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The Q3 GDP growth rebound has been robust and broad-based across countries around the world. The strong momentum seems to have been carried into the start of Q4, but the resurgence of Covid-19 cases and consequent containment measures are expected to weigh on economic activity in the remaining months of the quarter, albeit to a smaller degree than in the first pandemic wave in the spring. Our view is consistent with the market's consensus for a global economic recovery in 2021, helped by still-accommodative monetary policy and targeted fiscal support, as well as Covid-19 vaccinations. We expect GDP growth to rebound to 5.0% in 2021, after contracting by 3.8% in 2020.

Macro Picture

USA: Tentative signs of softening, but underlying momentum remains resilient

EA: Following the negative effect of the second lockdown, positive vaccine news suggest a strong rebound in H2 2021

UK: Stricter Covid-19 restrictions and lingering Brexit woes point to renewed contraction in Q4

EM: The RCEP has created the world's largest free trade zone, improving economic growth perspectives for emerging economies

CESEE: The severity of the Covid-19 second wave signaled that full recovery may take longer than initially anticipated

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Rates: Steepening of US curve reversed on the back of US elections outcome, while EU rates trended lower on the back of Covid-19 worries

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Credit: Tighter spreads across ratings spectrum with USD outperforming EUR and any widening should be capped by further CB support

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Negative repercussions from a third Covid-19 wave / Vaccine rollout delayed

Less supportive stimulus: Premature phase out of Covid-19 support measures

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Special Topics in this issue

- Cyprus Investment Program overview and impact on domestic economy

- EU Recovery Fund: disagreement on rule of law conditionality risks delaying its activation

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Latest Macroeconomic Developments & Outlook

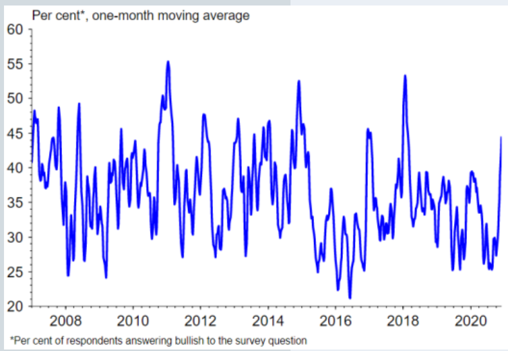
World Economic Outlook

Figure 1: MSCI Equity Index

Source: MSCI, Refinitiv Datastream, Fathom Consulting

The Q3 GDP growth rebound has been robust and broad-based across countries around the world. The strong momentum seems to have been carried into Q4, with the J.P. Morgan Global Composite Output Index advancing by 0.8pts to a 26-month high of 53.3 in October signaling expansion for the fourth consecutive month. Growth strengthened in both manufacturing (32-month high) and services (19-month high) industries, with all sub-sectors covered by the survey, barring consumer-facing industries (business and financial services, intermediate goods and investment goods categories), registering expansions of output at the start of Q4. Nevertheless, surging Covid-19 cases and containment measures in many parts of the world to curb the spread of the virus are expected to weigh on economic activity in the remaining months of the quarter, albeit to a smaller degree than the first round of infections and restrictions in the spring. Hence, growth is set to slow markedly from the record 37% annualized surge in Q3 global GDP, though still above potential for most countries except for Europe where we project a sharp contraction.

Figure 2: AAII Investor Sentiment Survey



Source: AAII, Refinitiv Datastream, Fathom Consulting

High-frequency leading indicators continue to point to a still resilient manufacturing sector globally, although the services sector remains relatively weak due to its higher sensitivity to the partial lockdowns in several countries. The US so far is holding up, maintaining strong underlying momentum despite escalating daily Covid-19 infections and record-high hospitalization rates that prompt more and more states to tighten restrictions. In Europe, the second Covid-19 wave seems to be getting under control; the latest epidemiological trends generally show a turnaround in the direction of infection rates, with euro area economies likely bottoming in the final quarter of the year. China stands out from the rest of the world and will, likely be the only major country escaping negative growth in 2020.

International equity markets had a record monthly performance in November, with major equity indices reaching new all-time highs. Oil prices also rallied with the Brent crude rising above $48/bbl, the highest level since early March. Prospects of a roll-out of Covid-19 vaccinations as soon as early next year, combined with waning political uncertainty in the US, favored risk-on sentiment, while EM markets have been aided by a near 2-year low in the US dollar and a recent increase in fund inflows. In particular, the Trump administration finally agreed to a formal transition process to President-elect Joe Biden, while the latter has named former Fed Chair Janet Yellen, who is in favor of a more expansionary fiscal policy, as his nominee for the position of US Treasury Secretary.

Our view is consistent with the market's configuration for a global economic recovery in 2021, helped by still-accommodative monetary policy and targeted fiscal support, as well as high-efficacy Covid-19 vaccines. Should vaccines be finally approved in late 2020/early 2021 as widely expected, mass production and vaccines distribution could follow by mid-2021, potentially leading to herd immunity by end-2021. We expect annual global growth to rebound to 5.0% in 2021, after contracting by 3.8% in 2020, with a noticeable acceleration starting from Q2 2021 onwards.

Developed Economies

US: Economic activity has recently lost some steam due to the third wave of Covid-19 infections and hospitalizations, but high-frequency indicators suggest that the underlying momentum remains generally supportive. In spite of falling income, personal spending held up relatively well as households continued to reduce their savings. Moderating goods demand and recently imposed restrictions on mobility to combat the spread of the pandemic suggest that the momentum in personal spending could decelerate further in the coming months, but spending should remain supported by a normalization in the savings rate. Meanwhile, the housing sector continues to show strong momentum, while October durable goods orders revealed broad-based gains in the ex-transportation categories. Overall, we have lifted further our 2020 GDP growth projection to -3.8% from -4.5% previously, on the back of stronger-than-expected data flow in Q4. Looking ahead, economic activity could decelerate further in Q1 2021 owing to the recent surge of Covid-19 infections, but a general distribution of Covid-19 vaccines from Q2 2021 onwards should underpin economic momentum with 2021 GDP rebounding by ca. 3.8%.

Euro area: Looking past the quarterly GDP increase of 12.6% in Q3, a second slump in economic growth is anticipated this winter due to the second round of lockdown measures. Nevertheless, the negative effect of the second wave on economic activity is expected to be a lot less severe than that of last spring, as the new restrictive measures are designed to allow more sectors (manufacturing, construction, public services, education) to remain open compared to March/April, and optimism for high efficacy vaccines in the following months should boost households' confidence in the euro area's economic recovery. Based on better-than-expected incoming data, we have revised higher Q4 2020 GDP growth, raising our 2020 overall GDP growth projection to -7.5% from -8.0% previously. Downside risks are expected to dominate through H1 2021, but - assuming mass production and distribution of vaccines by mid-2021 - we expect a robust rebound in H2 2021 when activity restrictions are fully lifted and recovery plans backed by EU financing begin to take effect, developing into a strong and synchronized expansion of around 4.8% in 2021.

EMU periphery: Following a bounce in Q3 GDP for the two largest Southern European economies, Italy and Spain, due to pent-up demand and the fast resumption of economic activity after the lifting of the first lockdown measures, economic recovery is expected to stall in Q4, as the second wave of the pandemic at the outset of the quarter prompted the reintroduction of various forms of strict measures. The anticipated slowdown is likely to be more pronounced in Spain, due to a number of negative idiosyncratic factors, including the economy's relatively higher dependency on tourism, one of the sectors most affected by the pandemic. However, in both countries, the level of restrictions is lighter compared to the first fully fledged lockdown in March and April, suggesting that the expected economic damage in the last quarter of the year is not likely to be as severe as it was in the spring. Beyond the weak winter, and barring a third wave of virus cases, the expected gradual easing of restrictions following the recent encouraging Covid-19 vaccine developments, should pave the way for a gradual improvement in economic activity in early Q2 2021, while, a stronger rebound is expected towards the middle of next year, supported by improved weather conditions and the mass Covid-19 vaccinations. However, due to the lasting scars of the pandemic, it will take much longer for the level of economic activity to return back to pre-crisis levels.

Emerging Economies

BRIC: In OECD's December Economic Outlook (EO), the forecasts of the GDP contraction for 2020 in Brazil and Russia were revised upwards while some loss of steam is anticipated for 2021, compared to the previous EO in the summer. Brazil's GDP is projected to shrink by -6% in 2020 and rebound by +2.6% in 2021 compared to -7.4% and +4.2% respectively, projected in June. On a similar footing, Russia is projected to shrink by -4.3% in 2020 and expand by +2.8% in 2021 vs -8.0% and +6.0% previously. The IMF, taking into account Brazil's economic contraction by -7% in H1 2020, foresees a sharper recession at a range of -5.8% for 2020 with a +2.8% comeback next year, in the Article IV completion statement. India is the outlier of the group as, according to the OECD, the economy is expected to shrink by -9.9% from -3.7% previously, while the 2021 forecast is kept stable at +6%. China's outlook has improved significantly for both 2020 and 2021. Whereas in June, GDP was anticipated to contract by -2.6% in 2020 and recover by +6.8% in 2021, currently, OECD foresees a +1.8% GDP growth rate in 2020, which could almost quadruple in 2021. The recent key development that refers to the Asian-Pacific part of the BRIC group pertains to the Regional Comprehensive Economic Partnership (RCEP) between China and other 14 countries in the Asia-Pacific region. The RCEP could potentially lead to the formation of the world's biggest free trade area, with the countries participating in it accounting for almost one third of the global GDP. While the deal was initiated by Indonesia, China is the largest participant in it, in terms of GDP, and as such its role is pivotal. However, India withdrew from the deal in November 2019, as there were worries that the country would be flooded by Chinese imports. China has stated that India may renegotiate its entrance to the club whenever the latter decides to. The timing the deal was pursued adds to its significance as trade jitters pop up at many parts of the world, with the US-Sino trade war prevailing.

CESEE: As of early December, six months after the initial re-opening of their economies, the epidemiological situation in many countries of the Central, Eastern and South-eastern Europe (CESEE) has aggravated. During the past weeks, most of them have been confronted with an exponential rise in Covid-19 related infections, hospitalizations and fatalities that hit new record highs. The sharp deterioration has put the CESEE region in the epicenter of media attention during the "second wave", because the countries have been hit disproportionally harder than their Western Europe peers. Even though the picture is not homogeneous across countries, the worsening of the epidemiological situation has prompted governments to reinstate health and social distancing measures and restrictions on public and economic activities, initially at the local level but soon at the national level. Some of them are one step away from a national lockdown. The resurgence of infections threatens the rebound prospects of the broader CESEE region in the Q4-2020 and undermines the growth rebound prospects of 2021-22. The second wave of infections will most probably put a break on the pace of recovery - not limited to the services sector - and signal that full recovery may take longer than initially anticipated.

Special Topic

Cyprus Investment Program: Overview and impact on the domestic economy

This section aims to give an overview of the Cypriot Investment Program (CIP) – an investor citizenship program – and its contribution to the domestic economy. Citizenship by investment is the process of obtaining a second citizenship and passport by investing in the economy of the host country. Citizenship by investment programs legally award citizenship status faster than traditional immigration processes. Two more EU countries, Bulgaria and Malta had their own programs awarding citizenship. Investor citizenship ("golden passport") schemes differ from investor residence ("golden visa") schemes. The latter aim to attract investment in exchange for residence rights in the country concerned, and exist in twenty EU member states.

The CIP program was initiated in May 2013 and was terminated in late 2020. The initial versions of the program gave applicants the flexibility to choose between different investments options to qualify for citizenship. The economic criteria of the program were revised twice, first in March 2014 and then in September 2016. Until the second revision of the program, a €2mn amount of investments in government bonds, or participation in the equity of domestic corporations, or deposits in the domestic banking system or losses of unsecured depositors of Bank of Cyprus and Laiki Bank in the bail-in events of 2013 or some combination of the above qualified as economic criteria for participation in the CIP.

The next program amendments in January 2018 and May 2019 aimed to strengthen the integrity of the program. The government changes – aimed to make the program more targeted and trustworthy – came in response to EU institutions' criticism that the transparency of the program should be bolstered. Among others, those changes put an annual cap on the number of awarded passports, raised the total cost of the application by increasing the required investment amount from €2mn to €2.5bn plus a €150,000 compulsory contribution to the state for research and affordable housing purposes, put additional layers of due diligence for prospective applicants and finally increased the minimum time of retaining the asset from three to five years.

According to the MoF calculations, a number of 2,855 persons had been awarded citizenship from June 2013 to December 2019, which corresponds to an inflow of €8.8bn, out of which €5.6bn were utilized in the domestic real-estate market. The data for 2020 are not available yet. According to the Ministry of Interior, there were 586 pending applications for examination from 2019-2020 (410 are from 2019 only) and around 40 more that were submitted after the government announcement for the termination of the program. The share of investment in construction and real estate activities has climbed to 90% of total inflows over time. On a cumulative basis, more than half of this amount was channelled to the construction & real estate sectors. The latter is important from a national accounts point of view because these inflows finance investment expenditure items with a multiplying effect on the real economy. The program has helped Cyprus to attract significant foreign investments in the real estate sector in the form of high-rise residential towers, which are located in Limassol & Paphos.

In the following tables we present some basic metrics and calculations related to the CIP. The first table contains the basic metrics of the number of awarded passports and the relevant inflows both to CIP and the share of real-estate investments. The second table contains the overall contribution of gross fixed capital formation and investment in dwellings. Table 3 contains the calculations of the Ministry of Finance for the CIP-related contribution of construction to economic activity from a production point of view and dwellings to GDP from an expenditures point of view under the assumption that CIP inflows as a share of total real estate transactions were allocated between one to three years before awarding citizenship. From a sustainability point of view, there were concerns expressed in public that the construction projects turn economic resources from the tradable sector to the non-tradable undermining the competitiveness of the economy. Thus, the economic rebound- before the pandemic-was poised to fade away once those construction projects are completed. The fact that those construction project were foreign-funded was considered as a mitigating factor for prudential risks for the banks.

Table 1: Basic Metrics of Cyprus Investment Program

	# Cases	Real Estate Purchase (€)	Residence (€)	Total Real Estate (€)	Total CIP Inflows €)	Real Estate Share in CIP (%)
2013	37	79.3	44.2	123.5	268.8	45.9%
2014	214	101.1+124.9	43.0+133.6	402.6	982.2	41.0%
2015	337	138.5	424.8	563.3	1,517.5	37.1%
2016	443	136.9	724.9	861.8	1,430.4	60.2%
2017	506	42.8+409.2	485.7	937.7	1,550.7	60.5%
2018	581	605.0	680.5	1,285.5	1,420.0	90.5%
2019	737			1,481.7	1,616.6	91.6%
Total	2,855			5,656.1	8,786.2	

Source: Ministry of Finance Study on CIP (September 2020)

Table 2: Gross Fixed Capital Formation & Dwellings Contribution to Economic Activity

	GFCF (%, YoY) 2010 prices	GFCF /GDP	GFCF contribu-tion GDP growth	Dwellings (%, YoY) 2010 prices	Dwellings contribu-tion	GDP (%, YoY)
2013	-15.6%	14.1%	-2.6ppts		-1.4ppts	-6.6%
2014	-7.4%	13.3%	-1.1ppts	-7.9%	-0.4ppts	-1.8%
2015	-1.8%	12.9%	-0.2ppts	-4.5%	-0.2ppts	3.2%
2016	+49.5%	18.1%	6.6ppts	29.7%	1.2ppts	6.4%
2017	+21.3%	21.0%	4.0ppts	16.4%	0.8ppts	5.2%
2018	-5.2%	19.2%	-1.1ppts	33.2%	1.7ppts	5.2%
2019	+2.0%	19.4%	0.4ppts	21.8%	1.5ppts	3.1%

Source: National Statistics, Eurobank Research calculations

Table 3: CIP-related Contributions to Economic Activity

	CIP Weighted Average Share to Construction	Construction to GVA	Dwellings to GDP	Multiplier
2015	19.5%			0.4
2016	17.3%	0.2	0.2	0.3
2017	21.1%	0.2	0.2	0.1
2018	30.5%	0.5	0.3	0.4
2019	37.5%	0.4	0.5	0.2

Source: Ministry of Finance Study on CIP (September 2020)

The CIP impact on economic activity is not limited to the national accounts. Employment in the construction industry has also benefited the most. According to the CYSTAT Labor Force Survey, the average annual employment increased cumulatively by 36.4% (i.e. approximately 10,752 employees) in 2013-2019. A large part of the increase could be attributed to the CIP given that the related projects were labor intensive. The impact on the real estate prices index has not been such to document a bubble. It hasn't been homogeneous either. The prices of real estate flat in Limassol – the area in which luxurious flats were built – benefited more compared to the country average. The average price of flat apartments in Limassol expanded by 21.2% cumulatively in 2014-2020 against only 5.5% for the relevant flat apartments national average and 0% for the Residential Property Price Index (RPPI) in the same period.

Following an extraordinary session in mid-October2020, the government cabinet approved the suspension of the scheme – citizenship by investment program – as of November 1st. According to the official statement by the Presidency, the proposal was put forward in response to "weaknesses" in the scheme that could be "exploited". The decision came in the aftermath of an Aljazeera controversial report which filmed allegedly high ranking officials making abusive use of the scheme. The infringement procedure initiated by the EU Commission (EC) on the issue will most probably put an abrupt end to these types of programs, even though the government has pledged to replace it with a new scheme that provides incentives to attract investments.

The EC[1] considers that the granting by these Member States of their nationality, and thereby EU citizenship, in exchange for a pre-determined payment or investment and without a genuine link with the Member States concerned, is not compatible with the principle of sincere cooperation enshrined in Article 4(3) of the Treaty on European Union. This also undermines the integrity of the status of EU citizenship provided for in Article 20 of the Treaty on the Functioning of the European Union. According to the EC, due to the nature of EU citizenship, such schemes have implications for the EU as a whole. When an EU member awards nationality, the person concerned automatically becomes an EU citizen and enjoys all rights linked to this status, such as the right to move, reside and work freely in the EU, or the right to vote in municipal elections as well as elections to the European Parliament. As a consequence, the effects of investor citizenship schemes are neither limited to the countries operating them, nor are they neutral with regard to other Member States and the EU as a whole. As a result, the Commission considers that the granting of EU citizenship for pre-determined payments or investments without any genuine link with the Member States concerned, undermines the essence of EU citizenship.

[1] https://ec.europa.eu/commission/presscorner/detail/en/ip_20_1925

Global Macro Themes & Implications

EU Recovery Fund: disagreement on rule of law conditionality risks delaying its implementation

After intense negotiations, EU leaders reached a political agreement back in mid-July on a deal for the €1.074trn Multiannual Financial Framework (EU budget) covering the period 2021-2027 and the €750bn EU Recovery Fund (official name: Next Generation EU) to assist Member States in addressing the Covid-19 outbreak, marking an important step on the road to post-pandemic recovery. However, four months after the agreement, progress on ironing out fine details has been slow. The main sticking issue is the rule of law conditionality attached to the disbursement of EU funding.

The rule of law, embedded in Article 2 of the EU Treaty, has been designed by the European Commission to protect the fundamental values of the European Union. It states clearly that, for a country to be part of the EU, it needs to agree and respect the Union's core values which include, inter alia, individual rights protection, fight against corruption and independence of the judiciary system, the press and tax fraud authorities. If the European Commission deems that a Member State breached the principles of the rule of law, upon approval by a qualified majority among Member States, a procedure could be triggered within three months, which, conditional on the consent of the European Council, could lead to sanctions, mostly in the form of the suspension, reduction or even restricted access to EU funding.

Poland, Hungary and lately Slovenia, oppose the rule of law conditionality attached to EU funding access, arguing that it lacks a legal basis. However, as they cannot block the deal for the ratification of the rule of law conditionality, they veto the deal for the EU Recovery Fund (and the EU Budget). That is because, whereas the approval of the rule of law requires a qualified majority (15 Member States representing at least 65% of the total EU population) and a simple majority in the European Parliament, the ratification of the EU Recovery Fund requires the unanimous approval by the European Council and then the approval of the 27 Member States' national parliaments. The opposing countries' main concern is that the new rule could be implemented arbitrarily against them, blocking their access to EU funding, as both Poland and Hungary have infringed the rule of law in the past. An investigation on these grounds against Poland started in January 2016 and opened the way for the European Commission to activate the Article 7 procedure on 20 December 2017, arguing that the disciplinary regime in the country undermined the judicial independence of judges and did not ensure the necessary guarantees to protect them from political control, as required by the Court of Justice of the EU. With respect to Hungary, the EU Parliament initiated the Article 7 procedure on September 2018 amid concerns about judicial independence, freedom of expression, corruption, rights of minorities and the situation of migrants and refugees. The aforementioned investigations for both countries are still ongoing. Sanctioning requires unanimous approval by EU Member States, and Hungary and Poland effectively prevent the other one being sanctioned.

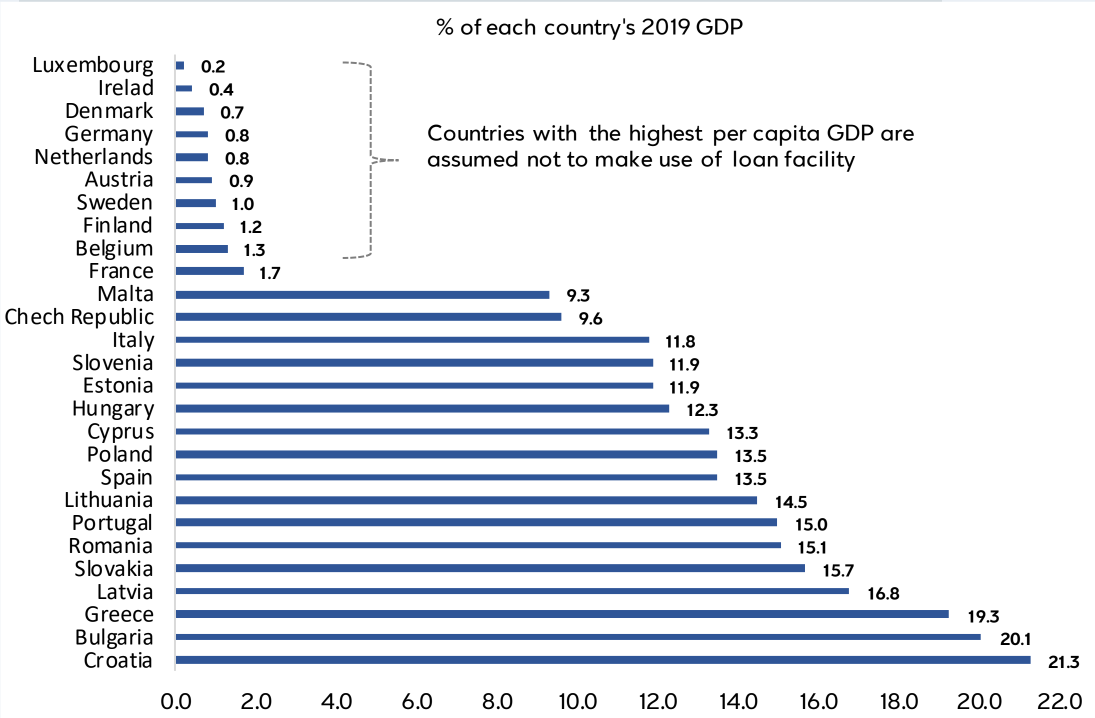
The European Commission's initial timeline envisioned the activation of the EU Recovery Fund at the beginning of 2021. However, as a compromise on the issue has yet to be reached, Germany which holds the EU presidency until the end of the year, has admitted recently that a delay seems increasingly likely. But, even if the Recovery Fund is approved soon by the EU leaders, it would take some time for it to enter into force as its ratification by the EU Member States' national parliaments is also required. For the European Commission to issue bonds in the financial markets on behalf of the EU, national parliaments have also to approve an increase in the Own Resource's ceiling —that represents the max amount each Member State is called to contribute to the EU budget annually to finance EU expenditures — to 2.0% of the GNI from 1.4% currently.

As regards the release of funds, for a Member State to receive funding from the Recovery Fund, it has to submit by April 2021, a national reform plan outlining its post-pandemic recovery strategy, which should also be consistent with country-specific recommendations embedded in the European Semester. Within two months after the submission, the proposed plan has to be approved by both the European Commission and the European Council by qualified majority voting (i.e. 55% of votes representing at least 65% of the EU population). To make a long story short, the recovery funds disbursements, initially expected in June, will likely be further delayed.

The next key event to watch for a way out of the current deadlock is the 10/11 December European Council. As regards the EU Budget for 2021-2027, eyes are on the European Parliament's last plenary of the year on 16 December. This is particularly important this year, as a delay in the approval of the budget could delay the activation of the EU Recovery Fund. In case the EU Budget is not adopted by year-end, the 2020 Budget would have to be rolled over to next year, which means that only programmes that already have a budget will carry on and, thus, several projects that expire at the end of 2020 would be discontinued. These include the structural funds, of which, paradoxically, both Hungry and Poland are among the main beneficiaries.
As suggested by the overall positive tone in the EMU sovereign bond markets over the last few weeks, there seems to be optimism that a deal will eventually be reached, as the rising second Covid-19 wave creates a sense of urgency for a resolution. However, to build a consensus within the European Council may take some time.

According to some commentators, among the options for a compromise could be: (i) the softening of the existing rule of law mechanism (an option less likely following calls by the European Parliament to the opposite direction); (ii) commitment to both countries that the rule of law mechanism will only be activated in case of serious violations; (iii) the two countries to be offered something in return on a completely unrelated issue; (iv) the two countries to be threatened that EU structural fund absorption could become more difficult. Should all these options fail, EU leaders could potentially: (v) make an intergovernmental budget agreement (like the ESM) to distribute funding under the EU Recovery Fund, excluding Hungary and Poland, or, (vi) make use of the Treaty's enhanced cooperation procedure that allows a smaller group of EU countries to reach a deal for budgetary issues, i.e. excluding Poland and Hungary from receiving any funds. However, these two options risk permanently dividing the EU and could take time to materialise as they would raise a number of practical issues, including the way to ensure debt mutualisation, as is currently the case for the EU Recovery Fund. In any case, Poland and Hungary have strong incentives to reach an agreement. Most important of all, however, is that both Poland and Hungary are entitled to sizable funding under the EU Recovery Fund, estimated at 13.5% and 12.3%, respectively, as a percentage of their 2019 GDP (Figure 3) and are also among the biggest net recipients of the current EU Budget (receiving between 2.5% and 3.5% of their respective GDP in 2018). Last but not least, both countries have been severely impacted by the pandemic and they are both in need of EU funding, suggesting that they may back down eventually.

Figure 3: EU Recovery Fund - Total projected allocation of grants and loans per Member State (% of each country's 2019 GDP)



Source: European Commission, Eurobank Research

Macro Themes & Implications in CESEE

The severity and duration of the pandemic Covid-19 second wave put more pressure on the economic activity in Q4-2020 and signaled that full recovery may take longer than initially anticipated

As of early December, six months after the initial re-opening of their economies, the epidemiological situation in many countries of the Central, Eastern and South-eastern Europe (CESEE) has aggravated. During the past weeks, most of them have been confronted with an exponential rise in Covid-19 related infections, hospitalizations and fatalities that hit new record highs. The sharp deterioration has put the CESEE region in the epicenter of media attention during the “second wave”, because the countries have been hit disproportionally harder than their Western Europe peers.

Even though the picture is not homogeneous across countries, the worsening of the epidemiological situation has prompted governments to reinstate health and social distancing measures and restrictions on public and economic activities, initially at the local level but soon at the national level. Some of them are one step away from a national lock-down. The high economic and social cost of a second lock-down, given the output losses incurred in Q2 in most cases, has deterred governments from taking more draconian measures fast enough at the risk of putting more strain on the domestic public health systems. The countries of the CESEE region had coped very well in the first phase of the pandemic. The lock-downs that were rapidly imposed and efficiently enforced by the governments, took their toll on economic activity but were successful in containing the pandemic.

Turning now to the economy, the Q3-GDP releases took center stage in the data releases of the past month. The Q2-GDP readings confirmed our deepest and earlier stipulated fears that the CESEE economies are poised to go through a very deep recession in 2020, deeper than the Great Recession of 2008-2009. The Q3-GDP readings across the CESEE region were positive reflecting the re-opening of the economies in the summer, but still lower on average on an annual basis, contributing to the output contraction of FY2020. Yet they were on average less positive than anticipated on a quarterly basis. On top, regional readings underperformed those of their euro area peers who managed to recover more ground. As things stand, the deeper the dive in output in Q2, the stronger the rebound in Q3.

The re-opening of the economies, even at the expense of keeping infections under control, had initially strengthened optimism in sentiment and surveys. Having plummeted to multi-year lows in April, those indicators rebounded for three or four months. However, the economic sentiment improvement stalled in September, in some cases it even declined slightly in October, but then it decreased visibly in November retrenching back to the levels of June-July at the previous reopening of the economies. Yet, given the rapid deterioration of the epidemic, it would be fair to say that the decline doesn’t reveal a sense of panic as in the first wave.

Overall, the economic sentiment releases more or less follow the common pattern of the previous months, which reflects two diverging trends within individual sub-categories. Confidence in industry and construction is broadly holding up better, maintaining most of the previous months' gains. In contrast, confidence among consumers as well as in services and retail trade is retreating. In our view, this most probably reflects renewed market concerns regarding the impact of the second wave of the pandemic and reveals the higher sensitivity of the services sector to the resurgence of the pandemic. The message from the Markit PMI manufacturing releases in November is similar. With the exception of Poland, PMI readings across the region decreased on a month-on-month basis and were broadly consistent with the trend in the euro area. A more thorough look reveals that participants appeared to be more concerned and less optimistic for the period ahead.

The leading indicators' releases coupled with the rise in infections have raised a lot of uncertainty over the economic outlook and a new set of challenges. The resurgence of infections threatens the rebound prospects of the broader CESEE region in the Q4-2020 and undermines the growth rebound prospects of 2021-22. The second wave of infections will most probably put a break on the pace of recovery - not limited to the services sector - and signal that full recovery may take longer than initially anticipated. Under the assumption that the restrictive measures will most probably remain in place in the first months of next year, a negative impact is expected on the output performance of Q1-2021. In addition, the logistics of the production, distribution and execution of vaccination on such a massive scale are so complicated that may require more investments and additional effort, which entail further delays. To make matters worse, the stand-off on the approval of the EU budget, if not resolved until the end of the year, may result in further delays in the disbursement of the much needed funds for the region. Hungary and Poland vetoed the EU's multi-year budget for 2021-27, thus blocking the Recovery Fund initiative, due to their disagreement in linking the disbursement of the funds with compliance with the rule-of-law. In that direction, given the aggravation of the epidemiological situation across the board, which point to increased probability for the recovery to be W-shaped vs a V-shaped, compelled us to revise again our forecasts for 2020-2021.

On the same wavelength, the EU Commission (EC) has recently revised the forecasts of 2020-2022 in its latest autumn forecasts in mid-November. In such an environment, the euro area is expected to contract by -7.8% (vs. -7.7% in May) in 2020 and then bounce back by 4.2% in 2021 (vs. 6.3% previously in May) and 3.0% in 2022. The EC now forecasts that on average economies in the region will face less painful contractions in 2020, but the rebound in 2021-2022 will not be as strong as it was envisaged back in the spring and certainly less symmetrical for everyone. In particular, for the economies of our focus, the GDP growth forecasts are as follows: 1) Bulgaria -5.1% in 2020, +2.6% in 2021 and +3.0% in 2022, 2) Serbia -1.8% in 2020, +4.8% in 2021 and 3.8% in 2022, 3) Romania -5.2% in 2020, +3.3% in 2021, and +3.8% in 2022, 4) Turkey -2.5% in 2020, +3.9% in 2021 and 4.5% in 2022, and 5) Cyprus -6.2% in 2020, +3.7% in 2021 and +3.0% in 2022.

CESEE Markets Developments & Outlook

Bulgaria

Government bond yields continued to drop across the board, ranging from 5 to 16 bps. The most notable yields drops were recorded in the long-end of the curve, namely the 2035 and 2050 tenors with a respective decline reaching 16 and 14 bps. The shorter end of the curve also declined by 12 bps for the 2024, 2027 and 2028 tenors, while the 2030 tenor yield dropped only by 4 bps. Local papers followed suit, with the 3, 10 and 20 year tenors dropping by 6, 7 and 16 bps respectively. On the Covid-19 front, Bulgaria has seen a rapid rise in cases, which puts additional pressure on the ruling party to increase spending and widen the budget deficit. The government successfully agreed on the 2021 budget parameters and set the new debt issuance target for the upcoming year at EUR4.5bn.

Serbia

Serbia is experiencing the third wave of Covid-19 which so far proves the hardest as the country reports roughly 50 deaths per day and 7 000 new cases on a daily basis.

The efforts of the National Bank of Serbia (NBS) to cushion FX rate volatility will most probably continue despite the significant drop in production. The gross FX reserves of the NBS at the end of October reached EUR13.1bn, an amount that is considered adequate to protect the RSD from a sudden depreciation. Also, the possibility of massive vaccination within H12021 is the second reason why we don't see any significant movement in neither the FX nor the fixed income space.

In November Serbia achieved a historic low borrowing cost in the Eurobond market, supported by a cross currency hedge that the Public debt agency performed. On November 23rd Serbia issued a 10-year Eurobond of USD1.2bn, at a coupon rate of 2.125% and a yield rate of 2.35%, which are both considered record low in terms of borrowing in USD. At the same time, aiming to hedge the newly raised public debt from FX risk, Serbia carried out its first currency swap operation, whereby it swapped liabilities under this Eurobond from USD into EUR, achieving a de facto 1.066% coupon rate for financing in EUR.

Looking at the yield curve of the RSD denominated government bonds, all tenors experienced yield drops ranging from 7 to 15 bps during the previous month. The sharpest decline occurred at the long-end of the curve with the 12-year bond falling by 15bps (from 4.15% to 4.00%). The shorter end of the curve, where the most traded tenors were the 5-year and 1-year ones, recorded softer yield drops, by 10bps and 7bps respectively.

Markets View

Foreign Exchange

EURUSD: The pair has now breached the 1.20 psychological level and is targeting higher levels ahead of the ECB meeting of the 10th of December. We believe that there is room for further short-term and medium-term appreciation as valuation, yield differential and risk correlation point to prolonged USD weakness. Furthermore, the technical picture is short- and medium-term constructive with initial targets seen to 1.2145 ahead of 1.2556/1.2617 (Feb'18 high and 200 MA). The first support is now at 1.20.

GBP/USD: Sterling continues its whipsaw amidst contradictory comments coming from the Brexit front as the December deadline is approaching. We believe that a deal will be struck in the following sessions and given EUR momentum, GBP/USD. The short-term support comes at 1.3260/90 area and the first resistance at 1.3450. If the positive scenario materializes we see room for further appreciation in 2021 targeting the 1.40 level.

Rates

EU: The level of EU rates remained unchanged for another month. Inflation expectations in Europe continued to be relatively low and therefore, the European swap curve remained in negative territory even at the long end. The 10-year swap rate average was -25bp in November and the 30-year swap rate little less than zero. Shift of curve also unchanged with 30s-10s at 23 basis points. As we are heading to the year-end market seems relative balanced. Good news for the Covid-19 vaccine are priced in for the next year but at the same time bad news regarding low inflation in the euro area for a prolonged period of time are also priced in. The ECB itself expects annual inflation of only 1.3% by 2022. Looking forward, we expect the EU curve to start steepening as we start leaving the pandemic behind us. A potential risk (apart of the low inflation) would be a longer duration of Covid-19 related debt issuance, which could result in flatter curves.

US: The level of the US yield curve remained relatively stable in November with the 10y swap rate hovering around 85bp. The steepening of the curve also continued with 30s - 5s also above 80 basis points. Looking forward, we expect yields to move higher but at a slower pace and a marginally steeper curve as we have many positive news. President Trump has more or less accepted his defeat in the US national elections and the Covid-19 vaccines have been announced. In addition, Janet Yellen, the former Fed Chairwoman, will be the next Treasury Secretary. During Mrs. Yellen's tenure, the Fed raised rates from near zero to 1.50%. Moreover, she has recently argued in favor of extraordinary fiscal support. We should keep in mind however, that most of the above are already priced in. Finally, a potential risk would be a selloff in the US equity market (which is overbought currently) and would certainly trigger a risk off move across markets.

Emerging Markets credit

The US election results, the Biden win and a potential split Congress helped investors to turn more constructive on EM risk at the beginning of the month. Then we saw a very strong rally after the positive vaccine trial results (Pfizer, Moderna and most importantly for EM AstraZeneca) as the EM countries have been hit especially hard by Covid-19. China issued for the first time a Euro bond at negative yield (5y tenor), while South Africa's sovereign credit was downgraded by both Moody's and Fitch to BA2 and BB- respectively with a negative outlook. Turkey assets have significantly outperformed, as investors have welcomed the appointment of Lutfi Elvan and Naci Agbal as Heads of the Treasury and Finance Ministry and the Central Bank respectively, replacing Berat Albayrak and Murat Uysal. This change has raised expectations of a better policy mix targeting Turkey's problems. We expect EM to benefit from less economic uncertainty as the Covid-19 impact should significantly ease over time and global growth will recover. China's robust expansion and a weaker USD will continue to be good news for EM. We are bullish on EM despite some near-term downside risks like a second wave of Covid-19.

Corporate credit

EUR cash corporate and synthetic credit spreads tightened in November, while the CDS-cash basis has now broadly returned close to pre-March sell-off levels. Broad-based compression throughout the month, with lower rated investment grades and BB+ outperforming higher rated credits. BB+ were -57bps tighter, BBB- -45bps, BBB -22bps, BBB+ -17bps, A- -13bps, A -13bps, A+ -7bps, and AA -7bps tighter. USD cash slightly outperformed IG EUR spreads (5 to 7bps on average). In HY space, EUR BB names were -88bps better compared to -80bps in USD, EUR B names were -160bps better on average versus -130bps on average in USD. Credit curves bull flattened as the ongoing hunt for yield pushed investors in longer durations and lower quality credits. EUR ITRX Main 5Y CDS and US CDX.IG 5Y CDS indexes were -17bps and -15bps tighter respectively on the month.

Technicals for cash remain strong, as lighter supply, year-end subdued activity, no major news items, and Central Bank support are tailwinds, especially for EU credit, helping the asset class outperform equities over the month, despite Covid-19 cases and lockdowns mounting. Macro continued making better prints across, and especially in China.

At sector level, European financials were the outperformers with Insurance -36bps better, Banks -22bps, Real Estate -33bps, followed by Consumer Services -27bps (Travel and Leisure -42bps, Retail -20bps) and Oil and Gas -22bps. Among Consumer Goods, Automobiles were -23bps better, while Food and Beverage lagged -7bps better. Industrial Goods and Services were -20bps better, while Healthcare, Technology and Telcos were -13bps better. In the US, Oil & Gas and Travel and Leisure were the outperformers both -36bps better on the month, while other sectors tightened -20bps on average.

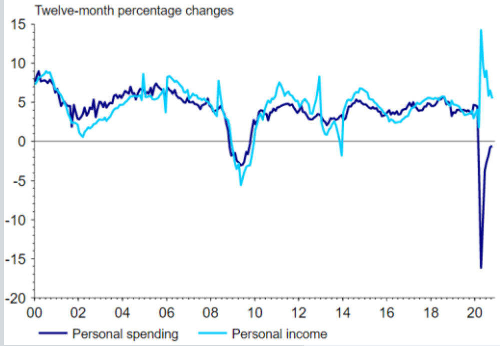
Given the important vaccine news over the month and the clearance of US elections as a news item, we believe that spreads will remain range-bound at current tight levels, despite any potential weak macro prints in Q4. Industries heavily affected by Covid-19 still have potential for further tightening, while lower beta credits have already run their tightening spree, having limited upside from here in our view. Mid-term risks for moderate widening can be higher inflation expectations, inducing higher rates, and any initiation of discussions on normalizing policy support schemes in 2021.

USA

Economy has lost some steam due to the third Covid-19 wave, but underlying momentum remains resilient

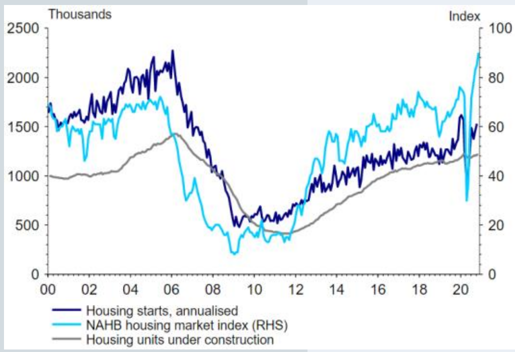
Following the expiration of the CARES Act, October personal income fell by 0.7%MoM amid a further drop of 6.2%MoM in transfer payments to households. In spite of falling income, personal spending held up, as households continued to reduce their savings; spending on goods was flat, consistent with softer retail sales, while spending on services rose by a hefty 0.7%MoM, urging us to push our Q4 GDP expectations higher. Moderating goods demand and recently imposed restrictions on mobility to combat the spread of the pandemic suggest that the momentum in personal spending could decelerate further, but spending should remain supported by a normalization in the savings rate from a still-elevated level of 13.6%[2]. Meanwhile, the housing sector continues to show strong momentum, while October durable goods orders showed strong and broad-based gains in the ex-transportation categories. Core capital goods shipments advanced 2.3%MoM after an upwards revised rise of 0.7%MoM in September, boding well for a robust increase in Q4 business investment. Overall, we have further lifted our 2020 GDP growth projection to -3.8% from -4.5% previously, on the back of stronger-than-expected data flow in Q4. Economic activity could decelerate further in Q1 2021 owing to the recent surge of Covid-19 infections, but a broad distribution of Covid-19 vaccines from Q2 2021 onwards should underpin economic momentum with 2021 GDP rebounding by ca. 3.8%. The fact that the US Treasury did not extend the emergency lending facilities under the CARES Act that expires at year-end could constitute a downside risk to growth, especially if there is a substantial deterioration in credit conditions. The expiration of several emergency loan programmes could raise the chances of the Fed increasing the duration of its Treasury purchases at its forthcoming December meeting, although we currently maintain our view for no material change in policy in the near future, absent any adverse developments in economic/market conditions. The November FOMC minutes suggest that the Fed may adjust the guidance on its asset purchases in December, but not the actual asset purchase program.

Figure 4: Despite falling income, personal spending increased amid elevated savings



Source: BEA, Refinitiv Datastream, Fathom Consulting

Figure 5: US housing sector continues to show strong momentum



Source: NAHB, Refinitiv Datastream, Fathom Consulting

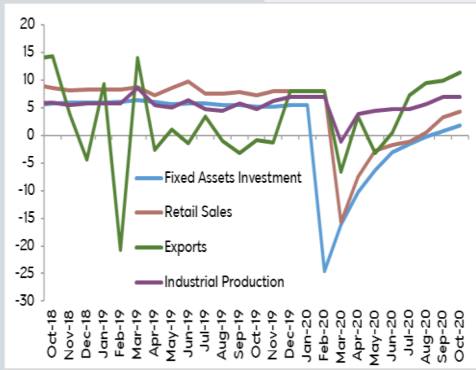
[2] Cumulative excess savings as a result of the Covid-19 pandemic are estimated at around $1.0trn, which accounts for about 80% of current monthly personal consumption.

China

Uninterrupted economic rebound allows for decisive reforms

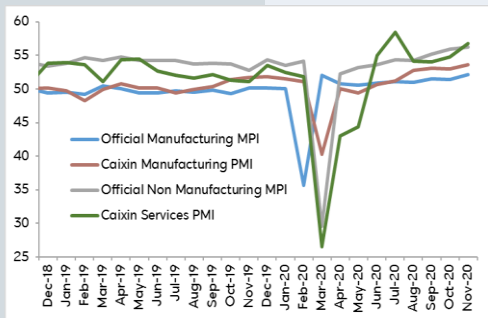
As we approach year-end, China's economic rebound continues. Both manufacturing PMIs, the official and the Caixin, picked up to 52.1 and 54.9 in November from 51.1 and 53.6 in October respectively, continuing the positive streak since April, with the Caixin print reaching a 10-year high. Previous month's concerns over the exports trajectory are currently culminated as the exports sub-index in the Caixin Manufacturing PMI picked up as well to 51.5 from 51.0 in the previous month. The non-manufacturing gauge also improved to 56.4 from 56.2. Apparently, both domestic and external demand is strong on the back of year-end holiday purchases. The aforementioned view is backed by October's hard data as well; industrial and auto production (+6.9%YoY and +15%YoY respectively) and retail sales (+4.3%YoY vs +3.3%YoY in September) continue firming. In this context, PBoC stated in the Q3 Monetary Policy Report (MPR) that the sustained economic rebound will allow for gradual and data-driven withdrawal of easing measures, adopted previously in order to support the economy during the pandemic. The PBoC made a crucial reference with respect to the exchange rate mechanism for the RMB as it has, reportedly, decided to allow market dynamics to determine, albeit to some extent, the RMB exchange rate. That said, the limited interventions of the Central Bank in the FX market so far this year, among other factors, have led to a remarkable appreciation of the CNY against the USD (+6% ytd). This month, market attention was also lured by the default of bonds issued by SOEs (State Owned Enterprises) and the agreement of the Regional Comprehensive Economic Partnership (RCEP) between China and other 14 countries in the Asia-Pacific region. The default of two high profile SOEs within a fortnight rocked the country's sizeable bond market and lead to a SOEs bond sell-off in mid-November. The event is so far translated by investors and analysts as diminishing disposition on behalf of the state to offer bail-outs and support financially non-creditworthy SOEs, although that seemed to be the pattern in China for at least 10 years, following the Great Financial Crisis. Concluding, the RCEP could potentially lead to the formation of the world's biggest free trade area, with the countries participating in it accounting for almost one third of the global GDP. While the deal was initiated by Indonesia, China is the largest participant in it, in terms of GDP, and as such its role is pivotal. The timing of the deal adds to its significance as trade jitters pop up at many parts of the world, with the US-Sino trade war prevailing.

Figure 6: Recent hard data point to firm recovery…



Source: Bloomberg, Eurobank Research

Figure 7: …mirrored in all PMIs as well

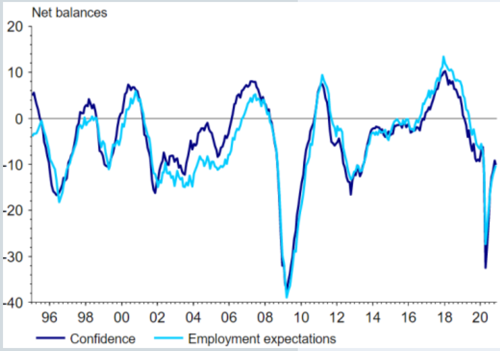


Source: Bloomberg, Eurobank Research

Euro area

A less severe lockdown-induced deceleration compared to last spring; positive vaccine news and prospects for a strong rebound in H2 2021

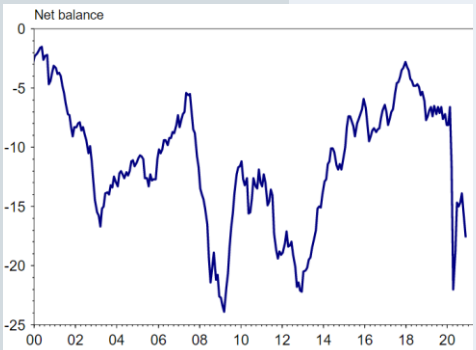
Figure 8: DG ECFIN manufacturing survey shows resilience



Source: EC, Refinitiv Datastream, Fathom Consulting

Looking past the quarterly Q3 GDP increase of 12.6%, which took activity to about 95% of the pre-virus level, a second slump in economic growth is anticipated this winter due to the second wave of Covid-19 infections and another round of lock-down measures. Following the September drop in industrial production (-0.4%MoM), partly driven by seasonal distortions in Italy, the virus-induced weakness in domestic demand does not bode well for Q4 as renewed uncertainty weighs on consumer and business confidence and keeps precautionary savings elevated. According to the November EC survey, the consumer confidence indicator decelerated for the second consecutive month to -18.7 from -16.5 in October. Meanwhile, the EA composite PMI moved into contractionary territory in November (-4.9pts to 45.1), with escalating Covid-19 infection rates weighing mainly on the services sector, while the manufacturing sector remained in expansionary territory but began to decelerate. Nevertheless, the negative effect of the second wave on economic activity is expected to be a lot less severe than that of last spring, as the new restrictive measures are designed to allow more sectors to remain open compared to March/April, and optimism for high efficacy vaccines should boost households' confidence in the economic recovery. Based on better-than-expected incoming data, we have revised higher Q4 GDP growth, lifting our 2020 overall GDP growth projection to -7.5% from -8.0%, previously. Downside risks are expected to dominate through H1 2021 with subdued GDP growth, as authorities will likely be forced to ease and tighten restrictions depending on the trajectory of the virus. Assuming mass production and distribution of vaccines by mid-2021, we expect a robust rebound in H2 2021 when activity restrictions are fully lifted and recovery plans backed by the EU financing begin to take effect, developing into a strong and synchronized expansion of around 4.8% in 2021. With weak inflationary pressures, the ECB should underpin the recovery with continuing support. We expect a package of monetary easing measures from the ECB at the 10 December meeting, including an increase of the PEPP envelope by about €500bn and an extension of the TLTRO3 discount beyond June 2021, but no deposit rate cut, absent a material deterioration in the growth outlook and/or financial conditions.

Figure 9: DG ECFIN consumer survey decelerates



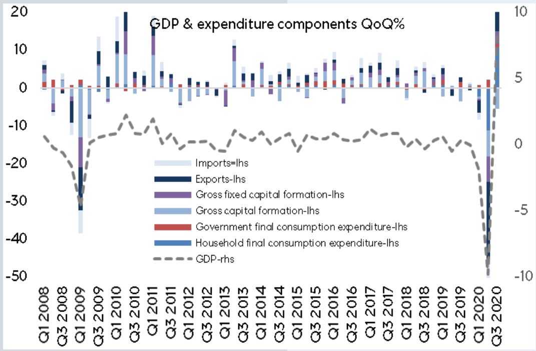
Source: EC, Refinitiv Datastream, Fathom Consulting

Germany

Strong momentum in manufacturing to cushion lockdown hit to Q4 GDP

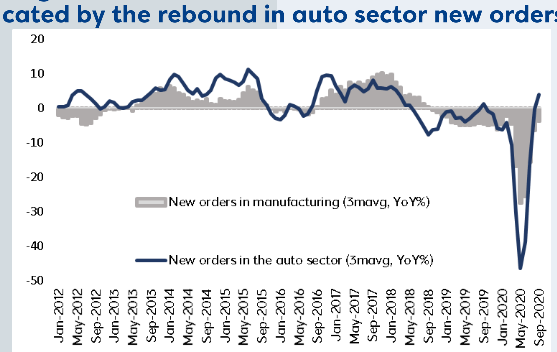
German Chancellor Angela Merkel and the heads of the 16 states decided to extend the so-called "lock-down light" from end-November to 10 January 2021, on the grounds that the number of new Covid-19 infections has stopped rising but is not yet falling clearly enough. Hence, all shops, schools and workplaces will remain open, but restaurants, hotels (for tourists) and arts/sports/leisure facilities will remain shut. Though the second lockdown imposed on 2 November should weigh on Q4 GDP, the expected economic damage is not likely to be as severe as it was in the first lockdown in the spring. Direct activity restrictions are relatively milder, with the affected sectors estimated to amount to just about 3% of Germany's gross valued added. Furthermore, as indicated by rising new orders, the growth momentum of the manufacturing sector remains upbeat, with new orders in the auto sector —the single most important industry for Germany's manufacturing — standing in September (latest available data) around 5.0% higher from the pre-pandemic levels of February 2020 (Figure 11). In addition, China's rebound should benefit the German export-oriented economy, while some front-loaded spending ahead of the planned expiration of the temporary VAT cut from 19% to 16% on 31 December 2020, may also limit the anticipated negative impact of the virus-related restrictive measures on Q4 GDP. In support of the above, Gfk consumption climate dropped to a four-month low of -6.7 in November, but still higher than the -23.1 trough in April, the PMI index for the services sector dropped further into contractionary territory in November (-3.3pts to 46.2), but the respective index for manufacturing remained broadly unchanged (-0.3pts to 57.9). Moreover, the IFO business sentiment deteriorated in November for the second consecutive month (to 90.7 from 92.5) although the monthly drop was near one fifth of that in March and April. We expect GDP to contract by c 5.0%QoQ in Q4, half the -9.8%QoQ drop in Q2 that was followed by an upward revised bounce of 8.5%QoQ in Q3, leaving the annual growth rate for the full year at -5.6%. As the cold weather favors infections, lockdown measures will probably have to continue through Q1 2021, while economic activity is likely to be further depressed over that period by the renewed increase in the VAT rate. That said, GDP is likely to remain in negative growth territory in Q1 2021, before warmer temperatures and large scale Covid-19 vaccination allow for the economy to pick up significantly, especially in H2 2020.

Figure 10: After a strong bounce in Q3, economic activity is likely to contract in Q4...



Source: Federal Statistical Office (Destatis), Eurobank Research

Figure 11: ...but far milder than in Q2, as indicated by the rebound in auto sector new orders



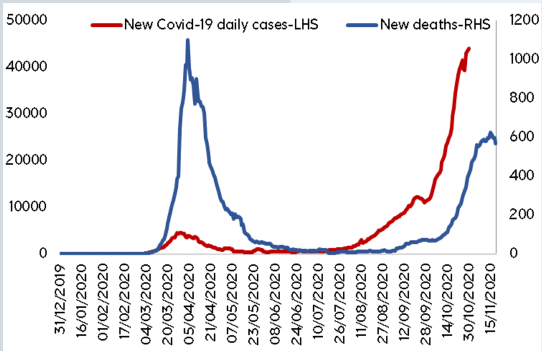
Source: Federal Statistical Office (Destatis), Eurobank Research

France

Gradual easing of restrictions ahead of the Christmas season

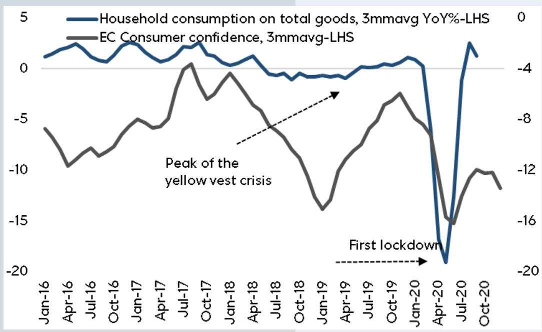
After a severe contraction of near 19.0% in H1 2020 compared to Q4 2019, GDP growth bounced back by a record 18.2%QoQ in Q3 2020, mainly driven by a pronounced improvement in both domestic and external demand. However, localized curfews in the second half of October, after the resurgence of Covid-19 cases and the imposition of a second lock-down on October 30, are set to have a major downward impact in economic activity in Q4, perhaps translating into a negative growth rate according to Finance Minister Bruno Le Maire, with the retail, leisure and hospitality sectors (that represent around 8.5% of the French economy) expected to be hit the hardest. Supporting the view for a hefty Q4 GDP decline, INSEE household confidence dropped by 4pts to a near two-year low of 90 in November, the INSEE business climate recorded a sharp drop of 11pts and returned to its June level of 79 over the same month, while the flash November Composite PMI fell further into contractionary territory, reaching a six-month low of 39.9 (-7.6pts), primarily due to France's large services sector, which bore the brunt of the new lockdown (-8.5pts to a six-month low of 38). These developments appear broadly in line with the INSEE's and Bank of France's estimate that the November economic activity was running 13% and 12%, respectively, below pre-virus levels, but still holding better than in April (first lockdown) when it dropped by 30%, as the latest restrictions are relatively looser, allowing for construction, manufacturing, schools and public administration to remain open. President Emmanuel Macron's announcement that lockdown measures would be eased gradually in three stages starting from November 28, perhaps in order to allow some reopening ahead of the Christmas season, should limit the size of the expected drop in Q4 GDP. Nevertheless, the hit to economic activity is still expected to remain sizable to c. -6.0%QoQ, leaving French GDP down between 9.0% and 10.0% for the whole year, before rebounding by around 6.0% in 2021, assuming no third wave in the early months of the year and an effective Covid-19 vaccine to be broadly available from around Q2 2021 onwards. Aiming to limit the expected decline in economic activity from the second Covid-19 wave, the government announced new support measures, worth around €20bn (to be used for the short-time work subsidy scheme, the small-company recovery fund and support the corporate sector), suggesting a wider budget deficit to around 11.3% this year and an increase in the debt-to-GDP ratio to near 120%.

Figure 12: New Covid-19 cases still above the 5k threshold President Macron has mentioned



Source: Oxford Covid-19 Government Response Tracker, Eurobank Research

Figure 13: Improving confidence will play a key role in boosting households' precautionary savings



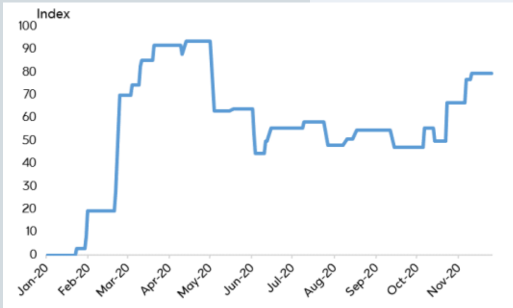
Source: INSEE, European Commission, Eurobank Research

Italy

GDP to contract again in Q4 amid renewed restrictions and a nationwide curfew, but manufacturing shows remarkable resilience

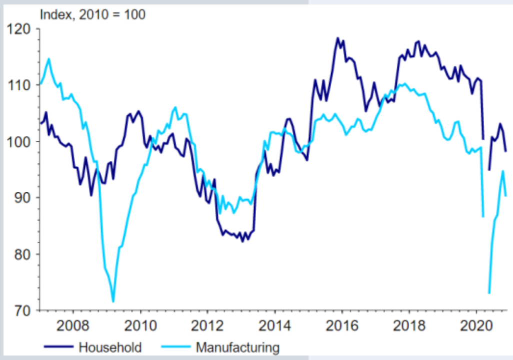
The downturn in the Italian services sector worsened in November, with the respective PMI falling to a 6-month low of 39.4 from 46.7 in October. Nevertheless, the PMI manufacturing survey signaled a fifth successive monthly improvement although the ongoing recovery lost some momentum, with the index declining to 51.5 from 53.8 in October. Like the PMI survey, the EC economic sentiment survey fell much less than in the spring, suggesting a less severe negative economic impact from the second lockdown. In particular, Italian economic sentiment fell 8.7pts to 81.5 in November, compared to a near-20pts decline in March to 83.7 and a further 20pts drop in May to 63.0. The EC survey reveals that the November hit was mainly concentrated in the services sector while the manufacturing sector showed remarkable resilience. As is the case with all euro area countries, the growth path in the following quarters will be largely dependent on the evolution of the Covid-19 pandemic. In Italy, a nationwide curfew between 10pm and 5am was introduced from 6 November until 4 December, while all regions have been split into three categories, 'red', 'amber' and 'yellow' depending on several criteria related to the Covid-19 infection rates. Looking past a large number of “red regions” that comprised ca. 50% of the Italian population, Calabria, Lombardy and Piedmont have been downgraded to “orange zones” on 29 November leaving Tuscany, Abruzzo, Campania, Valle d'Aosta, and the province of Bolzano still classified as “red zones”. Although not as stringent as in March/April, restrictive measures will take their toll on Q4 GDP growth. Nevertheless, the expected downturn will likely be less severe than previously envisaged, with countries like Italy that are more dependent on manufacturing, possibly outperforming their peers that are more service sector driven. For this reason, we have upgraded our 2020 GDP projection to -9.0% from -10.0%, previously, with a partial rebound expected in Q1 2021 amid a relaxation of the restrictive measures from December onwards. The distribution of the Covid-19 vaccine and the disbursements of the first tranches of the Recovery and Resilience Fund (RRF) are expected to stimulate economic activity in the second half of the year, boosting 2021 GDP growth to about 5.0%.

Figure 14: Italian Stringency Index increased but remains below March/April levels



Source: Oxford University, Bloomberg, Eurobank Research

Figure 15: Consumer and business confidence decelerated much less than in the spring

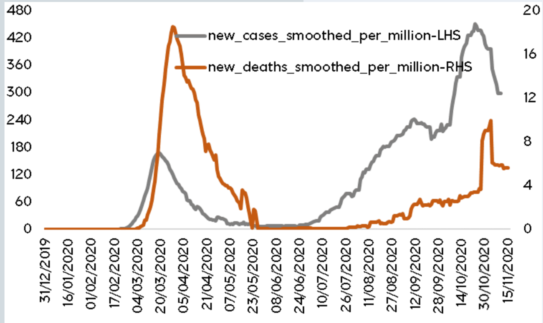


Source: Refinitiv Datastream, Fathom Consulting

Spain

Reliance on sectors worst affected by the pandemic points to renewed contraction in Q4

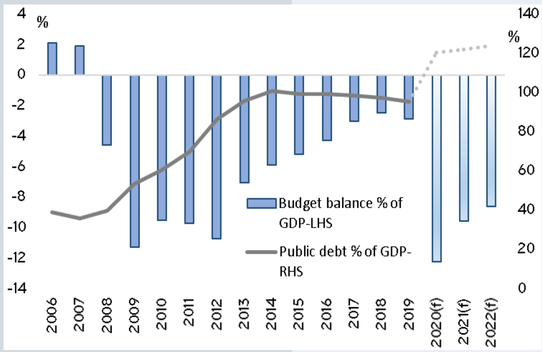
Figure 16: Second Covid-19 wave has prompted the reintroduction of strict measures



Source: Oxford Covid-19 Government Response Tracker, Eurobank Research

After a pronounced 22.1% drop in H1 2020 relative to Q4 2019, GDP growth rebounded sharply by 16.7%QoQ in Q3, thanks to pent-up demand and the fast resumption of economic activity after the end of the lockdown in June. However, looking at Q4, prospects for a sustained recovery have deteriorated, as reflected in the Composite PMI, which dropped deeper into contraction territory in October, after the second wave of the pandemic prompted the reintroduction of strict measures, largely decided by regional governments. However, due to Spain's heavy reliance on sectors worst affected by the pandemic, we expect negative GDP growth in Q4, and contraction of c. 12.0% for the whole year. Following the recent encouraging Covid-19 vaccine developments, the expected gradual easing of restrictions should pave the way for a gradual improvement in economic activity in early Q2 2021, while, baring a resurgence of virus cases, a stronger rebound is likely around the middle of next year, supported by improved weather conditions and the mass distribution of a Covid-19 vaccine (the government will start a comprehensive Covid-19 vaccination plan in Jan. 2021 and expects to have covered a "very substantial" part of its population by end-H1 2021). Meanwhile, the coalition government managed to reach a deal with small regional parties (Catalan parties ERC and PDeCAT, small left-wing Mas Pais) to pass the 2021 Budget, the first budget law to be approved by the Spanish Congress in three years as Spain has been rolling over its 2018 Budget, which was drafted by the previous conservative administration. On the fiscal front, based on its fiscal plan released in early October envisioning a GDP contraction of 11.2% in 2020 and a 7.2% rebound in 2021, the government projects a deficit of 11.7% this year and expects it to narrow modestly to c. -8.0% of GDP in 2021, as tax revenues are expected to remain low, reflecting large losses in 2020 economic activity. The government also anticipates public debt to shoot up to 118% in 2020 and rise further to 125% of GDP in 2021, while EU support should somewhat ease debt burden concerns, allowing for less national borrowing. Spain, one of the largest beneficiaries of the European Recovery Fund, has been allocated €140bn, out of which €73bn in the form of grants and the remainder €68bn in loans. Spain will also receive €21bn of loans from the SURE programme to cover the cost of the furlough schemes and €24bn of ESM pandemic loans to cover health spending related to the pandemic.

Figure 17: Dramatic deterioration in public finances



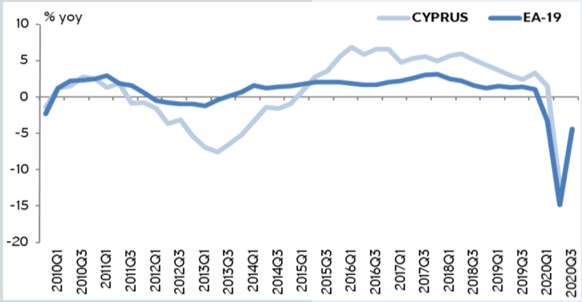
Source: Ameco, Eurobank Research

Cyprus

Third quarter's output performance surprised to the upside

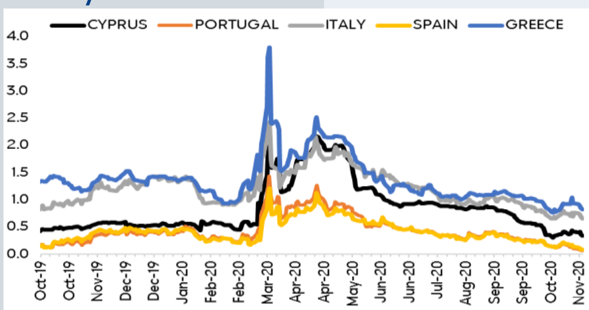
GDP on a seasonally adjusted basis rebounded by +9.4% QoQ in Q3 2020, which translates into -4.4% YoY compared to -12.1% YoY in Q2 2020, +1.5% YoY in Q1 2020, bringing GDP contraction at -5.1% YoY in 9M. Despite its sensitivity as a small, open and services-oriented with tourism making an important direct and indirect contribution, Cyprus is outperforming initial market and international organizations forecasts and euro area peers so far in FY2020. Only recently, the EC upgraded its GDP projection in FY2020 from -7.7% in July to -6.2% YoY in November. Accordingly, the Ministry of Finance forecast was revised to -5.5% YoY in 2020, while the 2021 budget forecast stands at +4.5% YoY. However, given the sharp deterioration in the epidemiological situation as of late Q3-early Q4, the downside risks to the outlook of 2021 have increased. Accordingly, the EC has downgraded its 2021 GDP forecast from 6.1% in May down to 5.25% in July and further to 3.7% in November. The recession turned out to be less severe than initially envisaged. First, the quick and sizeable and still ongoing financial support from the government and second the extensive use of banks loan moratoria. To mitigate the impact of the covid-19 crisis, the government has so far adopted a financial support package of 19.6% of 2019 GDP in fiscal measures (€1bn), government guarantees and liquidity support measures (€3.3bn), some of them extending until 2024. According to the latest EBA report, in June 2020 around half of the performing loans stock (as of December 2019) had been granted suspension of repayment, bringing Cyprus in the first place of the relevant EU ranking. Meanwhile, the picture from the latest high frequency indicators is illustrative of the challenges posed for the growth environment in Q4-2020. Retail sales in volume terms decreased on a monthly basis in September for a second consecutive month (-3.7% MoM vs. -5.6% MoM in August) despite the reopening of the economy. On an annual basis, retail sales contracted by -2.6% YoY in September, compared to -3.4% YoY in August and -0.1% YoY in July, bringing the 9M performance at -2.8% YoY. In addition, the economic sentiment indicator (ESI-CypERC) declined marginally by 0.5 points in November to 78.5 compared to 79.0 points in October. The monthly decrease resulted primarily from weaker business confidence in construction. The latter most probably stems from the abrupt termination of the Cyprus Investment Program (CIP). On top, consumer confidence retreated to the lowest level since April 2020.

Figure 18: Real GDP contraction on an annual basis in Q3 was in line with EA-19



Source: Eurostat, Eurobank Research

Figure 19: Long-term Cypriot government bond yields declined on ECB intervention



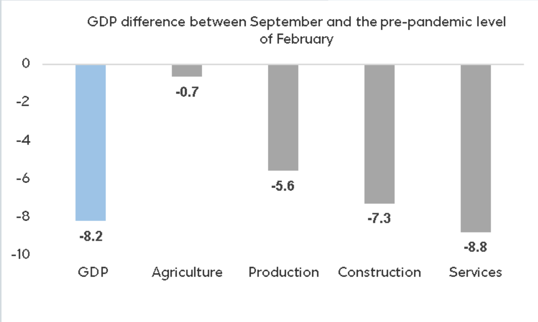
Source: Bloomberg, Eurobank Research

UK

Stricter restrictions to adversely impact Q4 GDP

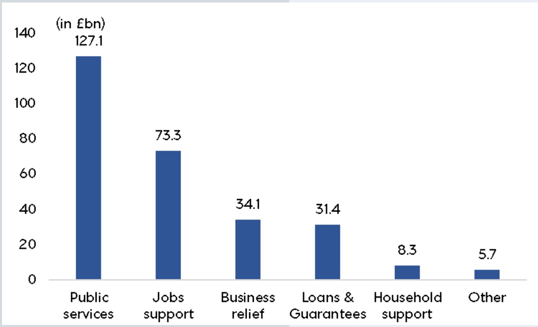
UK Prime Minister Boris Johnson announced that the national lockdown would end on 2 December and the country would return to a three-tier system of local restrictions, whereby more than 95% of the country's population would be in the tighter second and third tiers (in tier two, bans on indoor household mixing will apply, and pubs that do not serve food will be required to close, while tier three requires the closure of large parts of the consumer services sector, including hospitality and leisure). The new system, which will be revised every two weeks, will remain in place at least until April 2021, while the PM warned over the risk of another national lockdown early next year, if new cases rise sharply after Christmas (the government has announced a 5-day hiatus between 22 and 27 December). These measures, notably stricter than those imposed in November, will undoubtedly adversely impact Q4 GDP after a lower-than-expected 15.5%QoQ rebound in Q3, and should continue to weigh heavily on Q1 2021 GDP as they are expected to remain in place until April, at the earliest. Disappointing Q3 GDP rebound and stricter Covid-19 measures prompt us to revise lower our 2020 GDP projection to -11.3% from -10.0% previously. The economy is expected to start recovering around mid-2021, as sufficient immunization would allow a widespread easing of restrictions. On December 2, the UK became the first western country to approve a Covid-19 vaccine and the vaccination program is expected to begin over the coming days. Meanwhile, the Spending Review for 2021/2022 announced by Chancellor of the Exchequer Rishi Sunak, revealed further measures to support the economy during the second Covid-19 wave, with the focal point being a further £4bn for job support. The overall cost of the public support is estimated at £280bn this year (c. 11% of 2019 GDP), £88bn higher than initially estimated back in July (Figure 21). According to the Office for Budget Responsibility (OBR), on the assumption of an 11.3% GDP contraction this year (the largest drop in over 300 years), the combined impact of the pandemic on the economy and the government's fiscal policy response is expected to push the budget deficit to a post-war high of £394bn (19% of GDP), up from 2.5% in 2019, while public debt is projected to rise above 100% of GDP for the first time since 1960.

Figure 20: Disappointing Q3 GDP rebound leaves output still 8.2% below pre-pandemic levels



Source: ONS, Eurobank Research

Figure 21: Direct fiscal measures in response to Covid-19 have reached £280bn



Source: UK Office for Budget Responsibility (OBR), Eurobank Research

Bulgaria

GDP rebounds on a quarterly basis in Q3 mirroring the reopening of the economy

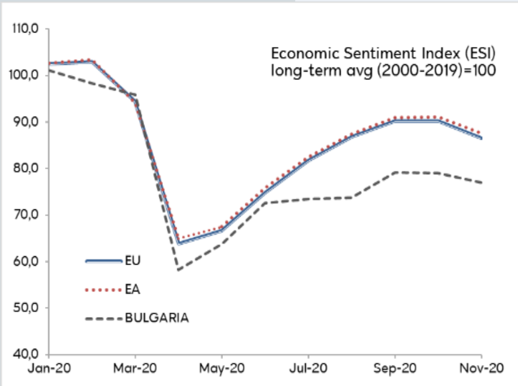
Bulgaria is no exception in the Covid-19 second wave, which is at play in the last two months in Europe and most parts of the world. Following the daily Covid-19 cases resurgence since October, the state of emergency has been extended by two more months, i.e. until January 2021 and additional social distancing measures, in order to prevent the spread of the virus, were put into force as of November 27 and will last until December 21, when the whole situation will be reassessed, hopefully towards a looser direction in view of the Christmas holidays. Authorities are currently pursuing a difficult balance between continuing economic activity and containing the pandemic, on the same lines as most countries. Just before the resurgence, GDP rebounded by +4.3%QoQ in Q3, compared to a -9.8%QoQ contraction in the previous quarter, albeit, on an annual basis, it continued to shrink by -5.2%YoY vs -8.2%YoY in Q2. More detailed data will be released on December 4. According to the EC's autumn economic forecasts (November 2020), the economy is expected to be heading towards a -5.1% contraction in 2020, before rebounding gradually by +2.6% in 2021. The respective forecasts in July stood at -7.0% for 2020 and +5.3% for 2021. Despite the overall GDP recessionary performance so far and the doubtful outlook for the last quarter of 2020, risks continue to remain broadly balanced, as the well-established fiscal discipline works as a buffer and thus a mitigating factor. That said, according to the Alert Mechanism Report for 2021, released by the EC in November, Bulgaria will not be subject to an in-depth analysis under the Macroeconomic Imbalances Procedure (MIP) given that the latest MIP report in February concluded that the country no longer experiences such imbalances. All the above are mirrored in the affirmation of the country's sovereign rating at BBB/A-2 by S&P inlate November with the outlook being kept stable. Regarding other recent important developments, Bulgaria refused to approve the European Union's membership negotiation framework for North Macedonia, blocking the official start of accession talks with the neighboring country. The rationale behind the veto lies, primarily, over historical and linguistic disputes.

Figure 22: Moderate sovereign credit risk is reflected in all recent ratings with stable outlook...

Agency	Evaluation	Action	Rating	Outlook
S&P	Nov-20	Affirmation	BBB/A-2	Stable
Moody's	Oct-20	Upgrade	Baa1	Stable
Fitch	Aug-20	Affirmation	BBB	Stable

Source: S&P, Moody's, Fitch, Eurobank Research

Figure 23: ...but economic sentiment lags sizably form the EU & EA average..



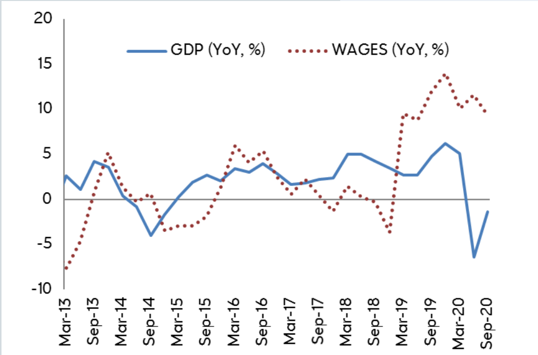
Source: Eurostat, Eurobank Research

Serbia

Economic activity is backed by ample fiscal support, albeit with alarming increase in public debt levels.

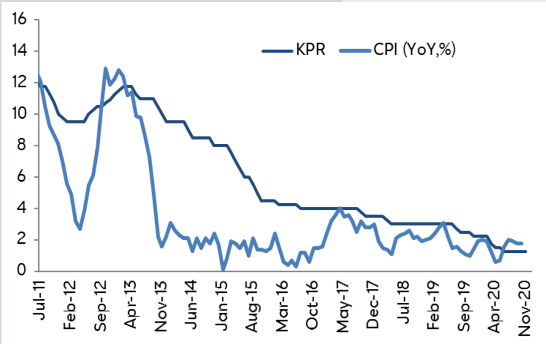
The second Q3 2020 GDP growth print came in at -1.4%YoY and +7.4%QoQ compared to -6.3%YoY and -9.3%QoQ in Q2, bringing the year to Q3 performance at -0.8% YoY. The recovery was broadly in line with the trajectory of high frequency hard data such as industrial production and retail sales throughout the third quarter of the year, albeit, October's respective figures point to some loss of momentum. As shown from the Q3 GDP print, while exports remained sluggish (-8.5% YoY in Q3 vs -20.5% YoY in Q2), domestic demand pointed signs of recovery as private consumption and investments may have continued to decline for a second quarter in a row but with evident signs of bottoming out (-0.9% YoY in Q3 from -8.2%YoY in Q2 and -5.5%YoY in Q3 from -12.9%YoY in Q2 respectively). The GDP performance is broadly backed by the buoyant public spending in flux. Specifically, the fiscal budget second review bill for 2020 was comfortably passed through the Parliament in November, envisaging, as broadly anticipated, a -8.8% of projected GDP deficit, which is twice as large compared to the previous targeted 2020 deficit in April. The revision came after the recent positively revised 2020 GDP recession forecast from -1.8% to -1.0% by the Ministry of Finance, which was, in sequence, verified by the NBS as well. In the November's Inflation Report, the Central Bank revised upwards the GDP recession forecast for 2020 from -1.5% to -1.0% while anticipating that the GDP growth rebound in 2021 will stand somewhere close to 6.0%. The fiscal support will be continued in 2021, albeit at more prudent levels, as the government endorsed a -3% of GDP deficit target for 2021. Along these lines, the Ministry of Finance raised USD1.2bn through a 10-year Eurobond, from the proceeds of which USD0.9bn will be directed to the partial buyback of the USD1.6bn Eurobond issued in 2011 that matures in September 2021, saving that way next year's interest payments and thus reducing total financing needs in 2021. Following the new Eurobond issuance, public debt has approached 60% of GDP, which is considered an upper limit by the Fiscal Council of the country.

Figure 24: GDP rebounds sizably in Q3 amid firm labor market conditions…



Source: European Commission, Eurobank Research

Figure 25: …and lack of inflationary pressures



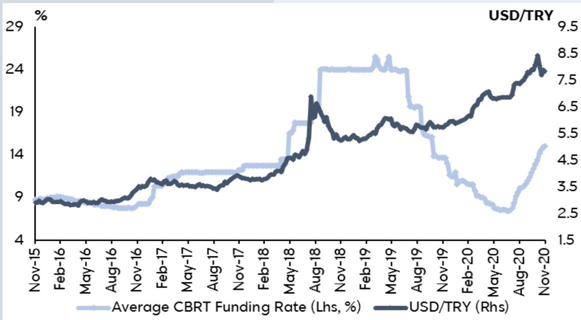
Source: Eurostat, Eurobank Research

Turkey

Change of leadership in key economic posts drivers market sentiment shift

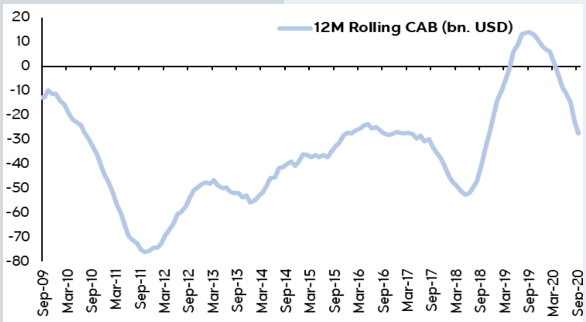
The market sentiment has shifted significantly across Turkish assets over the past month. Having plunged to an all-time low of 8.52/$ on November 7, the lira rebounded strongly as much as 7.53/$ on November 19 and then bounced back again ending the month at 7.84/$. The dismissal of the Governor of the Central Bank Murat Uysal after just 16 months in the post and the resignation of the Finance Minister Berat Albayrak, son-in-law of President Erdogan, were a twin shock to market participants. The change of leadership in both the Central Bank and the Ministry of Finance and the subsequent rhetoric change thereafter by their successors contributed the most in that shift. To that end, the CBRT under the leadership of the newly appointed Naci Agbal delivered on the market's expectations for a sizeable interest rate increase in late November. The CBRT increased its key policy rate (KPR)- the 1 week repo rate - by 475bps to 15.0%. More importantly, in the statement released afterwards, it simplified its monetary policy framework by switching to single rate funding instead of the effective funding rate (EFR), a weighted average of four CBRT facilities. The latter represents a significant step towards orthodox policies, increasing predictability and transparency. At the same time, CBRT emphasized its commitment to bringing inflation down. We have long argued that so far the policy mix has been overly concentrated in providing additional support to growth. The aggressive monetary policy stance had pushed real interest rates into deep negative territory, stoking concerns for the lira and for a resurgence in inflation at a later stage. In our view, the interest hike is a first step in the right direction to restore credibility, address financial stability risks but also attract portfolio inflows to finance the current account deficit and restore the relatively low, by any metric, FX reserves capacity of CBRT. Nevertheless, in order to succeed from a medium-term perspective, it also needs to be accompanied by a more conventional free markets oriented economic policy. The first signs from the newly appointed Minister of Finance, Mr. Lutfi Elvan are very promising. He vowed to implement market-friendly changes and improve the investment environment for international and domestic entrepreneurs, while using all tools to tackle inflation. Moreover, he added that strengthening institutions was important, and fiscal discipline would be maintained through realistic risk management.

Figure 26: Lira rebounded strongly in November upon the change of leadership in key posts



Source: Bloomberg, Eurobank Research

Figure 27: Macroeconomic imbalances have been unwinding rapidly in 2018-20



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)		
	2019	2020f	2021f	2019	2020f	2021f	2019	2020f	2021f	2019	2020f	2021f	2019	2020f	2021f
World	2.8	-3.8	5.0	3.5	2.6	2.7									
Advanced Economies															
USA	2.2	-3.8	3.8	1.8	1.2	2.0	3.7	8.2	6.5	-2.2	-2.3	-2.3	-6.3	-16.5	-9.5
Eurozone	1.3	-7.5	4.8	1.2	0.3	1.0	7.6	8.0	9.0	2.3	2.0	2.3	-0.6	-9.0	-6.0
Germany	0.6	-5.6	3.6	1.4	0.5	1.3	3.2	4.0	4.0	7.6	6.2	6.6	1.4	-6.2	-4.0
France	1.3	-9.4	5.8	1.3	0.5	0.8	9.2	8.5	10.5	-0.8	-1.7	-3.0	-2.8	-11.3	-7.8
Periphery															
Cyprus	3.2	-6.5	4.0	0.5	-1.0	1.0	7.1	8.0	7.5	-7.1	-10.0	-9.0	2.8	-4.5	-2.0
Italy	0.3	-9.0	5.1	0.6	-0.2	0.4	9.9	9.5	11.4	2.7	2.6	2.7	-1.6	-11.4	-7.0
Spain	2.0	-11.8	5.8	0.8	-0.3	0.8	14.1	16.7	17.7	2.0	1.6	2.2	-2.8	-11.7	-8.0
Portugal	2.2	-9.0	5.0	0.3	-0.1	0.6	6.5	8.0	8.4	-2.0	-0.9	-0.5	-0.3	-7.8	-4.2
UK	1.4	-11.3	3.5	1.8	0.9	1.8	3.8	5.0	7.0	-4.3	-3.1	-3.2	-2.5	-16.0	-9.5
Japan	0.7	-5.4	2.6	0.6	-0.1	0.0	2.4	2.9	3.1	3.6	2.8	3.1	-3.9	-13.0	-7.5
Emerging Economies															
BRICs															
Brazil	1.1	-4.8	3.5	3.7	3.1	3.3	14.0	13.9	13.7	-2.7	-0.5	-1.4	-1.7	-15.8	-7.5
China	6.1	2.0	7.5	2.8	2.8	2.1	3.6	4.0	3.8	1.2	1.3	1.0	-4.9	-6.4	-5.3
India	6.1	-8.8	8.5	3.7	5.5	4.2		*NA*		-0.9	0.9	-0.9	-0.2	-8.0	-6.4
Russia	1.3	-4.0	3.0	4.5	3.6	3.3	4.6	5.8	5.5	4.8	1.5	2.0	1.5	-2.5	-1.5
CESEE															
Bulgaria	3.4	-5.0	4.0	2.5	1.5	2.0	4.2	5.8	5.5	4.0	2.0	3.0	-1.0	-4.1	-2.5
Romania	4.1	-5.5	4.0	3.8	2.8	3.3	3.9	5.5	5.0	-4.6	-5.5	-4.0	-4.1	-9.0	-5.0
Serbia	4.8	-1.5	4.5	2.2	1.3	1.5	13.1	12.0	11.0	-5.8	-5.5	-5.0	0.2	-7.5	-2.0
Turkey	0.9	-3.5	4.5	15.2	12.5	12.0	13.8	15.5	15.0	1.1	-4.5	-1.5	-3.0	-7.0	-4.0

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

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Eurobank Fixed Income Forecasts

	Current	December 2020	March 2021	June 2021	September 2021
USA					
Fed Funds Rate	0.00-0.25%	0.00-0.25%	0.00-0.25%	0.00-0.25%	0.00-0.25%
1 m Libor	0.15%	0.17%	0.18%	0.19%	0.20%
3m Libor	0.23%	0.26%	0.27%	0.29%	0.31%
2yr Notes	0.16%	0.19%	0.23%	0.26%	0.30%
10 yr Bonds	0.92%	0.85%	0.93%	1.01%	1.10%
Eurozone					
Refi Rate	0.00%	0.00%	0.00%	0.00%	0.00%
3m Euribor	-0.52%	-0.49%	-0.48%	-0.47%	-0.46%
2yr Bunds	-0.72%	-0.72%	-0.67%	-0.64%	-0.62%
10yr Bunds	-0.53%	-0.52%	-0.47%	-0.40%	-0.32%
UK					
Repo Rate	0.10%	0.10%	0.10%	0.10%	0.15%
3m	0.04%	0.09%	0.11%	0.12%	0.13%
10-yr Gilt	0.33%	0.19%	0.20%	0.27%	0.35%
Switzerland					
3m Libor Target	-0.78%	-0.72%	-0.71%	-0.71%	-0.71%
10-yr Bond	-0.54%	-0.53%	-0.50%	-0.45%	-0.42%

Source: Bloomberg (market implied forecasts)

Eurobank

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