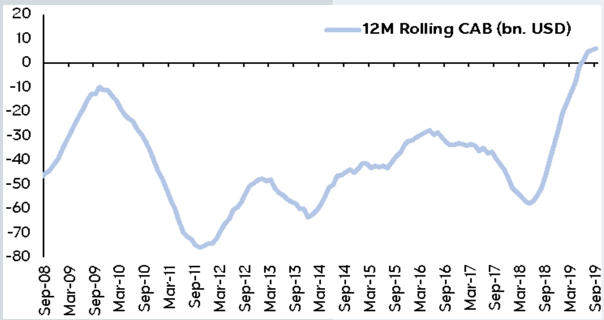
Notwithstanding the latest geopolitical developments, data releases are so far pointing to a further improvement of the macroeconomic conditions in H2 on the back of fiscal, credit and monetary stimuli. First of all, sentiment indicators' improvement has been broad-based, signalling the improvement of agents' general economic and employment expectations. The consumer confidence index rose by 2.9pts on a monthly basis to 59.9pts in November, for a second month in a row, compared to 57.0 in October. The seasonally adjusted manufacturing confidence index increased by 1.7pts to 105.9pts at the highest value since June 2018. Accordingly, the services confidence index rose by 0.6pts to 91.3pts in November. Although the retail trade confidence index fell by 1.1pts to 101.2pts, it remained in the optimistic territory of above 100pts. The seasonally adjusted capacity utilisation rate also improved by 0.7pps m/m to 76.7% in November. Second, the current account (CA) recorded a hefty surplus for a third consecutive month in September. In detail, the CA surplus expanded by 31.9% YoY to $2.5bn in September compared to $2.7bn in August up from $1.4bn in July bringing the twelve-month rolling surplus up to $5.1bn. The unwinding of macroeconomic imbalances is even more impressive given that the CA switched to a $3.6bn surplus in 9M-2019 compared to a $29bn deficit in the same period last year. Third, inflation dropped to the lowest levels in three years. Headline inflation slowed down to 8.6% YoY in October vs. 9.3% YoY in September down from 15.0% YoY in August compared to 16.7% YoY in July, coming again below analysts' consensus for the sixth consecutive month (Actual: +2.0% MoM vs Survey: +2.1% MoM). Core inflation (which excludes food, alcohol, tobacco, energy and gold prices) fell sharply to 6.7% YoY in October – at the lowest level since December 2016 – down from 7.6% YoY in September compared to to 13.6% YoY in August vs. 16.2% YoY in July. Inflation is expected to trend higher by year-end ending at ca. 12% below the Central Bank of Turkey (CBRT) latest inflation report projection. CBRT has already delivered a cumulative 1000bps in the last three meetings bringing rates down to 14%. Provided that inflation remains on this trajectory, further cuts by CBRT cannot be ruled out in the foreseeable future.

Figure 25: Central Bank slashed interest rates by 1000bps in the last three policy meetings



Source: Bloomberg, Eurobank Research

Figure 26: 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	3.5	3.0	3.0	3.6	3.2	3.2									
Advanced Economies															
USA	2.9	2.3	1.8	2.5	1.7	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	0.5	1.0	1.9	1.4	1.3	3.4	3.2	3.2	7.6	7.1	6.8	1.9	1.2	0.8
France	1.7	1.2	1.1	2.1	1.3	1.3	9.1	8.5	8.4	-0.6	-0.4	-0.5	-2.9	-3.5	-2.8
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	1.7	2.0	0.8	0.6	0.7	19.3	17.4	16.0	-2.8	-2.4	-2.4	1.0	1.2	1.2
Italy	0.8	0.2	0.5	1.3	0.7	1.0	10.6	10.3	10.3	2.5	2.8	2.9	-2.1	-2.0	-2.5
Portugal	2.4	2.0	1.6	1.2	0.5	1.0	7.0	6.5	6.2	0.1	-0.8	-0.9	-0.4	-0.2	0.0
Spain	2.4	1.9	1.5	1.7	0.9	1.2	15.3	14.1	13.4	1.9	2.4	2.5	-2.5	-2.3	-2.1
UK	1.4	1.1	1.2	2.5.	1.8	2.0	4.1	3.9	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	3.5	3.0	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	3.0	3.2	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

Eurobank Research

Eurobank Fixed Income Forecasts

	Current	December 2019	March 2020	June 2020	September 2020
USA					
Fed Funds Rate	1.50-1.75%	1.50-1.75%	1.36-1.60%	1.28-1.55%	1.27-1.50%
1 m Libor	1.70%	1.62%	1.59%	1.57%	1.58%
3m Libor	1.91%	1.82%	1.78%	1.76%	1.77%
2yr Notes	1.61%	1.52%	1.55%	1.57%	1.62%
10 yr Bonds	1.77%	1.71%	1.75%	1.82%	1.80%
Eurozone					
Refi Rate	0.00%	0.00%	0.00%	0.00%	0.00%
3m Euribor	-0.40%	-0.47%	-0.48%	-0.49%	-0.50%
2yr Bunds	-0.63%	-0.74%	-0.74%	-0.73%	0.70%
10yr Bunds	-0.36%	-0.50%	-0.47%	-0.44%	-0.38%
UK					
Repo Rate	0.75%	0.75%	0.75%	0.75%	0.75%
3m	0.79%	0.80%	0.79%	0.80%	0.82%
10-yr Gilt	0.67%	0.64%	0.76%	0.87%	0.96%
Switzerland					
3m Libor Target	-0.72%	-0.77%	-0.79%	-0.79%	-0.79%
10-yr Bond	-0.62%	-0.70%	-0.67%	-0.64%	-0.58%

Source: Bloomberg (market implied forecasts)

Eurobank

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