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GLOBAL & REGIONAL MONTHLY

The global growth outlook has improved considerably since May, as Q2 GDP contractions in major economies were typically less severe than previously feared and the subsequent bounce in Q3 has surprised to the upside. Although global manufacturing activity continues to normalize, the services sector is still running well below capacity. The pace of the global economic recovery looks likely to slow in Q4, as new Covid-19 infections in a number of key regions, the upcoming US presidential elections and Brexit-related jitters should induce significant uncertainty and, therefore, weigh on sentiment. For 2020 as a whole, we expect a 3.2% contraction in global GDP, followed by a recovery of 5.0% in 2021.

Macro Picture

USA: Underlying growth momentum looks resilient, but fiscal uncertainty constitutes a key downside risk

EA: Decelerating growth momentum from year end, accelerating again in H2 2021

UK: In spite of the expected GDP rebound in Q3, the growth outlook remains challenging

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CESEE: Second wave undermines the regional prospects of a rebound in 2H-2020&2021

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USA: Enhanced forward guidance signals near zero rates until at least 2023

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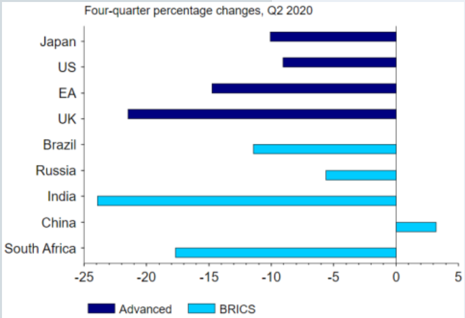
World Economic Outlook

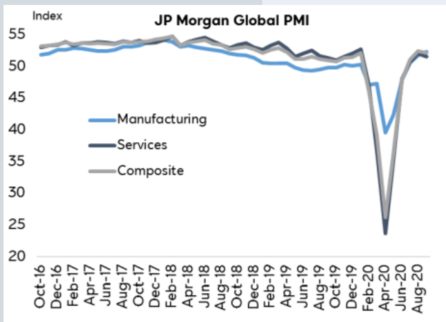
The global growth outlook has improved considerably since May, as Q2 GDP contractions in major economies, in response to lockdowns driven by the Covid-19 pandemic, were typically less severe than previously feared (Figure 1) and the subsequent bounce in Q3 - at least in its initial phase - has surprised to the upside. PMI surveys suggest that the global manufacturing recovery continued at the end of Q3, with the J.P. Morgan Global Manufacturing PMI increasing to a 25-month high of 52.3 in September from 51.8 in August, as 21 out of 29 nations for which PMI data were available signaled expansion (Figure 2). Faster upturns in the US and the euro area were in part offset by slower growth in the UK and China and the ongoing contraction in Japan, while, on a sectoral level, the improvement remained broad-based across the consumer, intermediate and investment goods industries. Although global manufacturing activity continues to normalize, the services sector, which tends to be more sensitive to the trajectory of the Covid-19 pandemic, is still running well below capacity. Indeed, the J.P. Morgan Global Services PMI declined marginally to 51.6 in September, remaining close to August's seven-month high of 52.0 (Figure 2). China seems to be an exception to the decelerating trend in services, as the official NBS Non-Manufacturing PMI increased to near a 7-year high of 55.9 in September, signaling the fastest growth since November 2013.

Figure 1: Q2 GDP contractions proved less severe than feared



Source: Refinitiv Datastream, Fathom Consulting

Figure 2: Global growth momentum slows but remains solid in September



Source: Refinitiv Datastream, Eurobank Research

The pace of the global economic recovery looks likely to slow in Q4, as new Covid-19 infections in a number of key regions that have triggered renewed restrictions, the upcoming US presidential elections and Brexit-related jitters should induce significant uncertainty and, therefore, weigh on sentiment. In the US, economic activity resumed rapidly after lockdowns were gradually lifted and the labour market has started to recover surprisingly fast. Although a sizeable increase in Covid-19 infections in July slowed down the recovery, a decline in new virus cases in August allowed the economy to accelerate again. The recovery is anticipated to continue well into Q4, but at a much slower pace after the sharp upsurge, partly due to the lack of a

Phase 4 spending deal. In the euro area, the resurgence in new Covid-19 cases - especially in Western Europe, i.e. Spain and France – represent a key risk factor for the economic outlook and could impede the ongoing recovery. However, we believe that the ensuing measures will be tightened on a regional level and include localized restrictions in several EA countries but not shutdowns of the entire economies. For 2020 as a whole, we expect a 3.2% contraction in global GDP, followed by a recovery of 5.0% in 2021.

Developed Economies

US: Following an upwards revision to Q2 GDP growth by 0.3pp to -31.4%QoQ saar, the overall quarterly decline remains the largest drop on record, followed by an expected robust rebound in Q3. Fiscal uncertainty constitutes a key downside risk to the economic outlook, with a new fiscal stimulus package most likely to be delivered after the November presidential election. Following the expiration of certain government pandemic assistance programs under the CARES Act, the resulting decline in households' income has already begun to weigh on economic activity, constituting a negative factor for GDP growth in Q4 before picking up from Q1 2021 onwards, amid some post-election fiscal support. Overall, we have revised upwards our 2020 GDP forecast and now expect a decline of 5.0%, given that there has been enough progress in the recovery and the momentum in underlying economic activity has exceeded expectations. The trajectory of the Covid-19 pandemic, coupled with the expected additional fiscal stimulus, are anticipated to determine to a great extent the pace of the US recovery.

Euro area: Although hard economic data up to July suggest a sharp rebound from the historical Q2 GDP contraction of 11.8%QoQ, the most recent economic indicators suggest slowing momentum towards end-Q3, likely reflecting the end of the technical rebound in activity and the resurgence of Covid-19 infections in Europe that mainly affect the services sector that is still running significantly below capacity. Inflationary pressures are likely to remain muted until the end of 2020, with slightly negative headline inflation prints amid subdued travel, recreation and leisure services activity, before gradually picking up in 2021 on the back of strengthening domestic and global demand helped by large-scale fiscal and monetary stimulus. Following the stronger Q2 GDP second estimate and upgrades to Q3 outlook for Germany and France, we revised upwards our 2020 GDP forecast to -8.0%, and expect economic activity to continue running below normal levels in H1 2021, particularly in the services sector. Hence, the strong rebound is anticipated to occur in H2 2021 with the investment boost from the European recovery programs and provided there will be widespread vaccinations against Covid-19 by then.

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 is expected to bounce back in Q3. However, as we go into Q4, hard data and sentiment indicators suggest that the improvement is likely to continue, albeit to a lesser extent. The anticipated slowdown is likely to be more pronounced in Spain, as the Eurozone's fourth largest economy, and especially the capital city of Madrid (accounting for around 20% of Spanish GDP), has been the epicentre of the second wave of Covid-19 infections in the EU. The number of daily new cases in Madrid last week was the highest compared to any other region in Europe, double the Spain's national rate and around 50% more than in France, which is the second most affected European country, forcing the central government to impose severe restrictions of mobility in the region. Adding to Spain's downside risks, tourism, a sector that is generally suffering the most from the pandemic, makes up for a particularly large share of the Spanish economy. It is also worth noting that more than half of total tourism expenditure is represented by foreign tourists, a higher rate compared to that of Italy and France, the other two major holiday destinations in Europe, making Spain's tourism sector much more dependent on foreign tourists. Against this background, we revised downwards our 2020 GDP growth forecast to -11.6% from -11.0% previously, while at the same time we revised upwards our growth forecasts for other major EA economies. On an encouraging note, generous ECB monetary policy support and the EU Recovery Fund are clear upside growth risks, as Spain is among the largest potential net recipients.

Emerging Economies

BRIC: Q2 GDP prints released in September revealed the divergent trends between China and the other three members of the group. One month later, the landscape remains broadly unchanged but with some signs of improvement in Q3, especially for the 3 out of 4 countries of the group, which are navigating recessionary waters in 2020. China's economic recovery remains intact. While the improvement at play since May was initially driven by the supply side, economic activity appears to have gained a more broad-based momentum now. In Brazil, the Covid-19 pandemic remains severe but has shown some signs of containment with daily new cases in early October hitting the lowest level since mid-May. On the economic front, the IMF, under the completion of Article IV mission in 2020, projected in early October a -5.8% recession in 2020, followed by a partial recovery of +2.8% in 2021. Russia's recession in 2020 is expected to turn out milder, i.e. around -4%, as leading indicators point to a strong recovery in Q3. Nevertheless, US elections in November tilt geopolitical risks to the downside. With India's economy having crashed by -23.9% YoY in Q1-2021 (April-June), a recovery is anticipated thereafter. Nevertheless, 2020 will be a year of deep recession of about -8% with an equivalent rebound expected in 2021.

CESEE: As of early October, four 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 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 sectors and keep politicians and policymakers under pressure for more stimulus.

Special Topic
US Presidential Elections 2020

With under 30 days to go, the US presidential elections are likely to lure market attention in the coming weeks. Former Vice President Joe Biden - the Democratic Party's nominee - seems to be well ahead of Republican President Donald Trump in the race for the presidency, with polling averages pointing to a solid lead of about 7.5-8.5 pp nationwide (and 4-5 points in swing states) and a similar share of voters still undecided. According to FiveThirtyEight's forecast model[1], there is an 81% probability of a Biden victory, having increased from 77% a week ago, while prediction markets suggest that Biden's chance of winning has stabilized and has even increased over the last week from 55% to 59%, mirroring a rather tighter election race. Besides, Hillary Clinton was also ahead in the polls as the Democratic presidential candidate against Donald Trump in 2016, but did not manage to win the elections eventually.

On 29 September, the first presidential debate was marked by interruptions and accusations by both candidates and was hence characterized as the 'worst presidential debate in history'. Be that as it may, Biden seems to have won the debate by 6 to 4, although the presidential debates do not seem to have a significant effect on the presidential election result. In fact, about 85% of the voters note that they had already decided which candidate they will support before the debate, and only two tenths say that the debate would have an impact on their voting intentions. Key dates to watch around the US presidential elections are included in Table 1, while the developments around the Covid-19 pandemic and the expected vaccines could also result in a considerable shift in voter support as we head towards the election day.

On 3 November, polls are expected to have closed between 18:00 EST (23:00 GMT) and 23:00 EST (04:00 GMT) across US states. The first states will likely start announcing results from 19:00 EST (00:00 GMT), but with postal ballots likely to be extremely high - and potentially questionable - there is a strong likelihood of protracted vote-counting, which could lead to the delay of the result beyond the 3 or 4 November. Indeed, according to PredictIt there is only a roughly 53% chance of a result on that day, while close results in critical swing states could mean that the election outcome may not be known by Inauguration Day with constitutional chaos ensuing.

Table 1: US Presidential election – timetable

Date	Event
7 October	Vice presidential debate in Salt Lake City, Utah
15 October	Second presidential debate in Miami, Florida
22 October	Third and final presidential debate in Nashville, Tennessee,
3 November	Election Day
14 December	Members of the Electoral College vote for the president and vice president
20 January 2021	Inauguration of new president and vice president

Source: Eurobank Research, news sources

[1] https://projects.fivethirtyeight.com/2020-election-forecast/

To win the 2020 presidential election, a candidate needs to ensure 270 Electoral College votes. According to the current projections for electoral votes based on state polls, Joe Biden has 225 solid or likely electoral votes versus Donald Trump's 125 solid or likely electoral votes. Looking at the swing states, Biden is polling ahead of Trump in seven out of eight key swing states (with the exception of Iowa) though he has seen his lead narrow in several states since the summer, as Republicans' approval ratings have rebounded somewhat after having plunged due to the Covid-19 pandemic, the subsequent economic recession and protests regarding George Floyd. More specifically, in Michigan, where 15 electoral votes are at stake, Biden has the higher lead (+7.1pp), followed by Wisconsin (+6.6pp), a Democratic stronghold since 1988 until Trump won marginally in 2016, Pennsylvania (+5.6pp) and Arizona (+2.6pp), a Republican stronghold where only one Democratic leader has won in the past 7 decades. In Florida, which holds the key to 29 Electoral College seats, Biden has currently a lead of 2.2pp.

Looking beyond the presidency, whether the new president will be able to get his policy agenda through Congress is highly dependent on the Senate and House of Representatives elections. The House of Representatives seems likely to stay under the Democrats' control (currently having 232 out of 435 seats), with the latest pricing pointing to an 85% probability. According to an analysis[2] by "RealClearPolitics", 214 seats lean towards the Democrats, with only 4 more seats needed to keep majority control. Nevertheless, the Senate - where Republicans currently hold 53 out of 100 seats - looks to be a close call, with prediction markets tilting marginally towards a Democratic victory as Democrats need to win 16 of 35 seats to get a majority, while Republicans need 21.

Table 2: The House of Representatives seems highly likely to stay under the Democrat's control

Senate	House of Representatives	Probability
Democrat	Democrat	60%
Republican	Democrat	29%
Republican	Republican	18%
Democrat	Republican	1%

Source: Smarkets
*Probabilities may not sum to 100% as trades take place at different times

Public policy programs of the two presidential race candidates

This part aims to describe the differences in the policy programs of the two presidential race candidates. The main findings have been derived from their campaigns[3], public statements and speeches as well their media coverage. The November 3rd election is crucial because it will shape how the new US leadership responds to a difficult set of economic, political, epidemiological, and social challenges.

- Depending on the election outcome, the areas of taxation (taxation rates for corporates & individuals), healthcare, infrastructure, regulation and international trade are going to be the focus of attention. Undoubtedly, the potential for a major shift in the implemented policies is most likely to take place under a new Biden administration instead of a President Trump second term. In any

[2] https://www.realclearpolitics.com/
[3] https://joebiden.com/joes-vision/ and https://www.donaldjtrump.com/

case, the policy outcomes would depend on the outcome of the elections in both houses and its reflection in their composition. The case of a "clean sweep" for the Democrats, that is a majority in both chambers, which carries a relatively lower probability compared to scenarios where a nominee is elected but without majority in both houses, entails potential for a major shift.

- President Trump appears to be advocating policies that stimulate the supply-side of the economy in a strategic plan to reinvigorate domestic growth. On the other hand, former Vice-President Biden calls for more expansionary government policies with additional public expenditure aimed at addressing inequality and climate change and boosting public infrastructure investments and healthcare spending.
- **Economic policy:** President Trump priority in the second term is to institutionalize the tax cuts introduced in 2017, at the second year of his first term with the budget reconciliation, with the tax overhaul of the Tax Cuts and Jobs Act (TCJA). If President Trump get re-elected, these tax cuts which are set to expire in 2025, will be extended until 2035. In addition, he has vowed for a "very big and bold" infrastructure investment bill ($2trn), as part of the next congressional coronavirus relief package, to be financed through budget savings and low interest rates. Biden's proposals are concentrated around a restart package to support the economy after the Covid-19 pandemic. Biden's proposals include repealing the TCJA's individual income tax reductions for high income taxpayers, raising the top marginal bracket to 39.6% from 37% currently and eliminating the favorable capital gains tax rate for high income taxpayers. His plan also calls for more spending on infrastructure and clean energy (a $2trn accelerated investment in the first term). Finally, the plan also provides for reducing incentives for domestic corporations to resort to tax havens, tax evasion, and outsourcing.
- **Regulation:** President Trump advocates less regulation in business & environmental issues. According to the NY Times, the Trump administration has repealed or weakened at least 100 environmental regulations. President Trump is a climate change skeptic starting the process of leaving the Paris Agreement for US, and a supporter of fossil fuels production and nuclear energy. On the other hand, a Biden administration would call for a repeal of President Trump's administration changes and a recommitment to the Paris Agreement on climate change. At the same time, a Biden administration would set ambitious targets for the elimination of carbon emissions for the electricity sector by 2035 and introduce a ban on new oil and gas projects on federal land.
- **Trade policy** has been an area in which both candidates have expressed some support for protectionist policies. President Trump has pioneered a trade war on China introducing a number of tariffs on goods' imports and imposing restrictions on Chinese business (including a stop on procurement from Huawei, sanctions on diplomats over Hong Kong riots, prohibitions on Tiktok, WeChat etc.). There is wide expectation in the market that a Biden presidency would not soften its stance on the US relation with China. Nevertheless, Biden trade policies are expected to be more predictable, strategic and disciplined. Finally, the consensus view is, that in a Biden presidency relations with the EU are anticipated to improve in trade and probably in major international politics issues, as he has many times called upon EU to team up with the US.
- **Monetary policy**: As far as monetary policy is concerned, Fed has been subject to unprecedented political pressure during the Trump presidency. President Trump has publicly criticized Fed's chair

Powell choices many times in the recent past. Yet, it appears that he has become more satisfied with Fed after the latter cut interest rates to 0.00-0.25% and restarted significant quantitative easing (QE). On the other hand, Biden has publicly called for Congress to demand that the Fed looks beyond its current mandate of containing inflation and maximizing employment and amend its mandate allowing it to address persistent racial economic inequalities (in jobs, wages and wealth). The reappointment of Powell in the post appears as the most probable scenario in either a Trump or a Biden presidency. In the latter case, a renewal of Powell's term would more likely be approved in a new less-friendly Senate in which Democrats may not have a majority.

- **Immigration**: This is an area with two fundamentally different approaches. President Trump's policy aims to crack down on undocumented illegal immigration because he argues that illegal immigration is highly correlated with the rise in criminality and the misuse of public resources and that illegal immigrants are competing unfairly with natives. In contrast, Biden argues that immigration is a core part of America's culture while the contribution from immigration in the labor market is important to keep the labor force growing. The election of Biden in office would likely result in the unwinding of President Trump's executive orders restricting immigration. During his term, President Trump introduced 400 executive orders for the regulation of immigration. Among them the ones that stand out are the national-emergency declaration aimed to build the border wall with Mexico and the attempt to abolish the Deferred Action for Childhood Arrivals (DACA) program, which offers legal protection for young immigrants who had been living in the country illegally. Biden's immigration policy proposals also include an increase in the number of employment-based immigration visas, tripling the number of visas granted to victims of human trafficking and raising refugee admissions.
- **Healthcare:** President Trump's proposal foresees deep spending cuts for healthcare expenditure via Medicaid and Medicare programs over the next decade. In addition, it provides for a 10% cut in the Health & Human Services Department budget. In contrast, Biden's proposals build on President Obama's Affordable Care Act by introducing a new Medicare-like public health insurance option and by increasing marketplace subsidies. The Biden Plan pledges to expand coverage to 97% of citizens by a number of amendments such as eliminating the 400% income cap on tax credit eligibility, lowering the limit on the cost of coverage from 9.86% of income to 8.5% and lowering the age eligibility to 60 from 65. Nevertheless, according to an analysis from the Committee for a Responsible Federal Budget[4], a non-partisan and non-profit organization, Biden's plan would have a gross cost of $2.25 trillion and add $800bn to deficits over a decade.

Impact of the elections on Emerging Markets

As the US is the world's largest economy, the forthcoming presidential elections draw more attention than any other ballot elsewhere in the globe. Their impact in the emerging world is multifaceted but, below we will focus on the trade and geopolitical aspect with key emerging economies. We are hesitant to conclude

[4] https://www.crfb.org/papers/primary-care-estimating-democratic-candidates-health-plans
https://www.moodysanalytics.com/-/media/article/2020/the-macroeconomic-consequences-trump-vs-biden.pdf

on a homogeneous impact on the EM region in any combination of scenarios as the latter consists of individual countries with strong idiosyncratic and divergent dynamics.

- **China:** President Donald Trump in 2018 began imposing tariffs and other trade barriers on China aiming at forcing the latter change its "unfair trade practices". These trade practices resulted in a growing US trade deficit, alleged theft of intellectual property and forced transfer of US technology intelligence to China. In response to the US trade measures, the Chinese government has accused the Trump administration of engaging in protectionism and retaliated with 'tit for tat' measures. While on 15 January 2020, the two countries reached a phase one agreement, tensions continue to persist. Regardless of whether there is a blue or a red wave or even a divided congress, the US stance towards China is broadly based on a bipartisan consensus, therefore the rivalry between the two countries is expected to last. In this context, the Biden campaign has avoided detailed commitments on the matter. While the rhetoric may change towards a more conventional and diplomatic approach under a Biden presidency, the US-China trade relations agenda is expected to remain unchanged in terms of substance.
- **Russia:** The two countries interact diachronically on opposite sides at a geopolitical level. More recently, Russia's annexation of Crimea in 2014, its involvement in the Syrian civil war that has resulted in frequent interactions between US and Russian forces and its boosting ties with Venezuela after the US sanctions towards the latter in past February leave limited room for essential differentiations in the US-Russian affairs with either political party in power. However, there are formal allegations that Russia currently attempts, as it had done in the 2016 elections, to influence the whole electoral procedure by spreading fake news that primarily aim to denigrate the democratic candidates; Joe Biden in 2020 and Hillary Clinton in 2016. The rationale behind these attempts seems to be the prevailing belief in Moscow that a Democratic party government will have stricter lines in their in-between geostrategic differences.
- **Brazil:** Having strong trade ties with the US, Brazil could benefit from a unified red waved congress as US economic growth could be more bravely supported through a stronger fiscal stimulus. However, Presidents Jair Bolsonaro and Donald Trump are very close ideologically and a Democratic party win could abolish the privileged access to the White House, which has been a key political asset in his presidential term so far. A Biden victory will complicate Brazil's stance on environmental issues as well, especially on deforestation reduction targets. While both US and Brazil have threatened to withdraw from the Paris Climate Agreement in the recent past, US under Biden has expressed the intention to reinstate its participation and Brazil could be pushed towards the same direction. Brazil's interaction with the US is multilateral and each facet could be differently affected whether Democrats or Republicans take the lead. That said, we conclude by adding that Brazil may have a more convenient relationship with China, who is its key trading partner in technology and could urge Brazil to adopt 5G technology under a Biden presidency as his demands from China are expected to be more targeted and less punitive than up to date.

Global Macro Themes & Implications

Brexit: Deal still possible in spite of the EU's legal threat over the UK's Internal Market Bill

The latest round of talks related to the future EU/UK trade relationship concluded on October 2 with no tangible progress. In more detail, there have been reports of UK concessions on state aid, the details of which have not yet been publicly announced, but the two sides remain apart on certain issues, mainly the dispute resolution mechanism, the so-called regulatory level-playing-field arrangements (i.e., the UK to remain close to basic EU rules) and the access of fisheries to UK waters. In an attempt to break the deadlock and push further to reach a kind of deal amid hopes that common ground could be found on sticking issues, UK PM Boris Johnson and European Commission President Ursula von der Leyen agreed to intensify negotiations and hold deliberations in the weeks of 5 and 12 October, ahead of the next EU Council Summit on 15-16 October. The latter, has been flagged as a tentative deadline for a trade deal so that there is adequate time for the agreement to be scrutinized and ratified from both the UK and the EU by the end of the year, when the transition period expires. The two sides aim to negotiate a Canada-type free trade agreement, whereby, after the end of the transition period on 31 December 2020, the UK will leave the EU customs union and single market enjoying quota-free and tariff-free trade on goods with the EU.

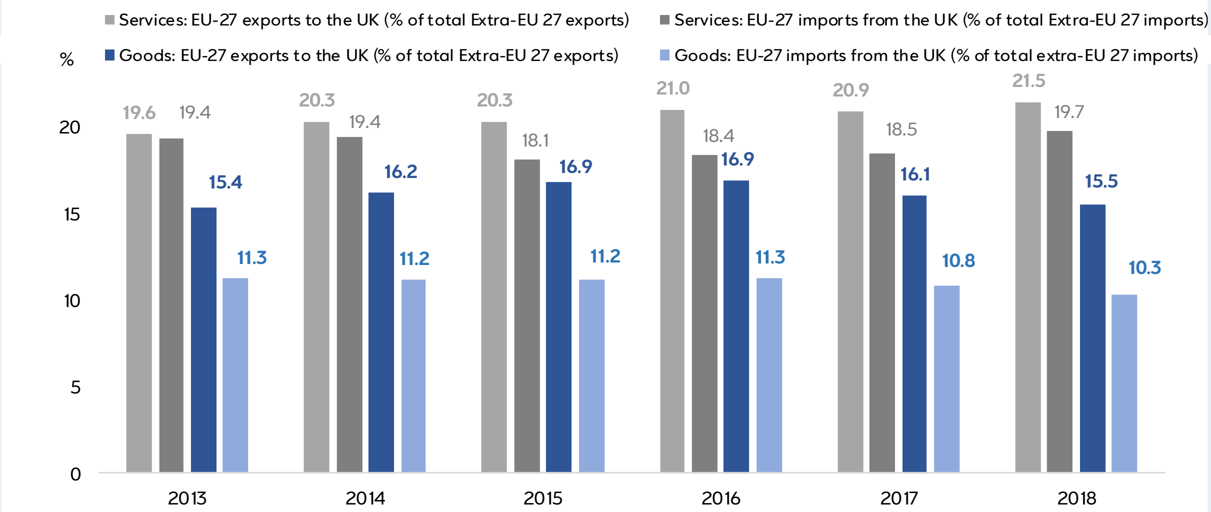
With a disorderly Brexit likely to make the post-Covid UK recovery even slower and the world economy struggling to return to pre-pandemic levels, especially given the recent resurgence in Covid-19 cases and the ensuing enforcement of tighter restrictions in several countries, we assign a higher-than-even probability to an outcome where the two sides eventually relax their positions. This assumes reciprocal moves by both sides that would allow them to reach a free trade agreement in principle, probably after the 15-16 October EU Summit but ahead of the year-end when the transition period expires, with more detailed discussions continuing afterwards (following the same pattern with the withdrawal negotiations when a deal was not reached until very close to the deadline). That said, if reports are correct, progress on the state aid issue is encouraging.

However, with the EU having launched formal infringement proceedings against the UK after the latter refused to abide by the former's request to withdraw the controversial parts of the Internal Market Bill (IMB) by the end of September, or face legal measures, a no-deal scenario remains a notable risk. More specifically, the EU sent a letter of formal notice to the UK government earlier this month, the first step in an infringement procedure that could end in the European Court of Justice, which can impose fines for non-compliance, a scenario that would apparently complicate Brexit talks further. The UK's IMB, if passed into domestic law, would authorize Ministers to overwrite and dis-apply certain aspects of the Northern Irish Protocol, which was signed and ratified with the EU late last year, as part of the legally-binding EU Withdrawal Agreement. Specifically, UK Ministers could decide whether to: (i) notify the EU in the event of government state aid decisions affecting goods trade in Northern Ireland, and (ii) waive the requirement for Northern Irish firms to fill out export summary declarations when sending goods to the rest of the UK. The UK government's rationale behind the IMB was that the Withdrawal Agreement threatens the economic integrity of the UK because it imposes between Northern Ireland and Great Britain a tariff border, which runs through the Irish Sea. The UK has until end-October to respond to the EU's letter of formal notice and explain its actions. On its part, the EU argues that the controversial parts in the IMB breaks international law on the grounds that it undermines the duty of cooperation in good faith included in the Withdrawal Agreement. The EU has warned that it would not sign a trade deal unless the controversial issues with the IMB are resolved amid concerns that, without the implementation of all terms of the Withdrawal Agreement, the Good Friday Agreement would be difficult to maintain.

However, if Brexit talks make progress in the coming weeks and a deal appears within touching distance, we do not expect the dispute on the UK's IMB to stand in the way of a EU/UK trade deal. That is on the assumption that the outstanding issues related to the implementation of the Norther Irish protocol could be addressed either through the EU-UK Joint Committee (the committee that oversees the implementation of the Withdrawal Agreement), or though progress in EU/UK trade talks. Under such a scenario, the UK could remove the controversial aspects of the IMB on the grounds that they would no longer be needed. That was probably the rationale behind the EU's decision not to suspend Brexit negotiations, in spite of the publication of the UK's IMB.

The controversial IMB passed its latest stage (third reading) in the UK's House of Commons on 30 September with a comfortable majority (340 in favor vs. 256 against) and was sent to the House of Lords for ratification (the Standing Orders of the House require every bill to receive three readings, on different days, before being passed and sent to the House of Lords). However, according to some reports, even if the IMB has been approved by the House of Commons - where the government has a comfortable majority of 80 seats - it is unlikely to be endorsed by the House of Lords un-amended. A robust majority in the House of Lords reportedly remains opposed to the IMB at its current form, on the basis of the reputation damage to the UK that it would cause. Should this be the case, the House of Lords could first amend the controversial parts of the IMB and send it back to the House of Commons or, in the most extreme scenario, they could delay the implementation of the IMB for 12 months, rendering it ineffective when the transition period expires at the end of December (according to the UK Parliament Act 1949, the House of Lords has a delaying power of up to one year via a simple majority). The UK's IMB is not expected to have its third (and last) reading in the House of Lords before November/December. That would give enough time to the UK government to remove the contentious parts of the IMB, conditioned on the progress in EU/UK trade talks.

Figure 3: EU/UK- Important trading partners



Source: Eurostat, Eurobank Research

Macro Themes & Implications in CESEE

The resurgence of infections threatens the rebound of the broader CESEE region in H2-2020 and undermines the growth prospects of 2021

As of early October, four 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. However, the picture is not homogeneous across countries. The number of cases in Central Europe (Poland, Czech, Slovakia) and the Baltics (Estonia, Latvia, Lithuania) are on the rise, whereas with the exception of Romania and Croatia, in the SEE (Albania, Bulgaria, Serbia, Bosnia & Herzegovina) the pandemic is gradually stabilizing if not retreating after the initial spike in cases. 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 imposed rapidly and enforced aggressively by the governments took their toll on economic activity but were successful in containing the epidemic. Upon the renewed rise of infections in late August, governments didn't react in the same way as 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, though the vast majority of them once again outperformed both consensus expectations and euro area peers – in most cases deters governments from taking draconian measures at the expense of putting more strain on the domestic public health systems. The latter in some cases suffer from chronic underfunding and understaffing, which makes the situation even more difficult to handle. But even after taking into account the latest developments, compared to other regions or countries across the world after seven months in the Covid-19 pandemic, the broader CESEE region seems to be in better shape, while their response to the pandemic may have largely been more successful than that of Western Europe and USA.

High frequency indicators point to continued improvement in August-September despite lingering uncertainty. The re-opening of the economies, even at the expense of a new rise in infections, has strengthened optimism in sentiment and surveys. Having plummeted to multi-year lows in April, those indicators continued their rebound in the last two-three months. However, the pace of improvement in economic sentiment releases has stalled if not declined in September. In addition, the rebound is neither strong enough nor uniform across individual sub-categories. The biggest gains were once again recorded in industry with services and consumer sentiment still lagging behind in 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 picture of the Markit PMI manufacturing releases in September conveyed a message of softness if not weakness. 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. Yet this improvement stalled in September raising 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. On the positive side, most economies hold to their earlier months' gains remaining above the critical threshold of 50, which marks the transition from contractionary to expansionary territory.

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 sectors 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. In that direction, if more high-frequency data for the next two GDP readings in Q3-Q4 point to an increased probability for the recovery to be W-shaped vs a V-shaped, we will be compelled to revise our forecasts further in 2020-2021.

CESEE Markets Developments & Outlook

Bulgaria

Short-term Eurobond yields slid 5-6 bps, while longer term yields gained 4-7 bps with the only exception being the 2035 tenor, which saw its yield sliding by 3 bps. The biggest move was registered in the belly of the curve, namely the 2028 paper with a 7 bps gain. Bulgaria returned to the international debt markets successfully in mid-September by offering 10-y and 30-y bonds at record low yields of 0.38% and 1.47% respectively. Local yields registered modest losses of 1-3 bps across the curve, with notable exceptions in the 7- and 10- year tenors, as their yields dropped by 11 and 8 bps respectively.

The political unrest continues to cloud the outlook as the ruling party resists to step down. Over the last few months, the incumbent government has been engaged in increasing public expenditures, broadly focused on raising salaries in the public sector and continuing to hand out extraordinary pension increases of EUR25 to each pensioner. Elections are still scheduled for March 2021, with results of polls pointing to a diverse mix of new and old political parties entering the new parliament.

Serbia

The government bond yield curve steepened modestly as yields rose slightly, especially at the long end. At the most recent 12-year RSD government bond auction, held on October 1st in the primary market, the achieved yield reached 4.30%, which is 30 bps higher compared to the yield achieved at the previous identical auction held one month ago. There was also an average 20bps rise in the yield on the secondary market for the same paper.

State-owned Telekom Srbija issued in late September its first corporate bond worth RSD23.5bn (EUR200mn). The RSD-denominated 5-year bonds were issued at an interest rate below 4% (3M BELIBOR+2.95 pp, i.e. 3.97%), while the buyers of the bonds were mostly specific domestic banks that have cooperated with Telekom Srbija for years. The funds raised will be used as working capital to fund, among others, the promotion of business activities and the refinancing of financial liabilities.

Concluding, the economic effect of the Covid-19 pandemic may not prove as harmful as initially thought. According to the most recent government estimations, GDP will shrink only by 1% in 2020, compared to a 3% estimation at the beginning of the pandemic. Serbia's very good agricultural crop this year as well as the announced capital projects that will be financed by the US International Development Finance Corporation (DFC) are expected to back a considerable rebound in the GDP growth trajectory in 2021. Nevertheless, in a different spirit from the government, the EBRD's Regional Economic Prospects report released on October 1, kept its forecasted GDP contraction rate at -3.5% in 2020, unchanged from the May forecast, while its 2021 GDP forecast was slashed to +3% from +6% previously.

Markets View

Foreign Exchange

EURUSD: Following a correction below 1.20 and almost touching the 1.16 level at the end of September, the drivers of the pair's dynamics are still related to the global Covid-19 pandemic effects, as well as expectations of what will be the reaction to fundamentals related to inflation and unemployment. More specifically, the focus is on the latest news headlines of Trump's coronavirus confirmation, which is considered by several analysts as another drawback, which could slow down the chances for a deal between Republicans and Democrats on the fiscal stimulus talks, but also on the reaction of the economy on the still high (but slightly reduced since August) unemployment rate, with a forecast to fall from 8.4% to 8.2%. This inserts a further hesitation to the investors' potential bullish feeling on the safe-haven dollar, which is still price-ranging on the 1.15-1.20 territory. We remain bullish on the pair with a support at 1.1550.

GBPUSD: Additionally to the market's reactions to the dollar and the equities markets from the US fundamentals and Trump's Covid-19 incident, the British pound's flows are also heavily driven by the Brexit-related stories. More specifically, the President of the European Commission Ursula von der Leyen, announced legal actions against the UK regarding the violation of the Brexit Withdrawal Agreement, triggering Boris Johnson's prompt response and call for an immediate talk with the Eurozone. The news boosted the pound higher, while investors seem to be skeptical about the final deal's structure, as well as on its timeline. We follow this skeptical rationale until a more concrete planning on the deal's timeline and handling steps shows up, and consequently, we trade the price range of the pair, with the low long trigger at 1.26 and the high short trigger at 1.32.

AUDJPY: Considering the historically high correlation with the equities markets, the pair is experiencing the high volatility effects of Covid-19 still-rising cases, while also waiting for decisive steps towards smoothing up of the major economies' fundamentals figures. JPY acting as a low-cost funding vehicle vs higher yielding currencies is still not reacting heavily to the not so clear news across the global economies, while AUD is not playing any crucial role in the flows and price dynamics either, leaving the pair fluctuating under the classical equities correlation regime. With the VIX Index fluctuating at around 30, we hold a passive risk-adjusted bullish position at the pair, while gradually adding on the position as volatility lowers, and exit the position on a potential consecutive market sell-off of more than 5% in a 5-day period.

Rates

EU: The level of the EU yield curve remained relative unchanged in September, with the 10y swap rate hovering around -22bp. In the same manner, the shift of the curve remained also unchanged with the 30s -5s balancing around 42bp. European economies are taking extra measures to deal with the second wave of the pandemic and at the same time there is a lot of uncertainty in the European Banking Sector, which is the most important factor in a well-functioning economy. A vaccine or a Brexit resolution would suggest a higher level of yields and a steepening of the curve. However, looking forward we believe that risks are for the curve to remain relatively balanced as we are approaching year-end and market participants seem reluctant to take any extra risks.

US: the yield curve continued its steeping during September. At the same time the level of the curve remained relatively stable with the 10y swap rate hovering around 70bp. Market seems to unwind some of the risk-off positions as too many bad news seem to be priced in for the US economy, while the unemployment rate has already fallen below 9%. Looking forward, we expect the steepening to continue as the US economy is expected to shrink by only 3.8% this year compared with the 7.3% projection in June and the equity market remains relatively strong despite the high volatility. At the same time, the FED has repeated that the rates will stay low in the foreseeable future so the front end of the yield curve is expected to remain at these levels.

Emerging Markets credit

Spreads in the Emerging Markets sovereign space were wider in Asia and EMEA, while LATAM continued its outperformance until the mid of the month to retrace back some of the move by the end of September (spreads ~10-20bps wider on average in September, across regions, except LATAM ~15 tighter). Lower quality in investment grade and high yield names underperformed (especially B's). Also, while sovereign spreads continued to perform well, quasi sovereigns underperformed. The JP EMBI sovereign spread index was wider around 18bps since late August. Global risk-off sentiment and commodities retracement in September did not help, but as the global macro and China related data continue to improve, we believe that there is room for tighter spreads, closely watching the Covid-19 developments and PMI data

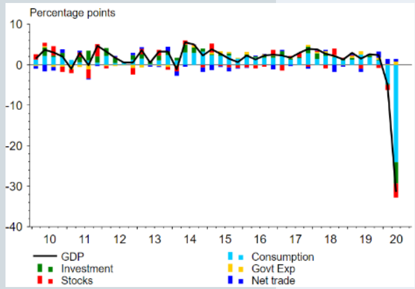
Corporate credit

Corporate spreads widened in September on the back of the general risk-off sentiment. USD and EUR IG widened by 6bps, with BBB underperforming. Rising Covid-19 cases and the upcoming US elections weighted on risk sentiment, while on the other hand, lighter supply (Interestingly new issue premiums were almost zero during the month) and stronger macro data were supportive of credit and limited the widening. HY spreads widened through most of September, before reversing somewhat in the final week of the month. Overall, spreads widened by 33bp over the past month. Within HY, the widening was led by BBs, while CCC outperformed. Curves flattened significantly as the short end sold off the hardest. At the sector level, healthcare, TMT and industrials delivered the weakest returns, while basic materials and consumer-related bonds held up better. In financials, spreads were wider with lower tier bonds and especially AT1s decompressing. The upcoming US fiscal package and potentially further ECB support, coupled with an uptrend in macro data, should put a cap on any spread widening related to increased Covid-19 cases or negative vaccine related headlines. Additionally, reduced supply and technicals will also support spreads, until end-2020. We expect credit to continue its relatively stable performance going forward and we see outperformance in the industries hit the most by Covid-19 upon potential positive vaccine developments.

USA

Underlying momentum in economic activity seems resilient, but fiscal uncertainty constitutes a key downside risk

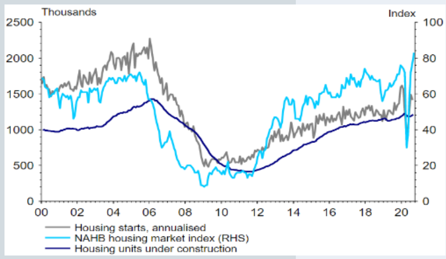
Figure 4: Contributions to GDP growth



Source: Refinitiv Datastream, Fathom Consulting

According to the BEA's 3rd estimate, Q2 GDP was revised higher by 0.3pp to - 31.4%QoQ saar, mainly reflecting an upward revision to personal consumption that was partly offset by downward revisions to non-residential investment and net trade (Figure 4). Nevertheless, the overall Q2 GDP decline remains the largest drop on record, followed by an expected robust rebound in Q3 helped by fiscal policy through the first round of CARES Act as well as monetary policy that has secured accommodative financial conditions. Fiscal uncertainty constitutes a key downside risk to the economic outlook, with a new fiscal stimulus package most likely to be delivered after the presidential election. However, a pre-election stimulus deal cannot be fully ruled out, as talks between Democratic House Speaker Nancy Pelosi and US Treasury Secretary Mnuchin showed openness to a deal from both sides. Following the expiration of certain government pandemic assistance programs under the CARES Act, the resulting decline in households' income has already begun to weigh on economic activity, constituting a negative factor for GDP growth in Q4 before picking up from Q1 2021 onwards, amid some post-election fiscal support. Indeed, headline retail sales growth softened in August, and core retail sales fell by 0.1%MoM, while durable goods orders growth decelerated in August to 0.4%MoM from 11.7%MoM in July. Nevertheless, jobless claims and the September ADP and payroll reports point to continuing strength of the labor market recovery, housing activity has rebounded to 2006 levels (Figure 5), while leading indicators incl. PMIs and consumer confidence suggest that the economic expansion extended well into September. Moreover, core capital goods shipments – used to calculate equipment investment in the GDP measurement – remain remarkably resilient, with the August level standing roughly 2.0% above their February print. Overall, we have revised upwards our 2020 GDP forecast and now expect a decline of 5.0%, given that there has been enough progress in the recovery and the momentum in underlying economic activity has exceeded expectations. On the monetary front, following its shift to an average inflation target regime, the Fed enhanced its forward guidance at the Sept. FOMC meeting, committing to keep rates near zero until at least the end of 2023. The Fed seems content with the current monetary policy stance and, therefore, should keep the current pace of the APP through end-2021. However, an extension of the duration of the purchases or an increase in the size of QE is possible, in case there are unexpected adverse developments to the economic outlook.

Figure 5: Housing activity has rebounded strongly helped by record low mortgage rates



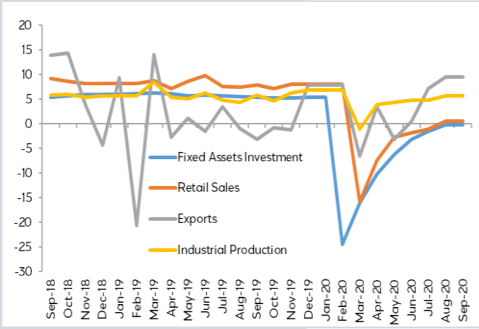
Source: Refinitiv Datastream, Fathom Consulting

China

As economic recovery strengthens, China grasps the opportunity for reforms

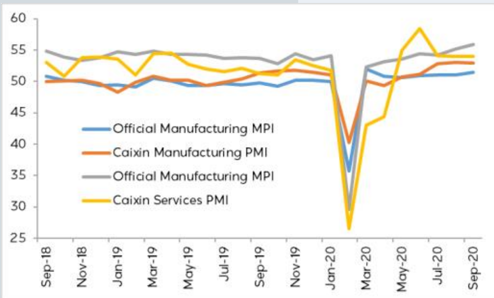
According to recent hard data, recovery remains intact. While the improvement at play since May was initially driven by the supply side, economic activity appears to have gained a more broad-based momentum now. From the supply side, industrial production (IP) rebounded faster compared to other metrics, rising by 5.6% YoY in August compared to 4.8% YoY in both July and June. Turning to the demand side, exports have firmed since July, outperforming expectations. Increases by 9.5% YoY and 7.2% YoY in August and July respectively from 0.5% YoY in June not only reflect increased external demand, particularly for hygiene-related products, but also mirror the recent shift in consumer behavior at a global level with a big portion of entertainment and tourism services having been substituted by purchases in goods and durables amid social distancing and protective measures. Fixed asset investments (FAI) in August have almost returned to the same levels of one year ago (-0.3% YoY), recovering gradually from the historic lows of -25.6% YoY in February. Even though retail sales have been lagging behind compared to the aforementioned demand indicators, they returned in positive grounds for the first time this year, as they expanded by 0.5% in August after having bottomed out in March and have been expanding ever since. In a nutshell, there are tangible signs that recovery is obtaining sustainable characteristics at a moment when fiscal policy measures have not fully unfolded yet, allowing for a wait-and-see stance in the monetary policy front, following the supportive easing measures in the previous months (among which RRR cuts for both major and smaller banks and Loan Prime Rate cuts 30bps cumulatively since the beginning of the year). Therefore, the announcements following the quarterly policy meeting of the PBoC in late September referring to the normalization of the monetary policy through increased efficiency in implementation and the long-anticipated draft rules for its global systemically important banks' (G-SIBs) ability to absorb losses in an effort to address systemic financial risks are timely well justified. Concluding, we stick to our forecast for a 2% GDP growth rate in 2020, with risks tilted to the upside, subject to the assumption that a Covid-19 resurgence in the winter months is promptly contained and we look forward to the key institutional events in the next quarter in order to reevaluate our view.

Figure 6: Recent hard data point to firm recovery...



Source: Bloomberg, Eurobank Research

Figure 7: ...mirrored in all PMIs as well



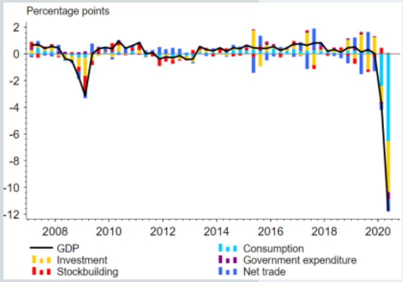
Source: Bloomberg, Eurobank Research

Euro area

Slowing growth momentum towards end-2020, before accelerating in H2 2021

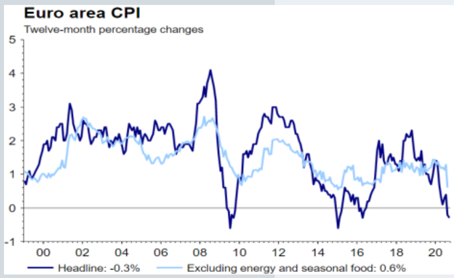
Although hard economic data up to July suggest a sharp rebound from the historical Q2 GDP contraction of 11.8%QoQ (Figure 8), the most recent economic indicators suggest slowing momentum towards end-Q3, likely reflecting the end of the technical rebound in activity and the resurgence of Covid-19 infections in Europe that mainly affect the services sector. IP expanded by 4.1%MoM in July, normalizing significantly from the 9.5%MoM rebound recorded in the prior month, while the unemployment rate ticked up only 0.1pp to 8.1% in August helped by the extended short-term work schemes by governments in several European countries. The composite PMI declined by 1.5pts to 50.4 in Sept., with services business activity falling into recessionary territory for the first time in three months (-2.5pt to 48.0). Nevertheless, the Sept. manufacturing PMI rose by 2.0pts to 53.7, marking the strongest growth in over two years led to a large extent by strong manufacturing upturn in Germany. Furthermore, the Sept. EC surveys point to continued deceleration in the economic recovery, with sentiment increasing to 91.1pts from 87.5 in the prior month but still remaining well below its long-run average of 100 pts. Persistent disinflationary forces continue to dominate, with headline inflation declining further in Sept. by 0.1pp to -0.3% driven mainly by technical and seasonal factors (Figure 9). Inflationary pressures are likely to remain muted until the end of 2020, with slightly negative headline inflation prints amid subdued travel, recreation and leisure services activity, before gradually picking up in 2021 on the back of strengthening domestic and global demand helped by large-scale fiscal and monetary stimulus. Following the stronger Q2 GDP 2nd estimate and upgrades to Q3 outlook for Germany and France, we revised upwards our 2020 GDP forecast to -8.0% from -8.5% previously, and expect economic activity to continue running below normal levels in H1 2021, particularly in the services sector. Hence, the strong rebound is anticipated to occur in H2 2021 with the widespread vaccinations against Covid-19 and the investment boost from European recovery programs. On the monetary front, the ECB is widely expected to ease the monetary policy stance again at its Dec. GC meeting, likely via extending/expanding the existing QE programmes. Further changes in the monetary policy stance will be highly dependent on the evolution of the Covid-19 pandemic so as to warrant an increase and extension of PEPP, as well as on the inflation outlook and whether it will require a more persistent form of policy easing than the PEPP.

Figure 8: Contributions to quarterly GDP growth



Source: Refinitiv Datastream, Fathom Consulting

Figure 9: Inflationary pressures are likely to remain muted



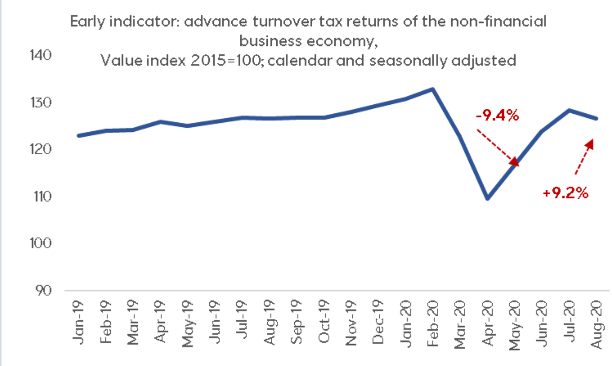
Source: Refinitiv Datastream, Fathom Consulting

Germany

Expected to bounce back strongly in Q3, but recovery to slow in Q4

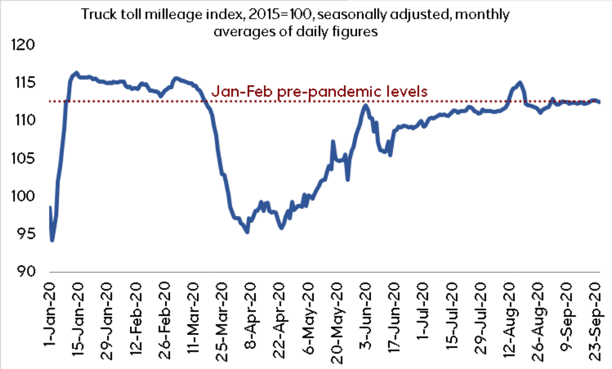
Following an historic 9.7%QoQ drop in Q2 GDP growth, July's hard data suggest that Germany should bounce back strongly in Q3. Industrial production rose by 1.2%MoM in July, taking May-July gains to 17.9% following a drop of 26.4% in the period between March and April, while, on a quarterly basis, it seems on track for a 10.0% increase in Q3, even without any further improvement in August and September. In a similar positive tone, barring any negative surprises, July's 2.7%MoM gain could push new factory orders up by 24.0%QoQ in Q3, while July's improvement of 4.7%MoM and 1.1%MoM in exports and imports, respectively, could take their quarterly growth rate up by 18.0% and 7.0% in Q3 and widen the trade surplus by c. €55bn, adding some 3pps to Q3 GDP. Supporting the above, a new leading indicator of the Federal Statistical Office, calculated on the basis of advance VAT returns submitted by companies, was 9.2% higher in August compared to Q2 average (Figure 11.). Bear in mind that the said indicator is considered to have a high positive correlation with GDP; in Q2 it dropped by 9.4%QoQ, which was almost the same rate of change than that the GDP recorded over the same quarter (-9.7%QoQ). However, while Germany is expected to recover faster than earlier expected in Q3, economic recovery in Q4 will continue but at a much slower pace. Another leading indicator of the Federal Statistical Office, the truck mileage index which is based on toll data, suggests that, as of August, manufacturing has recovered more than 90% of the March-April pandemic-triggered downturn so that any further improvement should be moderate from Q4 onwards. At the same time, the resurgence of Covid-19 cases and the associated re-introduction of some restriction measures have taken a toll on business activity. The Markit services PMI for September was re-adjusted back to expansionary territory at 50.6 from a flash estimate of 49.1, but still down for the second consecutive month. Amid expectations for a strong Q3 bounce back, we now expect Germany to contract by 6.0% in 2020, upwards revised from -6.5% previously. Meanwhile, the government's generous fiscal response to Covid-19 is expected to lead to a c. 8.0%-of-GDP general government shortfall, a large swing from a 1.4%-of-GDP surplus in 2019.

Figure 10: The new leading indicator of the Federal Statistical Office suggests strong GDP growth in Q3



Source: Federal Statistical Office (Destatis), Eurobank Research

Figure 11: Truck toll mileage index suggests a slow-down in manufacturing recovery from Q4 onwards



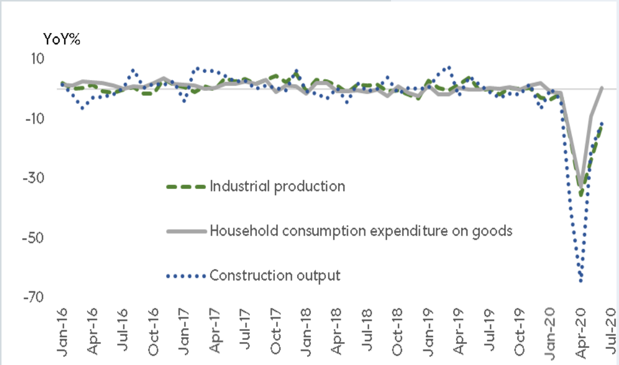
Source: Federal Statistical Office (Destatis), Eurobank Research

France

Post-lockdown recovery slows down following a resurgence of Covid-19 cases

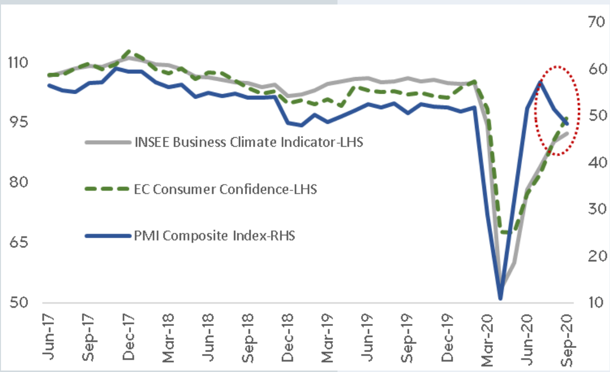
France was hit hard by the lockdown implemented from March 17 to May 11 to mitigate the spread of the Covid-19 outbreak, leading to a GDP decline of 13.8%QoQ in Q2, above a euro area average contraction of 11.8%QoQ over that period. However, the gradual lifting of containment measures as of mid-May and the government's forceful fiscal response to mitigate the economic effect of the pandemic, are anticipated to translate into a double-digit GDP bounce in Q3 (Figure 13) In support of the above, household spending on goods has returned into positive territory in annual terms (0.5%YoY in June and 0.6%YoY in July after a trough of -32.7%YoY in April), while industrial production and construction output continued to recover in July for the third consecutive month on a YoY basis, although both are still in negative territory (-8.1%YoY and -5.2%YoY, respectively, in July, following a, trough of -35.5%YoY and- -64.5%YoY in April). However, as we move into Q4, sentiment indicators suggest that the pace of the post-lockdown economic recovery is slowing, as respondents turn more cautious due to the recent resurgence in Covid-19 new cases and fears of a second national lockdown following the imposition of tougher coronavirus-related social distancing measures in several of the largest cities. As a result, the Composite Output PMI dropped by 3.1pts to a four-month low of 48.5 in September, the first decline since May entirely driven by the services sector, while both the INSEE Business Climate Index and the EC consumer sentiment indicator continued to advance in September for the fifth consecutive month, although at a moderating improvement pace (Figure 14). For the full year, we expect a 9.5% GDP contraction, upwards revised from -10.0% previously, following the €100bn (4.1%-of-GDP) Recovery Plan that was unveiled in early September, on top of the three fiscal stimulus packages announced earlier this year worth €5.4bn cumulatively. The last package is mostly focused on the "green transition" and supply-side stimulus, aiming to bring GDP back to pre-crisis levels and the unemployment rate below 10.0% by 2022; €4.5bn (0.2% of GDP) should already be used in 2020, €37bn (1.6% of GDP) is set to be spent in 2021 and the remaining in subsequent years.

Figure 12: Pronounced GDP bounce is expected in Q3 after the severe downturn in Q2



Source: INSEE, European Commission, Eurobank Research

Figure 13: Sentiment indicators suggest a slow down in the pace of post-lockdown recovery in Q4



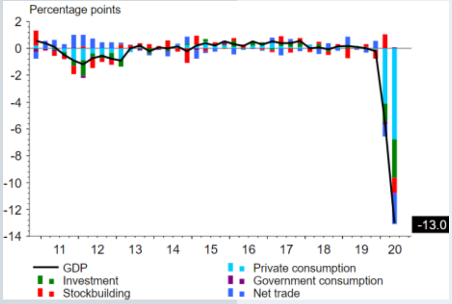
Source: INSEE, European Commission, Eurobank Research

Italy

Manufacturing recovery continues at a moderate pace, but the services sector remains in contraction territory

Leading indicators point to a continuation of the recovery in the Italian manufacturing sector in September, with the IHS Markit Italy Manufacturing PMI increasing marginally to a 27-month high of 53.2 from 53.1 in August, with operating conditions improving moderately again on the back of further solid expansion in both factory production and order book volumes. Moreover, foreign demand showed further signs of recovery from the economic impact of the Covid-19 pandemic, with new export orders increasing for the first time since April 2019. On the flipside, the downturn in the Italian services sector continued in September, with the IHS Markit Services PMI rising slightly to 48.8 from 47.1 in August, remaining though below the 50.0 threshold and signaling protracted contraction in the Italian services sector output. Business and consumer confidence strengthened in September, with the Istat's composite business confidence indicator expanding to 91.1 from 81.4 in August and revealing improved sentiment in all sectors. Meanwhile, the consumer confidence index rising to 103.4 from 101.0 in the prior month with broad-based improvement across consumers' economic assessment in the past year and expectations for the year ahead (Figure 15). Overall, Italy is expected to lag behind the EA average growth, given the country's high exposure to tourism and entertainment, with our 2020 GDP forecast unchanged at -10.0%. On the political front, the outcome of the September 20-21 regional elections and the constitutional reform was positive for government stability, as it reduces the risk of early elections. The Democratic Party managed to keep its majority in three of the four regions it was defending, while the referendum to reduce the number of MPs from 930 to 600 - mainly backed by the Five Star party - passed with 70% support. Regarding ERF and ESM, Italy has been allocated €209bn support from the EU (a mix of grants and loans) from the €750bn European recovery fund, and the Italian government has been working on project applications to access these funds, which are not expected before H2 2021. Hence, an ESM credit line in the intervening period is likely, especially in case adverse developments regarding the Covid-19 pandemic weigh further on public finances.

Figure 14: Contributions to quarterly GDP growth



Source: Refinitiv Datastream, Fathom Consulting

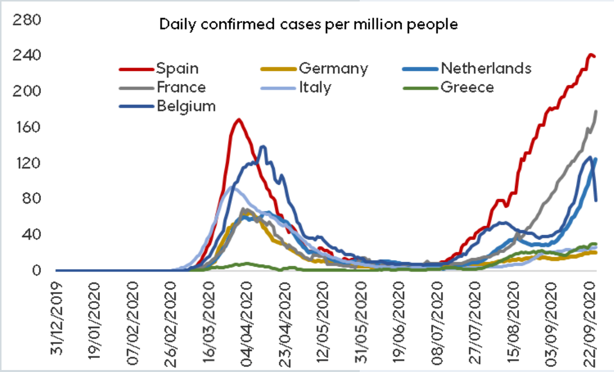
Figure 15: Consumer and business confidence on the rise

Source: Refinitiv Datastream, Fathom Consulting

Spain
Faced with Europe's worst second wave of Covid-19

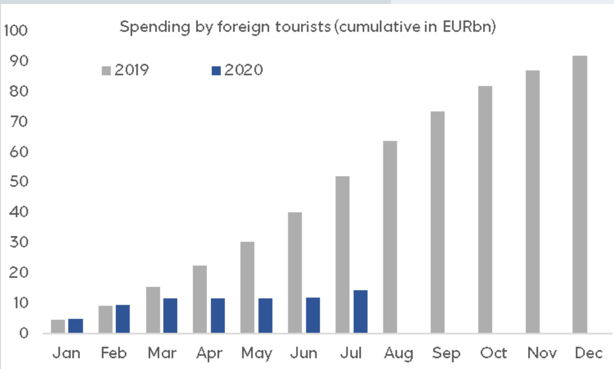
Spain, which has been among the worst affected EA countries by the first wave of Covid-19 — real GDP in Q2 2020 was 22.3% lower compared to end-2019— is now experiencing the worst second wave in Europe following a resurgence in new cases since mid-July (Figure 17). The Madrid region, the third most populated region in Spain, has been the Covid-19 epicentre in the country, with incidents of infections more than double the national average, leading to increasing pressure on its hospital capacity. As a result, the authorities were forced to introduce local lockdowns and mobility restrictions. These measures could weigh on consumer and investor confidence, limiting the scope for a quick recovery, beyond the expected technical bounce-back in Q3 driven by the lifting of containment measures and released pent-up demand, after the unprecedented downturn in the first half of the year. Adding to Spain's poor growth prospects, tourism which accounts both directly and indirectly for 14.6% of domestic GDP, a share much higher than the 10.4% average of the other three major EA economies, has been hit hard by the Covid-19 pandemic, with tourist arrivals down by 75%YoY in July and foreign tourism expenditure, which accounts for 60% of total tourism spending, lower by 79%YoY over that month (Figure 18). Against this background, we now expect a GDP contraction of 11.6% this year (from -11.0% previously) followed by 6.6% GDP growth in 2021, also helped by the EU Recovery Fund, as Spain is among the main beneficiaries (€140bn in funds and c. 7.0% of GDP in grants), with the Bank of Spain estimating that it could boost the level of GDP by an average of 0.2-0.3% in 2021-2023. Despite the relatively small fiscal stimulus due to budget constraints and the minority government's struggle to secure the necessary parliamentary support to pass measures intended to support the most affected by the pandemic (2.8%-of-GDP vs. an estimated EA average of 4.0%), the sharp economic downturn is expected to push the budget deficit close to 12%-of-GDP this year, the highest ever, and debt-to-GDP to a record high near 120%-of-GDP which could be viewed negatively by rating agencies.

Figure 16: Spain: Faced with Europe's worst second wave of Covid-19



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

Figure 17: Foreign tourism spending has collapsed



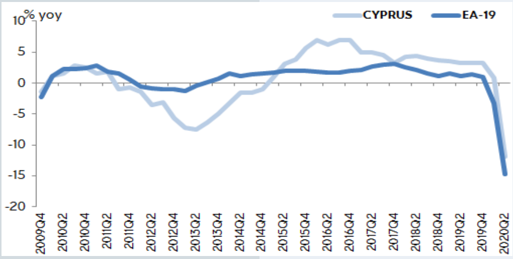
Source: INE, Eurobank Research

Cyprus

Sentiment improvement stalled in September

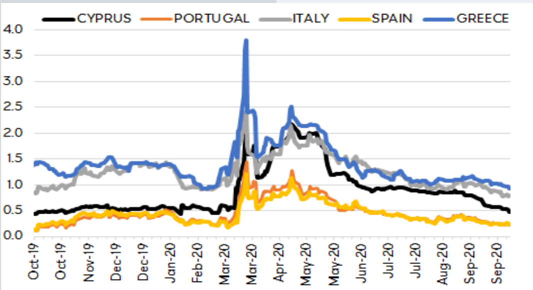
As of early October, the timely and consistent response of local authorities to the deepening Covid-19 crisis has averted a health crisis with numbers of infections and the death toll remaining very low until now, in comparison to other EU countries. Nevertheless, the impact of the Covid-19 pandemic has been detrimental in Cyprus as well, with stricter lockdown and social distancing measures putting the economy under stress (1H-2020 GDP:-5.5% YoY). To curb this negative impact, the government introduced a financial support package of €3.3bn in three stages, an equivalent of 19.6% of 2019 GDP. The package comprises of €1bn in fiscal measures including direct support, deferred government income in the form of payment suspension of direct and indirect taxes and other fees, as well as government guarantees and interest rate subsidies of €2.3bn facilitated by EIB to banks so that they provide cheap financing for SMEs, self-employed and large corporations who had no NPEs at the end of 2019. Meanwhile, the impact of the pandemic has started weighing on the fiscal side. As a percentage of GDP, the general government deficit stood at -4.6% in 7M-2020 vs. a +1.8% surplus in 7M-2019 with the FY2020 deficit expected at -4.3%. Meanwhile, the picture from the latest high frequency indicators' releases is mixed. Retail sales in volume terms improved to -0.5% YoY in July up from -1.5% YoY in June vs. -3.7% YoY in May and -28.6% YoY in April, bringing the year-to-July performance at -2.7% YoY. The monthly improvement (+6.3% MoM) reflects the reopening of the economy after the easing of the containment measures against Covid-19 pandemic. Having plunged in May at levels comparable to those seen in 1H-2013, at the peak of the previous banking crisis and bail-in events, the economic sentiment indicator improvement (ESI-CypERC) has stalled. The ESI-CypERC declined marginally by 1.0 point to 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. Unless there is a second wave of the pandemic, sentiment improvement is expected to accelerate further in the coming months. But even then, the economy is poised to undergo a painful recession in FY2020 given that it is small, open and services oriented with tourism making an important direct and indirect contribution. Tourist arrivals declined by 88.2% YoY down to 104,261 in August compared to 553,845 a year ago, bringing the year-to-August decline down to 84.5% YoY. In 1H-2020, tourism revenues amounted to €164.5mn compared to €1.425.2mn in the corresponding period of 2019, down by 88.5%.

Figure 18: Real GDP contraction in Q2 was the worst since 2012-2013



Source: Eurostat, Eurobank Research

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

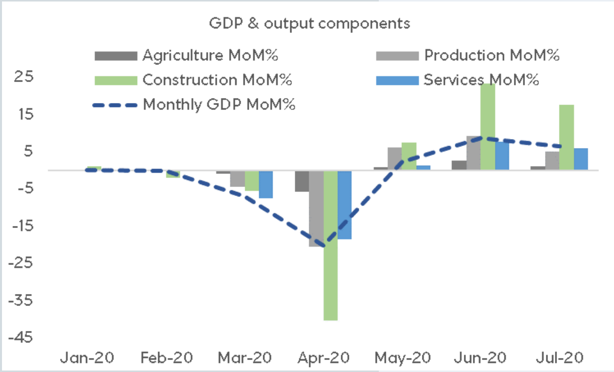


Source: Bloomberg, Eurobank Research

UK

Half of the lost ground since February has been recovered, but challenges remain

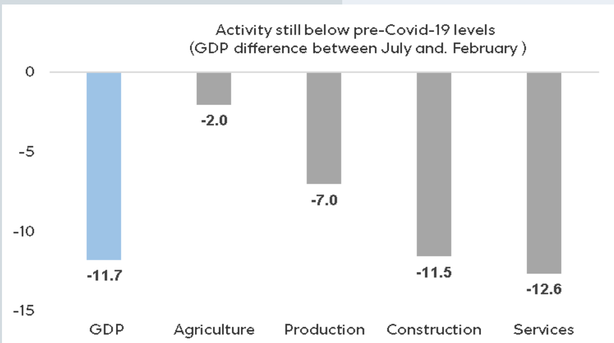
Figure 20: UK GDP bounced in May to July...



Source: ONS, Eurobank Research

After recording a 19.8% contraction in H1 2020 compared to H2 2019, one of the largest contractions among developed economies over that period on the back of a longer lasting lockdown, the UK economy is bouncing back. According to the most recent monthly GDP data, as of July, the UK has recovered around half of its lost ground since February, standing 11.7% below its pre-virus levels (Figure 22). The GDP jump in the period between May and July was driven by an improvement in all three of the UK's key sectors: services (+16.0%), agriculture (+4.8%), industrial production (+22.1%) and construction (+56.3%), as social restrictions were gradually lifted and more furloughed employees returned to work. The bigger-than-expected economic recovery, especially in the months of June and July, suggests that Q3 GDP is likely to surprise positively (though the BoE's Q3 GDP growth projection of 19.4%QoQ may still look too optimistic). However, the road back to pre-pandemic levels is still long as the UK growth outlook remains challenging. First, PM Boris Johnson announced in September new restrictions following the resurgence of Covid-19 cases and warned that they are likely to remain in place for six months amid concerns over a more severe second wave (currently around 15% of the UK population is subject to local restrictions). In addition, Brexit uncertainty adds to supply-side pressures as businesses await more clarity on the future relationship with the EU. Last but not least, the persistently high number of full-time furloughed workers (around 10% of total workers) at a time that job vacancies are around 50% below pre-pandemic levels, poses another downside risk for the UK economy. That said, a slowdown in the pace of economic recovery is highly anticipated in Q4, with GDP expected to contract by 10.0% in the full year, followed by 6.5% growth in 2021. With respect to Brexit, EU/UK negotiations continue despite their dispute on the UK's Internal Market Bill, with reports suggesting that little progress has been made thus far in bridging their differences in certain contentious issues. On the monetary policy front, the minutes from the BoE September meeting supported the view for more policy stimulus conditional on the risk of a nationwide lockdown and an unfavourable Brexit outcome.

Figure 21: ... but still 11.7% below its pre-virus levels



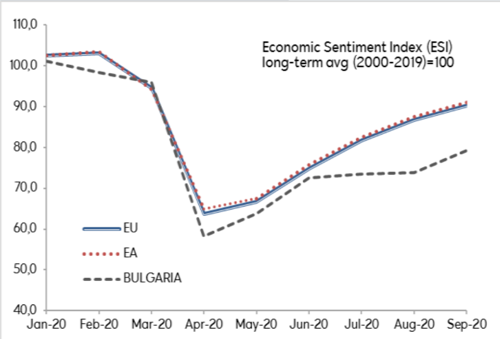
Source: ONS, Eurobank Research

Bulgaria

Despite ongoing political turmoil, sovereign funding costs remain low

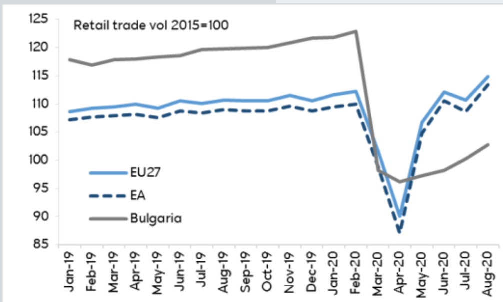
The supervision of the 5 out of the 6 systemic banks (UniCredit Bulbank, DSK Bank, UBB, PostBank, and Raiffeisenbank Bulgaria) by the ECB since October 1 signaled the country's entry into the banking union and the continuing endeavors to adopt the Euro. While the adoption of the euro is not expected before 2024 as the BNB Governor, Dimitar Radev stated in an interview recently, the 2 to 3 years period ahead marks a process of reforms and strengthening of the financial system of the country and has caught investors' attention. That said, the Ministry of Finance made good use of the favorable momentum and succeeded in tapping the international financial markets in mid-September by issuing 10-y and 30-y Eurobonds worth EUR2.5bn (BGN 5bn), covering this way a substantial portion of its financing needs for the rest of the year and creating additional cash buffers to support the economy in the challenging winter period ahead. Investors' interest was high resulting in oversubscription as bids reached EUR7.5bn in total. The average yields of the 10-y and the 30-y Eurobonds came in at 0.40% and 1.48% respectively and were widely considered very favorable. However, the aforementioned positive market developments are partially clouded by the ongoing political uncertainty since mid-July. Moreover, the EC's Cooperation and Verification Mechanism (CVM) monitoring will remain in place bringing consequently, the country, under double monitoring as it will also be subject to the new EC's Rule of Law monitoring mechanism. The latter will apply to all 27 member states and will include check reports, apart from judicial reform and anti-corruption efforts, on issues such as media freedom and pluralism. On the data front, retail sales stagnated in July (+0.1% YoY) after bottoming out in March (-20.10% YoY) and recovering ever since. Additionally, compared to the rest of the EU countries, Bulgaria recorded the largest annual decrease in retail trade in August according to Eurostat. Presumably, the political turmoil during the last two months weighs on private consumption as it fuels the existing pandemic-related uncertainty. To conclude, taking into account the above and considering that sound public finances mitigate the social unrest and its impact on private consumption, we keep our GDP growth forecast unchanged at -5% in 2020 with risks considered balanced, subject to a mild Covid-19 resurgence in the winter months ahead.

Figure 22: While the economic sentiment follows the EU & EA trend, it lags behind visibly



Source: European Commission, Eurobank Research

Figure 23: ..and so does the retail trade volume...



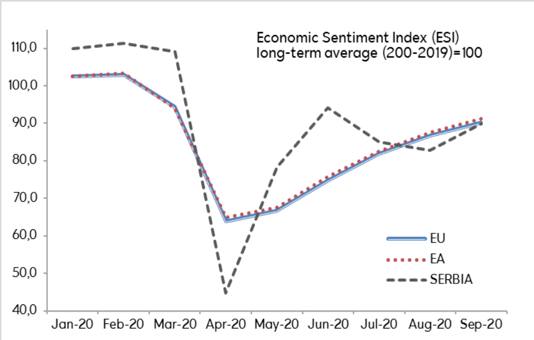
Source: Eurostat, Eurobank Research

Serbia

Recovery on track but room for further fiscal stimulus is limited

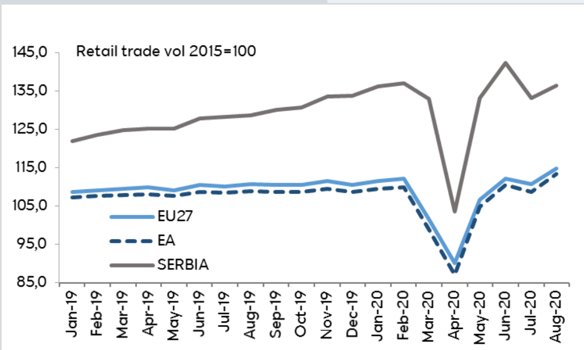
Recent key developments come from the external affairs front. In mid-September, Serbia and Kosovo signed a U.S. - brokered agreement in Washington in efforts to normalize their bilateral economic relations. The agreement includes, inter alia, enhanced co-operation in the implementation of infrastructure projects, the energy sector and the free movement of people, goods, services and capital and also foresees a freeze in the recognition campaigns on behalf of both countries. Indeed, the pact leaves major and difficult issues with sovereign and territorial aspects lingering, however it is considered a sign of progress in the two countries' bilateral negotiations, which were interrupted in late 2018 leading to the imposition of 100% trade tariffs by Kosovo on Serbian goods from November 2018 until June 2020. On the economic front, recent supply and demand indicators point to continuing economic recovery, following the Q2 GDP growth print at -6. 4%YoY. Specifically, industrial production after bottoming out in April (-16.6%YoY) and shrinking at a smaller scale in May (-9.3%YoY), has been recovering ever since (+2.6%YoY in June and 0.4%YoY in July) with a stronger rebound in August (+4.2%YoY). On the same pattern, retail sales continued recovering at the same pace in July and August (+4.7%YoY and +4.5%YoY respectively) after hitting the trough in April (-18.6% YoY). Taking into account the above, it came as no surprise that the Ministry of Finance and the NBS have upgraded their 2020 GDP forecasts from -1.8% and -1.5% respectively and expect the economy to contract by -1% in 2020. On a more conservative tone, in its recent BB+ affirmation of the country's long-term sovereign rating, Fitch forecast that GDP will contract by 2.2% in 2020, but expand by 5.2% in 2021, driven by recovering external demand, investment catch up and partial rebound in private consumption. Our forecast lies improved somewhere in-between, i.e. at -1.5% in 2020, followed by a +4.5% rebound in 2021. Risks appear broadly balanced subject to a mild Covid-19 resurgence in the winter months. Fiscal space will be limited in 2021 in case ongoing support of the economy is needed, following the augmented fiscal deficit in 2020 that is expected to exceed -7% of the projected GDP, compared to a marginal surplus of 0.2% of GDP in 2019.

Figure 24: The economic sentiment lies at the same levels with the EU & EA ..



Source: European Commission, Eurobank Research

Figure 25: ...while retail trade volume stands visibly above the EU and EA average...

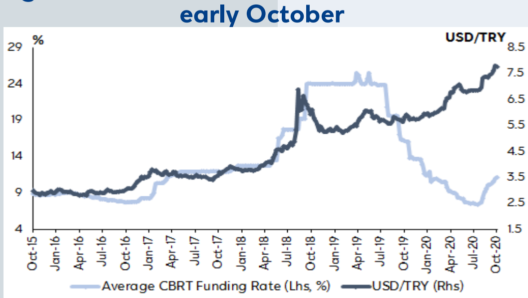


Source: Eurostat, Eurobank Research

Turkey

Lira recorded new historic lows despite CBRT rate hike

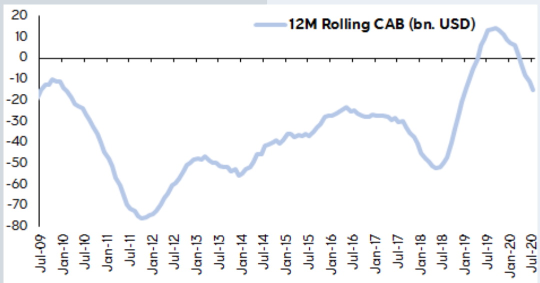
Figure 26: Lira recorded new historic lows in early October



Source: Bloomberg, Eurobank Research

The Central Bank of Turkey (CBRT) hiked its key policy rate (KPR) by 200bps at 10.25%, the overnight lending rate to 11.75% and the late liquidity window to 13.25% in late September. In its communication, CBRT cited higher than expected inflationary pressures resulting from a fast recovery from the initial Covid-19 pandemic shock. Recall that the CBRT had already taken measures to increase the effective funding rate in the last weeks prior to the policy meeting in an attempt to support the lira, thus reducing 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. The decision took by surprise the relevant surveys' consensus of Reuters and Bloomberg. We have long argued that so far the policy mix has been overly focused on providing additional support to growth. The CBRT had slashed the KPR by 1575bps in nine consecutive sessions in the current easing cycle and remained on hold. 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. In our view, the interest hike is a first timid step towards the right direction but negative interest rates, which is still the case, necessitate further hikes 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, constrained authorities' room for maneuver further. On top, the recent geopolitical developments in the Armenia-Azerbaijan regional armed conflict weigh on the lira outlook. Having been on a steady depreciation trend, the lira has continued sliding in the last two months touching new historic lows despite CBRT intervention (at 7.85/$ on October 7, -32.07% Ytd). Finally, rating agencies have initiated a new cycle of reviews. In mid-September, Moody's downgraded the long-term sovereign rating of Turkey to B2, with a negative outlook. According to Moody's, the country's external vulnerabilities are increasingly likely to crystallize in a balance of payments crisis. In addition, the country's institutions appear to be unwilling or unable to effectively address these challenges. Fiscal buffers, which have been a source of credit strength for many years, are also eroding. The negative outlook reflects the view that fiscal metrics could deteriorate at a faster pace than currently anticipated, the downside risks associated with the authorities' inadequate reactions and the elevated levels of geopolitical risk on several fronts. Recall, that Fitch had also affirmed its BB- rating but changed the outlook to negative in late August.

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



Source: National Authorities, Eurobank Research

Eurobank Macro Forecasts

	Real GDP (YoY%)			CPI (YoY%, avg)			Unemployment rate (% of total labor force)			Current Account (% of GDP)			General Budget Balance (% of GDP)		
	2019	2020f	2021f	2019	2020f	2021f	2019	2020f	2021f	2019	2020f	2021f	2019	2020f	2021f
World	3.1	-3.2	5.0	3.5	2.5	2.8									
Advanced Economies															
USA	2.2	-5.0	4.0	1.8	1.0	1.8	3.7	8.5	7.2	-2.2	-2.3	-2.4	-4.7	-16.8	-10.0
Eurozone	1.3	-8.0	5.5	1.2	0.4	1.1	7.6	8.3	9.5	2.7	2.5	2.0	-0.6	-10.0	-5.0
Germany	0.6	-6.0	4.2	1.4	0.8	1.3	3.2	4.5	4.0	7.6	6.1	7.0	1.4	-8.2	-3.5
France	1.3	-9.5	6.6	1.3	0.5	1.0	9.2	8.5	9.5	-0.8	-1.7	-1.2	-2.0	-10.2	-5.0
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	5.5	0.6	-0.1	0.6	9.9	10.0	11.5	2.7	3.0	3.0	-1.6	-11.5	-5.5
Spain	2.0	-11.6	6.6	0.8	-0.3	1.0	14.1	16.8	17.2	2.0	0.1	1.2	-2.8	-11.8	-7.8
Portugal	2.2	-8.4	5.8	0.3	0.0	0.8	6.5	7.0	7.5	-2.0	-1.0	-0.4	0.2	-7.8	-5.8
UK	1.4	-10.0	6.5	1.8	0.8	1.5	3.8	4.6	5.6	-4.3	-2.5	-2.2	-2.1	-13.0	-7.0
Japan	0.7	-5.5	2.3	0.6	-0.1	0.0	2.4	3.0	3.2	3.6	2.8	3.0	-3.9	-13.0	-7.5
Emerging Economies															
BRICs															
Brazil	1.1	-5.3	3.5	3.7	2.5	3.1	14.0	13.5	12.5	-2.7	-2.8	-0.7	-1.7	-15.7	-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	-7.8	7.5	3.7	5.5	4.2		*NA*		-0.9	0.5	-0.9	-0.2	-8.0	-6.4
Russia	1.3	-4.3	3.3	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	4.5	2.5	1.5	2.0	4.2	6.0	5.5	4.0	2.0	3.0	-1.0	-4.0	-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	12.0	11.0	13.8	16.0	15.5	1.1	-3.0	-1.5	-3.0	-7.0	-4.0

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

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%	0.20%	0.22%	0.23%	0.24%
3m Libor	0.22%	0.31%	0.34%	0.36%	0.37%
2yr Notes	0.15%	0.21%	0.28%	0.33%	0.38%
10 yr Bonds	0.76%	0.76%	0.88%	0.97%	1.05%
Eurozone					
Refi Rate	0.00%	0.00%	0.00%	0.00%	0.00%
3m Euribor	-0.51%	-0.46%	-0.61%	-0.58%	-0.57%
2yr Bunds	-0.70%	-0.63%	-0.61%	-0.58%	-0.57%
10yr Bunds	-0.51%	-0.40%	-0.32%	-0.26%	-0.19%
UK					
Repo Rate	0.10%	0.10%	0.10%	0.10%	0.10%
3m	0.05%	0.12%	0.14%	0.16%	0.16%
10-yr Gilt	0.28%	0.25%	0.29%	0.37%	0.42%
Switzerland					
3m Libor Target	-0.76%	-0.74%	-0.72%	-0.70%	-0.71%
10-yr Bond	-0.51%	-0.50%	-0.46%	-0.39%	-0.36%

Source: Bloomberg (market implied forecasts)

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