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GLOBAL & REGIONAL MONTHLY

Risk-on sentiment prevailed in May amid tentative signs of an economic rebound and a swift monetary and fiscal policy response that is unprecedented in size. Incoming economic data suggest that activity in both the manufacturing and services sectors might be starting to pick up again from the March-April lows, as developed economies gradually reopen which helps to boost investor sentiment. For the whole 2020, we expect much weaker growth in major developed economies, revising downwards our GDP growth projection to -3.2%, from -2.5% previously.

Macro Picture

USA: Unprecedented Q2 economic contraction, to be followed by a strong rebound in H2

EA: The immediate economic shock due to the lockdown seems to have bottomed-out

UK: Q1 GDP figures confirm an unprecedented downturn in economic activity

EM: Heading towards a multispeed recovery across emerging Asia, LatAm & CESEE

CESEE: Output performance above expectations in Q1-2020, optimism that the worst may already be behind

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EM: EM catch up rally with DM credit despite lack of support from CBs driven by reopening of economies and oil price recovery

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EA: ECB increased its PEPP envelope as expected, with a horizon extension to at least end-2021

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Idiosyncratic factors in EM: EMs that entered the crisis with idiosyncratic defects will need more time and resources to recover

Special Topics in this issue

- How is China coping after the lift of the lockdown?

- US/China tensions on the rise again

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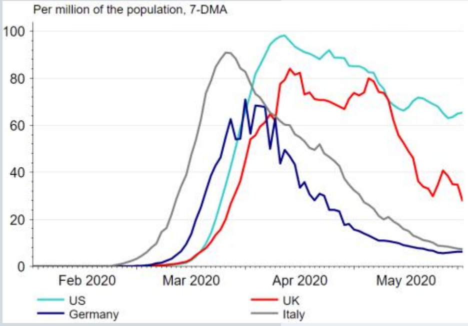


Source: Refinitiv Datastream, Fathom Consulting

Risk-on sentiment prevailed in May amid tentative signs of an economic rebound, following the gradual loosening of restrictions and the slow reopening of the economies, coupled with a swift monetary and fiscal policy response that is unprecedented in size. The Covid-19 pandemic seems to be getting under control, with the growth rate of new confirmed cases (Figure 1) and fatalities around the world continuing to slow. The recovery in global equity markets since late March has been remarkable (Figure 2) - with a jump in global equity market capitalization that totals about $15trn, a policy stimulus that amounts to ca. $18bn and an aggregate size of the major central banks' balance sheet currently at $22trn - shrugging off intensifying China-US trade tensions that have recently increased geopolitical uncertainty. Furthermore, incoming high-frequency economic data for major economies suggest that activity in both the manufacturing and services sectors might be starting to pick up again from the March-April lows, as developed economies gradually reopen and ease their lockdown restrictions helping to boost investor sentiment. Global PMIs in several advanced economies reported a noticeable easing in the recent downturn, following a V-shaped rebound witnessed in China since March. In the US, the recent trend in initial jobless claims points to a slowing rate of job separations, while consumer and homebuilder sentiment has modestly recovered. Consumer confidence has improved in Europe as well, with signs of a consumption rebound in Germany that has proceeded with partial re-openings since mid-April. For the whole 2020, we now expect much weaker growth in major developed economies, hence we have revised downwards our GDP growth projection to -3.2%, from -2.5% in May, pointing to the deepest contraction in post-war history. With the worst of the initial phase of the Covid-19 pandemic probably behind us, the big question now is whether the economic recovery should prove strong enough to continue beyond the technical rebound after the lockdown measures, given the sheer size and the potentially more structural nature of the shock caused by the pandemic. The future path of Covid-19 and the progress in the medical side should have a pivotal role, with the

Figure 2: Equities in local currency

Source: Refinitiv Datastream, Fathom Consulting potential to swing household sentiment either way. The biggest risk to the global economic outlook would be for renewed US-China trade tensions to coincide with a sudden setback on the pandemic front.

Developed Economies

US: Reflecting the negative economic effect of the pandemic, durable orders plunged by 13.6%MoM in April with broad-based weakness across the board, while stay-at-home orders implemented to reduce community spread led to a decline in trade volumes. Nevertheless, April personal income increased by 10.5%MoM, boosted by unemployment insurance benefits and direct stimulus, while the savings rate skyrocketed to a new historical high of 33%, boding well for a rebound in consumption in the quarters ahead. Overall, we have downgraded our US GDP growth outlook for 2020 to -6.0% due to an unprecedented retrenchment in Q2 GDP, and look for a recovery in H2 2020 largely dependent on the speed at which rehiring proceeds. Fearing a more persistent, pandemic-related negative impact on the US economy, the Fed is likely to enhance its forward guidance about the policy rate and its future asset purchases at its June meeting, with a more explicit outcome-based or date-based policy accommodation.

Euro area: Given that economic activity was fully disrupted in April due to lockdown and social-distancing measures to control the Covid-19 pandemic, we expect a much sharper double-digit contraction in Q2 before we see a gradual normalization at the very end of Q2 and into Q3. Indeed, the economic downturn in the euro area showed the first signs of easing in May as containment measures have been largely lifted across the continent. Our 2020 real GDP projection currently stands at -9.0%, revised downwards from -7.0% one month ago, due to sharply downgraded expectations for Q2 in Italy, France and Spain. Ultra-accommodative ECB monetary policy stance, combined with sizable fiscal boost, should help European economies to address the fallout of the Covid-19 crisis and reduce the risk of an uneven recovery across member states.

EMU periphery: The two biggest EMU peripheral economies, Italy and Spain, have been the most affected EA countries by the COVID-19 outbreak. 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%QoQo respectively, well above the EA average of 3.8%QoQ, even though only 2-3 weeks of Q1 were affected by lockdowns. Due to the prolongation of strict lockdown measures, both countries are expected to experience a substantially larger hit in Q2, probably around three times as much as in Q1, before they witness a sharp rebound in H2 2020, on the assumption of a continuing gradual but consistent lifting of restrictions that began in early May (Italy: 4 May, Spain: 11 May). Though the ultra-accommodative ECB monetary policy and the EU-wide fiscal response are expected to mitigate some of the anticipated economic downturn from the COVID-19 pandemic, real GDP of both Italy and Spain is expected to contract by around 10% each for the year, slightly deeper than -9% projected for the EA, taking into consideration that the tourism sector —which is likely to be among the most hit sectors from the pandemic with long-lasting negative effects— accounts for a relatively high share of GDP (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: During May, Brazil, Russia and India published their quarterly GDP growth prints, following China's release in mid-April. All readings point to severe economic deceleration but the severity is ranging between the 4 countries, based on idiosyncratic factors. **Brazil**'s Q1 GDP growth print came in at -0.3% YoY, from +1.7% YoY in Q4 2019. Economic activity decreased in Q1 for the first time since 2016 on an annual basis on the back of social distancing measures due to the Covid-19 outbreak, slowing global growth, trade tensions and regional political turmoil. Most worryingly, the Q2 GDP growth performance is not anticipated to offset the contraction in Q1 as the country, at the time of writing, is still away from flattening its virus curve. By June 1, Brazil ranks second in the world in terms of reported incidents (514.849 persons) and fourth in terms of human losses. While in Q1 2020, **Russia**'s GDP expanded by 1.6% YoY, down from 2.1% YoY in Q4 2020, in April alone, GDP contracted by -12% YoY in an illustration of recession dynamics. The country's official forecast stands at -5.0% in 2020 with the economy expected to be rebound in 2021, expanding by 2.8% and 3.0% in 2022. Nevertheless, forecasts bear a high degree of uncertainty, taking into account the oil production cuts agreed among OPEC+ countries in April and the evolution of the pandemic in the country so far. At the time of writing, Russia counts more than 415,000 of confirmed incidents with a heavy death toll of 4,855 persons. In **India**, economic output expanded by 3.1% YoY in Q42020[1], the slowest since Q42009. Overall, the impact of Covid-19 pandemic was only partially captured in the GDP data for Q4202020 as the nationwide lockdown was implemented in late March. As such, the lockdown's impact on economic growth will be more visible in the Q12021. In **China**, while the official manufacturing PMI disappointed in May, coming in below April's print and May's consensus, the respective index by Caixin rose to 50.7 in May from 49.4 in April, reinforcing the view that the economy is recovering. Prior to that, the NPC which was concluded in late May decided not to set a specific GDP growth target for the first time in two decades, easing the pressure on policymakers for a V shape recovery in 2020.

CESEE: Taking into account the official statistics and the relevant metrics of infections, hospitalizations and fatalities per country, it would be fair to say that the broader CESEE region seems to have largely addressed the spread of Covid-19 more successfully than Western Europe & USA. The further re-opening of the economies has created some optimism that the worst may be already behind. Having plunged to historic lows in April, the rebound of sentiment and survey data in May reflects the easing of strict containment and social distancing measures. First evidence from national accounts data in Q1-2020 –before the social distancing measures – show that the CESEE economies in most cases outperformed market expectations.

[1] The fiscal year of India is from 1 April to 31 March. FY 2019–20 means the financial year started on 1st April 2019 and ended on 31st March 2020. FY 2019–20 may also be written as FY 2020 and so on.

Special Topic

How is China coping after the lift of the lockdown?

From the starting point of the pandemic, to its peak and the gradual lift of protective draconian measures

As China is a couple of months ahead in coping with the Covid-19 pandemic, the rest of the world is closely monitoring its gradual return to normality, looking for lessons to be learnt for the next day. When the Covid19 appeared in December in China, the authorities acted decisively by adopting draconian measures. In late January, Wuhan, the city where the virus first appeared on December 8 was locked down by Chinese authorities in an attempt to contain the disease. Since January 23 and until April 8, when the Wuhan general lockdown officially ended, sporadic lockdowns were imposed locally when necessary in order to prevent new outbreaks. According to the Wall Street Journal, at its peak, China's quarantine was stretched to more than 20 provinces and regions. The draconian measures adopted, despite being criticized at the time of their imposition, proved effective in limiting the spread; China's official number of incidents stood at 83,000 by the end of May, when in the US the respective number exceeded 1.3mn. However, they also came with severe economic consequences. GDP contracted by -6.8%YoY in Q12020, compared to +6%YoY expansion in Q42019. While it is the worst performance since 1992, when China started to publish quarterly data, the print came as no surprise to the market (consensus at -6%) as it was unavoidable that that efforts to contain the Covid19 outbreak would negatively affect the country's economic output.

How should economic recovery be combined with actions against a second wave of the pandemic?

Along with the gradual lift of measures and the return to normality, the country's economic performance is under the microscope as well, as it may provide some guidance to other countries that are at an earlier stage in battling the pandemic. Two months after the reopening of the economy, a range of high frequency data point to a clear yet uneven and gradual recovery. China's road traffic data reveal that following the ease of lockdowns since February, traffic on the national highway network in March was already +10% YoY higher, climbing to +21% YoY in April (graph 3). However, the increase does not necessarily point to augmented economic activity as means of public transportation still keep their load factors lower and individuals who can afford it, prefer commuting by car, which explains, inter alia, the increased volume of car sales in April. China's auto sales increased by 4.4% YoY, putting an end to a 21month declining streak in the world's largest auto market. In any case, according to Trivium China, the economy is currently operating at 87% of its standard output capacity. In detail, 98.7% of large corporates has resumed operations, 30 provinces, which account for almost the entire GDP of China are reporting resumption rates between 90% and 100% and industrial enterprises operate at 87.8% of normal activity levels, from 85.2% one month ago. According to a recent paper by researchers in Brookings Institute and Caixin Insight Group[2] (Table 1), the return-to-work rate across provinces and first-tier cities is negatively correlated with infected case numbers, i.e. the higher the infection rate, the lower the subsequent rate for workers who return-to-work.

[2] https://www.caixinglobal.com/2020-05-16/reopening-chinas-economy-tracking-the-heartbeat-of-a-recovering-nation-101554931.html?utm_campaign=Foreign%20Policy&utm_source=hs_email&utm_medium=email&utm_content=88367628

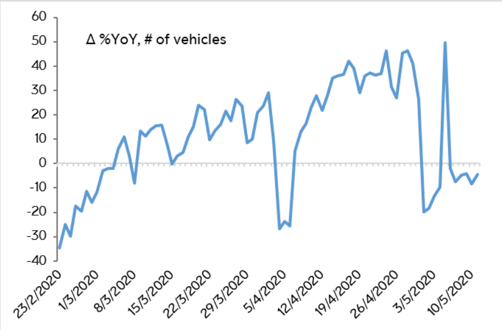
Moreover, in the same table, it is observed that manufacturing firms have the highest return-to-work rates, office buildings follow while shopping malls report the lowest rates. This observation reveals the priority in reopening the economy: High-impact, low-risk businesses are reopening more quickly, while low-impact, high-risk businesses are reopening at a slower pace. Manufacturing contributes ca 40% to China's GDP, while it is primarily a capital intensive sector of the economy, compared to retail sales in shopping malls that entail human capital and physical contact. Finally, Chinese authorities appear to have attached great importance to safety in their decision-making process. Consequently, although they prioritised the restart of the manufacturing sector, they did not hesitate to hold back in provinces that may have sizeable contribution in the country's GDP but suffer from high rates of infection (see Table 1: Hubei, Beijing, Henan).

Table 1: China's Return to work rates in March and April by province

Province	Provincial GDP share (2019)	# of infected people per million	Return to work rate %					
			Manufacturing Firm		Office Buildings		Shopping Malls	
			March	April	March	April	March	April
Guangdong	10,9%	14	80	73	68	75	54	59
Jiangsu	10,1%	8,1	82	86	64	76	62	69
Shandong	7,2%	7,8	76	94	66	71	64	68
Zhejiang	6,3%	22,1	93	101	71	84	59	58
Henan	5,5%	13,3	64	64	58	73	46	60
Sichuan	4,7%	6,7	75	72	56	67	63	68
Hubei	4,6%	1,151	44	67	39	59	46	48
Fujian	4,3%	9	83	99	81	93	62	75
Hunan	4,0%	14,8	87	77	70	77	58	74
Shanghai	3,9%	27,1	76	80	68	81	62	78
Anhui	3,8%	15,7	73	67	72	83	68	79
Beijing	3,6%	27,5	51	76	41	54	39	43
Hebei	3,5%	4,3	63	82	61	69	48	59
Shaanxi	3,9%	8	72	85	70	75	58	69
Liaoning	2,5%	3,3	74	82	76	81	71	71
Jiangxi	2,5%	20,2	80	66	70	76	49	63
Chongqing	2,4%	18,7	70	131	58	78	61	88
Yunnan	2,3%	3,9	72	76	69	76	61	71
Guangxi	2,1%	5,2	64	82	59	85	56	69
Inner Mongolia	1,7%	7,9	70	86	86	94	59	63
Shanxi	1,7%	5,3	59	77	62	72	46	55
Guizhou	1,7%	4,1	76	94	71	78	80	80
Tianjin	1,4%	12,2	78	76	50	61	34	47
Heilongjiang	1,4%	25	69	86	52	65	60	66
Xinjiang	1,2%	3,1	66	88	71	74	75	72
Jilin	1,2%	4,1	73	80	90	81	61	62
Gansu	0,9%	5,3	78	93	51	63	56	63
Hainan	0,5%	18	75	75	65	71	71	80
Ningxia	0,4%	10,9	74	103	57	58	60	62
Qinghai	0,3%	3	75	84	65	63	59	56
Tibet	0,2%	0,3	111	172	97	150	61	65
Total	100%	-	-	-	-	-	-	-

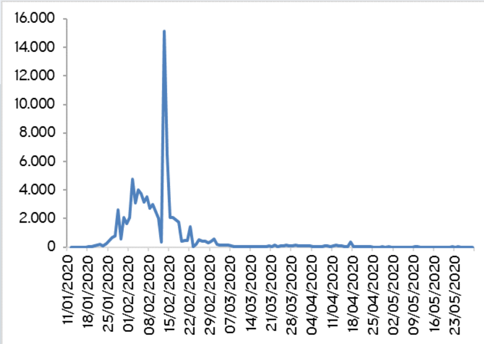
Sources: China's National Bureau of Statistics, Caixin Insight Group

Figure 3: Traffic in China's National Highway Network



Source: Fitch Ratings, China's Ministry of Finance, Eurobank Research

Figure 4: COVID-19 new daily cases in China



Source: Bloomberg, Eurobank Research

Assessing the risk of a second wave infection as economy reopens

Second-wave infections have basically come under control as China is on a steady downturn path regarding new cases. Those had fallen sharply by mid-March and have diminished further at the time of writing (graph 4). Moreover, on May 14, the Wuhan province entered into a "10 days of battle" to test all its 11mn residents, following six new cases in early May. As there would be despair, if the emblematic city were to suffer a new wave of Covid19, the government decided to examine its whole population. As of May 23, the battle has identified 189 asymptomatic cases, reducing that way the risk of contamination and thus eliminating, for the time being, the number of new cases.

Concluding, even though it is too early to infer certain judgements, the reopening of China's economy could be considered successful so far, considering that two months after the gradual lift of lockdowns and four since the peak of the stringent containment measures -when the economy was operating at only half of its capacity- economic activity is now approaching almost 90%, with the risks of a possible resurgence of the virus tilted to the upside. As the rest of the world seeks for direction on its road to reopening and its endeavors to balance between safety maximization and cost minimization, a closer look at China's formula could be useful.

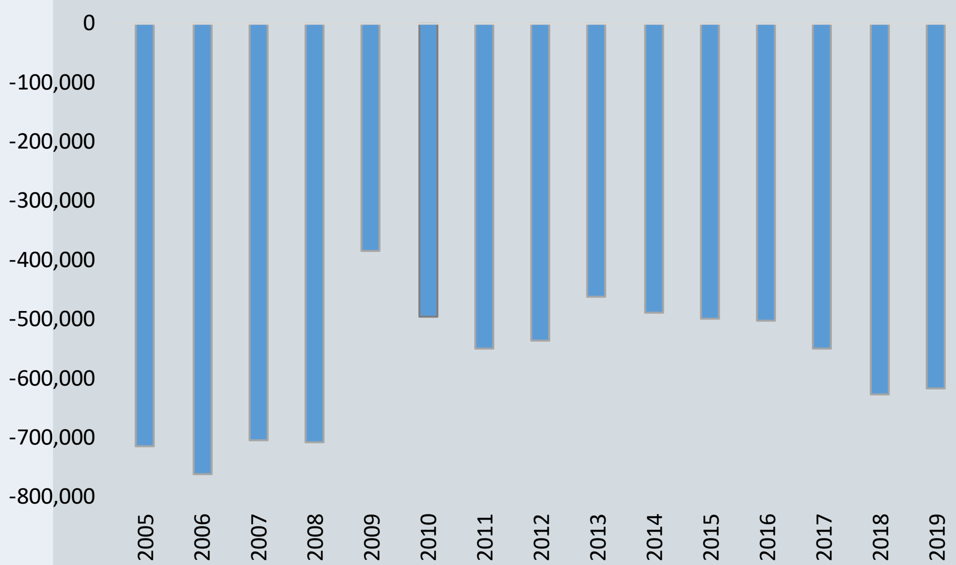
Global Macro Themes & Implications

US/China tensions on the rise again

US/China relations are heating up again, a few months after the two largest economies in the world signed a Phase-1 trade deal back in December 2019, following months of tensions and retaliatory tariffs. Among recent developments, the US administration has accused China over the handling of the COVID-19 outbreak, the US Senate passed a bill threatening to de-list Chinese firms of US financial exchanges in case they do not follow US audit and transparency regulations, the US Department of Commerce expanded export controls on US technology to Chinese telecommunications giant Huawei Technologies and the US administration decided to eliminate its preferential treatment for Hong Kong in retaliation to China's highly contentious national security bill to the city.

However, the US administration has left intact the Phase-1 trade deal that envisions, among others, a significant increase in Chinese total imports from the US, that would alleviate one of the key concerns of the US President, Donald Trump, ahead of upcoming US elections, namely the huge US trade deficit with China that amounted $346bn in 2019 (Figure 5). More specifically, China has committed to purchase an additional $200bn worth of US goods and services in 2020 and 2021 above the 2017 level (i.e., a $76.7bn increase in 2020 indicating a 60% rise of imports from the US compared to the 2019 level of imports, followed by a rise of $123.3bn in 2021). However, taking into consideration that China's domestic demand is much weaker than expected at the time the trade deal was signed due to the impact of COVID-19, the aforementioned import targets may prove unrealistic. Should this be the case, US/China relations are likely to face additional headwinds in the near future, further weighing on global growth prospects and delaying the economic recovery in the aftermath of the pandemic.

Figure 5: US trade deficit with China (in USDbn)



Source: BEA, Eurobank Research

Macro Themes & Implications in CESEE

The economies of the CESEE region are speeding up towards reopening after the lockdown period. First evidence from national accounts data in Q1-2020 – before the social distancing measures – show that the CESEE economies outperformed market expectations and their Euroarea peers

As of early June, taking into account the official statistics and the relevant metrics of infections, hospitalizations and fatalities per country, it would be 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. In order to achieve that, CESEE governments introduced tough social distancing measures and a ban on travelling with some even resorting to curfews. Having taken gradual and timid steps in the previous month, most of the governments are now speeding up towards reopening their economies in line with their announced roadmaps. The exit strategies foresee the expiration of the state of emergency regimes allowing for some removal of movement restrictions while maintaining some safety measures. During the first phase, small retail businesses (beauty salons, non-food shops) - but not shopping malls – were allowed to reopen and public transportation is restored. In the second phase of the plans, shopping malls, hotels, educational centers and sport facilities are allowed to reopen and intercity travelling would be allowed as of early to mid-June.

The further re-opening of the economies has created some optimism that the worst may be behind. The rebound of sentiment and survey data in May reflects the easing of strict containment and social distancing measures. Having plunged to historic lows in April, economic sentiment readings for both advanced and emerging European economies released earlier this month rebounded modestly. Having plummeted to multi-year lows, all sub-indices rebounded with the consumer, industry and services registering the biggest spikes. The picture of the Markit PMI manufacturing releases in May 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 May. In any case, uncertainties are still very high and it is still highly doubtful when sentiment and survey indicators could reach their pre-crisis levels any time soon.

The national accounts readings for Q1-2020 has also sent a positive signal. First 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, the CESEE economies were clear outperformers compared to their Euroarea 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. 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 started revising downwards their forecasts and publishing their views to reflect the new harsh realities. In its new European Economy Spring Forecasts released in mid-May, the European Commission (EC) warned that the output losses of the Covid19 pandemic are expected to be larger than the losses that triggered the global financial crisis in 2009. In the EC baseline scenario, which assumes that the pandemic fades in the 2H-2020 and remains under control thereafter, while the policy measures both at a national and multilateral level prove effective — the global economy is set to contract by -3.5% in 2020 followed by a rebound of 5.2% in 2021 as economic activity normalizes, helped by policy support. To illustrate the magnitude of the forecast revisions, the relevant forecasts for 2020 and 2021 stood at +3.0% and +3.1% respectively in autumn 2019.

In such an environment, according to the spring forecasts, the Euroarea and EU-27 are expected to contract by -7.7% and -7.4% respectively in 2020 and then bounce back by 6.3% and 6.1% in 2021. The relevant forecasts for 2020 stood at 2.5% in October 2019 and 2.6% in January 2020. EC now forecasts that all economies in the broader CESEE 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 -7.2% in 2020 and rebound by +6.0% in 2021. Serbia is forecast to contract by -4.1% in 2020 and expand by +6.1% in 2021, Romania by -6.0% in 2020 and +4.2% in 2021, Turkey by -5.4% in 2020 and +4.4% in 2021 and finally Cyprus by -7.4% in 2020 and +6.1% in 2021.

Finally, the EC has outlined its proposal for a recovery package that encompasses the Multiannual Financial Framework (MFF) for 2021-27 and a recovery instrument named "Next Generation EU". This instrument, would boost the MFF in 2021-24 with €750bn (5.4% of EU27 GDP). Two-thirds of Next Generation EU, approximately €500bn would be distributed to member countries as grants, while the remaining one-third €250bn would be distributed in loans. The vast majority of the CESEE economies, which are also EU members, are going to be net recipients/beneficiaries of this recovery package. Although it is still not finalized, the EC proposal suggests that the South-Eastern European countries remain well supported in terms of funds allocation relative to size of their economy: Bulgaria (€15bn, 19.3% of GDP) and Croatia (€12.1bn, 22.4% of GDP) are expected to be among the top net recipients/beneficiaries followed by Romania (€21bn, 9.4% of GDP) and Cyprus (€1.1bn, 4.9% of GDP). Baltics (Lithuania, Latvia, Estonia) are also doing very well. Last, CEE economies (Hungary, Poland, Slovakia) are also expected to be net recipients, but nevertheless receive on average smaller amounts of the funds than their peers in proportion to the size of their economies.

CESEE Markets Developments & Outlook

Bulgaria

Eurobond yields slid across the board, ranging between 15-24 bps, with the 2027 and 2028 paper yields losing 22 and 24 bps respectively. Local currency government bond yields registered modest gains of 2-4 bps across the short end of the curve, while the longer tenors, namely the 10 and 20 years, saw yields spiking by 32 and 13 bps respectively. S&P rating agency recently affirmed Bulgaria's credit BBB/A-2, but revised downwards the outlook from positive to stable, citing a short term fiscal disequilibrium, caused by the COVID-19 outbreak. As a response to the Covid-19 pandemic and the shutdown of almost the entire economy for two months, the government implemented several anticyclical measures, with the most prominent being the VAT rate reduction to 9% from 20% for all restaurants and other food related companies.

Serbia

Serbia is returning to normality after having acted promptly in mid-March by declaring the country in a state of emergency and invoking partial curfew that led to reduced internal and external movement of people. By the end of May, Serbia had 234,019 people tested, out of which 11,300 were found positive on COVID-19. From the confirmed cases, 6,438 incidents have been cured while 241 persons passed away.

In order to contain the negative consequences of COVID-19, the government introduced a €5bn economic plan. In order to finance the aforementioned plan, the government raised €2bn through a seven-year Eurobond issuance at the yield of 3.375% with an annual coupon of 3.125%. Since the Covid-19 outbreak, the country's sovereign spread (vs the German 10YBund) spiked to 393bps in May 29 from 327 in the end of February.

As a result, the NBS has increased the pace of intervention on the local FX market in order to alleviate the negative effect on the dinar, stemming from the moderate sell-off of RSD denominated bonds due to COVID-19 outbreak. Although we do not have precise numbers for May, we have reasons to believe that the NBS sold a similar amount to the previous month, i.e. EUR440mn. Thus, the EUR/RSD rate remained almost unchanged, hovering around the same levels since the beginning of the year, i.e. between 117.50 and 117.60. Finally, new borrowings will lead to ca 7% of GDP fiscal deficit for this year and the overall public debt-to-GDP ratio will climb to 60% from 51% at the beginning of the year.

Markets View

Foreign Exchange

EURUSD: The pair has finally moved outside its recent 2-month range and stands at 1.1230 at the time of writing. The technical picture is now bullish and the risk is for a test of the 1,14 area. The move higher is attributed to a wider USD selloff on the back of positive risk sentiment as well as Eurozone positive developments regarding the rescue fund and a change of the German stance on fiscal spending. We are now buyers at dips and expect the March highs (1.1450) to be challenged. Support comes at the 1.1180 area with resistance at 1.1400

GBPUSD: GBP moved higher as well due to general USD weakness. The pair still remains in the tight 1.23/1.265 range and we expect the top of the range to be tested. Support comes at 1.2380 and major resistance is at 1.2550 (current 1.2545).

USDJPY: The pair stayed in a tight range during May (108.00 – 106.20). During the first days of June the pair broke higher on the back of positive risk sentiment and steepening of the USD curve. The pair seems supported for now and a move higher to 110 level is expected.

Rates

EU: As the European economy started coming out of its lockdown and further talks about burden sharing within the EU became centre stage (with the announcement of the Recovery Fund) German bond prices headed lower with the yield curve bear steepening as the long end underperformed. 10yr bund yields increased by 22bps to -0.36% while the core significantly underperformed the periphery. The announcement of the increase of the PEPP program by 600bn and the reinvestment of any maturities from PEPP until 2022, will further enhance the convergence between core and peripheral yields. Short end EUR swaps rates are also normalizing further leading to diminished funding stresses. The German Constitutional Court decision seems to have reinforced the resolve of the ECB further while according to the PEPP details announcement, the programme is applied with no large deviations from the capital keys, easing further market concerns. We expect the Germany 5-30s to test 0.85% (currently at 0.73%) and yields to remain range-bound overall. Meanwhile, the funding of the Recovery Fund has created a new AAA asset, the EU bond that will be a competitor to core and semi-core.

US: US yield curve steepened significantly with 5-30s widening from 0.90% to 1.19% on long end supply as the short end remained anchored. The move was driven by the 29bps increase in 30yr yields. The 10-year spread to Germany tightened by 5bps to 1.12%, despite 10yr yields increasing by 14bps to 0.78% as the Fed reduced purchases. The pain trade remains for further increase in rates albeit a failed reopening due to a second wave of COVID infections or a significant escalation of the US-China trade war.

Emerging Markets credit

After stalling a little in April, EM continued its catch up to the rally in US credit as EM countries are reopening as well. Risks to a successful outcome are significant in the space, given infection levels remain elevated in a lot of major EM countries like Turkey, South Africa, Brazil, Mexico and India. The EMBIG sovereign spread index tightened by 100bps with HY names outperforming. B tightened by 175bps and BB by 100bps, compared to 60bps in BBB and 20bps in A. Region-wise, LatAm was the obvious underperformer as it was the only region to widen. SSA the clear outperformer trading 300bps tighter with second best MENA at 150bps tighter. The significant oil bounce, from the historic negative price move, has also helped performance in the space, with oil exporters having more room to tighten. Overall spreads, especially in HY remain at elevated/recessionary levels, despite the recent performance, reflecting the higher external vulnerabilities. If there is no widespread pick-up in COVID infection rates there is significant tightening left. The space posted a 6.8% total return in May but remains at -5.9% YTD. Downgrades continue at a steady pace reaching 58 in total in 2020. We maintain our constructive view to IG EM.

Corporate credit

Continued strong support by central banks and removal of lockdowns globally led to further tightening of credit spreads. EUR IG tightened another 9 bps, with curves bull steepening as the 1-5 years sector outperformed. Financials had another strong month tightening by 13bps vs 7bps in non-fins, with Tier 1 and Tier2 outperforming. BBB compressed with A and AA. Sector-wise the laggards of the rally since end-March (Autos & Parts, Basics Resources, Construction, Oil & Gas, Travel & Leisure) were the outperformers in May. All this despite significantly lower PEPP participation in the credit market than initially expected. USD IG saw similar price action with EU but with much bigger moves as USD funding pressure abated. Corporates tightened by 25bps with curves bull steepening and BBB outperforming AA/A by 16bps. Autos and Energy were by far the best performers.

In EUR HY curves disinvested further with compression between rating (CCC to BB) continuing. All sectors performed well with the anticipation that fallen angels will be included in the ECB's APP in the near future. EU HY fares better on strong government support. Lufthansa was in focus after accepting a government bailout package. Similar price action in the US HY space, with Hertz the high profile default. Curve inversion remains significant with 240bps, between short and long end bonds, but down 30bps versus the month before.

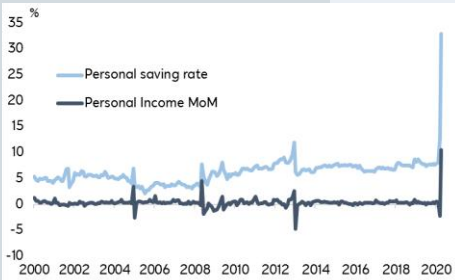
The primary market remained strong with EU HY coming to life as well. New issue premiums decreased further as demand from investors remained high and allocations low, leading to significant follow-through bids in the secondary market. EUR investment grade credit remains our preferred choice of exposure and we are extending to 10+ year tenors. The recently announced LTROs have provided further boost to carry on significantly reduced funding cost. We remain cautious in HY where name selection is much more important and further defaults are expected.

USA

Unprecedented Q2 economic contraction, followed by a strong rebound in H2

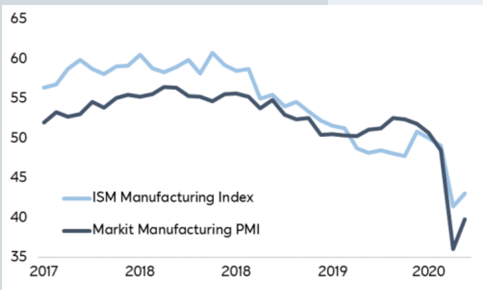
Reflecting the negative economic effect of the pandemic, durable orders plunged by 13.6%MoM in April with broad-based weakness across the board. With nonessential services shut across most of the country, the fallout in transportation, live entertainment and hotels was exceptional, pointing to remarkably weak business fixed investment in Q2. In addition, stay-at-home orders implemented to reduce community spread led to a decline in trade volumes in April, with the advance estimate revealing a $32.2bn drop in goods exports (-29.1%YoY) and a reduction of $26.8bn in goods imports (-20.1%YoY) over the same month. Nevertheless, April personal income increased by 10.5%MoM, boosted by unemployment insurance benefits and direct stimulus as part of the CARES Act 2020, which more than offset declines in wage and salary income. In its analysis of the effects of Selected Federal Pandemic Response Programs on Personal Income[3], the BEA reported that economic impact payments to households and unemployment insurance increased in April by $2.6trn/$216bn and $360bn/$30bn, respectively, on an annualized/monthly basis. As a result, the savings rate skyrocketed to a new historical high of 33%, boding well for a rebound in consumption in the following quarters should the economy reopen and jobs become available. Meanwhile, recent jobless claims suggest that unemployment has likely peaked pointing to a pickup in the hiring rate. Overall, we have downgraded our US GDP growth outlook for 2020 to -6.0% due to an unprecedented retrenchment in Q2 GDP, and look for a recovery in H2 2020 largely dependent on the speed at which rehiring proceeds. Being highly concerned about a more persistent negative pandemic-related impact on the US economy, the Fed is likely to enhance its forward guidance about the policy rate and its future asset purchases at its June meeting, with the April FOMC minutes highlighting the possibility for a more explicit outcome based or date-based policy accommodation. The completion of the monetary policy framework review, including inflation objective's changes and additions to the monetary policy toolkit (i.e. front-end yield curve control), to clarify Fed's future monetary policy actions, is expected later this year, not until the September FOMC meeting at the earliest.

Figure 6: Direct stimulus and unemployment benefits supported income & saving in April



Source: BEA, Eurobank Research

Figure 7: ISM and PMI Manf. improve in May, but keep signaling a further contraction



Source: Bloomberg, ISM, Markit, Eurobank Research

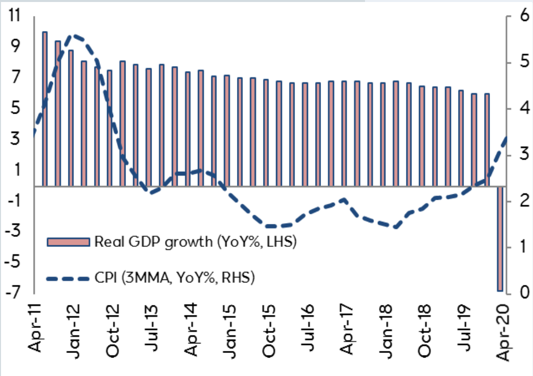
[3] https://www.bea.gov/sites/default/files/2020-05/Effects-of-Pandemic-Legislation-on-Personal-Income.pdf

China

The economic recovery remains on track but on a gradual and uneven pace, with supply outpacing demand

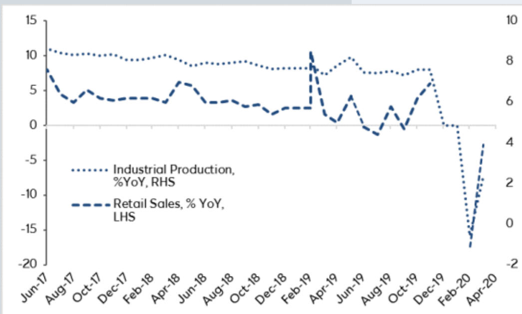
Postponed since mid-March due to the pandemic outbreak, the National People's Congress (NPC) finally concluded on May 28. Following the worst economic performance since 1992, as the Q1 GDP growth print revealed in mid-April (-6.8%YoY in Q12020, compared to 6%YoY growth in Q42019), the government decided not to set a specific GDP growth target for the first time in two decades, easing the pressure on policymakers for a V shape recovery in 2020. The absence of a specific growth target allowed the Politburo to set economic targets in a wider perspective such as stabilising employment and reducing poverty. The 2020 official fiscal budget deficit target is set at 3.76trn yuan or 3.6% of GDP, compared to 2.76trn yuan or 2.8% of GDP in 2019. Adding to the official budget deficit the special and central local government bond issuance, the augmented fiscal deficit is likely to reach 8.1% of the government-projected 2020 nominal GDP, up from 5.0% of GDP in 2019. The augmented fiscal deficit will be partly used to finance RMB2.5trn of new tax cuts for enterprises, especially for SMEs. On the monetary front, Premier Li Keqiang stressed that the government will not flood the economy with liquidity, but will also not hesitate to adopt additional measures if needed. It remains to be seen whether the measures, policies, priorities and targets set by the NPC are enough to support the economy. According to recent hard data, the big picture is that the recovery remains on track but on a gradual and uneven pace, with supply outpacing demand. Indicatively, the increased coal consumption in May by 17% implies that industrial production could increase further in May compared to +3.9% in April. However, retail sales declined by 7.5% YoY in April, albeit to a lesser extent compared to March. Finally, while the official manufacturing PMI disappointed in May, coming in below April's print and May's consensus, the respective index by Caixin rose to 50.7 in May from 49.4 in April, reinforcing the view that the economy is recovering.

Figure 8: Q1 GDP growth sinking in the battle with Covid-19



Source: Bloomberg, Eurobank Research

Figure 9: Mixed picture of hard data



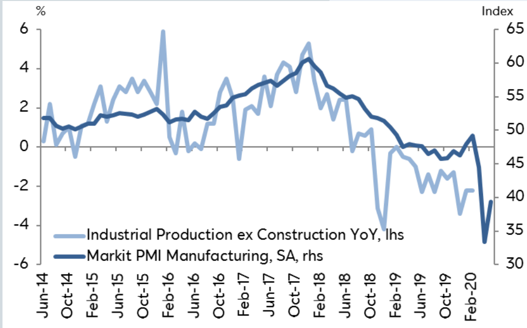
Source: Bloomberg, Eurobank Research

Euro area

The immediate economic shock due to lockdown seems to have bottomed-out

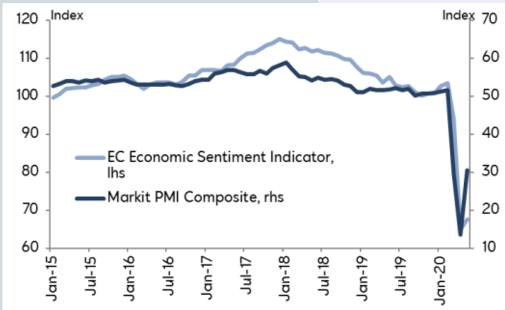
Lockdown and social-distancing measures to control the Covid-19 pandemic have taken their toll on March industrial production, which fell by 11.3%MoM leaving the Q1 decline at -3.3%QoQ and a negative carry-over of roughly -8.0% into Q2 (Figure 10). Given that activity was fully disrupted in April, we expect a much sharper, double-digit contraction in Q2 before we see a gradual rebound at the very end of Q2 or even Q3. Indeed, the economic downturn in the euro area showed the first signs of easing in May as containment measures have been partially lifted across the continent. Although still stuck in contractionary territory, the rate of decline seems to have eased in both manufacturing and services, with the respective May PMIs rising by 6pts and 18.5pts to 39.4 and 30.5, respectively. According to the PMI survey, Q2 GDP is expected to decline by an unprecedented quarterly rate of around 10% but the May increase adds to expectations that the slump should continue to moderate as lockdown restrictions are further eased heading into the summer. Adding to the above, the EC's May Economic Sentiment index edged up by 2.6pts to 67.5 following the record declines of March and April, reflecting a recovery in industry and consumer confidence (Figure 11). Our 2020 real GDP projection currently stands at -9.0%, revised downwards from -7.0% one month ago due to sharply downgraded expectations for Q2 in Italy, France and Spain. On the monetary front, the ECB increased its PEPP program by €600bn to a total of €1,350 at its June 4 meeting, and extended the horizon of the purchases to at least the end of 2021 and, in any case, until the GC judges that the crisis is over. The easier ECB monetary policy stance, combined with the expected fiscal policy boost amounting to ca. €2.4trn i.e. 17% of GDP (Recovery Fund Next Generation EU proposal of €750bn, new EU budget for 2021-27 of about €1.1trn, €100bn SURE programme, €240bn ESM pandemic precautionary credit line, and €200bn EIB plan), should help the European economies address the fallout of the Covid-19 crisis and reduce the risk of an uneven recovery across member states.

Figure 10: Manufacturing continues to contract sharply, but the downturn seems to be easing



Source: Bloomberg, Markit, Eurobank Research

Figure 11: Leading indicators suggest that the trough of economic activity is likely behind us



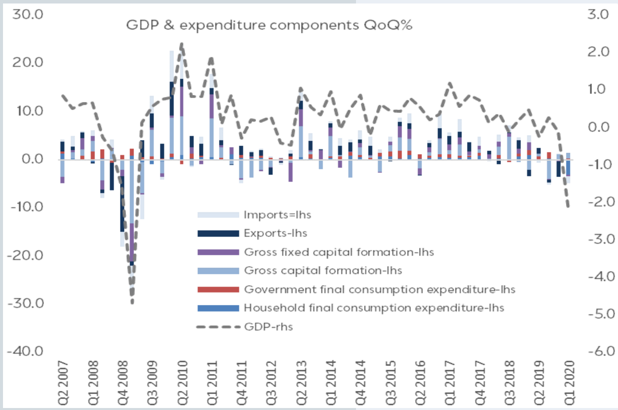
Source: Bloomberg, Markit, EC, Eurobank Research

Germany

The trough of economic activity has probably passed

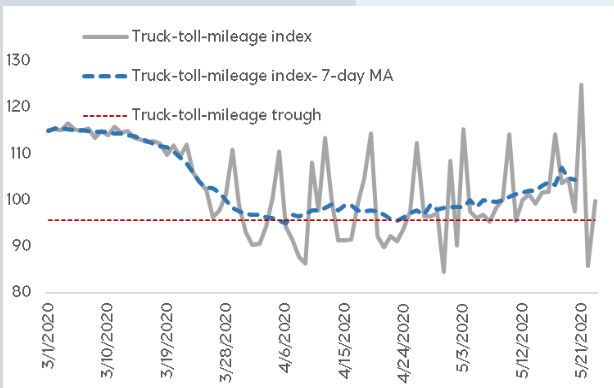
Germany's Q1 2020 GDP dropped by 2.2%QoQ, the biggest quarterly decline since Q1 2009, mirroring the effect of just less than two weeks of coronavirus-related lockdown measures (imposed on 22 March). However, the Q1 contraction was less severe than expected and less pronounced compared to the euro area average (-3.8%QoQ) thanks to strong January/February data following depressed economic activity in December and laxer lockdowns compared to those imposed in most western European countries. Meanwhile, Q4 GDP 2019 was revised lower to -0.1%QoQ from 0.0%QoQ previously, suggesting that the Eurozone's biggest economy is officially in recession. Based on the expenditure approach, Q1 GDP components fell sharply, with the exception of government consumption (+0.2%QoQ), and gross capital formation (+1.1%QoQ), with the latter gaining support from a near 7-year increase in construction (+4.1%QoQ) on the back of a completely mild weather in the first two months of the year. Full lockdowns remained in place in the first three weeks of April but confinement measures were gradually lifted by 20 April, while most of them were removed by late-May as the number of new infections had been falling continuously since early April (full restrictions still apply for large public events and sports events that involve physical contact, while there are still some barriers to international travel/tourism). That said, economic activity is expected to gain some momentum from May onwards but to remain below normal levels for some time (i.e., below pre-pandemic GDP levels) due to lasting impediments to global trade and lingering limitations on social life and travel. Supporting the above, daily activity data such as the truck-toll-mileage index, suggest that the trough of economic activity is probably behind us (figure 13). Assuming that measures adopted to support the economy from the pandemic will prove effective, we expect GDP to decline by c. 6.5% this year, with economic activity unlikely to return to pre-crisis levels before late-2021.

Figure 12: Germany's Q1 GDP contracts for the 2nd quarter in a row, but less-than-expected



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

Figure 13: Truck-toll-mileage has ticked up; trough of economic activity has probably passed



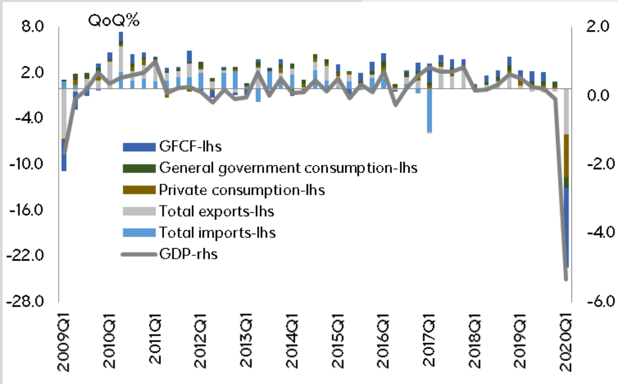
Source: Federal Statistical Office (Destatis), Eurobank Research

France

Q1 GDP contracts by the fastest pace since 1968, worse is set to come in Q2

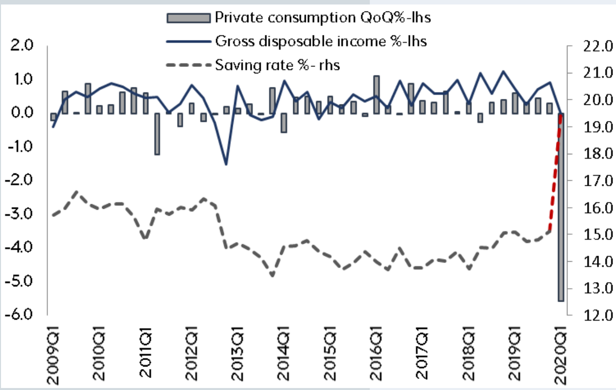
France's Q1 GDP was revised higher, contracting by 5.3%QoQ, less than -5.8%QoQ initially reported. Nevertheless, it was still the deepest quarterly fall since Q2 1968, reflecting the magnitude of the severe economic ramifications of the strict lockdown measures that had been in place from 17 March until 11 May to contain the spread of the COVID-19 outbreak. Q1 GDP contraction followed a 0.1%QoQ decline in Q4 2019, suggesting that the economy has entered recession for the first time in more than ten years. Final domestic demand (excl. inventories) subtracted 6.0pp from Q1 GDP, with household expenditure falling by 5.6% QoQ (revised up from -6.1%), public expenditure declining by 1.4% QoQ (revised up from -2.0%) and gross fixed capital formation contracting by 10.5% QoQ (revised up from -11.8%). The contribution of foreign trade was zero as imports fell by 5.7% QoQ (revised up from -5.9%) and exports fell by 6.1% QoQ (revised up from -6.5%), while inventories added 0.6pp to Q1 GDP (revised down from 0.9pp). Meanwhile, household gross disposable income dropped slightly in Q1 (-0.1% QoQ after +0.9% QoQ in Q4 2019), while, on the back of an increase of just 0.3%QoQ in household consumption prices, household purchasing power fell by a relatively limited 0.4% QoQ given the scale of the fall in activity, following a 0.7%QoQ rise in the prior quarter. As a result, the record high decline in household consumption in Q1 was presumably driven by a sharp increase in the savings rate to 19.6%, the highest level since late 1978 (Figure 15). Due to the prolongation of strict lockdown measures until 10 May, Q2 GDP is expected to contract even more significant compared to Q1 when containment measures were in place for just two weeks, with the INSEE estimating it at -20%QoQ. The gradual easing of lockdown restrictions on a départment-by-départment basis, along with the government's fiscal package (€110bn) and state guarantees (up to €300bn in business loans), are anticipated to help economic activity rebound as of Q3, with GDP contracting by around 10% in FY2020 (revised downwards from -8% in May) and budget deficit reaching an unprecedented 10%-of-GDP.

Figure 14: Q1 GDP was revised higher but still marks the deepest quarterly fall in half a century



Source: France's INSEE, Eurobank Research

Figure 15: Record drop of Q1 household consumption presumably driven by a sharp increase in the savings rate



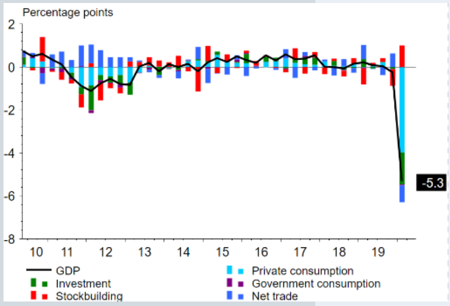
Source: France's INSEE, Eurobank Research

Italy

Slower, yet substantial, drop of business activity

Being one of the hardest-hit in the EU due to the Covid-2019 crisis, the Italian economy reported a 5.3%QoQ GDP contraction in Q1 (revised lower from -4.7%QoQ previously) on the back of depressed domestic demand coupled with a weak external sector (Figure 16). The restart of many services sector activities on May 18 has resulted in a slower, yet substantial, drop of business activity during May. The IHS Markit Services PMI rose to 28.9 from a record low of 10.8 reported in April. The loosening of restrictions and the slow reopening of the economy led to an easing in Italian manufacturing downturn, with the IHS Markit Manufacturing PMI increasing to 45.4 from April's nadir of 31.1. Nevertheless, Istat's business and consumer confidence indicators have not yet shown signs of recovery, plunging to an all-time low of 51.1 and a six-year low of 94.3 in May, respectively. Following a downwards revised quarterly drop in Q1 and an expected sharper contraction in Q2, we have downgraded our 2020 GDP forecast to -10.5% from -9.0% previously, pushing the annual government budget deficit close to 12% of GDP and resulting in a general government debt-to-GDP ratio of close to 165% at the end of the year. The Italian government's 2020 GDP forecast of -8.0% (DEF 2020) is way too optimistic compared to projections from other major institutions, while the Bank of Italy's regular bi-annual macroeconomic forecast (as of May 15) points to a 9.0% GDP contraction and highlights downside risks related to the strength of the recovery, the world economic outlook and the potential financial repercussions from the coronavirus crisis (Table 2). Undoubtedly, much will depend on the effectiveness of the government's measures to cushion the economy from the impact of the Covid-19 outbreak, with the most recent "Relaunch" Decree unveiled on 13 May and worth €55bn coming on the heels of a €25bn stimulus package launched in March. The package is aimed at mitigating massive unemployment and easing financial strains caused by containment measures on businesses, including, among others, €25.6bn to help employees and self-employed with temporary redundancy schemes, €4bn to cut the regional business tax (IRAP)[4] and €6bn of grants to small businesses (max €40k/firm). As the longer-term economic impact of the social distancing measures begins to take shape, discretionary spending may have to increase further by the end of the year, especially if the damage to employment proves to have a more pronounced impact on household demand.

Figure 16: Contributions to quarterly GDP growth



Source: Refinitiv Datastream / Fathom Consulting

Table 2: Italy's main macroeconomic forecasts

	Bank of Italy (15 May)	EC (6 May)	DEF 2020 (24 April)	IMF (14 April)	Eurobank (4 June)
GDP growth (%)	9.0	-9.5	-8.0	-9.1	-10.5
Gen Budget Balance (% GDP)	-	-11.1	-10.4	-8.3	-12.0
Gen Govt Debt	-	158.9	155.7	155.5	165.0
Unemployment rate (%)	-	11.8	11.6	12.7	12.0

Source: EC, IMF, DEF 2020, Bank of Italy, Eurobank Research

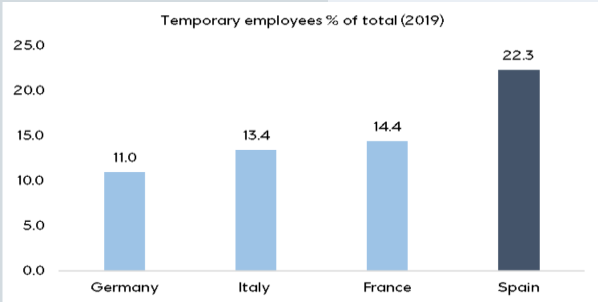
[4] For firms with annual turnover below €250mn

Spain

Among the hardest hit EA countries from the COVID-19 outbreak

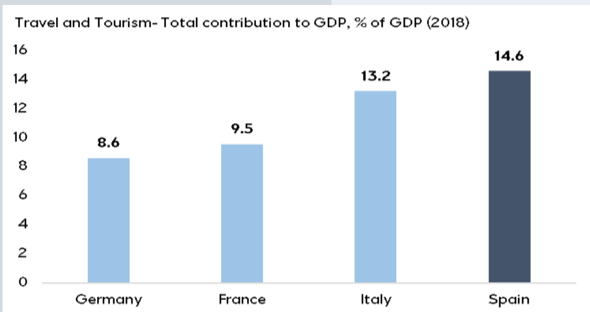
Spain's real GDP growth rose by an average 2.8% in the last five years (2014-2019), above 1.9% for the EA over the respective period, thanks to several structural reforms undertaken in response to the global financial crisis. However, the severe outbreak of the COVID-19 pandemic is expected to result in an unprecedented contraction of economic activity, with Spain likely to be one of the hardest hit major EA economies. That is mostly due to: (i) the adoption of relatively more severe containment measures as Spain, along with Italy, were the most affected EU Member States from the COVID-19 outbreak. As a result, Spain's Q1 GDP contracted by a record pace of 5.2%QoQ, well above the EA average of 3.8%QoQ; (ii) Spain's labor market appears to be the most vulnerable to the pandemic and the lockdown measures relative to the other major EA countries. Supporting the above, employment in Spain is relatively more concentrated in the services sector (especially tourism) which is likely to be one of the most affected sectors by COVID-19, while elevated levels of temporary employment is another worrying issue as these workers are more likely to loose their jobs and stay unemployed for longer (Figure 17). Not surprisngly, despite the governments' measures to limit job losses, including the furloughing scheme (ERTE) that provides 70% of the salary and is reduced to 50% after six months, unemployment has already increased significantly in Spain, with the unemployment rate rising to a one-year high of 14.1% in Q1; (iii) tourism accounts for 14.6% of Spain's GDP, well above the 10.4% average of the other three big EA economies (Figure 18). Under the assumption of a continued gradual, but consistent relaxing of restrictions that began in early May, we expect Spain's GDP to start recovering in Q3 and decline by 9.5% in FY2020 (revised downwards from -9.0% in May). The projected sharp downturn in economic activity is anticipated to have a severe negative impact on government finances, with the general budget deficit projected to increase for the first time since 2012, from 2.8% in 2019 to around 10% or even higher in 2020 (the Social Security Reserve Fund has already spent €4.5bn (0.4% of GDP) in job support measures just for April.

Figure 17: Spain has the highest share of temporary employees among big EA economies



Source: Euroastat, Eurobank Research

Figure 18: Tourism in Spain accounts for a larger share of GDP compared to the other three big EA economies



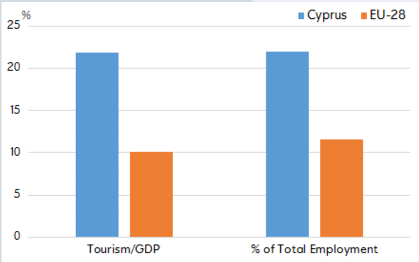
Source: World Travel and Tourism Council, Eurobank Research

Cyprus

The first country to tap the ESM's Pandemic Crisis Support fund

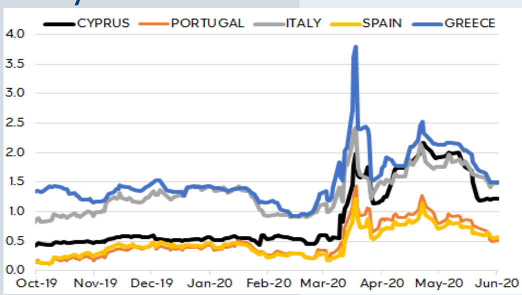
The flash estimate of Q1-2020 provided the first indication of the impact of the covid19 shock on economic activity. Real GDP slowed sharply to -1.3% QoQ/0.8% YoY in Q1-2020 vs. 1.0% QoQ/3.2% YoY in Q4-2019. The reading is the lowest since Q4-2014, but still much higher compared to that of the Euroarea (-3.8% QoQ/-3.2% YoY). According to CYSTAT, the deceleration is mainly attributed to the sectors: "Hotels & Restaurants", "Manufacturing", "Arts, Entertainment and Recreation", "Other Service Activities" and "Construction". However, CYSTAT stressed, that due to the unprecedented situation, it had to make imputations for the short-term indicators of March, based on a common for all EU members' methodology. Thus, CYSTAT implied that the future revision of the flash estimate may be greater than usual, either to the positive or the negative side. The Covid19 crisis – the second economic shock in less than seven years – finds Cyprus in a position of relative strength. Both, the sovereign balance sheet and the banking sector position has strengthened over the past years. The latter is one of the major differences with the crisis of 2013. The second difference is that the Covid19 pandemic is a symmetric to all economies public health shock whereas the crisis in 2013 was idiosyncratic for Cyprus, rooted in the oversized and weak domestic banking sector and the expansive fiscal policies in the post-Lehman Brothers period 2008-11. In any case, the shock will most probably push the economy to outright recession, given that it is small, open and services-oriented with tourism & travel having a substantial direct and indirect contribution (21.9% of GDP, 22% of total employment). 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. In that direction, authorities will reopen airports for flights with 19 countries in a two-phase plan on June 9 while hotels will open earlier on June 1. Finally, Cyprus will become the first country to tap the ESM's Pandemic Crisis Support fund (up to 2% of GDP in 2019, which translates to an amount of €439mn) to cover its increased healthcare expenditures. The Ministry of Finance will evaluate the total healthcare spending due to the Covid19 pandemic, including a new intensive care unit in the Nicosia General Hospital and diagnostic checks for infections, and then apply to the ESM. Although it is still not finalized, the EC proposal for the €750bn Recovery Fund suggests that the country will receive €23bn in the form of grants and loans against a €1.2bn contribution, leading to a net size of economic support of €1.1bn or 4.9% of GDP.

Figure 19: The contribution of tourism & travel industry is pivotal to the economy



Source: WTCC, Eurobank Research

Figure 20: Long-term Cypriot government bond yields declined on ECB intervention



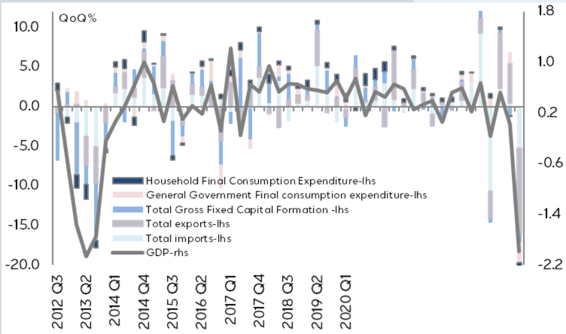
Source: Bloomberg, Eurobank Research

UK

In the midst of an unprecedented downturn

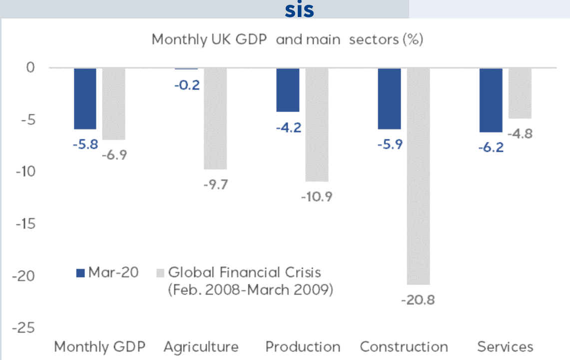
UK GDP contracted by 2.0%QoQ in Q1 2020, the sharpest decline since the global financial crisis, reflecting the impact of the lockdown measures imposed to curb the COVID-19 spread. Based on the expenditure approach, household consumption recorded the largest contraction in more than ten years (-1.7%QoQ), alongside declines in government consumption (-2.6%QoQ) and gross fixed capital formation (-1.0%QoQ), while exports decreased by a higher pace compared to that of imports (-10.8%QoQ vs. -5.3%QoQ, respectively), pushing trade balance (including precious metals) back into negative territory (-0.9% of nominal GDP vs. +1.4% in the prior quarter). On a monthly basis, in March, when lockdown measures were first introduced (23 March), GDP contracted by a record 5.8% primarily driven by services, following a drop of just 0.2% in February and 0.1% positive growth in January. This compares with a 6.9% decline in output over the entire financial crisis (Figure 22), confirming that the UK is in the midst of an unprecedented downturn in economic activity. Since containment measures were first introduced in late March, we expect to see the full economic impact in April that would probably mark the peak of recession, while the UK government's phased plan for gradually exiting the lockdown will likely allow the economy to gain some momentum as of mid-May and into June. For Q2, we expect GDP contraction of ca. 20%QoQ followed by a gradual modest recovery, as elevated uncertainty over the global growth prospects, Brexit woes and rising unemployment —in spite of the government's Job Retention Scheme that runs until the end of October—, are expected to weigh on the recovery path. Aiming to prevent a more pronounced economic downturn and following the dovish tone of the minutes from the May policy meeting, the BoE is expected to ease its monetary policy further in the near-term, while the likelihood of QE expansion at the 14 June policy meeting cannot be ruled out. With the stock of asset purchases projected to amount over a third of UK GDP by mid-Q3, the BoE is likely to consider other options further down the road. However, the bar for negative interest rates still remains high.

Figure 21: UK Q1 GDP 2020 contracted by 2.0%QoQ, the sharpest decline since Q4 2008



Source: ONS, Eurobank Research

Figure 22: UK GDP contracted by 5.8%MoM in March compared to -6.9% over the entire global financial crisis



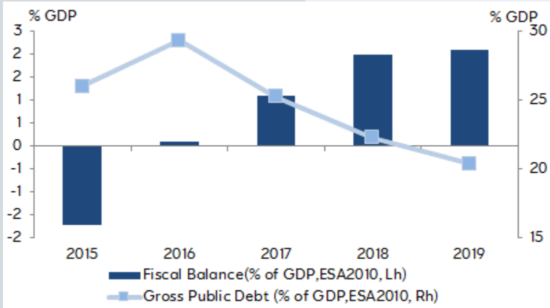
Source: ONS, Bloomberg, Eurobank Research

Bulgaria

The worst seems to be over for the economy

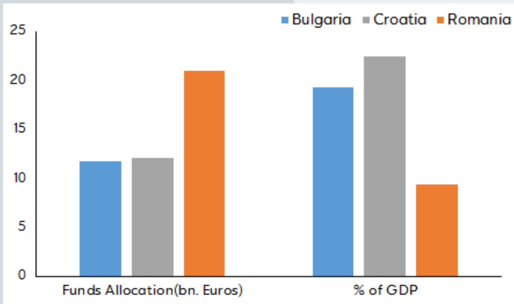
The flash estimate of Q1-2020 provided the first indications of the impact of the covid-19 shock on economic activity. Real GDP slowed sharply to 0.3% QoQ/0.8% YoY compared to 0.8% QoQ/3.1% YoY in Q4-2019. The deceleration reflects largely the lockdown and social distancing measures imposed as of mid-March. The reading is the lowest since Q3-2014, but is nevertheless still much higher compared to that of Euroarea (-3.8% QoQ/-3.2% YoY). Bulgaria is among those few economies with a positive quarterly reading in EU-28. However, high frequency indicators imply a much deeper contraction in Q2. On a calendar and not seasonally adjusted basis, industrial production dived by -6.9% YoY in March vs. flat in February and -0.6% YoY in January. Retail sales in constant prices declined by -14.6% YoY in March vs. +5.5% YoY in February and +3.4% YoY in January. Unemployment is trending north. According to the LFS survey, unemployment spiked to 4.5% in March up from 4.0% in February and 4.1% in January. The Economic Sentiment Indicator (ESI) and Employment Expectations Indicator (EEI) improved in May to 72.2 and 86.4 points from 58.3 and 75.1 in April respectively. In May, ESI recovered about one fifth of the decline since March and EEI almost one third. The worst seems to be over for the economy. In the absence of a second wave of infections, the 2H ouput rebound looks very likely as lockdown and social distancing measures are scheduled to be eased further soon. Having expanded by 3.6% on average in 2015-19, the economy is set to contract for the first time since 2009. The government has revised its GDP forecast in 2020 to -3.0% contraction. The IMF and the WB forecasts stand at -4.0% and -3.7% respectively and the latest EC Spring forecast is more pessimistic at -7.2%. The speed of recovery remains a key uncertainty. The lower dependence of the country on tourism & leisure, better fundamentals and low credit levels are a good starting point. On top, the prospect of ERM2 participation and EU membership will secure access to cheap funding and financial assistance to mitigate the impact of the recession. Bulgaria is also expected to be among the top net recipients/beneficiaries of the new €750bn EU recovery fund that is being set up. Although it is still not finalized, the EC proposal suggests that the country will receive €15bn in the form of grants and loans against a €3.3bn contribution, leading to a net size of economic support of €11.3bn or 19.3% of GDP.

Figure 23: Bulgaria's fiscal position is sound



Source: Bloomberg, Eurobank Research

Figure 24: Allocated funds proposal from EU Recovery Fund for Bulgaria-Croatia-Romania



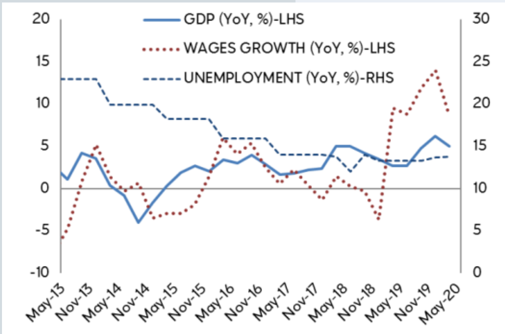
Source: European Commission, Eurobank Research

Serbia

Q1 GDP growth print at 5.0% YoY points to a mild recession in 2020

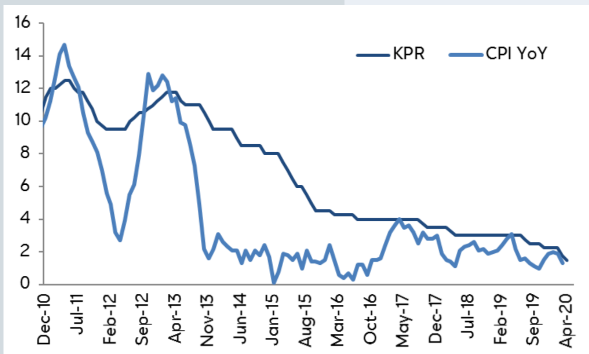
June found Serbia with the virus curve substantially flattened. While in April confirmed incidents had climbed to more than 9,000 from 1,500 in late March, during May incidents increased modestly by 2,400. As a result, the government decided on May 6 to abolish the state of emergency imposed in mid-March so as for the country to gradually return to normality. According to Q1 national accounts print, GDP growth expanded by 5.0% YoY, compared to 6.2% in Q4 2019, the highest pace since 2008. In terms of expenditure, GDP growth was primarily driven by investments, which, albeit lower compared to Q4, contributed ca 2.2pps, while private and public consumption jointly accounted for another 2pps in the headline economic growth reading. Net exports had a negative contribution. Despite the strong kick-off of 2020 and the favorable soft data, as captured in the Economic Sentiment Indicator (ESI) in May, the negative impact from the Covid-19 pandemic will be felt most probably in Q2. April's hard data, such as industrial production shrinking by 17% YoY, after remaining almost unchanged in March, i.e. -0.1% YoY, and retail trade dipping by -18.6% YoY, point to the negative impact of the lockdown measures on the economy, implying that Serbia will not avoid navigating in contractionary waters in 2020. Despite the more optimistic view of the NBS for the country's economic performance in 2020 (recession -1.5% in 2020 and strong rebound by 6.0% in 2021), we maintain our forecast for 2020 at -2.5%, defying more conservative forecasts coming from the EC and the EBRD of -4.1% and -3.5% recession respectively. Finally, the EU enlargement process report will be published in autumn, instead of this spring, as the EC is currently focused on the battle against the Covid-19 pandemic. Serbia is not anticipated to open any new chapters until the respective report is released since EU member states usually consult it before making any relevant decision. So far, Serbia has opened 18 out of 35 chapters in its EU accession talks, two of which have been provisionally closed.

Figure 25: Strong Q1 GDP growth print but some loss of steam in labor market



Source: Bloomberg, Eurobank Research

Figure 26: Monetary easing continues in efforts to contain the recession



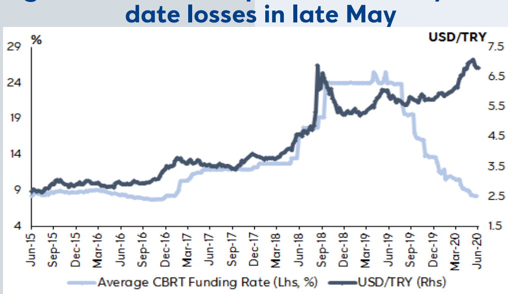
Source: Bloomberg, Eurobank Research

Turkey

Central Bank delivered 50bps rate cut, the smallest in the easing cycle so far

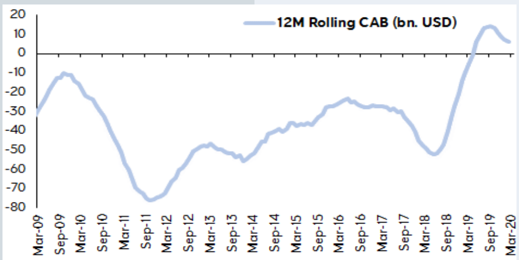
On May 21st, the Central Bank of Turkey (CBRT) cut its key policy rate (KPR) for the ninth consecutive time, the 1-week repo rate by 50bps from 8.75% to 8.25%, bringing the cumulative easing since July to 1,525bps. The decision – the smallest rate cut so far in the easing cycle – was in line with the relevant surveys' consensus of Reuters and Bloomberg. In the accompanying statement, CBRT took notice of the bottoming out signs of economic activity high frequency indicators following the steps taken towards normalization in the second half of May. Moreover, the CBRT assessed that despite the lira weakness, the rise in unit costs from declining production and sales, and the negative impact of seasonal and pandemic-related effects on food prices led the disinflationary effects of weaker aggregate demand conditions to increase. The latter combined with sharply lower energy and imported commodities prices are expected to weigh more on the inflation outlook in 2H-2020. In our view, the room for further rate cuts in the near future 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 expanionary 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 in the last months, the lira has recouped some of its losses in late May (currently at 6.76/$ as of June 4, -13.8% Ytd) driven by those expectations. As of late May, the pandemic has begun to weigh on the economy but the full impact remains to be seen in the coming months. From that point of view, the national accounts performance in Q1-2020 (+4.5% YoY) is not illustrative of the ful year dynamics, as social distancing measures were imposed in late March. Having posted multi-year lows in April, sentiment indicators rebounded modestly in May reflecting the easing of lockdown measures and the containment of the pandemic. Having dived to an 11-year low at 66.8pts in April vs. 99.7 in March, the manufacturing confidence index rebounded to 76.9pts in May. Accordingly, the services confidence index rose by 5pts to 51.1pts in May, compared to to 46.1pts in April vs. 92.5pts in March. The seasonally adjusted capacity utilisation rate also rose by 0.8pps m/m to 62.7% in May. On top, the consumer confidence index rebounded by 4.6pts on a monthly basis to 59.5pts in May up from 54.9pts in April, which was the lowest level ever recorded in the data series since 2004.

Figure 27: Lira recouped some of its year to date losses in late May



Source: Bloomberg, Eurobank Research

Figure 28: 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	6.0	1.4	0.5	1.4	3.2	4.0	3.5	7.6	6.1	7.4	1.4	-7.0	-2.0
France	1.3	-10..0	8.0	1.3	0.4	1.0	8.5	10.0	9.8	-0.8	-0.2	-0.4	-3.0	-9.9	-4.5
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	-7.0	4.0	0.3	0.0	0.7	6.5	9.5	8.5	0.0	-0.6	-0.4	0.2	-6.5	-1.8
Spain	2.0	-9.5	6.0	0.8	0.0	1.0	14.1	19.0	17.0	2.0	3.2	2.8	-2.8	-10.0	-6.8
UK	1.4	-8.5	5.5	1.8	1.0	1.5	3.8	6.7	6.2	-3.8	-4.2	-4.5	-2.1	-10.6	-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	-4.0	2.5	3.7	2.5	3.1	14.0	13.5	10.8	-2.7	-2.8	-1.5	-1.7	-10.5	-7.0
China	6.1	1.7	7.0	2.9	1.3	1.7	3.6	4.4	4.2	1.2	0.5	0.8	-4.9	-8.1	-5.6
India	6.1	-1.5	6.0	3.7	4.8	4.0		*NA*		-0.9	-1.0	-0.9	-0.2	-4.0	-6.0
Russia	1.3	-5.0	3.0	4.5	3.2	4.0	4.6	5.7	4.9	4.8	1.3	1.8	1.5	-5.0	-1.5
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 Fixed Income Forecasts

	Current	June 2020	September 2020	December 2020
USA				
Fed Funds Rate	0.00-0.25%	0.00-0.25%	0.00-0.25%	0.00-0.25%
1 m Libor	0.17%	0.29%	0.25%	0.25%
3m Libor	0.33%	0.55%	0.47%	0.47%
2yr Notes	0.19%	0.22%	0.28%	0.36%
10 yr Bonds	0.79%	0.64%	0.77%	0.88%
Eurozone				
Refi Rate	0.00%	0.00%	0.00%	0.00%
3m Euribor	-0.35%	-0.36%	-0.40%	-0.41%
2yr Bunds	-0.62%	-0.69%	-0.69%	-0.66%
10yr Bunds	-0.33%	-0.50%	-0.46%	-0.40%
UK				
Repo Rate	0.10%	0.10%	0.10%	0.10%
3m	0.24%	0.31%	0.24%	0.24%
10-yr Gilt	0.30%	0.30%	0.35%	0.43%
Switzerland				
3m Libor Target	-0.65%	-0.72%	-0.72%	-0.72%
10-yr Bond	-0.37%	-0.59%	-0.53%	-0.48%

Source: Bloomberg (market implied forecasts)

Eurobank

Eurobank Research

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