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GLOBAL & REGIONAL MONTHLY

Incoming economic data have recently surprised to the upside, with the global economy moving closer to stabilizing during June, as rates of contraction eased significantly in both the manufacturing and service sectors. Economic conditions improved as lockdown restrictions to contain the spread of Covid-19 were relaxed around the globe, businesses re-opened and consumer and business confidence were restored. Nevertheless, global economic activity remains far lower than normal, expected to contract by a total of 3.2% in 2020, while possible further waves of Covid-19 infections could potentially lead to a setback in the rebound.

Macro Picture

USA: Recovery continued through June, but risk of a setback remains as new Covid-19 cases are rising fast

EA: Evidence for a near-term rebound in activity, but economies remain far from normal capacity utilization rates

UK: June PMIs point to a pick-up in economic activity as lockdown measures are eased further

EM: Many EMs will experience severe GDP contractions, amid lack of coordinated economic policies

CESEE: Economies took a breather after reopening but the road to full recovery remains long and uncertain

Markets

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Rates: European and US yields expected to move higher, with long end underperforming on smooth reopening and increased supply

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CESEE: Sizeable economic support programs in place across the region

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-Brexit talks remain deadlocked, but compromise possible

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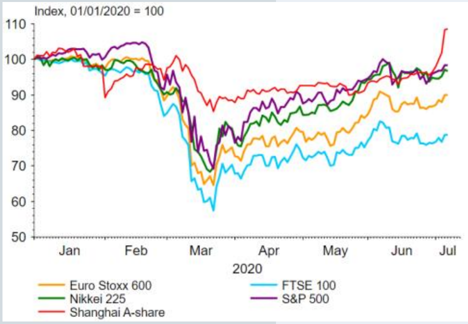
World Economic Outlook

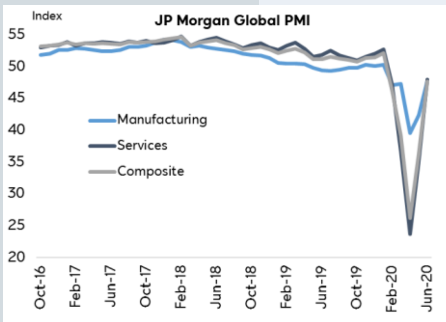
The unprecedented Covid-19 induced economic shock has been surprisingly accompanied by the biggest equity market rally in recent years with investors shrugging off market over-valuation and downward revisions to earnings (Figure 1). The MSCI World index has surged by more than 30% since late-March lows, with the NASDAQ Composite index at a record high as the tech sector has outperformed other sectors, and the Chinese bourses are pricing in a sharp upturn in the world's second largest economy. Incoming economic data have recently surprised to the upside, with the global economy moving closer to stabilizing during June, as rates of contraction eased significantly in both the manufacturing and services sectors. Economic conditions improved as lockdown restrictions to contain the spread of Covid-19 relaxed around the globe, businesses re-opened and consumer and business confidence were restored. The J.P. Morgan Global Composite Output rose to a five-month high of 47.7 in June, up by a record 11.4 pts from 36.3 in May, with both the manufacturing and services respective indices rising to the greatest extent in their respective series histories and breaking the records set in the previous month (Figure 2). With the short-term investors' focus on improving macroeconomic data that add to the evidence of a V-shaped recovery, it should be noted that global economic activity still remains far lower than normal, and it is not expected to return to pre-Covid levels until end-2021 at the earliest, at least for most advanced economies, so any optimism regarding better-than-expected high frequency indicators should be treated with caution. Meanwhile, heightened uncertainty amid possible further waves of infections could potentially lead to a setback in the rebound. Although rising Covid-19 infection rates have so far been localized in China and Europe, they seem to be on an uptrend across many emerging economies and certain US states in the South and West. Furthermore, geopolitical developments regarding US/China trade tensions, US/EU trade negotiations, Brexit and/or US presidential elections in November

Figure 1: Major equity indices in 2020 (in USD)



Source: Refinitiv Datastream, Fathom Consulting

Figure 2: Rates of contraction in manufacturing and services eases sharply



Source: Refinitiv Datastream, Fathom Consulting

could also present a risk to an already fragile economic recovery. Overall, we keep our GDP forecast unchanged at -3.2% for 2020, expecting a shallow economic upturn in H2 2020 and 2021, with some countries lagging far behind and uncertainty remaining at elevated levels.

Developed Economies

US: High-frequency economic data continue to point to a rapid recovery in activity as US states emerge from lockdown. The recent rebound in durable goods consumer spending seems to be translated into gains in factory demand and production, as the ISM manufacturing PMI moved into expansionary territory in June, with the majority of industries reporting growth on the month. The gradual re-opening of the US economy, coupled with a faster-than-expected bounce in employment growth, is boosting consumer sentiment. Nevertheless, the recent surge in the number of new Covid-19 cases in certain US states has raised concerns about whether the recent improvement can be sustained. Overall, we maintain our US GDP growth forecast for 2020 to -6.0%, but there is an increasing risk of a setback in the rebound, largely dependent on a potential second wave of coronavirus cases. Negotiations on a fourth US fiscal stimulus package are about to begin when the US Senate returns on 18 July, while, on the monetary front, the Fed seems ready to complete its policy framework review implementing enhanced forward guidance and open-ended asset purchases, most likely in September. The June FOMC minutes indicate that the Fed is likely to adopt some kind of average inflation targeting, while the scope for yield curve control seems rather limited.

Euro area: Following the first evidence in May for a near-term rebound in economic activity, incoming data continue to surprise to the upside as consumer and business confidence are being restored, providing some hope that the recovery could be quicker than expected. Despite the encouraging evidence that recovery is well underway, we do not yet see a clear upside risk to our 2020 GDP forecast of -9.0%. We would have to see this uptrend to continue before revising upwards our growth outlook, given our current expectations for a more cautious consumer with a higher propensity to save coupled with a weaker labor market. Adding to the above, the resurgence of Covid-19 cases in Western Germany and Portugal and the re-imposition of containment measures - though locally - have increased fears of second waves of the pandemic, highlighting the uncertain path to recovery. On the political front, there is still considerable disagreement with the co-called Frugal Four regarding the size and the modalities of the Next Generation EU plan, although Germany and France seem willing to reach an agreement at the 17-18 July Special European Council meeting.

EMU periphery: The two biggest EMU peripheral economies, Italy and Spain, have been the most affected EA countries by the COVID-19 pandemic. Having both undergone stricter lockdowns compared to the other big EA economies, their Q1 GDP contracted by a record pace of 5.3%QoQ and 5.2%QoQ respectively, well above the EA average of -3.6%QoQ, even though the nationwide lockdowns lasted only about only 2-3 weeks. With strict lockdown measures remaining in place throughout early May, April hard data and May sentiment indicators suggest that the hit in Q2 could be around two times bigger than that in Q1. The rebound is expected to begin in Q3 on a quarterly basis, on the assumption of a continuing lifting of restrictions that began in early May (Italy: 4 May, Spain: 11 May). Though the ultra-accommodative ECB monetary policy and the EU Recovery Fund proposed by the European Commission are clear upside growth risks (both countries are among the largest potential net recipients of funds and grants), real GDP of both Italy and Spain is expected to contract by around 10% each for the year as a whole, slightly deeper than -9.0% projected for the EA, with activity levels unlikely to return to pre-crisis levels before 2022. Supporting the above, the tourism sector —which is likely to be among the most hit sectors from the pandemic with long-lasting negative effects due to travel restrictions and consumer behavior—accounts for a relatively high share of GDP for both countries (Italy: 13.2%, Spain: 14.6%) and employment is highly concentrated in that sector (Italy: 14.9% and Spain: 14.7% of total employment).

Emerging Economies

BRIC: In June's WEO, released in late June, the IMF revised downwards significantly its GDP forecasts for 2020 for the 3 out of the 4 countries of the BRIC group. Brazil's economy is forecasted to contract by -9.1% and rebound by 3.6% in 2021. India and Russia are forecasted to shrink by -4.5% and -6.6% before they return to positive GDP growth rates of 6% and 4.1% respectively next year. India's downwards revision was the sharpest in the BRIC group. In April's WEO, India was expected to continue expanding by 1.9% in 2020. Between April and June, the epicenter of the pandemic shifted towards EMs, rendering the Covid-19 crisis a BRIC crisis. Brazil, Russia and India experienced the fastest spread in new cases over the past month and that places them among the top four countries in total cases, behind the US. The only bright exception in the group is China. According to May's hard and June's soft data the economy appears to be gathering pace while the spike of incidents that began in mid-June, thanks to a rapid and aggressive campaign of testing, appears to have been tamed. Therefore, China will be the sole country of the BRIC that will avoid economic contraction and post a timid, yet positive GDP growth rate above 1%.

CESEE: The broader CESEE region took a breather in June after the economies reopening in the post-lock-down period, but the road to full recovery remains long and uncertain. A new rise of infections, hospitalizations and fatalities per country across the region has shown up in the official statistics and the relevant metrics. Even though it is not clear whether this is the beginning of a second wave or the initial result of the economies re-opening, it has created a new bout of uncertainty and cast a renewed cloud over the economic outlook for the second half of an already burdened year. Despite lingering uncertainty, the further re-opening of the economies has strengthened optimism that the worst may be behind. Driven by the easing of the strict containment and social distancing measures, sentiment and survey indicators continued their rebound in June.

Special Topic
Is Turkey heading for an economic crisis?

This short analysis aims to raise awareness on the vulnerability of the Turkish lira and the increased probability that the government will seek multilateral financial assistance. An IMF program seems out of the question according to the government rhetoric, but at some point may become unavoidable if the situation keeps deteriorating, i.e. capital outflows and/or interest rate cuts continue, or a geopolitical risk materializes, given that Turkey is currently involved in two war fronts. At the moment, the Central Bank claims that it is negotiating a currency swap with the FED, which appears to be a more preferable option. Turkey and Turkish assets have been at the epicenter of international markets' attention. Lira has been on a steady depreciating trend since July 2019, when CBRT engaged in a new easing cycle. Ever since, CBRT has delivered a cumulative 1,575bps, bringing the Key Policy rate at 8.25% currently, from 24%, in nine consecutive MPC meetings. Lira has now slipped to its lowest point since last May trading a little below 7/$ (at the time of writing: 6.85/$), being one of the worst performing EM currencies so far in 2020 (Year to date:-15.2%)

Concerns are rooted in a) Unorthodox monetary policies implemented by CBRT b) the lack of adequate FX reserves and the inability to replenish them c) relatively high liabilities of the private sector in foreign currency. At the same time, these concerns are magnified by: d) an adverse world & domestic environment: the COVID19-induced recession, capital outflows from EMs and e) heightened geopolitical uncertainties. In more detail:

- Unorthodox CBRT monetary policies: President Erdogan has staunchly supported low interest rates aimed at boosting economic activity. Apart from this being directly negative for the lira, it has raised doubts about the Central Bank's independence and concerns over CBT falling significantly behind the curve. Currently, real interest rates are negative as inflation is still in double-digit territory, 12.6% YoY in June up from 11.4% YoY in May and 10.9% YoY in April, reversing its previous downward trajectory for the first time since last October. Negative rates augment pressure on the lira; on an ex-ante basis they are mildly positive, only if the year-end inflation projection is fulfilled (forecast of 7.4% for 2020, just revised down from 8.2% previously; 5.4% in 2021 on lower projections for energy & food inflation). Recession pushes inflationary pressures down but the devaluation pushes them up.
- The defense of the lira has subsequently led to a reserves drawdown. As of May, gross international reserves (FX reserves + Gold) stood at USD90.9bn down from USD106.1bn in late 2019, with FX reserves alone at USD59.2bn. CBRT has been implementing swap agreements with the banking sector and foreign Central Banks (currently at USD56.7bn) to boost its USD liquidity. The latest anecdotal evidence brings net FX reserves at USD29.1bn in late May factoring in the minimum reserve requirements of the banks. If accurate, and factoring in the swap agreements, the net FX reserves have already declined to zero or even negative.
- The subsequent drawdown in FX reserves has raised concerns among the investment community that Turkey may not have enough to shoulder a disruption in external financing. The problem is rooted in the indebtness of the corporate sector, not the sovereign or the consumer segment. External financing

needs are high: the corporate sector is short net (Assets-Liabilities) FX by USD170bn as of April2020. Out of the liabilities stock, 32% is short-term.

- The quick correction in the previous sizeable current account deficit has helped to reduce the financing needs but it has not erased them. The CAB as a percentage of GDP switched to a surplus of 1.2% in 2019 vs a deficit of -2.7% in 2018 and -4.8% in 2017. The baseline scenario assumed a broadly balanced CAB in 2020 given that the gains from lower imported energy will be offset by lower export activity (especially from the tourism sector).
- The first monthly readings in Jan-April point to a deterioration beyond the baseline scenario. Driven by a negative services income balance reflecting travel income losses from the Covid19 pandemic, the current account deficit deteriorated further to USD5bn in April compared to USD4.8bn in March, compared to only USD470mn in April 2019. Thus, the current account deficit reached USD12.9bn in Jan-Apr, which translates to -1.9% of projected GDP compared to a USD 885mn deficit in the same period of 2019.
- Adverse domestic and world economic environment: Turkey is confronted with a deep recession for the second time in two years. The outbreak of Covid19 finds the economy in a very fragile state. Fiscal, credit and monetary stimulus had pushed earlier the economy out of a technical recession. Underpinned by strong fiscal, credit and monetary stimulus, GDP growth jumped by 6.0% YoY in Q4-2019, at the strongest pace since Q1-2018, compared to only 1.0% in Q3-2019, bringing the FY2019 reading at 0.9% vs. 2.8% in FY2018. Further on, GDP expanded by 4.5% YoY in Q1-2020 driven by still strong domestic demand dynamics. However, the economy is now confronted with the risk of a deep recession in 2020, followed by a dynamic rebound in 2021 (IMF WEO, FY2020: -5% FY2021:+5%). According to official statistics, the number of persons infected with Covid19 has reached 206,844 and the number of fatalities 5,241. It is widely known that the official statistics underestimate both figures, given that the government implemented partial social distancing measures and with time-delay.
- Macroeconomic policies have been primarily guided by electoral considerations. An excessive emphasis has been placed on growth, which is dated back in the post-military coup era (2016-2018) in an effort to increase the probability of the ruling party leader to get reelected in the President's post and concentrate more executive powers around him under the new constitutional amendments. Pro-cyclical government stimulus, which is bound to eventually fade away, supports growth at the expense of higher inflation. The latter erodes the purchasing power of households and corporates, undermines their confidence in domestic financial assets, deters them from investment decisions, and increases external vulnerabilities at a time of a deteriorating global financing environment. Prospects for a sustainable medium-term growth trajectory look very challenging taking into account the lack of reforms in recent years and the unwillingness on behalf of politicians to push for the reform agenda.
- Geopolitical risks remain in the background: Geopolitical risks remain key to the lira's performance. Worries over President Erdogan's power concentration, frictions with the US and EU, as well as tensions near the country's border with Syria and the country's involvement in the Libya civil war remain in the forefront. Along these lines, the EU accession process appears to have been derailed.

Global Macro Themes & Implications

17-18 July EU Council: the next milestone for the long-awaited European Recovery Instrument to help economies recover from the unprecedented pandemic-induced downturn

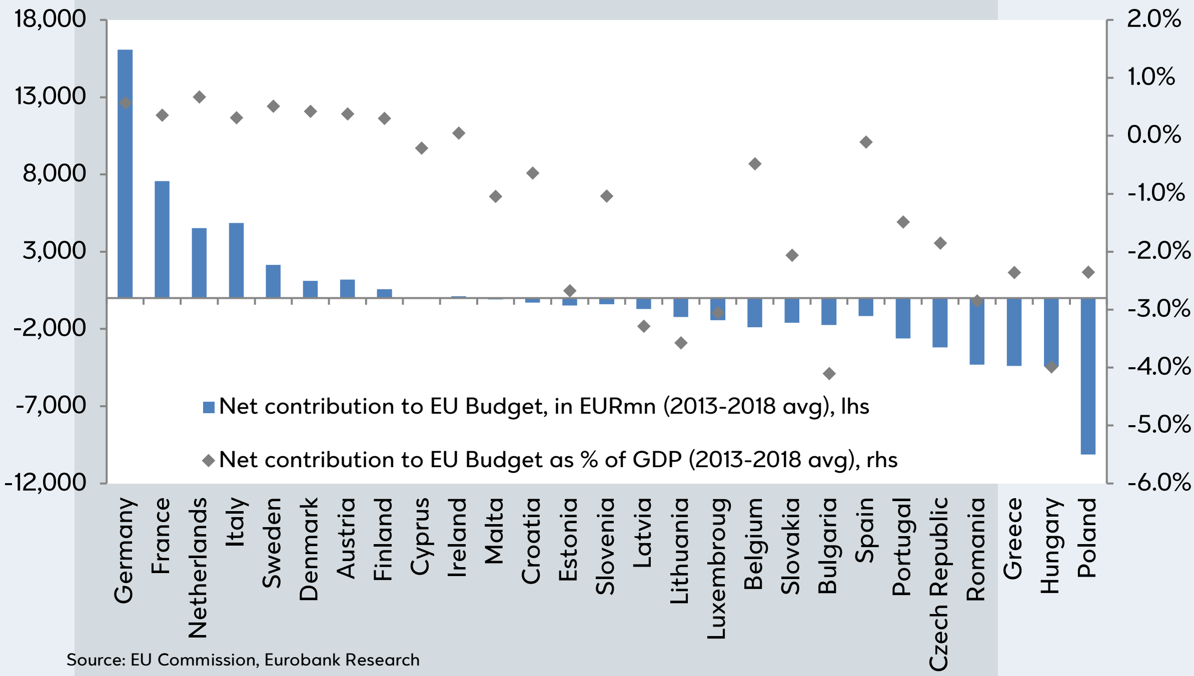
EU heads will hold a special meeting on 17-18 July, the first in-person since the beginning of the Covid-19 outbreak, to discuss the long-awaited EU Commission proposal for a €750bn European Recovery Instrument (5.4% of GDP) labelled "Next Generation EU" and the new EU budget of €1.1trn, the EU's Multiannual Financial Framework (MFF) for 2021-2027 (1.1% of GDP per year). The Recovery Instrument, which is intended to be of an extraordinary and temporary nature, will finance the crisis response between 2021 and 2024; about two-thirds of the resources are to be distributed to member states as grants and the remaining one-third as loans, repaid gradually by the beneficiary member states, with the objective to boost public investment, finance private investment and improve welfare systems The scheme foresees that the Recovery Instrument will be financed by European Commission borrowing from the markets on behalf of the EU taking advantage of its triple-A rating with long-maturity bonds, the repayment of which will start no earlier than 2028 and will be completed by 2058, using national commitments to the EU budget as a guarantee. To repay the bonds, the EU Commission has proposed higher contributions from member states from 1.2% currently (to 2.0% of their GNI for the period until the bonds are finally repaid in 2058) and/or new own resources, for example trough a tax on large corporations, a new EU tax on plastic waste, a carbon border tax and a digital tax. Recovery Instrument funds will come with conditions attached, linked to "sound economic policies and structural reforms", especially with regard to the green and digital agendas.

EU member states are still a long way from an agreement on the EU Recovery Fund and the new EU Budget. The Netherlands, Austria, Sweden and Denmark —four relatively wealthy countries that constitute the so-called "Frugal Four" and are known for their preference in fiscal prudence— have voiced concerns about certain modalities of the Recovery Instrument, including its size, the grants-to-loans ratio, duration, allocation between members, conditionality for grants, governance and budget rebates. Bear in mind that the EU budget mainly benefits the relatively poorer members (net recipients), mostly in Central and Eastern Europe, while the main bulk of expenditures is covered by the wealthier members in the North and Western Europe (net contributors).

Together with the MFF (EUR €1.1tn), the EU Commission's short-term unemployment reinsurance scheme, the so-called SURE (€100bn or 0.7% of GP), the ESM pandemic precautionary credit line (€240bn or 1.7% of GP) and the EIB plan focused on SMEs (€200bn or 1.4% of GDP), the EU Recovery Instrument would bring the total EU stimulus to address the pandemic and support economic recovery to €2.4tn (17.1% of GDP).

Germany holds the rotating EU presidency since 1 July and Chancellor Angela Merkel aims for a political agreement on the EU Recovery Instrument by the end of July, before the summer recess, although she acknowledges that negotiations will be tough, suggesting that a political agreement at the next EU Council meeting on 17-18 July may be difficult to reach. Should this be the case, negotiations could be extended until September, making the release of any significant resources from the Recovery Fund unlikely before 2021 as approval by the national parliaments of all 27 EU member states as well as the EU parliament is also required. Be that as it may, the Recovery Instrument will provide meaningful resources for the kick-start of the EU economy from the Covid-19 pandemic and, importantly, will send a strong signal regarding the potential deeper fiscal integration of Europe.

Figure 3: Net contribution to the EU Budget



Source: EU Commission, Eurobank Research

Brexit talks remain deadlocked, but compromise possible on the condition of mutual concessions

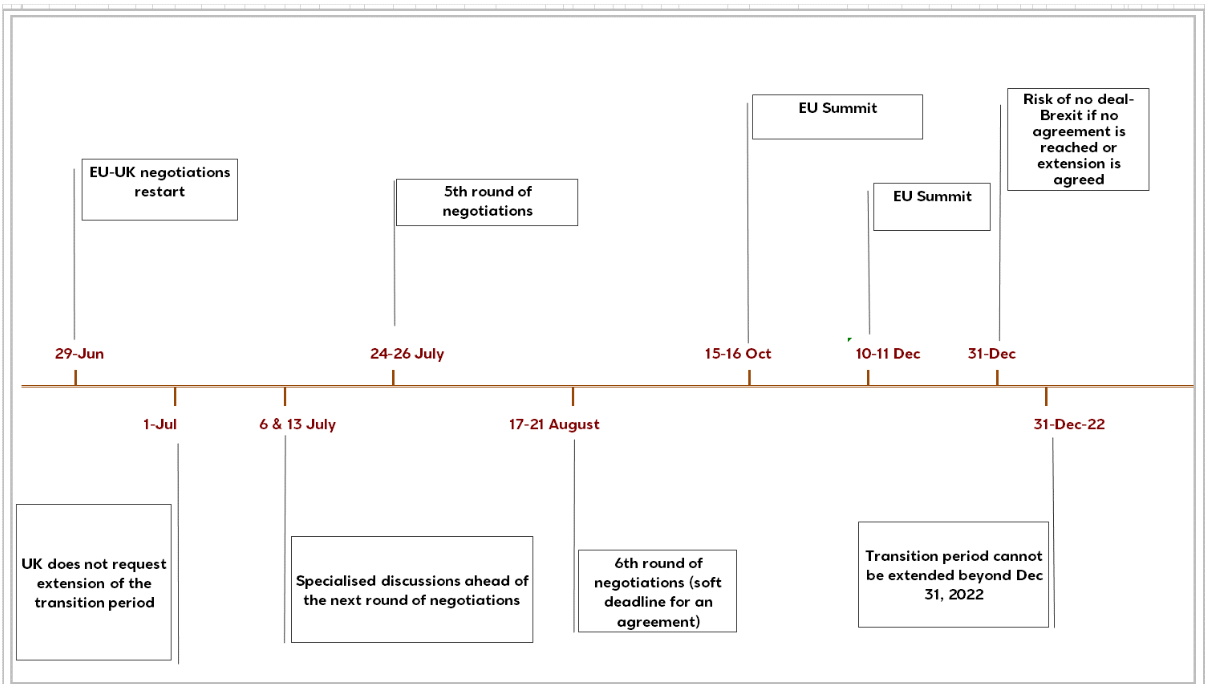
After formally leaving the European Union on 31 January 2020 following the ratification of the Withdrawal Agreement, the UK entered as of 1 February a transition period, which expires on 31 December 2020, giving the government time to come in full agreement with the EU on the principles governing the future EU/UK relationship. During that period, the UK will maintain privileges and obligations as if it were an EU member state (such as the single market, the customs union access, and the four freedoms of movement) but will lose representation and voting rights in EU institutions.

The fourth round of talks related to the future UK/EU trade relationship concluded on 5 June and, as expected, without significant progress. The two sides aim to negotiate a full free (Canada type) trade agreement (quota-free/tariff-free trade on goods), with a view to reaching a comprehensive agreement on their long-term economic relationship that will include trade in both goods and services. In an attempt to break the deadlock, UK PM Boris Johnson, European Commission President Ursula von der Leyen and European Council President Charles Michel agreed on 15 June to intensify Brexit deliberations and hold negotiations every week throughout July and August, starting from 29 June. Though the UK has threatened to walk away from the negotiating table if no significant progress has been achieved by the end of July, the real deadline for an agreement to be sealed is the 15-16 October EU Summit, so that there is adequate time for it to be ratified by the end of the year, when the transition period expires, from both the UK and the EU (approval by a number of national and regional parliament may also be required as the deal may lay outside the EU competences). As the Boris Johnson administration had long stated, the UK refused to submit a request for an extension to the Brexit transition period embedded within the Withdrawal Agreement, further compressing the already incredibly tight timeframe available for an agreement (such a request would have to be submitted by the end of June and the extension would last up to two years).

According to reports, the core remaining disagreements focus on: (ii) the EU fisheries access to UK waters, and (ii) the so-called regulatory level-playing-field arrangements (i.e., the UK to remain close to basic EU rules). In more detail, the EU would consent to a Canada-plus type free trade agreement, contingent on the UK abiding by the continuation of current fishing rights in UK waters and the EU's level playing field "to prevent distortions of trade and unfair competitive advantages". On its part, the UK is aiming for a purer Canada-style free trade agreement, rejecting any commitments to a regulatory level playing field and pushing, instead, for full sovereign control. It also aims to become an independent coastal nation, offering merely an annual review on the EU fishing access and quotas to UK fishing waters. The UK also rejects the role for the European Court of Justice in enforcing any future trade deal.

With the global economy facing its deepest recession in the last decades and a disorderly Brexit likely to make the post-Covid UK recovery even slower, our central scenario is that the two sides will eventually relax their positions, assuming reciprocal moves by both sides, and will manage to seal a free trade agreement ahead of the year-end (following the same pattern with the withdrawal negotiations when a deal was not reached until very close to the deadline). Supporting the above, a number of recent press reports suggest that, though fundamental disagreements remain, both sides signal willingness to compromise conditional on mutual concessions. The deal could most probably concentrate on the removal of quotas and tariffs on goods trade, while, with the EU insisting on regulatory issues and given the constraint of time, talks on trade in services will likely prove more difficult and an agreement will likely take longer to be reached. However, with significant disagreements remaining, a no-deal Brexit scenario at the end of 2020 cannot be ruled out completely, especially in the absence of discernible progress in talks in the coming weeks after a more intense period of deliberations.

Table 1: Brexit: EU/UK negotiations, timeline & important deadlines



Source: EU Commission, Press, Eurobank Research

Macro Themes & Implications in CESEE

The broader CESEE region took a breather in June after the economies reopening in the post-lockdown period, but the road to full recovery remains long and uncertain.

Having taken gradual and timid steps in the previous month, most of the governments have accelerated the reopening of their economies in June in line with their announced roadmaps that describe the gradual steps in lifting the restrictive measures. As of early July, upon the economies reopening, a new rise of infections, hospitalizations and fatalities per country across the region has shown up in the official statistics and the relevant metrics. Even though it is not clear whether this is the beginning of a second wave or the initial result of the economies re-opening, it has created a new bout of uncertainty and cast a renewed cloud over the economic outlook for the second half of an already burdened year. In any case, by comparison with other regions or countries across the world after three months in the pandemic, it's still fair to say that the broader CESEE region seems to have largely addressed the spread of Covid-19 more successfully than Western Europe and USA.

Despite lingering uncertainty, the further re-opening of the economies has strengthened optimism that the worst may be behind. Driven by the easing of the strict containment and social distancing measures, sentiment and survey indicators continued their rebound in June. Having plunged to historic lows in April, economic sentiment readings for both advanced and emerging European economies released earlier this month bounced further back. Having plummeted to multi-year lows, all sub-indices rebounded with the consumer, industry and services ones registering the biggest spikes. The picture of the Markit PMI manufacturing releases in June was equally encouraging. After having dropped steeply across the board in April – in some cases the plunge was even steeper than that seen in the Great Recession – PMI indices also bounced back in June. On the negative side, most of those PMI indices remain in contractionary territory despite the rebound. In our view, this may reflect market concerns for a second wave of the pandemic. From that point of view, uncertainties are still very high and it is still highly doubtful when they will able to reach their pre-crisis levels.

The revised national accounts readings for Q1-2020 have also sent a positive signal. The evidence from national accounts data in Q1-2020 – before the social distancing measures – show that the CESEE economies in most cases performed above market consensus expectations. This is important because it creates a higher starting point for the regional economies entering the recession. Looking at the data on a country by country basis we conclude that with the exception of the Czech Republic (-3.3% QoQ/-2.0% YoY) and Slovakia (-5.2% QoQ/-3.8%YoY), the CESEE economies were clear outperformers compared to their euro area peers. The economies of our focus (Bulgaria, Cyprus and Serbia) fared much better even by regional standards. In fact, Bulgaria was among those few economies that expanded on both a quarterly and an annual basis (+0.3% QoQ/+2.4% YoY) in Q1-2020. The quarterly readings of both Cyprus (-1.3% QoQ/+0.8% YoY) and Serbia (-0.6% QoQ/+5.0% YoY) were much stronger than the regional and EU-28 averages. Finally, Turkey, a clear outlier, expanded by +0.6% QoQ/+4.5% YoY emerging from its previous recession in

2019. In the analysis of the GDP prints across the region, it looks like net exports primarily and investments to a lesser extent were the components that suffered the biggest declines, pushing net exports' contribution into deep negative territory and leaving domestic demand as the key driver to support GDP dynamics.

In this post-Covid19 shock environment, international organizations and rating agencies have been revising downwards their forecasts and publishing their views to reflect the new harsh realities. In its new Global Economic Prospects released in mid-June, the World Bank (WB) warned that the Covid19 pandemic is leading to the deepest global recession since the Second World War. According to WB, the ultimate growth impact is still uncertain, and an even worse scenario is possible if it takes longer to bring the health crisis under control. Moreover, the pandemic is likely to exert lasting damage to fundamental determinants of long-term growth prospects, further eroding living standards for years to come.

Consequently, the WB slashed its growth forecasts dramatically across the board in both advanced and emerging Europe economies due to the impact from the Covid-19 pandemic. In the WB baseline scenario, despite unprecedented policy support, the global economy is set to contract by -5.2% in 2020, the deepest global recession in eight decades, and then rebound by 4.2% in 2021 as economic activity normalizes. To illustrate the magnitude of the forecast revisions, the relevant forecasts for 2020 and 2021 stood at +2.5% and +2.6% respectively back in January 2020.

In such an environment, according to the WB forecasts, the Euro area and Europe & Central Asia (the sub-region closer to our economies of focus from a geographical point of view) are expected to contract by -9.1% and -4.7% respectively in 2020 and then bounce back by 6.3% and 3.6% in 2021. The relevant forecasts for 2020 stood at +1% and+2.6% in January 2020. WB now forecasts that all economies in the broader region will face painful contractions in 2020, yet the rebound will not be symmetrical for everyone in 2021. In particular, for the economies of our focus, Bulgaria is now expected to contract by -6.2% in 2020 and rebound by +4.3% in 2021. Serbia is forecast to contract by -2.5% in 2020 and expand by +4.0% in 2021, Romania by -5.7% in 2020 and +5.4% in 2021, Turkey by -3.8% in 2020 and +4.4% in 2021 and finally Albania by -7.4% in 2020 and +6.1% in 2021.

CESEE Markets Developments & Outlook

Bulgaria

Eurobond yields recorded sharp drops across all maturities, as investors continued to seek positive returns. Yield drops ranged between 12-69 bps, with the 2022 papers posting the smallest change. On the other hand, the 2027 and 2028 papers attracted strong market interest, which was strongly reflected in the respective decline of their yields, namely 59 and 69 bps. Local papers also had an eventful month, with the 5-, 7- and 10-year tenors having their yields sliding by 20-25bps, while the yields of the 20 year papers jumped by 13bps. During June, the Ministry of Finance did not hold any auctions.

Serbia

Despite the eventful agenda during June, both on the politics and the Covid-19 front, the dinar has failed to show any vividness. It has been maintained relatively unchanged by the National Bank of Serbia through constant FX interventions whenever market movements pushed towards imbalances. As a result, the FX rate has been partially unchanged, trading in the narrow corridor between 117.50 and 117.65 since the beginning of the year.

However, partial lockdowns in areas where the pandemic is intensifying again will most probably have a significant impact on the economy. Taking into account that the government will be reluctant to raise funds for an additional EUR5bn package in support of the economy as such a movement would push the public debt above 55% of GDP (currently at 52.5%) and possibly hurt Serbia's credit rating, a possible second pandemic hit could weigh more than the first one. Already, during the January-April period, Serbia has generated a fiscal deficit of RSD114bn (approx. EUR1bn), compared to a surplus of RSD5.5bn in the same period last year. Moreover, between January and May, the value of exports totaled to EUR6.42bn, which is 9.5% YoY lower. Imports declined by 7.1% as well to EUR8.92bn, setting the trade deficit to EUR2.5bn, wider by 0.5% YoY. That said, assuming that global demand keeps recovering in such a slow pace and presumably hurting the country's current account balance, the price for preserving the FX rate stable could be reflected in a sizable reduction of the FX reserves the NBS traditionally holds.

On the fixed income market, signs of stabilization are observed following the initial bond sell off during the pandemic breakout. That said, the whole curve steepened on a monthly basis, with 3Y Treasuries yield falling by 34bps to 2.16%, which is a much steeper drop compared to the 13bps decline of the 12Y government bond yield, trading around 3.71% at the time of writing.

Markets View

Foreign Exchange

EURUSD: The pair reached the 1.14 target and has consolidated in the 1.12/1.14 range ever since. In the absence of new information, the technical picture remains constructive as long as the 1.1170 level is not breached. We are now buyers at dips close to support zone of 1.12, targeting the 1.14 highs. Support comes at 1.1180 area with resistance at 1.1400

GBPUSD: GBP moved lower due to general USD strength. The pair still remains in the tight 1.23/1.265 range and we are now trading at the bottom of the range. Support comes at 1.2250 and major resistance is at 1.2550 (current 1.2545).

USDJPY: The pair continued to trade inside a tight range during June (108.00 – 106.20). During the first days of June the pair broke higher on the back of positive risk sentiment and steepening of USD curve. However, the flattening that followed led to a sharp correction down to the 106.00 area.

Rates

EU: The steepening of the yield curve came to a stall in the first week of June as the strong recovery took a breather. After having one of the best quarters on record, most markets now face the risk that a second wave of coronavirus could derail the reopening of many EU economies. We believe that the yield curve should continue to steepen, which is a typical yield curve reaction when coming out of a recession. However, the rest of the year will depend on Covid19 developments, which are impossible to predict. The drivers are to a large extent offsetting one another (higher supply of debt vs lower core inflation) but the tail risks weigh on the optimistic side (e.g. a vaccine or much greater step towards fiscal union)and suggest a slight steepening for eur curves.

US: US yield curve faced steepening pressures at the beginning of the month amidst a risk on sentiment with 2-30s swaps widening to 0.7% as the short end remained anchored. The move was quickly reversed as many economies faced elevated or even accelerating infection rates. Although the Covid19 resurgence restrains a repricing higher of yields, we believe that this is temporary and given the strengthening data, which confirm a rapid recovery, we expect that the curve will steepen amidst a higher move in long term yields

Emerging Markets credit

After further consolidation in May, spreads in EM remained mostly sideways in June, especially at the second half of the month, completing a substantial positive performance since late March, and catching up further with DM spreads and yield levels. Risks to a successful reopening are starting to materialize as infection rates in LatAm and other regions escalated in June. The JP EMBI sovereign spread index tightened 50 bps more in early June before retracing some of the rally the last two weeks as the Covid-19 related news are becoming alarming again. Talks over restructuring $65 billion of Argentine debt were ongoing in a struggle to overcome the final hurdles to an agreement with creditors. (July 24 deadline for an accord). Region-wise, LatAm underperformed. Oil consolidation around 40$/b, is helping most of oil exporters for now. Overall spreads, remain at elevated/recessionary levels, despite the 3-month rally since early April, reflecting the higher external vulnerabilities and the potential of a second wave economic impact. We maintain a constructive view to IG EM as the full effects of the first wave are still developing, but EM dedicated funds are starting to increase their allocation in the space (+Russia, Colombia, Mexico), as weaker USD and stronger commodities support valuations. Difference between IG and HY names has narrowed more, trading at 350bps, only 35bps wider than pre sell-off levels.

Corporate credit

Further consolidation in spreads, despite strong supply and amid CB continued support. Progressive removal of lock downs and better-than-expected economic data, especially in the US, led to further tightening of credit spreads on the first half of June. EUR IG outperformed US as spreads tightened by another 15 bps. June ends on some retracement of recent rally as spreads edged wider since month start levels. Financials underperformed after strong supply amid worries that the second wave will hit DM sooner than expected, especially in the US. The compression trade in cap structure continued for the most part of June with T2 outperforming Senior. T1 seems able to perform as well going forward. Net issuance slowed in June further supporting new issues and spreads. USD IG spreads tightened in a similar fashion with EU supported by normalization of USD funding pressure. Corporates tightened by 15bps.

In EUR HY all sectors performed well as the relative value hunt kicks in. Dispersion is high and is expected to remain so, but the space is supported by strong government actions. Wirecard Scandal hit the news mid-June as CEO resigned and was arrested over a USD 2bn missing fraud.

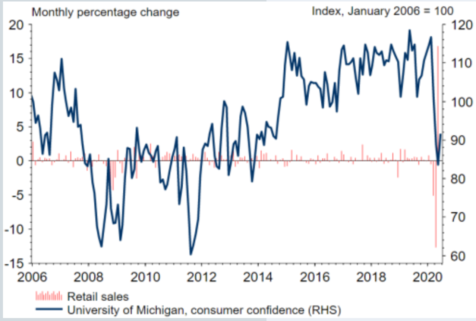
The primary market remained strong with HY hitting the market. New issue premiums were in many cases flat to secondary or even tighter. The new TLTRO is helping more financials and especially periphery, as the better parts of the cap structure are now a proxy trade for Sovereigns. Name selection is important especially in HY space where default rates are expected to increase.

USA

Economic recovery continued through June, but there is a risk of a setback in the rebound as new Covid-2019 cases are rising fast

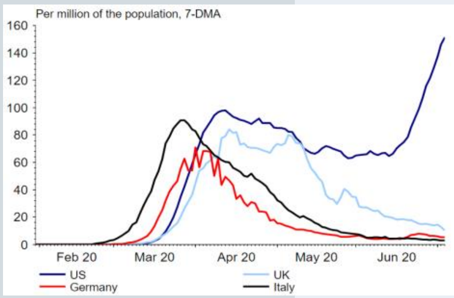
High-frequency economic data continue to point to a rapid recovery in activity as US states emerge from lockdown. May retail sales surged by 17.7%MoM, with broad-based strength across categories, retracing about half of their pre-Covid February level. May personal consumption expenditures rose by 8.2%MoM mainly due to an increase in the consumption of goods, while auto sales improved further in June to 13.1mn, from 12.2mn in May. The recent rebound in durable goods consumer spending seems to be translated into gains in factory demand and production, as the ISM manufacturing PMI moved into expansionary territory to 52.6 in June (+9.5pts), with the majority of industries reporting growth on the month. Meanwhile, June Employment Report strongly exceeded expectations, with a 4.8mn increase in nonfarm payrolls coming on top of net upward revisions to the prior two months and a 2.2pp decline in the U3 unemployment rate to 11.1%. Goods' sector employment is recovering quite quickly, as nearly half of the 2.5mn job losses recovered over the last couple of months, while service sector payrolls have recovered only one-third of the 18.8mn losses up to date. The gradual re-opening of the US economy, coupled with a faster-than-expected bounce in employment growth, is boosting consumer sentiment. The Univ. of Michigan consumer sentiment index increased for the second consecutive month in June, to 78.9, with gains across the current conditions and expectations indices, while the Conference Board's index of consumer confidence rose to 98.1 on the month, reporting the largest monthly gain since late 2011. Nevertheless, the recent surge in the number of new Covid-19 cases in states like California, Texas, Florida and Arizona and the subsequent re-tightening of restrictions on fears that hospitals may soon reach capacity have raised concerns about whether the improvement in the US economy and the labor market can be sustained, especially following recent elevated numbers of jobless claims and the rising trend in the number of permanent layoffs. Overall, we maintain our US GDP growth forecast for 2020 to -6.0% expecting a robust rebound in H2 2020 following a substantial contraction in Q2, but there is an increasing risk of a setback in the rebound largely dependent on a potential second wave of coronavirus cases.

Figure 4: High frequency indicators have recovered from recent lows



Source: Refinitiv Datastream, Fathom Consulting

Figure 5: Covid-19 new daily cases are surging in a number of US states



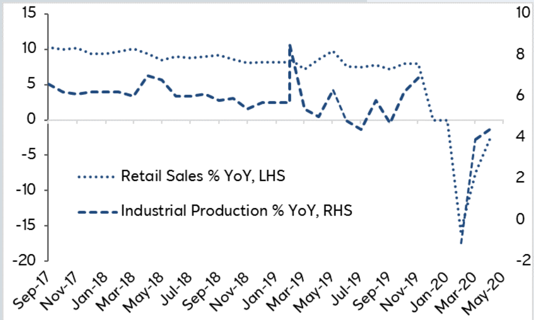
Source: Refinitiv Datastream, Fathom Consulting

China

Hard and soft data point to steady recovery, albeit amid uncertainty around Covid-19 resurgence

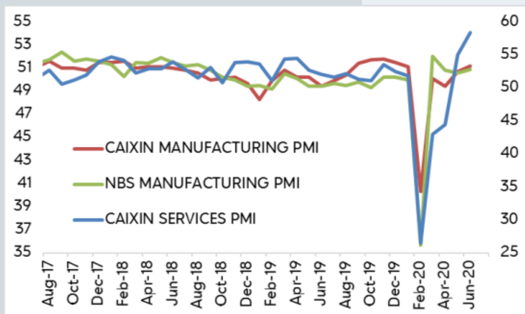
Following Q1 GDP contraction of -6.8%YoY from 6%YoY growth in Q42019, according to May's hard data the economy appears to be gathering pace. Industrial production improved to 4.4%YoY vs 3.9% in April. Retail sales kept shrinking, albeit at a slower pace, i.e. -2.8%YoY from -7.5%YoY in April, posting the best print since December 2019. Fixed assets investments (FAI) growth came in at -6.3%YoY, which is improved compared to the -10%YoY contraction in April. Forward looking data, such as June's PMIs imply that the positive momentum continued in June as well. Official manufacturing PMI came in above expectations, rising by 0.3pts in June to 50.9, following the decline of -0.2pt in May from 50.8 in April. In an even more positive tone, the Caixin PMI on the services industry rose to 58.4 in June from 55 in May, the highest level since April 2010, indicating a faster pace of recovery in both supply and demand sides. More importantly, improved prints in both services PMI, the official and the Caixin, released in late June and early July respectively leave room for some optimism regarding the potential impact of a second wave of Covid-19 infections. The spike of incidents began in mid-June and as such it is taken into account in the responses of the purchasing managers in the services industry, which is considered more vulnerable than the manufacturing in case of a second hit. In brief, during the past 3 weeks in one of Beijing's food markets more than 300 new cases were traced, leading to the partial shutdown of the capital, which is considered the most protected city in the entire China. As things stand, thanks to, inter alia, a rapid and aggressive campaign of testing, the second wave appears to have been tamed. On the policy front, the PBOC cut the interest rates on its re-lending and re-discounting facilities, two of the numerous channels through which the central bank injects liquidity into the financial system, by 25bps on July 1, setting them at 2.25%, and 2% respectively. As both interest rates are mainly used for lending small urban commercial banks, rural commercial and cooperative banks, the aforementioned cuts most probably focused on pumping liquidity to small and medium enterprises, which are the locomotives of the country's GDP growth.

Figure 6: In May, hard data continue to improve...



Source: Bloomberg, Eurobank Research

Figure 7: ...and so do June's soft data, pointing to steady recovery



Source: Bloomberg, Eurobank Research

Euro area

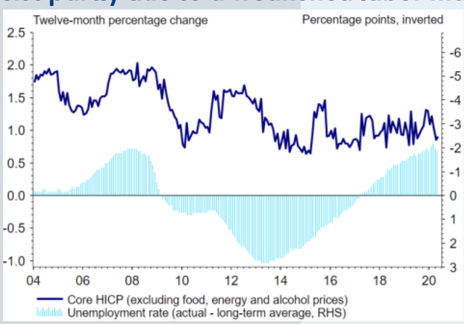
Evidence for a near-term rebound in activity, but economies still remain far from normal capacity utilization rates

Following the first evidence in May for a near-term rebound in economic activity, incoming data continue to surprise to the upside, providing some hope that the recovery could be quicker than previously expected. Following double digit declines in March and April, retail sales increased by 17.8%MoM in May, partly reversing the losses of the previous months. Both service and manufacturing PMIs continued to rebound in June, rising to four-month highs of 48.3 and 47.4, respectively, as most European economies returned back to business, remaining however, still far from normal capacity utilization rates. Persistent low inflationary pressures should boost consumer purchasing power; June core HICP edged down to 0.8%YoY, and we look for downward core pressures until the end of the year partly due to post-lockdown soft demand and the implementation of the temporary VAT rate cut in Germany. To this end, ECB GC Fabio Panetta highlighted recently a highly uncertain inflation outlook with disinflationary forces at the forefront. Despite the encouraging evidence that recovery is well underway, we do not yet see a clear upside risk to our 2020 GDP forecast of -9.0%. We would have to see this uptrend to continue before revising upwards our growth outlook, given our current expectations for a more cautious consumer with a higher propensity to save coupled with a weaker labor market. Adding to the above, the resurgence of cases in Western Germany and Portugal has increased fears of second waves of Covid-19, highlighting the uncertain path to recovery. On the political front, there is still considerable disagreement with the co-called Frugal Four regarding the size and modalities of the Next Generation EU plan, although Germany and France seem willing to reach an agreement at the 17-18 July Special European Council meeting. Regarding monetary policy, apart from the extension of the PEPP programme in June bringing the new total to €1.35 trillion, the extension of the time horizon of the net purchases at least until end-2021, and the reinvestment of the purchases' proceeds until at least 2022, the ECB's liquidity measures are also playing a determinant role in facilitating the flow of credit to the private sector, with 742 euro area banks taking in June the highest amount of liquidity on record (€1,308bn in TLTRO3.4).

Figure 8: Incoming data continue to surprise to the upside

Source: Refinitiv Datastream, Fathom Consulting

Figure 9: Downward core pressures are likely to persist partly due to a weakened labor market



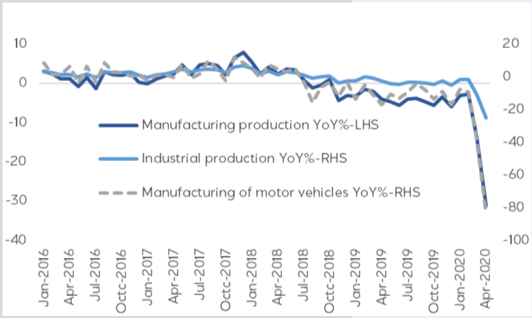
Source: Refinitiv Datastream, Fathom Consulting

Germany

Leading the EU post-lockdown recovery path

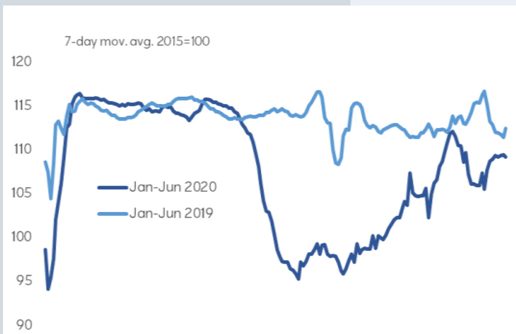
Following a 2.2%QoQ decline in Q1 2020, the biggest since Q1 2009 marred by around two weeks of coronavirus-related lockdown measures (imposed on 22 March), GDP is expected to record an even more pronounced contraction of around 10%QoQ in Q2 on the back of a further 3 weeks of total national lockdowns (cautious relaxation started on 20 April). I dropped by a record high of 25.3%YoY in April after an 11.1%YoY decline in March, primarily due to a 32.2%YoY drop in manufacturing in the wake of an all-time high fall of 83.3%YoY in auto production (Figure 10). Reflecting the significant economic effect of the containment measures and the unprecedented global economic downturn due to the Covid-19 crisis, exports dropped by 23.6%MoM in April and imports fell by a much lower pace of 14.9%MoM, pushing the trade balance from a large surplus to deficit for the first time in around 40 years. However, as suggested by a series of high frequency indicators, which rebounded strongly in May and continued to improve in June supported by the ongoing reopening of the economy, the crisis has probably peaked in April. Several mobility and road-tool traffic statistics, including the truck-toll-mileage index, are approaching relatively rapidly pre-crisis levels (Figure 11), making the Eurozone's biggest economy the frontrunner in the EU recovery path, favored by the laxer lockdowns compared to those imposed in most southern and western European countries and the relatively earlier reopening of the economy as Germany was more successful in containing the virus outbreak during the first wave. In addition, aimed to cushion the severity of the pandemic and help kick-start the economy, the government mounted a record fiscal response (amounting to 23% in the form of cash grants and c. 30% in loan guarantees), larger compared to that of its peers or that adopted during the GFC. Paving the way for a strong rebound in the second half of the year, fiscal support includes a temporary 3pp VAT cut to 16% and a 2pp cut for the reduced VAT rate to 5%, that could help Germany's GDP contract by 6.5% for the year as a whole, faring notably better than the other major EA economies.

Figure 10: Record drop in auto production was the main factor behind the sharp fall in Apri's IP



Source:, Federal Statistical Office (Destatis), Eurobank Research

Figure 11: Truck-toll-mileage: the gap is closing



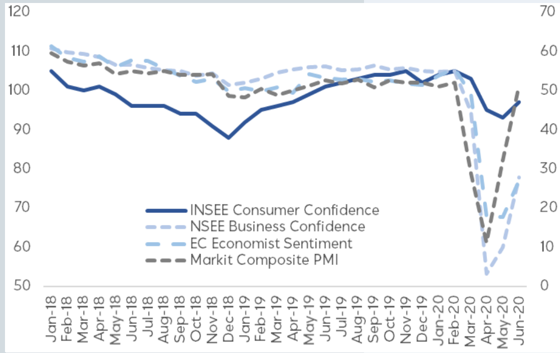
Source: Federal Statistical Office (Destatis), Eurobank Research

France

Cautious but clear post-lockdown economic recovery underway

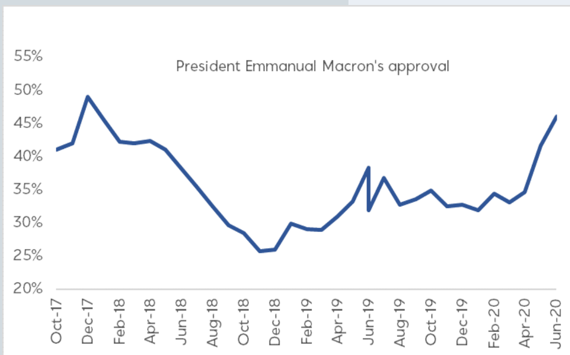
The gradual lifting of restrictions that started on 11 May has led to a cautious but clear economic recovery in recent weeks. France's INSEE estimates that economic activity could be running by an average 14% below normal in June, after operating 25% and 35% below normal in May and in April, respectively. Various soft data show a noticeable improvement from April's trough, including, the INSEE consumer confidence index which recovered further in June strengthening to a three-month high of 97, the INSEE business climate index which improved for the second month in a row coming in at 77.8, and the composite flash June Markit PMI which rose by 19.6pt to 51.7 in June after a 21pt uptick in May, with both manufacturing and services PMI returning back into growth territory (Figure 12). However, the INSEE still expects GDP to collapse 15%QoQ in Q2 after having contracted by 5.3%QoQ in Q1 as the full impact of the virus-related lockdowns and social distancing measures imposed on 17 March will be seen in this quarter. The gradual easing of virus-related restrictions, along with the government's forceful fiscal response to mitigate the economic effect of the pandemic, are anticipated to help economic activity rebound as of Q3, with GDP contracting by 10.0% in FY2020 followed by a 6.3% increase in 2021, rending unlikely a return to pre-crisis levels before mid-2022. Following the unveiling of the third 2020 draft budget in early June, which targets a budget deficit of 11.4% of GDP, the government's coronavirus response measures amount to €136bn (5.6% of GDP) including special measures for sectors worst hit by the pandemic, such as tourism, automotive industry and aeronautics, while state guarantees total €460bn (19% of GDP). The Covid-19 crisis has also political implications. Whereas public support for President Emmanuel Macron has increased significantly during the crisis (Figure 13), his party LREM, which has lost majority in the lower house, suffered a heavy defeat in the second round of municipal elections on 28 June as it failed to win any major city, with the exception of former PM Edouard Philippe who was re-elected mayor of Le Havre.

Figure 12: Various confidence indicators improved in June for the second consecutive month from April's trough, mainly those related to business activity



Source: INSEE, European Commission, Bloomberg, Eurobank Research

Figure 13: Popularity support for France's President has increased significantly during the crisis



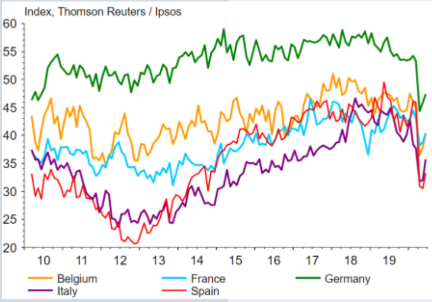
Source: Press, Eurobank Research

Italy

Deterioration in economic conditions eased further in June as more parts of the economy reopened

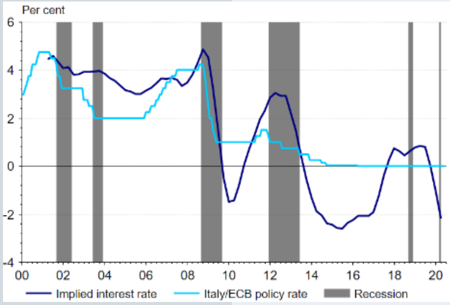
The Covid-19 pandemic and the associated restrictive measures led to a significant downturn in Italian economic activity in the first half of the year. Although the economy continued to contract during June, the pace of the downturn eased noticeably as containment measures to combat the Covid-19 pandemic were relaxed and further parts of the economy reopened. June IHS Markit manufacturing and services Purchasing Managers' Indices (PMI) rose to 47.5 and 46.4 from 45.4 and 28.9 in May, respectively, with factory production increasing for the first time since July 2018 -although the rise was only mild- and smaller reductions in business activity and new orders. Additionally, the Istat's composite business confidence indicator, comprising of the manufacturing, construction, services and retail sectors, increased from a historical low of 52.7 in May to 65.4 in June with broad-based improvement across sectors, while the consumer confidence index rose to 100.6 from an over six-year low of 94.3 in the prior month on the back of stronger current and future components. Overall, the Italian economy is expected to contract by ca. 10.5% in 2020, with the government having announced three response fiscal packages with a total budget impact of ca. €75-80 bn (~4.2% of GDP). Looking beyond the short-term risks associated to the pandemic, the main risk relates to the strength and sustainability of the recovery. While the government's extensive guarantees schemes limit the risk of insolvencies and non-performing loans, they could have a severe negative impact on government finances. Hence, it is of vital importance neither to withdraw the fiscal boost prematurely risking to extend the economic downturn, nor to provide extensive fiscal support with ineffective measures adding to the public sector's liabilities. On the political front, the ruling coalition continues to lose support and has recently lost majority in the Senate, following the recent defection of Senator Alessandra Riccardi who abandoned the Five Star Movement (M5S) to join the Lega. The never-ending turmoil within the M5S, with two other senators reportedly being ready to join the Lega as well, is complicating the government's longevity, making it more and more dependent on the support of independent or other senators in order to enjoy parliamentary majority.

Figure 14: Italian consumer sentiment rebounds, in line with other member states



Source: Refinitiv Datastream / Fathom Consulting

Figure 15: Italy implied vs actual policy rate



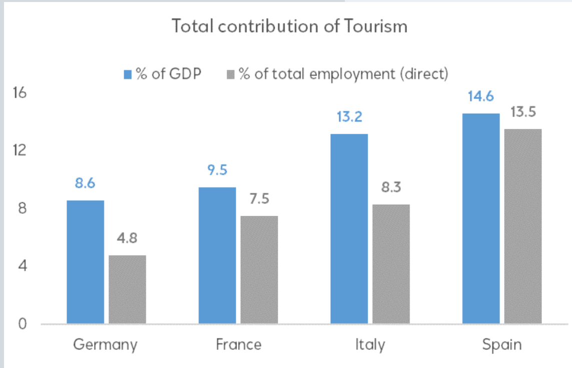
Source: Refinitiv Datastream / Fathom Consulting

Spain

Impact of the COVID-19 pandemic likely to prove persistent

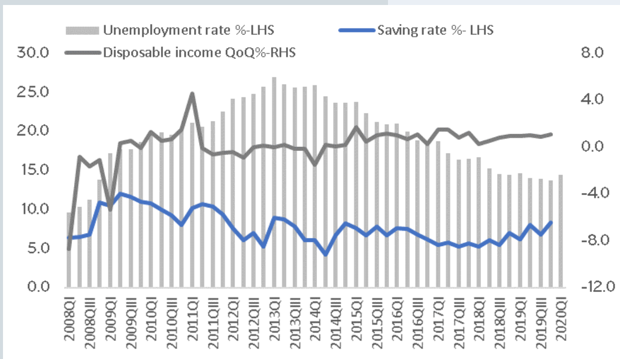
The strict nationwide lockdown and social distancing measures adopted in mid-March to mitigate the spread of the Covid-19 outbreak, led to an unprecedented 5.2%QoQ GDP contraction in Q1, the highest ever and well above the EA average of -3.6%QoQ. Though these measures have started to gradually ease since early May —at a varying speed among municipalities dependent on epidemiological characteristics— GDP should fall even further in Q2 as the full brunt of the containment measures is felt. Assuming a slow but steady lifting of restrictions and a gradual improvement in consumer sentiment, GDP is expected to recover in Q3 followed by a more modest gain in Q4, but given the depth of the projected H1 downturn, the anticipated recovery in H2 is unlikely to prevent 2020 GDP from contracting by 9.6%, before rebounding by 6.0% in 2021. This would leave GDP still below pre-pandemic Q4 2019 levels at the end of next year, in spite of the government's ample support to address the economic impact of the pandemic (fiscal support in the form of cash grants amounts 9.4%-of-GDP and loan guarantees 16.1%-of-GDP), suggesting that the effect of the Covid-19 shock will likely prove persistent. That is because of a number of factors, including Spain's unfavorable labor market conditions. Temporary employees account for a relatively high share of employment, a reason behind the increase in the unemployment rate to a 1-½ year high of 14.4% in Q1, double the EA average, in spite of the government's generous unemployment schemes to protect jobs. In addition, tourism, which is among the hardest hit sectors from the pandemic, accounts for a relatively high share of Spain's GDP and employment (Figure 16). The expected sharp fall in economic activity and government's ample stimulus are anticipated to have a severe negative impact on public finances, with the general budget deficit projected to increase in 2020 for the first time since 2012 to above 10%-of-GDP, leaving Spain vulnerable to potential rating downgrades.

Figure 16: Tourism accounts for a large share of Spain's GDP & employment



Source: World Travel and Tourism Council, OECD, Research Eurobank Research

Figure 17: Relatively low saving ratio going into the pandemic and rising unemployment, likely delay the expected economic recovery



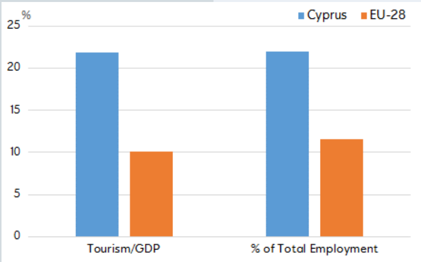
Source: INE, Eurostat, Eurobank Research

Cyprus

Economic sentiment bottoming out in June

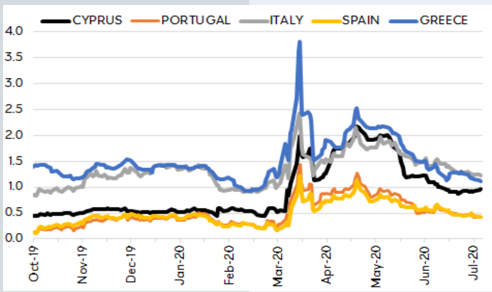
On a seasonally adjusted basis, real GDP slowed to -1.3% QoQ/0.8% YoY in Q1-2020 compared to 1.0% QoQ/3.2% YoY in Q4-2019 and 1.4% QoQ/3.2% YoY in Q3-2019. Final consumption dynamics (1.4% QoQ/3.9% YoY in Q1-2020 vs. -1.0% QoQ/2.8% YoY in Q4-2019) made a 3.1ppts contribution to GDP growth in Q1-2020. The bulk of it came from government consumption (+7.8% QoQ/+16.3% YoY) as private consumption remained subdued (-0.1% QoQ/+1.0% YoY). Investment spending, at constant prices, was higher on an annual basis (+15.1% QoQ/+29.1% YoY) driven by transport equipment, which is related to ship purchases as investment in residential and contruction projects remained flat. However, the negative inventories performance resulted in gross capital formation having a smaller contribution (+1.5ppts). Finally, net exports' contribution was negative (-3.8ppts in Q1-2020 vs. -5.8ppts in Q1-2019). That was the combined effect from both exports contracting by -4.5% QoQ/-5.3% YoY, and imports dropping by +1.0% QoQ/-0.2% YoY. The timely and consistent response to the deepening Covid19 crisis averted a hygiene crisis with infections and fatalities remaining very low in Cyprus until now, by comparison with EU peers. Nevertheless, the impact of the Covid19 pandemic is expected to be detrimental, with stricter lock-down regulations and social distancing measures putting the economy under stress in Q2 and a mild rebound starting as of Q3. The first indication in that direction comes from the sentiment that bottomed out in May-June. Having plunged below its long-run average in April, at levels comparable to those seen between late 2012 and 1H-2013, at the peak of the previous banking crisis and bail-in events, the economic sentiment indicator (ESI) started recovering. Unless there is a second wave of the pandemic worldwide, sentiment improvement is expected to accelerate further in the coming months. But even then, it would be hard to see how Cyprus could escape a deep recession given that it is a small, open and services oriented economy with tourism & travel having a substantial direct and indirect contribution to GDP (21.9% of GDP) and employment (22% of total employment) and professional services, maritime transport and logistics constituting the backbone industries. In our baseline scenario, we forecast that the output losses could be contained at -7.5% in 2020 followed by a strong rebound in 2021. Meanwhile, the impact of the pandemic has started weighing on the fiscal side. As a percentage of GDP, the general government deficit stood at -2.6% in 5M-2020 vs. a 0.9% surplus in 5M-2019 with the FY2020 expected at -4.3% according to the Ministry of Finance baseline scenario.

Figure 18: The contribution of tourism & travel industry is pivotal to the economy



Source: WTCC, Eurobank Research

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



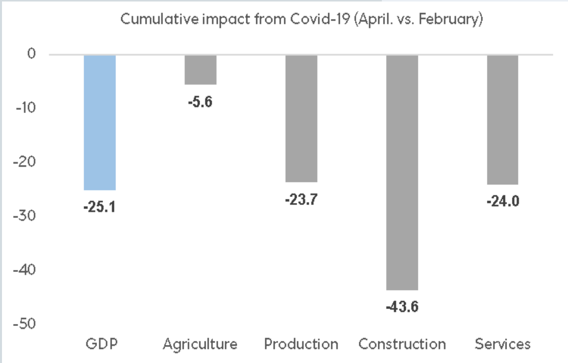
Source: Bloomberg, Eurobank Research

UK

Post-lockdown recovery likely to be slower than its peers

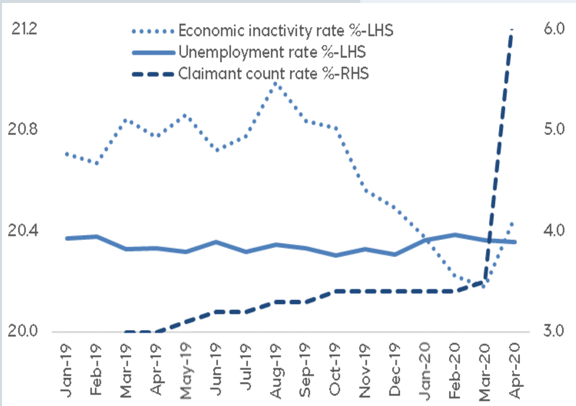
UK April GDP contracted by a record pace of 20.4%MoM, mirroring a full month of national lockdown (the UK was put into lockdown on 23 March). Following a 5.8%MoM GDP decline in March, the cumulative output drop during the lockdown period is 25.1% (Figure 20). Steep declines were seen across all sectors, with construction being by far the hardest hit. However, as the lockdown is gradually easing since mid-May, April will likely mark the trough of economic activity. Indeed, a string of high frequency indicators for May and June, including PMIs, has surprised positively, pointing to a recovery in the remainder of Q2, especially in June, following the re-opening of non-essential shops (15 June) and the government's decision to expedite the re-opening of parts of the hospitality sector (22 June from 4 July initially planned), as the looming spectre of large scale business bankruptcies is purportedly pushing for a more rapid easing of restrictions. However, GDP growth in Q2 as a whole is expected to collapse by an unprecedented pace of 20%QoQ (BoE estimate), before domestic economic activity partially bounces back in Q3 favored by the further easing of restrictions. Pubs, restaurants, hairdressers and cinemas will all be allowed to reopen on 4 July, along with the relaxation of the 2-metre social distancing requirement to 1-metre, even though several members of the government's scientific advisory committee (SAGE) warn about the risk surrounding a second outbreak as the number of new cases, albeit on the decline, is still elevated. That said, the UK outlook seems surrounded by huge uncertainty, with post-lockdown recovery likely to be slower than peers. Brexit concerns prevail while there are increased risks of long-term damage to the economy, particularly stemming from the labor market, once the government's employment subsidy schemes are wound down and eventually completed in October. The BoE increased QE in June but the marginally hawkish tone of the minutes suggests that further stimulus would likely require a material deterioration in the UK economic outlook.

Figure 20: Broad-based slowdown in the UK in the lockdown period



Source: ONS, Eurobank Research

Figure 21: Increased inactivity prevented a rise in the April's unemployment rate but a sharp rise in the claimant count rate points to a weakening labor market



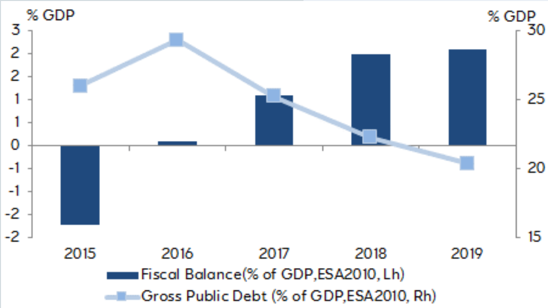
Source: ONS, Eurobank Research

Bulgaria

Sound fiscal position and quick marching towards the ERMII mitigate the impact from Covid-19 resurgence

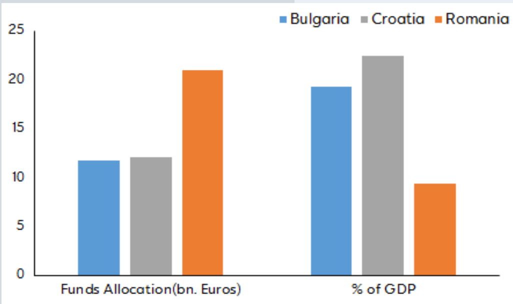
While the handling of the pandemic has been considered overall successful so far, given the low number of infections and fatalities, the easing of measures since mid-May resulted in a pickup of cases in June and led the government to extend the state of emergency due to Covid-19 until July 15. The adopted lockdown measures to combat the first wave of infections entailed a significant economic cost, part of it already felt in the Q1 GDP growth print released in early June (0.8%YoY in Q1-2020 vs 3.1%YoY in Q4-2019) while the prolongation of measures can only intensify the negative impact, which will be visible in Q2's reading of economic output. We consider the timing of the resurgence of Covid-19 cases aggravating as Bulgaria, compared to its regional peers, relies substantially on tourism (accounts for ca 12% of GDP) which is flourishing in the summer. In this context, all forecasts of international organisations' point to a recession in 2020 and a rebound in 2021, albeit with substantial variability among their estimates. OECD, the European Commission and the World Bank forecasts stand at -8%, -7.2% and -6.2% while those of the IMF and the EBRD at -4.0% and -5.0% respectively in 2020. Accordingly, all of them predict a rebound in 2021 which, assuming no second wave of infections, ranges from +2.4% (OECD) and +6% according to the EC and the IMF forecasts. As things stand, risks for the economy are tilted to the downside. However, mitigating factors that could restrain the magnitude of the recession can be identified as well. The country's healthy fiscal and external position allows for optimism that there is room for the implementation of anticyclical policies in order to mitigate the impact of the crisis. Moreover, under the European Commission's EUR750bn proposal in the new instrument Next Generation EU, the net economic support is expected at EUR11.7bn, or 19.3% of its GDP, placing the country among the most benefitting from EU support, along with Croatia. Finally, the completion of the FiBank share capital increase which was the only pending prerequisite in the ERM II accession process brings the country closer to the Eurozone. In fact, Fabio Panetta, Member of the Executive Board of the ECB, stated in June that 'the first available window for Bulgaria and Croatia to join the euro area would be 2023, if all preliminary assessments are successful'.

Figure 22: Bulgaria's fiscal position is sound



Source: Bloomberg, Eurobank Research

Figure 23: Allocated funds proposal from EU Recovery Fund for Bulgaria-Croatia-Romania



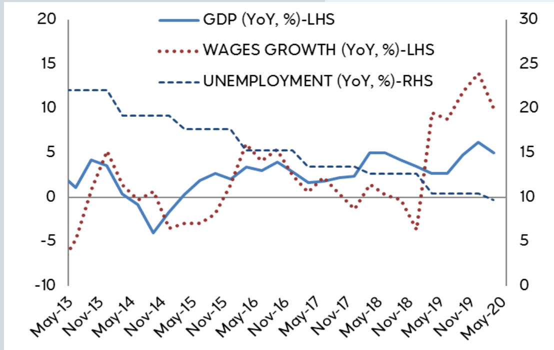
Source: European Commission, Eurobank Research

Serbia

SNS's landslide victory signals policy continuity amid Covid-19 resurgence

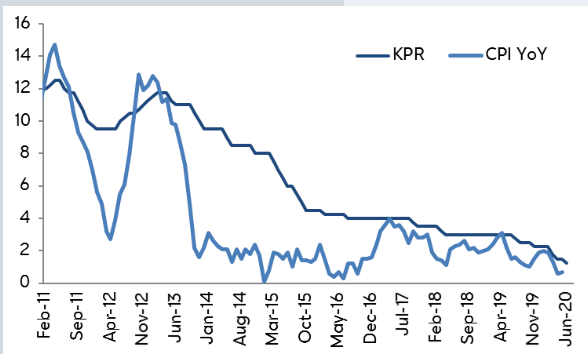
June's dominant development comes from the political scene. The center-right ruling coalition, SNS, succeeded a landslide victory by gaining 63% of the votes and securing 189 out of the 250 parliamentary seats. The weak turnout of ca.48%, lower compared to that of the 2016 elections, casted a shadow over the overwhelming outcome but it is broadly attributed to the boycott campaign by the SNS's key opposition coalition Alliance for Serbia and fears over Covid-19 transmission. The result of the elections signals policy continuity and as such fiscal prudency and increased public investment, under the Serbia 2025 plan, are likely to remain key government priorities. On the foreign policy agenda, the EU accession endeavors are expected to gain speed, letting aside the fact that Serbia fosters its ties both with Russia and China either through its participation in the Russian-led Eurasian Economic Union, EAEU, and the Belt and Road Initiative that infuses sizeable Chinese FDI in the country. That said, right after his reelection and following a one-day visit to Brussels on Friday where he met with top level representatives of the EU institutions, President Aleksandar Vučić expressed the view that by the end of the new Government's term in 2024, the accession negotiations with the EU will have been completed, and that it is realistic for the country to become an EU member by 2026. However, the normalization of relations with Kosovo remains a key obstacle towards this direction and progress on this front should and is expected to be pursued so as to ensure the viability of the European aspirations. On the pandemic front and its economic repercussions, while in June the virus curve was substantially flattened, the easing of measures thereafter resulted in a severe surge of Covid-19 cases forcing the government to declare a state of emergency in the capital, Belgrade, and to re-impose a series of protective restrictions. The re-instatement of the state of emergency coincided with the IMF's fourth review completion under the Policy Coordination Instrument (PCI). The Fund kept its GDP growth forecast at -3% in 2020 and stated that the PCI may be implemented broadly on track, but objectives for the remainder of the program are required given the sharp economic deterioration.

Figure 24: Strong Q1 GDP growth print and firm labor market



Source: Bloomberg, Eurobank Research

Figure 25: Monetary easing continues in efforts to contain the recession



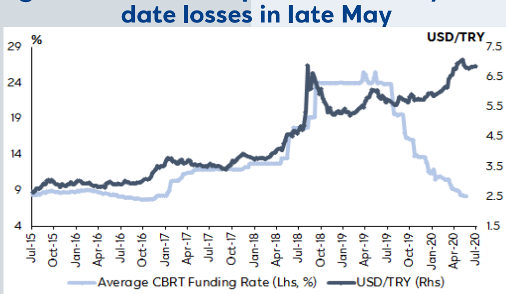
Source: Bloomberg, Eurobank Research

Turkey

Central Bank paused the easing cycle in late June

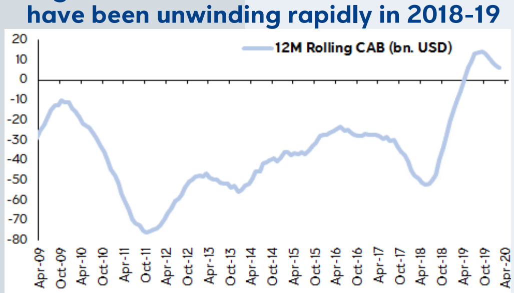
On June 25th, the Central Bank of Turkey (CBRT) left its key policy rate (KPR) unchanged at 8.25%. Recall that the CBRT had slashed the KPR by 1575bps in nine consecutive sessions in the current easing cycle. The decision – the first so far in the current easing cycle in a year – took by surprise the relevant surveys' consensus of Reuters and Bloomberg. In our view, the CBRT decision most probably signals the end of the easing cycle. We have argued that room for further rate cuts under the current circumstances is very limited. So far, the policy mix has been focused on providing additional support to growth. Further rate cuts were also warranted by the expansionary stance of major Central Banks and the substantially weaker global growth environment. On the other hand, the aggressive monetary policy stance has pushed real interest rates into deep negative territory, stoking concerns for the lira and for a resurgence in inflation at a later stage. The relatively low, by any metric, FX reserves capacity of CBRT urged authorities to negotiate new or expand on existing swap agreements with other Central Banks. Having been on a steady depreciation trend, the lira has continued strengthening in the last two months recouping some of its losses (at 6.85/$ on July 2, -15.2% Ytd) driven by those expectations. Meanwhile, GDP remained in an expansionary mode in Q1-2020, although the impact of the Covid19 pandemic became more apparent in the weaker input from the services sector. Underpinned by still strong domestic demand dynamics, GDP slowed to 0.6% QoQ on a seasonally adjusted basis in Q1-2020 vs. 1.9% QoQ in Q4-2019 compared to 0.4% QoQ in Q3-2019, albeit slowing from 1.7% QoQ and 1.0% QoQ in Q2 and Q1 respectively. On an annual basis, GDP expanded by 4.5% YoY in Q1-2020 – below consensus expectations (Bloomberg: 44.9%) – down from 6.0% YoY in Q4-2019 & 1.0% in Q3-2019. From a demand side point of view, private and public consumption expanded by 5.1% YoY and 6.2% YoY respectively, making a combined contribution of 3.9ppts. Net exports made a negative contribution of 4.3ppts with exports contracting by -1% YoY and imports growing by 22% YoY. Investments (-1.4% YoY) weighed further on economic activity subtracting 0.4ppts. Finally, inventories made a hefty contribution of 5.3ppts, offsetting some of the output losses. Having posted multi-year lows in April, all sentiment indicators rebounded in May and June reflecting the easing of the lockdown measures and the containment of the pandemic whilst signaling the bottoming out of economic activity contraction.

Figure 26: Lira recouped some of its year to date losses in late May



Source: Bloomberg, Eurobank Research

Figure 27: Macroeconomic imbalances have been unwinding rapidly in 2018-19



Source: National Authorities, Eurobank Research

Eurobank Macro Forecasts

	Real GDP (YoY%)			CPI (YoY%, avg)			Unemployment rate (% of total labor force)			Current Account (% of GDP)			General Budget Balance (% of GDP)		
	2019	2020f	2021f	2019	2020f	2021f	2019	2020f	2021f	2019	2020f	2021f	2019	2020f	2021f
World	3.0	-3.2	5.0	3.5	2.6	3.0									
Advanced Economies															
USA	2.3	-6.0	4.0	1.8	0.8	1.8	3.7	10.5	8.5	-2.3	-2.6	-2.8	-5.8	-15.0	-9.0
Eurozone	1.2	-9.0	4.5	1.2	0.2	1.1	7.5	9.5	8.5	3.3	3.4	3.6	-0.6	-8.0	-3.5
Germany	0.6	-6.5	5.0	1.4	0.5	1.5	3.2	4.0	3.5	7.6	6.1	7.4	1.4	-8.5	-3.2
France	1.3	-10.0	6.3	1.3	0.4	1.0	8.5	10.0	10.3	-0.8	-0.9	-0.7	-3.0	-11.4	-5.7
Periphery															
Cyprus	3.2	-7.5	5.0	0.5	-0.5	0.5	7.1	10.0	9.0	-7.1	-10.0	-9.0	2.8	-4.0	-2.0
Italy	0.3	-10.5	5.0	0.6	0.0	0.8	10.0	12.0	10.5	2.8	3.1	3.1	-1.6	-12.0	-4.5
Portugal	2.2	-8.0	5.0	0.3	0.0	0.7	6.5	9.5	8.5	0.0	-0.6	-0.4	0.2	-7.8	-3.0
Spain	2.0	-9.6	6.0	0.8	0.0	0.8	14.1	19.0	17.0	2.0	3.2	2.8	-2.8	-11.0	-6.8
UK	1.4	-8.5	5.5	1.8	1.0	1.5	3.8	6.7	6.7	-4.3	-4.2	-4.5	-2.1	-12.0	-7.0
Japan	0.7	-4.0	2.0	0.5	0.0	0.2	2.4	3.0	2.4	3.6	1.7	1.9	-2.8	-7.0	-3.0
Emerging Economies															
BRICs															
Brazil	1.1	-6.5	3.4	3.7	2.5	3.1	14.0	13.5	12.5	-2.7	-2.8	-1.5	-1.7	-13.5	-7.0
China	6.1	2.0	7.0	2.9	2.5	2.0	3.6	4.4	4.2	1.2	0.5	0.8	-4.9	-8.1	-5.6
India	6.1	-4.5	7.2	3.7	4.2	4.0		*NA*		-0.9	-0.5	-0.9	-0.2	-7.0	-5.0
Russia	1.3	-5.0	3.0	4.5	3.2	4.0	4.6	5.7	4.9	4.8	0.6	1.5	1.5	-5.0	-2.5
CESEE															
Bulgaria	3.4	-4.5	4.0	2.5	1.5	2.0	4.2	8.5	7.0	4.0	2.0	3.0	-1.0	-4.0	-2.5
Romania	4.1	-6.5	5.0	3.8	2.5	3.5	3.9	9.0	6.5	-4.6	-5.5	-4.0	-4.1	-7.5	-4.0
Serbia	4.8	-2.5	4.5	2.2	1.0	3.0	13.1	14.0	13.0	-5.8	-6.5	-5.0	0.2	-5.0	-0.5
Turkey	0.9	-5.5	4.5	15.2	10.5	10.0	13.8	17.0	15.5	1.1	-1.0	-0.5	-3.0	-7.0	-4.0

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

Eurobank Research

Eurobank Fixed Income Forecasts

	Current	September 2020	December 2020	March 2021
USA				
Fed Funds Rate	0.00-0.25%	0.00-0.25%	0.00-0.25%	0.00-0.25%
1 m Libor	0.16%	0.22%	0.25%	0.26%
3m Libor	0.28%	0.38%	0.42%	0.44%
2yr Notes	0.16%	0.27%	0.33%	0.39%
10 yr Bonds	0.69%	0.84%	0.94%	1.05%
Eurozone				
Refi Rate	0.00%	0.00%	0.00%	0.00%
3m Euribor	-0.44%	-0.36%	-0.37%	-0.37%
2yr Bunds	-0.68%	-0.65%	-0.62%	-0.58%
10yr Bunds	-0.43%	-0.44%	-0.38%	-0.30%
UK				
Repo Rate	0.10%	0.10%	0.10%	0.10%
3m	0.11%	0.21%	0.18%	0.19%
10-yr Gilt	0.21%	0.34%	0.36%	0.43%
Switzerland				
3m Libor Target	-0.68%	-0.68%	-0.69%	-0.69%
10-yr Bond	-0.40%	-0.48%	-0.46%	-0.43%

Source: Bloomberg (market implied forecasts)

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