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Eurobank Research

GLOBAL & REGIONAL MONTHLY

Q3 GDP data confirmed the expected global economic recovery, but the reintroduction of lockdowns in major economies could pose significant downside risks to growth in Q4. Overall, we expect a global GDP contraction of -3.8% in 2020 before recovering by 5.0% in 2021, as emerging market economies - excluding China - are likely to register greater loss of output over 2020 than previously projected. October was a rather tough month for risk assets. Since its record high in early September, the MSCI Global Index has experienced greater volatility, while an attempt at a new high in mid-October was eroded by the resurgence in Covid-19 infections around the world, particularly in the Eurozone and the UK.

Macro Picture

USA: Following the Q3 GDP bounce-back, significant momentum seems to pass on to Q4

EA: Strong Q3 rebound but resurgence in Covid-19 cases lead to "lockdown lite" regimes in Q4

UK: Second-wave partial lockdown imparts large downside risks to Q4 GDP

EM: Covid-19 second-wave in many EMs weighs on their already complicated economic outlook

CESEE: Second wave prompts tighter sanitary measures & restrictions, putting pressure on the economic activity in Q4

Markets

FX: USD range bound with short term support from US election outcome. GBP surprisingly strong despite Brexit negotiation delays and lockdown

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

EM: Spreads tighter overall with idiosyncratic exemptions. Potential US election result of split government could support the asset class

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

Policy Outlook

USA: Fed's commitment to zero rates; QE pace tied to economic developments

EA: ECB committed to ease further in December, likely via extending/expanding PEPP/QE

UK: Risks for further BoE policy stimulus if the partial lockdown lasts longer than currently scheduled

CESEE: Second wave may put pressure on policymakers for additional stimulus

Key Downside Risks

Covid-19 burden pushes healthcare system capacity close to exhaustion: Governments might be forced to extend/escalate the tighter measures/lockdowns introduced recently

Delayed outcome of US elections: Increased risk-off sentiment may lead to increased EM outflows through a possible assets sell-off

Escalation of US/China tensions: New tariffs, cancellation of the Phase I trade agreement

Special Topics in this issue

- Strong investor interest for the first SURE transaction

- Further monetary policy easing expected by the ECB in December

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Contents

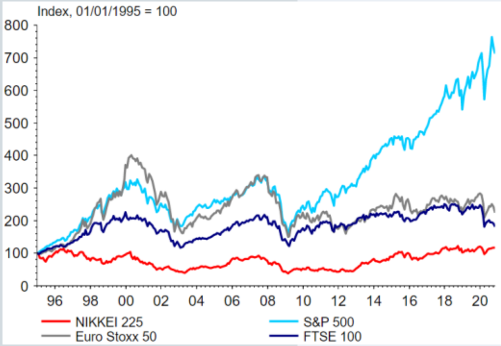
Macro Views

Latest Macroeconomic Developments & Outlook

World Economic Outlook

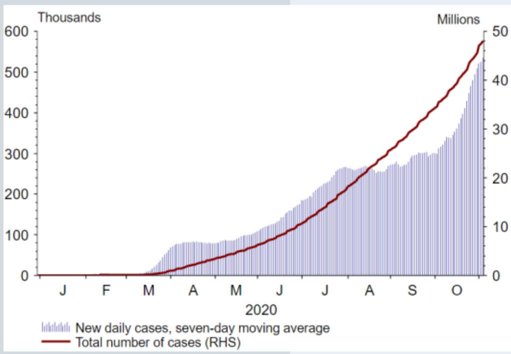
October was a rather tough month for global equity markets, with the S&P500 index recording monthly losses of ca. 2.8%. US equity indices have historically had a negative performance in October in US Presidential Election years, but the slump in the US equity market in the past week (S&P500 index ca. -5.6%) was the worst compared to any pre-election week since 1928. Since its record high of 2,494.1 pts on 2 September 2020, the MSCI Global Index has experienced greater volatility, and an attempt at a new high in mid-October was eroded by the resurgence in Covid-19 confirmed infections in the major economies and renewed lockdown measures, particularly in the Eurozone and the UK. Although strong Q3 GDP data releases confirmed the recovery of the world economy over the summer amid a return to 'normalcy', most economies never returned to pre-Covid-19 activity levels. Meanwhile, the reintroduction of restrictive measures and partial lockdowns for November, in response to the untamed virus resurgence of new Covid-19 cases across Europe, could weigh heavily on confidence, particularly in the service sector, and cause the euro area GDP to fall into contractionary territory again in Q4. A second wave of coronavirus is also evident in the US, but the strong underlying momentum suggests that the deceleration expected in Q4 will likely be less severe. Looking ahead, the 2020 US election could have important implications for the economic outlook. The US Presidential Election race seems to be tighter than the opinion polls and model predictions had suggested. The final election outcome remains too close to call, although at the time of writing appears headed towards a Democrat victory and a divided Congress, with Republicans retaining control of the Senate and Democrats holding majority in the House of Representatives. Nevertheless, the clear election result may not be known for some time as Donald Trump's team has called for recounts and filed lawsuits, laying ground for a contested election outcome, so uncertainty could last for days weighing on investor sentiment in the near term. A progressive "Blue Sweep" outcome, in which Joe Biden wins the presidency and Democrats take control of the Senate that would provide the most fiscal stimulus to the economy in 2021 pushing up growth and inflation expectations, seems unlikely

Figure 1: Equities in local currency



Source: Refinitiv Datastream, Fathom Consulting

Figure 2: Global confirmed Covid-19 cases on the rise



Source: Refinitiv Datastream, Fathom Consulting at the moment. In any case, significant fiscal expansion is required so as to support personal income and spending, otherwise the fiscal impulse could turn negative in terms of its impact on GDP. Major central banks, including the Fed and the ECB, are urging greater use of fiscal policy, but governments should address the challenge of the rising trend in government debt levels and budget deficits. Global debt-to-GDP ratio is currently at a record high and continued fiscal expansion will highlight potential fiscal constraints. Turning to emerging markets, Northeast Asia's economies should continue to lead the global economic recovery, with China being the only major economy to enjoy positive GDP growth this year amid enhanced credit expansion and targeted fiscal measures. Overall, we have updated downwards our global growth projection for 2020, expecting a GDP contraction of 3.8% before recovering by 5.0% in 2021, as emerging market economies - excluding China - are likely to record greater loss of output over 2020 than previously projected.

Developed Economies

US: Q3 real GDP advanced by 33.1%QoQ saar, the largest increase on record, following a 31.4% drop in Q2 due to the imposition of stay-at-home orders. The economic rebound was driven mainly by consumer spending and business fixed investment on the back of the government's pandemic assistance programs that supported household incomes. Following the stronger-than-expected GDP bounce in Q3, and the most recent economic data for personal income, consumption, trade and inventories suggesting that activity carried significant momentum into Q4, we have revised upwards our 2020 GDP growth projection to -4.5% from -5.0%, previously, with further fiscal stimulus and a zero-rates Fed policy to create a positive backdrop for the economic outlook. Nevertheless, downside risks to activity could arise from worsening Covid-19 trends and/or a breakdown in fiscal stimulus talks. Having enhanced its forward guidance in September, the Fed is not expected to make any material announcement in the near future, possibly awaiting more clarity on the post-election fiscal policy picture before committing to any policy changes.

Euro area: Economic activity rebounded by a stronger-than-expected pace of 12.7%QoQ, following the largest fall on record of 11.7%QoQ in Q2, leaving the euro area GDP -4.3% below pre-crisis levels; while the Big 3 - France, Italy and Germany - are closer to normal levels (all at ca. -4.0%), economic activity in Spain is currently severely behind (-9.0% relative to pre-pandemic levels). Although the second wave of the Covid-19 pandemic and renewed local containment measures across Europe bring downside risks in Q4, hitting particularly a subset of service sector activities and, hence, pointing to a contraction in economic activity, we maintain our 2020 EA GDP growth projection at -8.0% as the better-than-expected Q3 performance is a hopeful sign that the economy will be able to rebound from lockdown if effectively supported by expansionary fiscal and monetary policies. The uncertainty surrounding our forecast looms large, given the possibility of stricter containment measures and longer-lasting lockdowns that could lead to a negative GDP growth in Q1 2021 and, hence, push the economy into a double-dip recession.

EMU periphery: Following the unprecedented Q2 GDP decline in the two largest Southern European economies, Italy and Spain, which had been the most affected EA countries by the first wave of the Covid-19 pandemic, economic activity bounced back strongly in Q3 rising by a higher-than-expected pace of 16.1%QoQ and 16.7%QoQ, respectively, supported by the gradual lifting of the first-wave restrictions and pent-up demand. However, although activity recovered during the summer, governments in both countries were forced to escalate their policy response to the pandemic, as a reaction to the untamed virus resurgence of new Covid-19 cases, with strict limitations to the hospitality/entertainment businesses and additional constraints to personal mobility in order to timely flatten the curve ahead of the Christmas season. Stricter measures imply that the recovery will be stalling in Q4 2020, with the anticipated slowdown likely to be more pronounced in Spain, the epicentre of Europe's Covid-19 second wave, 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/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. Although we acknowledge that risks are skewed to the downside, stemming from the epidemiological circumstances, at this stage, we stick to our forecast for 2020 GDP contraction of -10.0% and -11.6% in Italy and Spain respectively, as the expected Q4 negative print is likely to be offset by the firmer-than-expected Q3 GDP rebound in both countries.

Emerging Economies

BRIC: In October's World Economic Outlook (WEO), the IMF affirmed Brazil's GDP contraction forecast of -5.8% for 2020 and its rebound by +2.8% in 2021, as cited in the Article IV Concluding Statement released in October too, a few days prior to WEO. The aforementioned latest forecasts by the Fund were revised significantly compared to those published in June. 2020's projection was improved by 3.3ppts from a -9.1% economic recession previously while 2021's forecast was shaved by 0.8p down from +3.6% in June. Moving on to Russia, 2020 GDP contraction is now projected at -4.5% in WEO up from -5.5% in the previous outlook in April. Earlier in October, on the same tone, the EBRD maintained its 2020 GDP contraction forecast at -4.5%. The IMF expects GDP to rebound by +2.8% in 2021, which is lower than its +3.5% forecast in spring. The outlook in India has worsened significantly with the IMF's 2020 forecast lowered by 5.8ppts to -10.3% in FY2020-21, given the country's domestic demand plunge with a strong rebound by 8.8% expected in FY2021-22. The gloomy outlook is confirmed by the World Bank (WB) as well with the latter anticipating, in its latest South Asia Economic report, a -9.6% economic contraction in FY2020-21, following a +4.2% growth in FY2019-20. China remains an outlier not only in the BRIC group but at a global level. Both the IMF and the WB continue to anticipate positive GDP growth at 1.9% and 2.0% in 2020 respectively.

CESEE: As of early November, five months after the initial re-opening of their economies, the epidemiological situation in many countries of the Central, Eastern and South-eastern Europe (CESEE) region has worsened. During the past weeks, many of them have been confronted with a sharp rise in infections, hospitalizations and fatalities related to the Covid-19 pandemic, raising fears that the "second wave" has been in full force. The resurgence of infections across the CESEE region prompts governments to adopt tighter measures, which put pressure on the economic activity in Q4 and cast more doubt on the rebound prospects of 2021. It was only a matter of time before the aggravation of the epidemiological situation was reflected in the pace of improvement of sentiment indicators. The second wave of infections will most probably put a break on the pace of recovery, raise new challenges for the last quarter especially for the services sectors and keep politicians and policymakers under pressure for more stimulus.

Special Topic

Strong investor interest for the first SURE transaction

One of the major credit events that lured market attention in October was the successful launch of social bonds issuance under the SURE programme. Specifically, on October 20, the EU issued a EUR 17bn dual tranche social bond, the highest amount ever borrowed in the history of the EU, split over two distinct tenors: EUR10bn with a maturity of 10 years and EUR7bn with a maturity of 20 years. The deal gathered a record order book of more than EUR 233bn, an amount more than twice the maximum amount of the entire SURE programme, driving the overall cover ratio to 13.7x (more than EUR145bn for the 10-yr bond, also a record high for a single European bond tranche, and more than EUR88bn for the 20-yr bond). Fund managers were the largest investor group, but demand by Central Banks and official institutions was also very strong, with insurance companies and pension funds having a stronger focus on the 20-yr tranche. Reflecting the high level of interest, the terms for both bonds were particularly attractive, with the 10-year bond being priced at 3bps above mid-swaps and the 20-year bond at 14bps over mid-swaps. In the following lines, we summarize the key characteristics of the programme and we attempt to explain the reasons behind the robust market interest in SURE bonds.

- ✓ **"What's for SURE?"**

The SURE programme is part of the EU's European Recovery and Resilience Facility, engineered to combat the Covid-19 pandemic economic consequences (Table 1). It was presented in public on May 27 as part of the European Commission's (EC) major and sustainable recovery plan, reaching the unprecedented amount of EUR2.39trn, which corresponds to c. 17% of 2019 EU-GDP.

Table 1: Budget for European Recovery & Resilience

Next Generation Fund 2021-2023	EUR750bn
Multi Annual Financial Framework 2021-2027	EUR1,100bn
EIB Financing for SMEs	EUR200bn
ESM Pandemic Crisis Support	EUR240bn
SURE PROGRAMME	EUR100bn
Total Amount	**EUR2,39trn**

Sources: European Commission, Eurobank Research

As shown in the timeline below (Figure x), the European Instrument for temporary **S**upport to mitigate **U**nemployment **R**isks in an **E**mergency (SURE) was proposed by the European Commission in April, approved by the European Council in May and put in effect in October. The program aims to help the Member States cover the costs of shielding jobs and take other similar measures, particularly for the self-employed, in order to alleviate the impact of the pandemic on unemployment, and thus public health and society. It amounts to EUR100bn loans towards EU Member states so as for the latter to adopt and cover the cost of national Short-Time Work (STW) schemes[1] and compensate the self-employed.

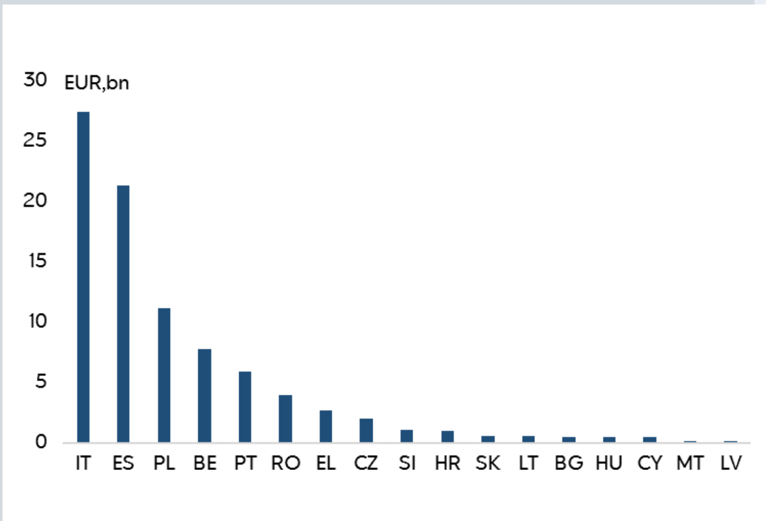
All 27 EU Member States are eligible for SURE loans. So far, 17 Member States have applied for support reaching EUR 87.8bn and 3 of them (Spain, Italy Poland) have received in total EUR 17mn (Figure 3). All countries with funding costs above the EU's (currently at around 0%) are expected to request access. That means, for countries including Italy, Spain and Portugal, SURE loans represent a cheaper channel of funding, while countries such as Germany and the Netherlands would not be better off should they make use of the programme. In absolute terms, the biggest beneficiaries are Italy (EUR27.4bn), Spain (EUR21.3bn), Poland (EUR11.2bn), Belgium (EUR7.8bn) and Greece (EUR2.7bn), with the first three having already received the first loans, at the auction held on October 20. The EU aims to complete its SURE funding by mid-2021. (Table 2).

Table 2: SURE amounts drawdown cascade

Total SURE Budget in 2020 and 2021	EUR100bn
Scheduled amounts to be issued in 2020	EUR30bn
Already issued amounts in 2020 on 20 October	EUR17bn
Scheduled amounts to be issued in 2021	EUR70bn
Remaining funds for 2020 and 2021	EUR83bn

Sources: European Commission, Eurobank Research

Figure 3: SURE amounts per country



Sources: European Commission, Eurobank Research

- ✓ **Mechanics and Technical Characteristics**

The EC, under the EU as a triple "AAA"- rated by all agencies supranational issuer, issues EU bonds in international capital markets and uses the proceeds for back-to-back lending to Member States, and then

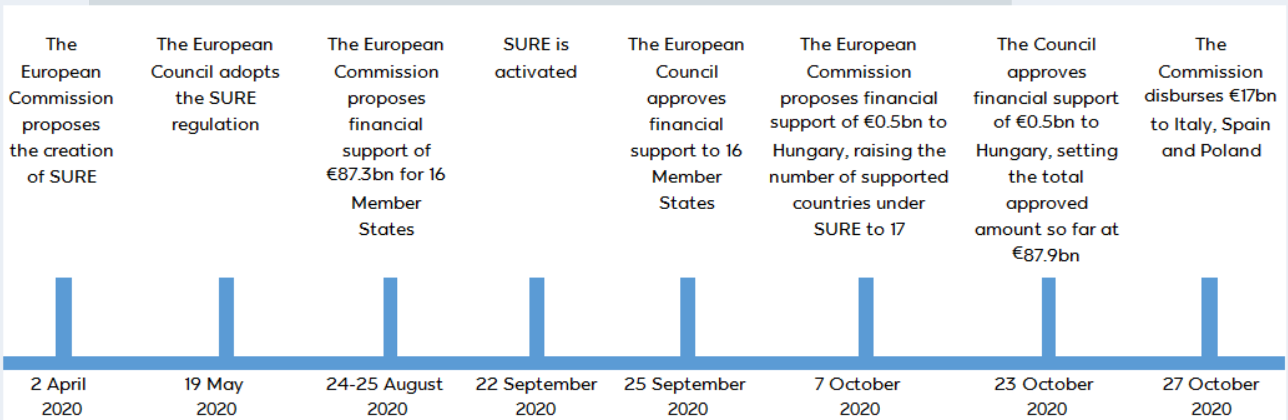
[1] Short-time work (STW) schemes are defined in a 2020 European Commission regulation proposal as 'public programmes that allow firms experiencing economic difficulties to temporarily reduce the hours worked while providing their employees with income support from the State for the hours not worked'.

transfers the funds directly to the borrowing country through a loan of the same maturity as the bond issued by the EU. As a result, the EU does not carry interest rate risk, as the cost of the bonds is passed on to the borrowing country. The bonds are denominated in EUR and have maturities ranging from 3 to 30 years, while the loans to any Member State will have a maximum average maturity of 15 years. Therefore, at any time, and leaving aside the first issuance, the weighted average maturity of the outstanding amount of SURE bonds must not exceed 15 years. To protect the EU's AAA rating, loans granted under the SURE programme are guaranteed by the EU Budget but also an additional €25bn of guarantees by Member States [each Member State's contribution to the overall amount of the guarantee corresponds to its relative share in the total EU gross national income (GNI). Therefore, if a Member State fails to repay its SURE loan on time, the EU will be able to use these extra guarantees first. The period of financial assistance will be 18 months and the assistance will be disbursed in maximum 8-10 instalments, depending on the size of the loans (the maximum number of 10 instalments will apply to loans higher than €10bn). The country receiving the loan will also pay the cost of funding of the EU for each instalment plus any fees, costs and expenses. The sole conditionality for a Member State having access to the SURE facility is the use of the resources exclusively to finance short-term work schemes and similar measures. Approval requires only a qualified majority in the European Council.

✓ **SURE bonds and reasons explaining strong investor interest**

SURE bonds will be used as social bonds with their proceeds designated to finance programmes with a positive social impact. To that end, SURE bonds are aligned with the four components of the Social Bond Principles (the use of proceeds, selection of projects, management of proceeds and reporting) established by the International Capital Market Association (ICMA). That said, the "social bond" character of SURE bonds was a key reason behind the success of the first issuance in October, as it helped to attract investors who wish to assist EU Member States in supporting employment through these difficult times. Another factor boosting demand was the substantially higher offered yield compared to those offered by safe-haven German bonds, which have very similar credit ratings. Potential ECB demand in the secondary market also favored.

Figure 4: From proposal to the issuance of the first SURE bonds



Sources: European Commission, Eurobank Research

Global Macro Themes & Implications

ECB firmly committed to recalibrate its instruments and deliver a comprehensive package in December aimed at supporting the economy

As widely expected, the ECB Governing Council (GC) left all monetary policy parameters unchanged at the 29 October meeting, leaving the Pandemic Emergency Purchase Programme (PEPP) envelope untouched at €1,350bn and reiterating that net asset purchases under the PEPP will be conducted until at least the end of June 2021 and reinvestment until at least end-2022. The GC also maintained the key policy rates unchanged, and repeated its commitment to keep rates at current or lower levels until the inflation outlook robustly and consistently converges to a level sufficiently close to, but below, 2%.

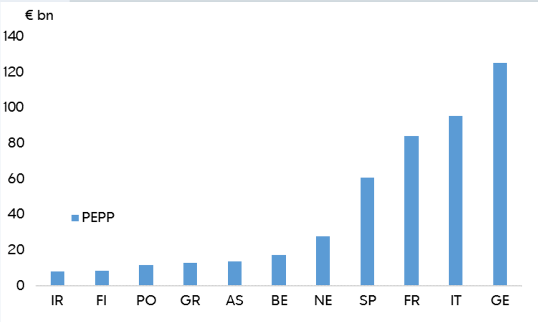
ECB officials highlighted that the current environment of risks is clearly tilted to the downside, given the resurgence of the Covid-19 pandemic. New containment measures announced by most euro area governments are likely to weigh on the economic outlook, with the Introductory Statement noting that the recovery "is losing momentum" instead of the "strong rebound" in activity mentioned at the September meeting. On the inflation front, according to the GC, the medium-term outlook remains subdued on the back of low energy prices and muted underlying price pressures amid weak demand, particularly in the tourism and transport sector, while temporary factors will likely keep inflation into contractionary territory until early 2021.

In an unusual introduction in the decision statement, the ECB signaled that additional monetary policy easing will be provided at the December meeting in view of the updated macroeconomic projections, stating that it "will recalibrate its instruments, as appropriate, to respond to the unfolding [Covid-19] situation and to ensure that financing conditions remain favourable to support the economic recovery and counteract the negative impact of the pandemic on the projected inflation path". ECB President Christine Lagarde reported unanimous agreement on the need for re-calibration based on an in-depth re-assessment of the incoming information, including the evolution of the pandemic, prospects for a safe and effective Covid-19 vaccine and developments in the exchange rate.

The growth and inflation outlook in the euro area should warrant a strong policy response by the ECB in December. President Lagarde highlighted the effectiveness of the PEPP and TLTRO-III in supporting the economy, suggesting that an extension of the existing programmes could be announced at the December meeting, without however ruling out other policy measures. Currently, there is still more than half of the PEPP available, given that as of 30 October ca. €628bn of the current €1,350bn envelope have been used so far, €62bn of which in October. As is evident in Figure 6, weekly PEPP purchases currently stand at low levels compared to the Mar-May and the Jun-Jul periods, with the average pace of purchases over the past four weeks at about €14bn and purchases for the week commencing October 26 at roughly €11bn, the lowest level since the beginning of the programme.

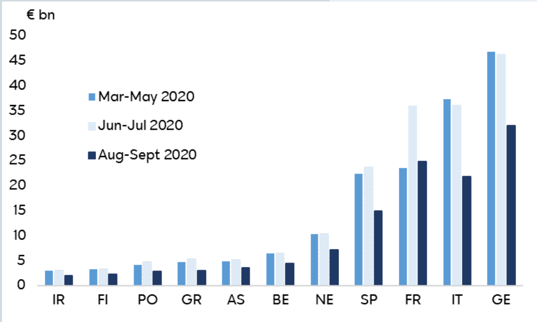
Following the resurgence in Covid-19 infection rates across Europe, and the subsequent expansionary fiscal policy to contain the economic impact of the new restrictive measures, more monetary policy stimulus is needed in order to prevent a potential tightening in financial conditions and a rise in borrowing costs, especially in an environment of higher fiscal deficits. We share the view that PEPP is the ECB's preferred policy tool in the short-term, and anticipate a six-month extension of PEPP net purchases and reinvestment until at least the end of 2021 and mid-2023, respectively. The PEPP envelope could increase by about €400-500bn, and be accompanied by an increase in the monthly pace of its APP programme, especially since the temporary €120bn envelope ends in December. Although a further rate cut seems less likely at the moment, as negative rates have started to hurt household lending, we cannot fully rule out this possibility as part of a comprehensive response package in case there is a sudden and sharp drop in inflation expectations or a strong EUR appreciation.

Figure 5: Cumulative Public Sector Purchases (as at end September 2020)



Source: ECB, Eurobank Research

Figure 6: Net purchases by country under the PEPP



Source: ECB, Eurobank Research

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Macro Themes & Implications in CESEE

The resurgence of infections across the CESEE region prompts governments to adopt tighter measures, which put pressure on the economic activity in Q4 and cast more doubt on the rebound prospects of 2021

As of early November, five months after the initial re-opening of their economies, the epidemiological situation in many countries of the Central, Eastern and South-eastern Europe (CESEE) region has worsened. During the past weeks, many of them have been confronted with a sharp rise in infections, hospitalizations and fatalities related to the Covid-19 pandemic, raising fears that the "second wave" is in full force. However, the picture is not homogeneous across countries. In any case, overall, the worsening of the epidemiological situation has prompted governments to reinstate tighter sanitary measures and restrictions on public and economic activities.

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. Upon the renewed rise of infections in late August, governments more mildly than in the first phase taking less strict and more localized measures. The high economic and social cost of a second lock-down given the output losses incurred in Q2 – the economies across the region recorded historic output contractions in Q2 – in most cases deterred governments from taking draconian measures at the expense of putting more strain on the domestic public health systems. However, if things keep deteriorating, more drastic measures cannot be ruled out in the coming months.

It was only a matter of time before the aggravation of the epidemiological situation was reflected in the pace of improvement of high frequency indicators. 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 continued their rebound in the last three or four months. However, the pace of improvement in economic sentiment has not only stalled in September but in some cases it even declined slightly in October. Overall, the economic sentiment releases more or less follow a common pattern, which reflects two diverging trends within individual sub-categories. Confidence in industry and construction is broadly maintained at the previous months' improved levels but among consumers as well as in services and retail trade it is losing steam. 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.

After having dropped steeply in April – in some cases the plunge was even steeper than that seen in the Great Recession – PMI indices bounced back in the next months and the picture of the Markit PMI manufacturing releases in October was broadly positive. Firstly, with the exception of Russia, PMI readings across the region increased further on a month-on-month basis and were broadly consistent with the improving trend in the Euro area. On the positive side, most economies hold to their earlier months' gains remaining above the critical threshold of 50, which marks the boundary between contraction and expansion. However, upon a more thorough look, participants appeared to be more concerned and less optimistic for the period ahead given the threat of new restrictions. On top, the pace of improvement, which decelerated further in October, has raised fresh concerns for the upward momentum of manufacturing activity across the board, even though the correlation of PMI indices with manufacturing activity is not necessarily so strong in every case.

The leading indicators' releases coupled with the rise in infections have raised a lot of uncertainty over the economic outlook. The resurgence of infections threatens the rebound prospects of the broader CESEE region in the H2-2020 and undermines the growth prospects of 2021. The second wave of infections will most probably put a break on the pace of recovery, raise new challenges for the last quarter, especially for the services sector, and keep politicians and policymakers under pressure for more stimulus. 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 are widely expected to be positive on a quarterly basis 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. In that direction, looking forward to more high-frequency data for the next GDP reading in Q4 pointing to increased probability for the recovery to be W-shaped vs a V-shaped, we are compelled to revise our forecasts in 2020-2021.

On the same wavelength, the IMF has recently revised the forecasts of 2020-2021 in its latest World Economic Outlook (WEO) in mid-October. In such an environment, according to the WEO, the emerging and developing Europe is expected to contract by -4.6% (vs. 5.8% previously in June and -5.2% in April) in 2020 and then bounce back by 3.9% in 2021 (vs. 4.2% previously in June & April). The IMF now forecasts that on average economies in the region will face less painful contractions in 2020, but the rebound in 2021 will not be as strong as it was envisaged back in April and certainly less symmetrical for everyone. In particular, for the economies of our focus, Bulgaria is now expected to contract by -4% in 2020 and rebound by +4.1% in 2021. Serbia is forecasted to contract by -2.5% in 2020 and expand by +5.5% in 2021, Romania by -4.8% in 2020 and +4.6% in 2021, Turkey by -5% in 2020 and +5% in 2021 and finally Cyprus by -6.4% in 2020 and +4.7% in 2021.

CESEE Markets Developments & Outlook

Bulgaria

Following the issue of the new Eurobonds, all tenors experienced yield drops ranging from 3 to 9 bps. The most notable yield drops were registered in the short-end of the curve, namely the 2023 and 2024 tenors, with a respective decline of 8 and 9 bps. The longer end of the curve, which now consists of 10-, 15- and 30-year papers, also declined by 2, 8 and 5 bps accordingly. Local papers saw similar yield drops in the 2-, 3- and 20-year tenors, while the yield of the 7-year tenor rose by 11 bps.

Following the recent resurgence in Covid-19 cases, the ongoing protests lost much of their vigour, reducing the probability of early elections. Focus has turned to the 2021-2023 fiscal budgets, which entail projections over large deficits in order to finance increased spending for public sector salary increases and a rise in the minimum pension. Consequently, the government counts on the deficit to be funded exclusively with fresh local and possibly international debt offerings in 2021. Looking forward, in 2022 and 2023, the government has two Eurobonds maturing, which will be re-funded by new Eurobonds amounting to 2-2.5 bn EUR.

Serbia

On the FX front, the outlook remains unchanged. EUR/RSD continues to trade range-bound, albeit at a narrower margin of 117.50-117.60 as the National Bank of Serbia (NBS) stands ready to intervene on both sides of the said range.

On the fixed income market, we noticed some kind of stabilization during the previous month, with an almost parallel downside shift in the government bond yield curve. Roughly speaking, bond yields fell slightly by ca 5bps at the short-end of the curve and by ca 10bps at the long-end. In more detail, the 15-month government bond is trading at 1.87% on the secondary market, which is 4 bps lower compared to one month ago, while the 12-year government bond is trading around 4.10%, compared to 4.20% at the end of the September.

Markets View

Foreign Exchange

EURUSD: Trading in the 1.1600-1.1830 range nearly the entire month and we anticipate it to continue until year end. The second wave of Covid-19 infections in Europe and the outperformance of the US economy, provide support to the USD for now. The ECB stated that while Q3 GDP data surprised positively, Q4 growth faces significant downside risks and signaled additional actions in December, while the US elections result seems to point to reduced fiscal stimulus providing extra support to the USD, although in the medium-term both candidates' policies point to a weaker USD.

GBPUSD: Under the same context, Covid-19 and US elections have had the same effects on the pound as on the EUR with the added unknown of Brexit negotiations. GBP traded in tight 1.2900-1.3200 range and positioning remains on the bullish side, as the market expects a positive resolution by mid-November in the EU-UK negotiations. We side with this consensus view.

AUDJPY: The pair still follows the historical high correlation with the equities market, and as such, it experienced the same trading range dynamics, between 73 and 78.5. Once we are past the US elections results and with China recovering strongly, we anticipate a break higher for the pair with a target of 80. On the downside, major support remains the 200-day moving average at 72.82.

Rates

EU: The level of the EU yield curve remained relatively unchanged for one more month, as the market continues to price low rates for a prolonged period of time. The 30y swap rate oscillated around zero for a seventh consecutive month, but in a much tighter range taking volatility lower. The curve slope remained unchanged with 10s -30s balancing around 22bp. Looking forward, we do not expect any significant movements as we are heading into year-end. Any positive developments on the vaccine would trigger a steepening of the curve, but it seems quite unlikely at the time, as most of Europe is going through its second virus wave and the economies are slowing down again.

US: Rates moved higher across the curve in October with the 10y swap rate reaching 90bps from 73bps the previous month. The bear steepening also continued with 5-30 widening by 10bps to 87 before retracing to 81 on Election Day. Looking forward, a lot depends on the final result but with a split presidency/senate it looks like the steepening could be over in the near term. We should keep in mind that US cases continue to surge, in a pattern similar to Europe, which has increased expectations for a slowdown in Q4 and thus lower short end yields.

Emerging Markets credit

Emerging market spreads were volatile as they rallied in the first half of the month before giving up back most of the gains and reversing again post US elections. The JPM EMBI+ sovereign spread index was at 400bps at the time of writing, 12bps tighter than at the end of September. Region-wise EMEA tightened by 7bps with Turkey (+23bps wider) and Iraq (+65bps wider) being the underperformers, while South Africa and Ukraine were 40-50bps tighter. LATAM ended 8bps tighter with Brazil at -23bps being the outperformer. ASIA tightened by 4bps with Indonesia and Philippines 10bps faring better. Overall, higher quality Sovereigns were well supported by rising commodity prices, loose monetary policies and a strong rebound from China. Turkey credit remained relatively stable given the continuing weakness of its currency (TRY hit new all-time lows at 8.54 vs USD) and the general geopolitical issues the country is facing. We see value in the short end of high rated names where curves remain surprisingly wide. Going forward, the expected US election results should lead to a weaker USD and low rates for longer, which should be supportive for emerging markets external debt.

Corporate credit

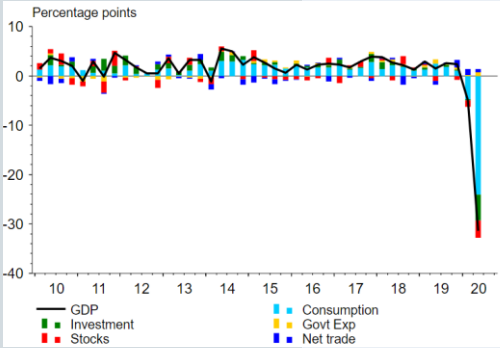
Cash corporate spreads tightened in October, while synthetic credit spread widened to close the negative basis persistent since the March sell-off. Lower rated investment grade outperformed with BBB-A compressing by 4bps. Credit curves bull flattened significantly as the hunt for yield kept pushing investors to longer maturities. USD IG outperformed EUR IG as it remains relatively wide. We saw a similar outperformance of USD HY spreads versus EUR HY, by 20bps across the curve, as the latter were unchanged in the past month. Lighter supply and Central Bank support remain a tailwind for EU credit helping the asset class outperform equities over the last couple of weeks despite stalling economic numbers and new lockdowns across the continent. At the sector level, European banks lagged the rally while retail, construction, materials and autos tightened the most. That was not the case with US credit where we saw significant spread tightening across all sectors, driven also by the move higher in rates. Overall, we expect credit to continue its steady performance into year-end, although capital gains are probably a thing of the past. We are wary of industries heavily affected by Covid19 as we head into the second wave globally but we also favor opportunities in light of potential positive vaccine news. The potential of a split US government is also supportive of credit, despite the lack of a large stimulus package.

USA

Following the GDP rebound in Q3, significant momentum seems to pass on to Q4

According to the advance estimate of Q3, real GDP advanced by 33.1%QoQ saar driven mainly by consumer spending and business fixed investment, the largest increase on record after a 31.4% drop in Q2 due to the imposition of stay-at-home orders. The government's pandemic assistance programs seem to have given a boost to household incomes, while the gradual relaxation of restrictions and expanding domestic demand helped support capital expenditures. Residential investment also rebounded sharply, helped by record low mortgage rates, substantial savings and a structural surge in the single-family suburban houses. On the flipside, external demand was a drag on growth, as the post-lockdown demand led to a jump in imports of manufactured goods, while government spending also declined mainly due to less federal spending support. Although activity has decelerated significantly since its initial mechanical bounce and government income support is waning, real personal spending in September revealed that goods consumption rose further above pre-Covid-19 levels, while services categories like health care and recreation continued to normalize. Nevertheless, overall services spending remains subdued and still has some way to go before it recovers to pre-pandemic levels, given that it is highly dependent on the evolution of the virus. Following the stronger-than-expected increase in Q3 real GDP, and the most recent economic data suggesting that a significant momentum has passed on to Q4, we have revised upwards our 2020 GDP growth projection to -4.5% from -5.0%, previously, with further fiscal stimulus and a zero-rates Fed policy creating a positive backdrop for the economic outlook. Nevertheless, downside risks could arise from worsening Covid-19 trends and a breakdown in fiscal stimulus talks, as well as protracted uncertainty over the election outcome. On the monetary front, having enhanced its forward guidance in Sept, the Fed is not expected to make any material announcement in the near future, possibly awaiting more clarity regarding the post-election fiscal policy picture before committing to any policy changes. Early Fed action could be triggered by adverse developments in the economic/market conditions, which could be driven by rising Covid-19 cases and additional related restrictions or an unwanted tightening of financial conditions.

Figure 7: Contributions to US GDP growth



Source: BEA, Refinitiv Datastream, Fathom Consulting

Figure 8: Strong underlying momentum passed on to Q4

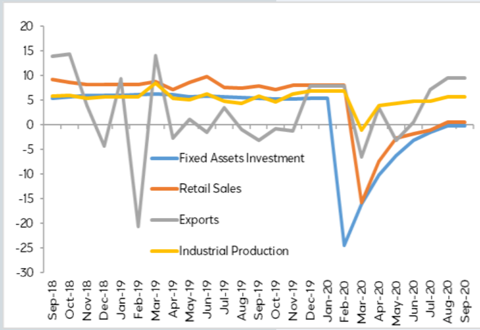
Source: Refinitiv Datastream, Fathom Consulting

China

Long-term economic and geopolitical strategy unwinds amid strengthening economic momentum and so far taming of the pandemic

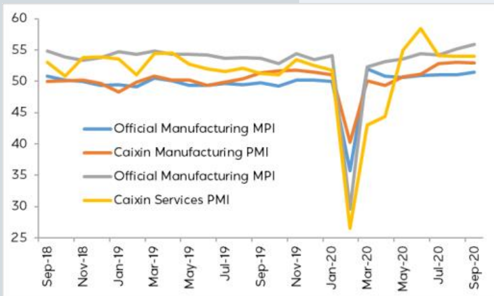
At its Fifth Plenum last week, the 19th Central Committee of the Communist Party of China (CPC), unfolded its economic and political targets for the 14th Five-Year Plan for the period 2021-2025 and the long-term development programme to 2035 and set the guidelines on how to achieve them. While details will not be available before the National People's Congress approves the policies in March 2021, the key takeaways, as these are derived from the communique and press release, pertain to: i. the convergence of the GDP per capita with the level of moderately developed countries, i.e. pursuing a higher quality economic development with no explicit GDP growth target set for the next five years, ii. self-reliance regarding technological development, iii. full release of the growth potential and strengthening of domestic demand and iv. gradual decarbonisation of the economy. The blueprint of the 14th Five-Year plan coincides with a stronger momentum of the economy as the Q3-2020 GDP print as well as hard and soft data showed. GDP expanded by +4.9%YoY in Q3-2020, compared to +3.2%YoY in the previous quarter and after sinking by -6.8%YoY in Q1-2020. Despite the lack of GDP breakdown by expenditure, supply and demand data point to a balanced recovery. Industrial production (IP) continued to rebound in September, rising above market expectations by +6.9%YoY vs +5.6% YoY in August and +4.8% YoY in both July and June. Retail sales, which returned to positive territory for the first time this year in August, expanding by 0.5%YoY, after having bottomed out in March and have been expanding ever since, continued to increase by +3.3%YoY in September. October's manufacturing PMIs were favourable as well, as they both came in above market consensus, with the Caixin increased and the official a tad lower (53.6 and 51.4 vs 53.0 and 51.5, respectively in September), compared to the previous month. If there is a figure to raise an eyebrow, it is the sub-index of new export orders in the Caixin index, which captures the sentiment of smaller and export oriented firms whereas the official focuses on large and state owned enterprises. Even though this figure remained in expansionary territory, it came in weaker compared to September's print, raising doubts on whether the Covid-19 second wave, which is currently spreading in the rest of world, will leave the external demand dynamics unaffected.

Figure 9: Recent hard data point to firm recovery...



Source: Bloomberg, Eurobank Research

Figure 10: ...mirrored in all PMIs as well



Source: Bloomberg, Eurobank Research

Euro area

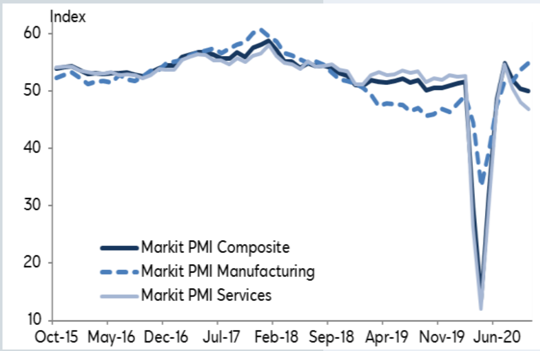
Strong Q3 GDP bounce back, but renewed Covid-19 cases lead to "lockdown lite" regimes in Q4

According to the "flash" Q3 GDP reading, economic activity rebounded by a stronger-than-expected pace of 12.7%QoQ, following the largest fall on record of 11.7%QoQ in Q2. Italy, France and Spain, countries that suffered the most by the Covid-19 crisis, led the recovery recording the largest GDP in increase in Q3, while Germany, hit less by the first wave of the pandemic, posted a smaller rebound. The economic recovery left EA GDP -4.3% below pre-crisis levels; while the Big 3 - France, Italy and Germany - are closer to normal levels (all at ca. -4.0%), economic activity in Spain is currently severely behind (-9.0% relative to pre-pandemic levels). Although the EA GDP composition is not available yet, France's and Spain's GDP releases suggest that both domestic demand and net trade added positively to overall growth, although exports remain well below pre-crisis peaks. Looking ahead, the near-term economic outlook has deteriorated significantly due to the latest Covid-19 epidemiological trends that have showed rising infection cases to new highs across Europe. France and Germany have announced "lockdown lite" regimes for November, while Italy introduced more stringent restrictive measures. The Markit Composite Index stagnated during October falling by 0.4pts to 50.0, as a fall in services was offset by a German-driven rise in manufacturing. Although the second wave of the Covid-19 pandemic and renewed local containment measures bring downside risks in Q4, hitting particularly a subset of service sector activities and, hence, pointing to a contraction in economic activity, we maintain our 2020 GDP growth projection at -8.0% as the better-than-expected Q3 performance is a hopeful sign that the economy will be able to rebound from lockdown, if effectively supported by expansionary fiscal and monetary policies. The uncertainty surrounding our forecasts looms large, given the possibility of stricter containment measures and longer-lasting lockdowns that could lead to a negative GDP growth in Q1 2021 and, hence, push the economy into a double-dip recession. More fiscal support in the form of bridging measures in the following months is warranted, on top of the discretionary stimulus measures already adopted by governments, while easier monetary policy signaled by the ECB should ensure that financing conditions remain favorable to support the economy.

Figure 11: Contributions to EA quarterly GDP growth

Source: Eurostat, Refinitiv Datastream, Fathom Consulting

Figure 12: PMI points to Stagnation at start of Q4



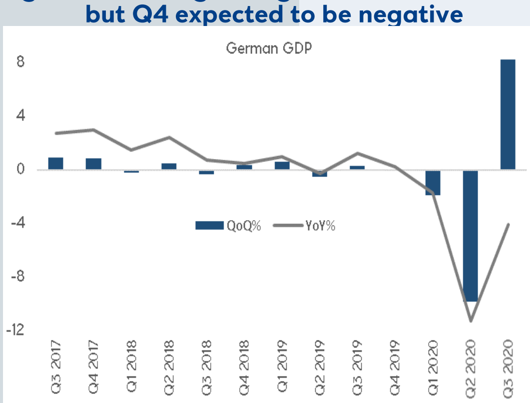
Source: IHS Markit, Bloomberg, Eurobank Research

Germany

Strong rebound of GDP in Q3, but renewed contraction expected in Q4

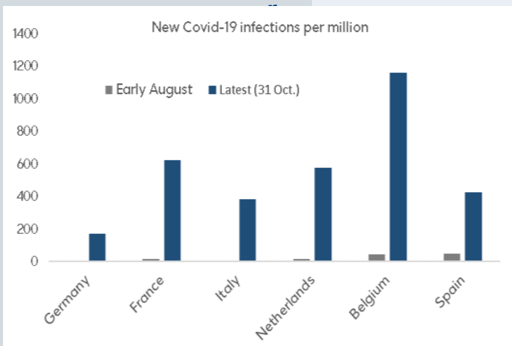
Germany's Q3 GDP rose by a higher-than-expected 8.2%QoQ following two consecutive quarterly declines, including the unprecedented plunge of -9.8%QoQ in Q2 (Figure 13. Though Q3 GDP growth was the highest quarterly gain ever, it was still not enough to offset the 11.7% cumulative quarterly fall in the first half of the year, leaving economic activity still 4.2% below pre-pandemic Q4 2019 level. As is always the case, the Federal Statistical Office did not provide the detailed figures with the flash estimate, but according to its press release, household consumption, equipment investment and exports were the main drivers behind the Q3 GDP bounce (detailed figures due on November 24). However, as suggested by the 2.2%MoM decline in September's retail sales, the economy has probably started to lose momentum as Q3 drew to a close, amid increased uncertainty due to the resurgence in Covid-19 cases (though at a slower pace than in neighbouring countries, Figure 14). Aiming to bring the pandemic under control as the restrictions imposed earlier at the state and municipal level (rather than at the federal one) failed to slow the rapid uptick in new cases, the German Chancellor and the Prime Ministers of the federal states agreed on new tighter measures that took effect on 2 November and will last until end-November. The measures are similar to those imposed in March/April, but the big difference is that nurseries, schools, many services (such as hairdressers) and all retail shops will remain open, while manufacturing and construction will not be affected. Hence, the expected economic damage is not likely to be as severe as it was in the spring. The government has also announced a number of measures to support businesses and the self-employed directly impacted by the new restrictions, reportedly worth up to €10bn. In addition, people and businesses have become somewhat accustomed to living with Covd-19 and, thus, can better assess the personal risk than in March/April when there was a greater sense of fear. Nevertheless, taking into account the share of directly affected sectors in German GDP (c. 3%) and the expected hit on many other sectors from contact restrictions, Q4 GDP is likely to decline by around 0.5%QoQ, assuming that restrictions will be lifted by end-November, while 2020 GDP is now set to contract by c. 5.8%, slightly less than previously anticipated, thanks to the higher-than-expected Q3 GDP rise.

Figure 13: Strong GDP growth rebound in Q3 but Q4 expected to be negative



Source: Federal Statistical Office (Destatis), Eurobank Research

Figure 14: New cases in Germany far behind those of neighbouring countries



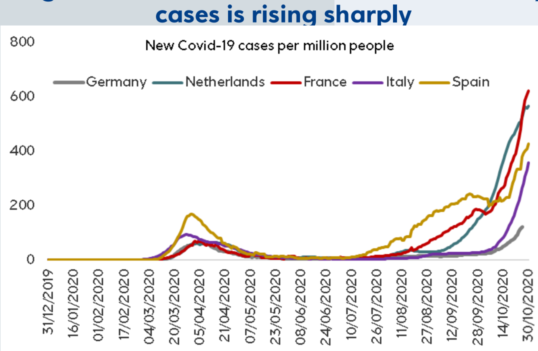
Source: Oxford Covid-19 Government Response Tracker, Eurobank Research

France

Second nationwide lockdown expected to lead to negative Q4 GDP print

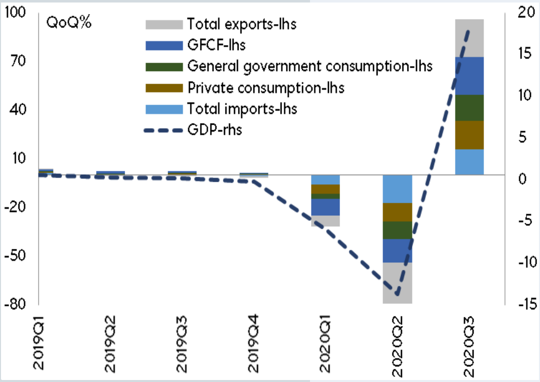
The number of new confirmed Covid-19 cases has been rising significantly since mid-August, exceeding the peak of the first wave of the pandemic in March-April (Figure 15). This is leading to an increase in hospital admissions, including those requiring intensive care, with more than half of ICU beds being used by Covid-19 patients. After a series of tighter restrictions in recent weeks — including the 21:00-06:00 curfew in several large cities affecting around 70% of the country's population — failed to halt the mounting pressure on the healthcare system, President Emmanuel Macron announced that, starting from October 30, France goes into a second national lockdown for a minimum of four weeks, while the situation will be reassessed every fortnight. The target is to rapidly reduce the number of daily cases to around 5,000 and the occupancy rate of Covid-19 patients in ICU units in Covid-19 hotspots from 35% as of end-October to c 10-15%. Mobility will again be severely restricted and most of non-essential shops (including bars and restaurants) will be closed, suggesting that economic activity will be affected meaningfully in Q4 2020, perhaps translating into a negative growth rate, according to Finance Minister Bruno Le Maire. This will follow a higher-than-expected 18.2%QoQ GDP growth rebound in Q3 (Figure 16), mainly driven by a pronounced improvement in private and public spending (adding 9.2pp and 2.6pp, respectively). However, the drop in economic activity in Q4 is likely to be milder than the one recorded during the full lockdown of last spring. This time, public sector services including schools, factories and building sites, will remain open. In addition, the announcement of the new lockdown has been accompanied by the activation of new government support measures for businesses (mostly in the form of grants rather than loans and tax deferrals), aiming to, according to the Finance Minister, limit the expected decline in economic activity during the lockdown to 15% vs. the baseline, compared to a 30% drop in the first lockdown. According to the Ministry of Finance, the cost of the new support measures for businesses is estimated at €15bn per month of lockdown, while Budget Minister Olivier Dussopt expects the budget deficit to widen to 11.3% of GDP this year instead of the previous estimate of 10.2% of GDP. In spite of more stringent virus containment measures, we stick to our forecast for 2020 GDP contraction of -9.5%, as the expected Q4 negative print is likely to be offset by the higher-than-expected strength of growth in Q3.

Figure 15: The number of new Covid-19 daily cases is rising sharply



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

Figure 16: Sharp GDP growth rebound in Q3



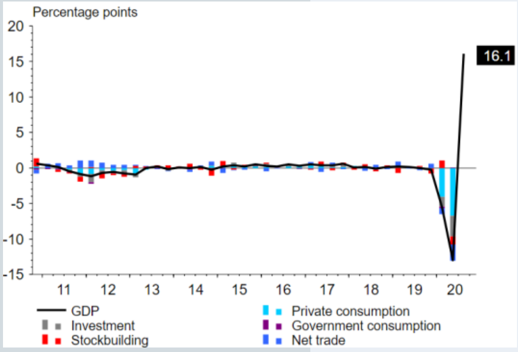
Source: INSEE, Eurobank Research

Italy

The second wave of Covid-19 weighs on GDP growth expectations

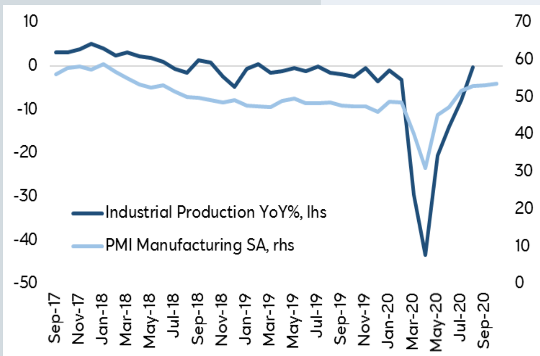
Real GDP bounced back in Q3, increasing by a firm 16.1%QoQ after Q2's record collapse of -13.0% amid stringent restrictive measures. Industrial production rebounded strongly in the summer, surpassing January levels with a spectacular 19.6%MoM increase in consumer durables output, while leading indicators over the past couple of months pointed to a sustained recovery in the Italian manufacturing sector. In particular, the Markit Manufacturing PMI climbed to a 31-month high of 53.8 in October, from 53.2 in September, on the back of accelerated growth of both output and total new orders. Furthermore, business confidence improved throughout Q3, while positive momentum was carried into Q4 as the respective Istat's composite indicator rose further to 92.9 in October from 91.3 in September, amid improved sentiment in the manufacturing, construction and retail trade sectors. Nevertheless, there was a remarkable deceleration in services activity in October, while the recovery in household sentiment has tapered. Indeed, the consumer confidence index dropped to 102.0 in October from a six-month high of 103.3 in September, boding ill for private spending at the start of Q4. With Covid-19 infections moving up sharply, the government announced new restrictive measures to remain in place for a month. Meanwhile, the sharp rise in admissions to intensive care units (ICU) in recent days has increased expectations that the Italian government could introduce tougher lockdown measures with subsequent higher economic costs. ICU occupancy is reportedly running at around 25% of capacity with a clear upward trend, vs. 4% in early October, while the respective ICU occupancy was around 80% during the first wave of infections. Overall, we maintain our 2020 GDP projection at -10.0%, as the downward revision to Q4 growth stemming from the reinstatement of spring-like containment measures has been offset by the stronger-than-expected growth performance in Q3. The key uncertainty to the outlook lies on the duration of second-wave restrictions, conditional on the healthcare developments in the near-term. Our base case assumes a gradual improvement in the epidemiological trends in December, otherwise GDP could fall by an even larger amount in 2020.

Figure 17: Contributions to quarterly GDP growth



Source: Eurostat, Refinitiv Datastream, Fathom Consulting

Figure 18: PMI Manufacturing at a 31-month high in October

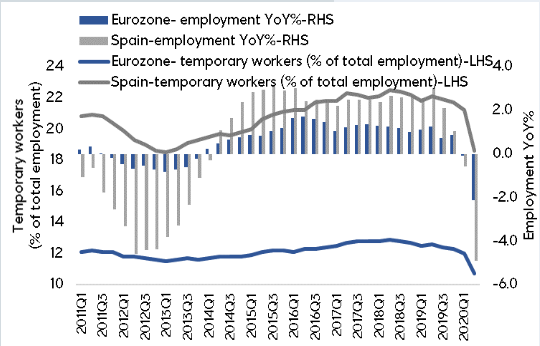


Source: IHS Markit, Bloomberg, Eurobank Research

Spain

Tighter restrictions pose risk of contraction in economic activity in Q4

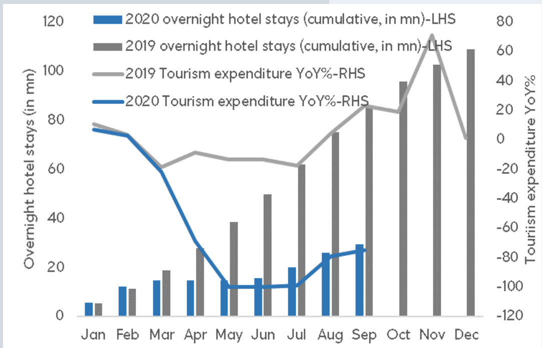
Figure 19: Sharp drop in employment partially driven by large share of temporary contracts



Source: INE, Eurobank Research

Spain was among the worst affected EA countries by the first wave of Covid-19, leading the government to impose one of the strictest and longest national lockdowns that resulted in a 13.5% GDP growth contraction in H1-2020 compared to H2-2019, the sharpest such drop in the EA. In Q3, GDP rebounded sharply by 16.7%QoQ thanks to pent-up demand and the fast resumption of economic activity after the end of the lockdown in May. However, in spite of the authorities' cautious approach in lifting restrictions, Spain has been experiencing one of the worst Covid-19 second waves since late July. Amid severe pressure on Spain's healthcare system (the ICUs occupancy rate has risen to 25%), the government announced on 24 October a curfew-style tighter set of restrictions with nationwide application, albeit significant regional variations, mainly involving capping of capacity in the hospitality sector and additional constraints to personal mobility at local level, pointing to risks of an abrupt stop in economic recovery in Q4 following the Q3 GDP technical bounce-back. Posing considerable downside risks for Spain's near-term growth outlook, authorities may have to impose even stricter measures in the coming weeks, if pressure on hospital capacity keeps rising, as the winter is arriving and people spend more time indoors, which suggests better conditions for the virus to spread. Meanwhile, health concerns will likely weigh on consumer spending, along with worries over job prospects, as the unemployment rate rose further in August to a 2½-year high of 16.4%, one of the highest in the EA, mainly due to less extensive use of furloughing compared to other EA countries and the high incidence of temporary contracts that renders redundancies easier (Figure 19). The ongoing political fragmentation (the coalition lacks a majority in parliament) and the country's reliance on tourism (accounts for 14.6% of domestic GDP, both directly and indirectly), one of the sectors most affected by the pandemic, will likely magnify the drag on Q4 GDP, pointing to risks of a negative print (Figure 20). Nevertheless, following the higher-than-expected Q3 GDP rebound, at this stage, we stick to our projection for GDP growth contraction of 11.6% this year, though risks are for a more pronounced drop in case of further escalations in virus measures if pressure on healthcare system keeps rising.

Figure 20: Spain's tourism sector heavily affected by the pandemic



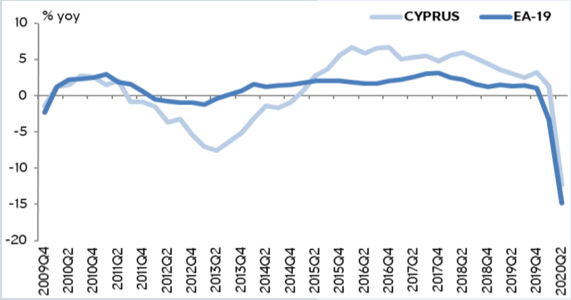
Source: INE, Eurobank Research

Cyprus

Government suspended the 'citizenship by investment' program

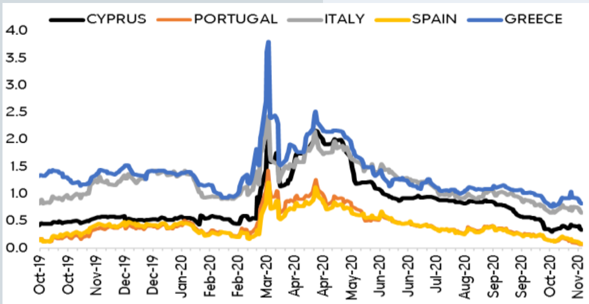
Following an extraordinary session in mid-October, the government cabinet approved the suspension of the 'citizenship by investment program' (CIP) as of November 1st. According to the official statement by the Presidency, the proposal was put forward in response to "weaknesses" in the scheme that could be "exploited". The decision came in the aftermath of an Aljazeera controversial report, which allegedly filmed high ranking officials making abusive use of the scheme. The CIP (an investment in real estate enabling the beneficial owner to acquire the Cypriot passport) has helped Cyprus to attract significant foreign funded investments in the real estate sector in the form of high-rise residential towers, which are located in Limassol & Paphos. According to the MoF calculations, 1,864 persons have been awarded citizenship in 2013-2018, which corresponds to an inflow of €6.6bn out of which €3.6bn were utilized in the domestic real-estate market. Even before the changes in the program in May 2019, concerns were voiced publicly that the economic rebound is poised to fade away once those construction projects were to be completed. The government changes, aiming to make the program more targeted and trustworthy, came in response to EU institutions' criticism that the transparency of the program should be bolstered. However, the infringement procedure initiated by the European Commission on the issue will most probably put an abrupt end to these types of programs even though the government has pledged to replace the current program with a new one. Meanwhile, the picture from the latest high frequency indicators has raised concerns for the growth outlook of H2-2020. Retail sales in volume terms decreased on a monthly basis in August (-6.1% MoM vs. +6.3% MoM in July). The monthly deterioration most probably reflects the concerns of consumers about the rise of infections during that month and the much lower than anticipated tourist arrivals this summer (-88.2% YoY in August and -85.3% YoY in 8M-2020). Retail sales contracted by -3.5% YoY in August, down from -0.5% YoY in July, up from -1.5% YoY in June, bringing the year-to-August performance at -2.7% YoY. Having plunged in May at levels comparable to those seen in H1-2013, the improvement of the economic sentiment indicator (ESI-CypERC) has stalled. The ESI-CypERC declined further by 1.6 points to 79.0 points in October, down from 80.6 points in September, vs. 81.6 in August, up from 79.7 in July, 75.2 in June and 72.9 in May. The monthly decrease resulted from weaker business confidence in services, retail trade and, to a lesser degree, in industry.

Figure 21: Real GDP contraction in Q2 was the worst since 2012-2013



Source: Eurostat, Eurobank Research

Figure 22: Long-term Cypriot government bond yields declined on ECB intervention



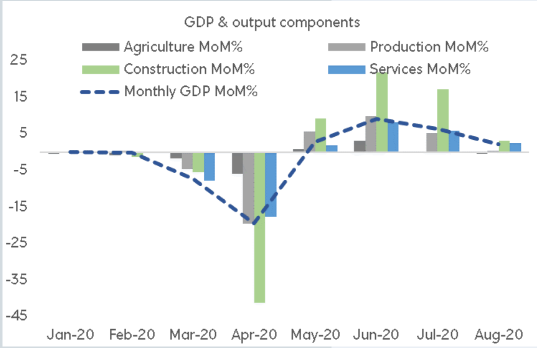
Source: Bloomberg, Eurobank Research

UK

Second nationwide lockdown darkens the near-term growth outlook

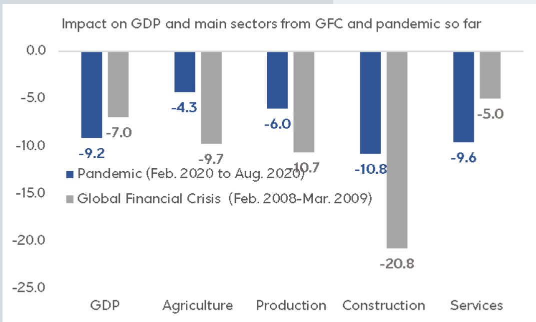
The UK is clearly in a second Covid-19 wave, while the government is struggling to bring it under control. Daily new cases have surpassed 20k lately, the infection rate is currently at record highs and hospitalization levels have hit their highest level since late June, suggesting that the imposition of tighter restrictions in recent weeks that consisted mostly of local lockdowns and industry targeted curfews, failed to contain the virus's spread. Aiming to prevent a "medical and moral disaster" for the NHS, PM Boris Johnson announced a four-week long second nationwide lockdown as of 5 November. Even though it is lighter compared to the first lockdown in the spring as schools, universities and colleges will remain open, along with the construction and manufacturing sectors, the resulting restrictive movement of people and the hit on sentiment, will deal a significant blow to the UK's near-term economic outlook. Rising unemployment (the unemployment rate hit a 3½ year high of 4.5% in the three months to August), the end of the "Eat Out to Help Out" (EOHO) scheme on August 31, and gradually reduced fiscal support (according to the new job support scheme that will replace the existing one in November, the government contribution to wage costs will drop to 60% from 80% currently), add to the case for a meaningful slowdown in Q4 GDP. Persisting headwinds from Brexit create additional drags on the UK's recovery path. According to reports, progress has been made in EU/UK talks but not on all contentious issues. Deliberations have intensified with an intention to reach an agreement by mid-November, so as to leave time for the European Parliament to ratify it before year-end. Meanwhile, the state of play in the UK economy remains gloomy heading into winter. Timely activity indicators are not encouraging (PMIs, Gfk consumer sentiment), suggesting that growth had already downshifted as Q3 drew to a close, hurt by the impact of local lockdowns in many parts of the country, especially in the north of the UK. At its monetary policy meeting in early November, the BoE announced a larger than expected £150bn QE package, but the prospect of further stimulus is likely, if the partial lockdown lasts longer than currently planned. Awaiting Q3 GDP data (Nov. 12), we stick to our forecast for a 10.0% GDP contraction this year, with risks skewed to the downside stemming from the path of the virus, Brexit and the labor market outlook.

Figure 23: Growth lost momentum in August after a strong rebound in June and July



Source: ONS, Eurobank Research

Figure 24: GDP still 9.2% below pre-Covid levels



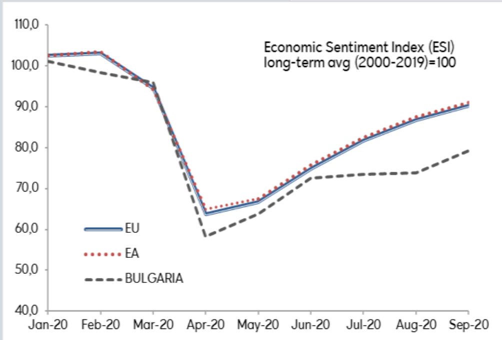
Source: ONS, Eurobank Research

Bulgaria

Along with fiscal stimulus deployed in the battle against the pandemic, reforms should rank highly as well

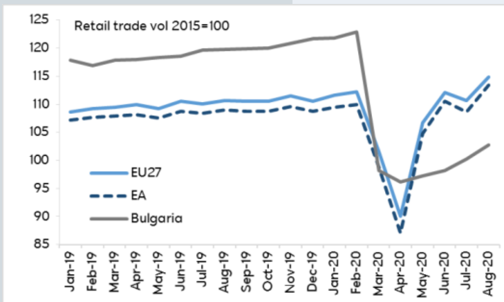
In October, a plethora of economic reports from international financial institutions (IMF, World Bank and EBRD) and public authorities (the National Bank of Bulgaria and the Ministry of Finance) were published, all citing forecasts for a GDP recession ranging between -3.0% and -5.5% in 2020 and a recovery between 2.5% and 4.1% in 2021. At the same time, Moody's raised the country's unsecured and long-term issuer sovereign rating in foreign and local currency by one notch to Baa1 with a stable outlook, from positive previously. As broadly expected, ERM II entry in July 2020 was one of the two main pillars upon which the upgrade was based, as the completion of the reform programme – a prerequisite for the entry – has ironed the country's credibility regarding its commitment to join the Eurozone. The second pillar was the overall strong fiscal profile against the adverse background of the Covid-19 pandemic. The country entered the crisis with a strong fiscal position as the public debt stood at 20% of GDP and the budget run a mild deficit of -1% in FY2019, after several years of modest surpluses. It is the aforementioned fiscal discipline that allowed the government not only to increase the budget target for 2020 to -4.4% of the projected GDP but also to table and get approval for a budget bill that envisages a -3.9% fiscal deficit in 2021. Without a doubt, the expansionary fiscal policy is imperative under the current circumstances, as it has assisted the economy from contracting further so far and will continue to act supportively in 2021 as well. However, the challenge in the budget of 2021, when elections are also scheduled to take place, is the appropriate targeting to push agenda reforms more vigorously, such as the increase of the digitalization level of the economy, along with increases in social spending, in particular for pensions, public wage hikes and benefits, which are also necessary up to a certain extent. Specifically, the Covid-19 crisis has brought to light the need for digital reforms in health care, education and the labor market, at a time when recent Eurostat data reveal that the level of digital skills of the Bulgarian people is substantially below the EU average. Concluding, we stick to our forecast of -5.0% GDP contraction in 2020 with risks, however, tilted to the downside given the hard to predict course of the pandemic and its subsequent negative economic impact.

Figure 25: While the economic sentiment follows the EU & EA trend, it lags behind visibly



Source: European Commission, Eurobank Research

Figure 26: ..and so does the retail trade volume...



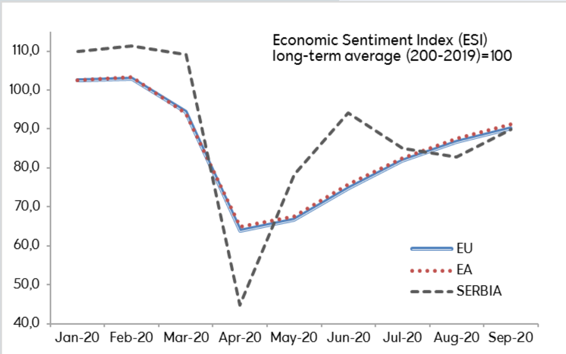
Source: Eurostat, Eurobank Research

Serbia

Long awaited government formation, with its mandate being to navigate the economy in uncertain waters, as second wave comes stronger

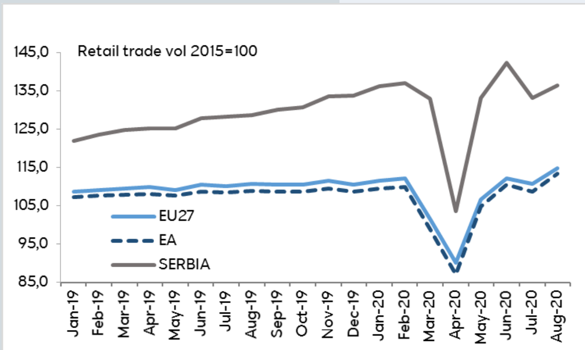
Following June's elections, a government under the same Prime Minister, Ana Brnabic, was finally formed and approved by the parliament on October 28th. The government will be short-lived as President Aleksandar Vucic intends to hold parliamentary elections, ahead of their time, i.e. in April 2022, along with presidential ones. In her keynote address, the PM tabulated the governmental work in the following six pillars: i. fight the coronavirus pandemic and strengthening the health care system, ii. preserve the vital interests of the Serbs in Kosovo, iii. fight organized crime, iv. maintain the country's independence and independent decision making, v. the rule of law and vi. speed up reforms on the European path and strengthen the economy. While the new government is a pro-European one, it will also maintain "friendly" relations with Russia and China. Meanwhile, a few days earlier, the European Commission (EC) released its annual enlargement reports, tracking the progress of candidate countries aiming to join the EU. Serbia, along with Bosnia and Herzegovina, appear to have travelled the shortest distance towards the EU acquis, compared to the other candidate peers (Albania, Kosovo, Montenegro and North Macedonia). The outcome of the report is contradictive once combined with the regular government declarations over European integration as one of Serbia's strategic goals. In brief, the report reveals that there has been some progress on the economic front and in the fight against corruption and organized crime but little progress in the areas of judiciary reform and freedom of expression. In the same context, i.e. highlighting the need to implement more vigorously an ambitious structural reforms agenda, came the completion of the fifth and final review under the IMF's Policy Coordination Instrument (PCI).. Bottom-line, hard data, such as industrial production and retail sales, point to economic recovery in Q3-2020, following the sharp contraction of -6.2% YOY in Q2-2020. We stick to our forecast of -1.5% in 2020 with risks, however, tilted to the downside given the hard-to-predict course of the pandemic and the consequent negative economic impact.

Figure 27: The economic sentiment lies at the same levels with the EU & EA ..



Source: European Commission, Eurobank Research

Figure 28: ...while retail trade volume stands visibly above the EU and EA average...



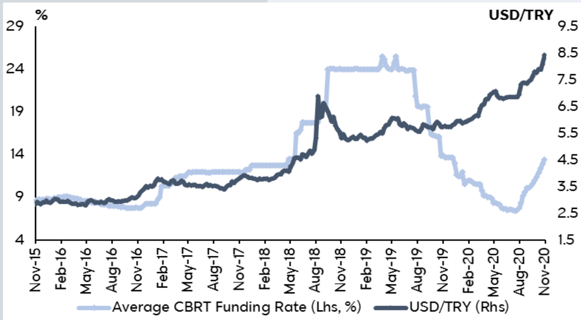
Source: Eurostat, Eurobank Research

Turkey

CBRT reluctance to hike headline rate pushed Lira to new historic lows

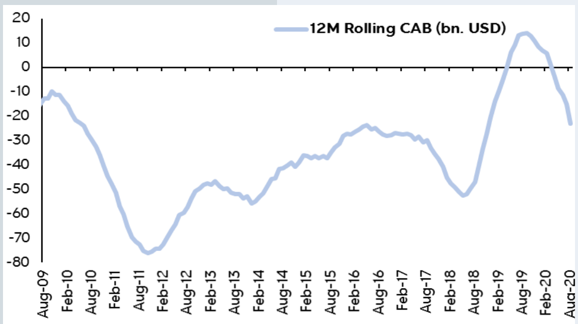
Having surprised the markets in the previous session, the Central Bank of Turkey (CBRT) surprised them once again as well as the relevant surveys of Reuters and Bloomberg in late October. The CBRT left its key policy rate (KPR) and the overnight lending rate unchanged at 10.25% and 11.75% respectively, but increased the corridor for the late liquidity window rate (LLW) by 150bps to 300bps above the O/N lending rate, bringing it to 14.75%. In its communication, the CBRT cited the need to enhance flexibility in liquidity management taking into account the tightening of financial conditions since August. Recall that the CBRT had already taken measures to increase the effective funding rate in the weeks prior to the policy meeting in an attempt to support the lira, reducing thus the need to use the formal rate. Thus, in the CBRT view, the aforementioned tightening steps should be reinforced in order to contain inflation expectations and to restore the disinflation process. According to the MPC minutes release a few days later, headline inflation followed a higher-than-envisaged path driven by the fast economic recovery from the Covid-19 pandemic with a strong credit momentum, and the adverse financial market developments for the lira. From the latter point of view, CBRT revised upwards its inflation forecasts to 12.1% at year-end, and to 9.4% for end-2021 in its latest inflation report. 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 last CBRT decision doesn't contribute to restoring policy credibility. Negative real interest rates, which is still the case even if the effective funding rate (EFR), a weighted average of four CBRT facilities, is used as a proxy for calculations, necessitate further hikes sooner or later to restore credibility and address financial stability risks. The relatively low, by any metric, FX reserves capacity of CBRT, despite new or existing swap agreements with other Central Banks, coupled with the high external refinancing requirements from short-term corporate liabilities, constrain authorities' room for maneuver further. On top, the recent geopolitical developments in the Armenia-Azerbaijan regional armed conflict as well as the disputes with Greece and more recently with France weigh on the lira outlook. Having been on a steady depreciation trend, the lira has continued sliding in the last three months, touching new historic lows despite CBRT interventions (at 8.41/$ on November 4, -41.4% Ytd).

Figure 29: Lira recorded new historic lows in early November



Source: Bloomberg, Eurobank Research

Figure 30: 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	2.8	3.0									
Advanced Economies															
USA	2.2	-4.5	3.8	1.8	1.3	2.0	3.7	8.7	7.2	-2.2	-2.3	-2.3	-6.3	-17.0	-9.5
Eurozone	1.3	-8.0	5.0	1.2	0.4	1.1	7.6	8.3	9.5	2.7	2.6	2.6	-0.6	-10.0	-5.0
Germany	0.6	-5.8	4.2	1.4	0.8	1.3	3.2	4.5	4.0	7.6	6.4	6.8	1.4	-8.2	-3.5
France	1.3	-9.5	6.6	1.3	0.5	1.0	9.2	8.5	10.0	-0.8	-1.7	-1..2	-2.0	-11.5	-6.7
Periphery															
Cyprus	3.2	-7.5	5.0	0.5	-0.5	0.5	7.1	8.0	7.5	-7.1	-10.0	-9.0	2.8	-4.5	-2.0
Italy	0.3	-10.0	5.0	0.6	-0.1	0.6	9.9	10.0	11.5	2.7	3.0	3.1	-1.6	-11.5	-6.0
Spain	2.0	-11.6	6.6	0.8	-0.3	0.8	14.1	16.8	17.8	2.0	0.8	1.2	-2.8	-11.7	-7.5
Portugal	2.2	-8.8	5.0	0.3	0.0	0.5	6.5	7.7	8.4	-2.0	-1.0	-0.8	-0.3	-7.8	-4.0
UK	1.4	-10.0	6.0	1.8	0.8	1.5	3.8	5.3	6.9	-4.3	-3.1	-3.5	-2.1	-14.0	-7.0
Japan	0.7	-5.5	2.3	0.6	-0.1	0.0	2.4	3.0	3.0	3.6	2.5	2.8	-3.9	-13.0	-7.0
Emerging Economies															
BRICs															
Brazil	1.1	-5.3	3.5	3.7	2.5	3.1	14.0	13.5	13,3	-2.7	-1.5	-1.0	-1.7	-16.7	-7.0
China	6.1	2.0	7.5	2.8	2.8	2.1	3.6	4.8	4.4	1.2	0.9	0.7	-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	-5.5	3.5	4.5	3.6	3.3	4.6	5.8	5.5	4.8	1.5	2.0	1.5	-4.5	-2.5
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

Eurobank

Eurobank Research

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	0.14%	0.18%	0.20%	0.21%	0.21%
3m Libor	0.22%	0.30%	0.33%	0.34%	0.35%
2yr Notes	0.15%	0.20%	0.25%	0.29%	0.33%
10 yr Bonds	0.75%	0.76%	0.86%	0.96%	1.05%
Eurozone					
Refi Rate	0.00%	0.00%	0.00%	0.00%	0.00%
3m Euribor	-0.52%	-0.47%	-0.46%	-0.44%	-0.43%
2yr Bunds	-0.78%	-0.67%	-0.64%	-0.60%	-0.58%
10yr Bunds	-0.65%	-0.47%	-0.41%	-0.34%	-0.29%
UK					
Repo Rate	0.10%	0.10%	0.05%	0.05%	0.05%
3m	0.04%	0.10%	0.11%	0.11%	0.13%
10-yr Gilt	0.23%	0.23%	0.25%	0.32%	0.38%
Switzerland					
3m Libor Target	-0.77%	-0.73%	-0.72%	-0.72%	-0.72%
10-yr Bond	-0.54%	-0.50%	-0.44%	-0.41%	-0.36%

Source: Bloomberg (market implied forecasts)

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