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New Covid-19 cases growth has started to decelerate globally, fueling hopes for an exit path from the pandemic. Meanwhile, better-than-expected Q4 GDP prints point to increased resilience of the global economy as consumers and businesses seem to be adapting to subdued contact-intensive activity. Nevertheless, global infections remain at elevated levels, while new variants of the virus constitute a major cause of concern. Overall, we expect an upwards revised GDP growth of 5.5% in 2021, on the back of additional fiscal policy measures and expectations of a vaccination-induced acceleration of activity later in the year.

Macro Picture

USA: Additional fiscal stimulus boosts our 2021 GDP projection

EA: The Q4 GDP decline sets the scene for a double-dip recession

UK: Beyond Q1, the quick pace of vaccinations could lead to a strong economic recovery

EM: Covid-19 resurgence and limited progress on the vaccination roll out cast shadows on Q1 2021 GDP growth

CESEE: Vaccine supply bottlenecks and new virus strains make growth recovery prospects for the CESEE region more challenging in H1 2021

Markets

FX: USD strength versus the EUR due to US economy outperformance should find support in the 1.19-1.20 area before the next move higher

Rates: EU and US rates pressured higher, with curves steepening, due to increasing inflationary pressures

EM: Negative total returns due to rising US rates and delays in the vaccination timeline but tightening spreads. LatAm the underperformer

Credit: Spreads were broadly unchanged, with USD slightly outperforming EUR. Buying from Central Banks to limit any widening despite expensive valuations

Policy Outlook

USA: Fed's pledge for continued policy support; tapering announcement not expected before Q4

EA: Very accommodative policy stance by the ECB to maintain favorable financing conditions

UK: Further BoE policy accommodation conditional on negative growth surprises

CESEE: Need to extend fiscal & monetary support in 2021

Key Downside Risks

Covid-19 vaccines insufficiently effective to new more contagious strains / hesitation or delays in vaccination: Covid-19 restrictions will stay in place for longer

Policy support withdrawn before sustained economic recovery is on track

Limited room for further easing in EMs: Due to already low real rates and inflationary pressures from surging prices of non-energy commodities

Special Topics in this issue:

-Biden Administration's "American Rescue Plan"

-Vaccination roll-out in the CESEE region, the paradigm of Israel as a small country for the broader region

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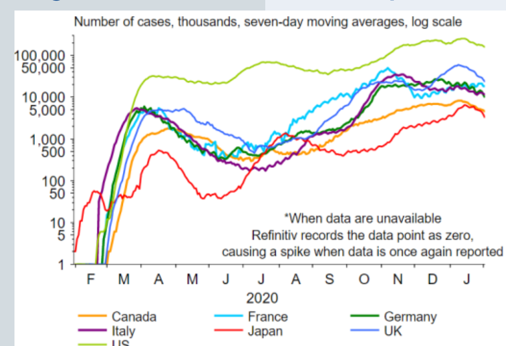
Macro Views

Latest Macroeconomic Developments & Outlook

World Economic Outlook

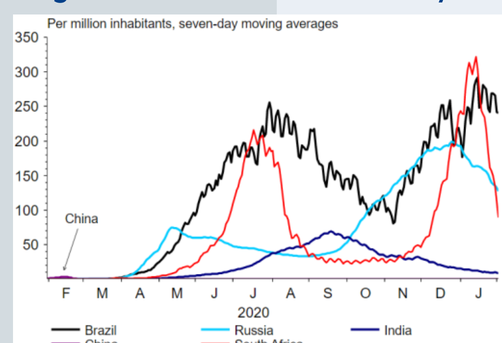
Recent vaccine approvals and the start of the vaccination process in certain regions such as the UK, the US and the Euro area have fueled hopes for an exit path from the pandemic later this year. New Covid-19 cases growth has started to decelerate globally, a sign that the lockdown measures across countries to prevent the spread of the virus are bearing fruits. Meanwhile, better-than-expected Q4 GDP prints in several countries around the world point to increased resilience of the global economy as consumers and businesses seem to be adapting to subdued contact-intensive activity. Nevertheless, global Covid-19 infections remain at elevated levels, surpassing 103.4 million reported cases and 2.23 million fatalities, while new and more transmissible variants of the virus constitute a major cause of concern and make the way to herd immunity more challenging given the uncertainty about the exact efficacy rates of current Covid-19 vaccines. Mobility restrictions will likely continue to weigh on economic activity in Q1 as stringent containment measures are expected to remain in place in several states of America and European countries, the UK's lockdown will extend into mid-February, and China imposed travel restrictions during Lunar New Year and banned large gatherings. The GDP growth deceleration in early 2021 is anticipated to give way to a strengthening momentum in Q2 2021, as vaccines and treatments become more widely available and mobility restrictions are gradually eased. The US fiscal stimulus and the EU recovery fund resources will largely determine the global growth recovery in 2021, which is expected to be supported also by continued monetary policy support as signaled by major central banks. Overall, our 2021 GDP forecast has been revised upwards by 0.5 pts to 5.5% compared to our previous projection, on the back of additional fiscal policy measures in several countries and expectations of a vaccination-induced acceleration of economic activity later in the year.

Figure 1: G7 Covid-19 new daily cases*



Source: Refinitiv Datastream, Fathom Consulting

Figure 2: BRICS Covid-19 new daily cases



Source: AAII, Refinitiv Datastream, Fathom Consulting

Developed Economies

US: Real GDP decelerated significantly in Q4 2020 as further fiscal policy support was delayed and Covid-19 infections increased leading to extensive social distancing measures. Nevertheless, economic activity proved fairly resilient to the Covid-19 crisis throughout 2020, with GDP falling by 3.5%, thanks to unprecedented fiscal and monetary support and the faster-than-expected development of vaccines. Looking ahead, we expect a notable pick-up in economic activity in 2021, boosted by a rebound in personal spending and business fixed investment, as well as robust residential investment. The US economy is projected to grow by 5.2% in 2021, with the upward revision reflecting mainly additional fiscal policy support. Mirroring additional fiscal stimulus as well as accelerated vaccination, Fed Chair Jerome Powell signaled at the post-January FOMC meeting press conference that the Committee's 2021 outlook has improved, although the official statement acknowledged that the pace of activity and employment has recently moderated. Powell's dovish rhetoric on inflation, and his statement that any talk of tapering asset purchases is "premature", point to a later tapering of Fed's asset purchases. Hence, a tapering announcement by the Fed is not expected before Q4 2021.

Euro area: Real GDP contracted by a less than expected 0.7%QoQ in Q4 2020 after a sharp rebound of 12.4%QoQ in Q3, mirroring a milder negative economic impact of the second Covid-19 wave compared to the spring, as several sectors remained open and people have adapted somewhat to restrictions. The expenditure component breakdown already published in some countries suggests that the Q4 GDP decline was mainly attributed to softer private consumption, which was partially offset by fixed investment and external demand. The Q4 GDP print increases the possibility for a double-dip recession in the euro area, given that the softening of economic activity is expected to continue into early 2021, as new strains of the virus pose downside risks to the outlook in terms of potentially reduced efficacy of vaccines and increased transmissibility. Consequently, current (or even tighter) restrictions will likely weigh on personal consumption expenditures in Q1, before we witness a gradual improvement from Q2 onwards, as warmer weather and broader vaccinations improve the epidemiological picture and European governments gradually ease restrictions. Overall, we anticipate a strong rebound of 4.2% in 2021, following a hefty contraction of 6.8% in 2020.

EMU periphery: Among the two largest Southern European economies, Spain outperformed towards the end of 2020, as Q4 GDP surprised to the upside, growing by 0.4%QoQ (-9.1%YoY) against expectations for a contraction. This development is attributed mainly to more localised and milder than in most other EA countries Covid-19 restrictions, particularly as regards capacity constraints and opening hours for hospitality venues. In spite of the lower than expected Q4 GDP decline, Spain's annual GDP for the full year 2020 fell by 11.0%, the deepest contraction in recent history and among the steepest declines in the EA for a number of idiosyncratic factors, including the economy's relatively higher dependency on tourism, which is one of the sectors most affected by the pandemic. On the flipside, Italy's Q4 GDP fell by -0.2%QoQ (-6.6%YoY), mirroring the effect of the stricter measures, relative to the rest of the EA, that were adopted to curb the second Covid-19 wave. For the full year 2020, Italy's GDP fell by 8.9%, modestly less than expected

a few months ago. With governments in both countries expected to keep existing containment measures in place or even tighten them further until at least late Feb./early March as the pandemic continues and new more contagious variants have raised concerns about the efficacy of the existing vaccines, expectations are for a renewed contraction in Q1 2021 We do not anticipate a significant rebound in economic recovery before immunization rates and improved weather conditions allow for a widespread lifting of restrictions , which will probably not take place before early H2.

Emerging Economies

BRIC: Brazil: Both the World Bank (WB) and the IMF in their recently released outlooks revised upwards their forecasts for 2020. The IMF narrowed its real GDP contraction forecast to -4.5% for 2020 vs the -5.8% drop expected in October. The Fund raised also the 2021 GDP growth forecast by 0.8pp to +3.6% from +2.8% previously, while for 2022 the forecast climbed to +2.6% from +2.3%. On the same footing, the WB reduced the 2020 GDP recession forecast to -4.5% from the -8.0% in June, while it also increased the 2021 growth forecast by 0.8pp to +3.0%. **Russia**: According to an official preliminary estimate, GDP contraction reached -3.1% in 2020, following a 2.0% expansion in 2019. The print is better than the -3.9% official assumption taken into account into the 2021 budget law, the GDP contraction of -3.6% projected by the IMF, -4.0% by the World Bank and -4.3% by the OECD. According to the WB, GDP growth is expected to rebound by +2.6% in 2021 and +3.0% in 2022 with the IMF being more optimistic, i.e. +3.0% and +3.9% in 2021 and 2022 respectively. **India:** Both institutions revised upwards their forecast for 2020, which, however is expected to be more severe than -8%. The IMF foresees a rapid recovery of 11.5% in 2021, while the WB projects a +5.4% rebound. In 2022, GDP growth is seen to lie above 5.0% by both. **China:** The only large economy that succeeded in growing instead of contracting in 2020 (+2.3%) is expected by both institutions to accelerate its footing in 2021 by ca 8% before cooling down to a GDP growth rate above 5.0% in 2022. Meanwhile, the Covid-19 resurgence that appeared in mid-January has been contained with the reinforcement of restrictive measures. However, as similar upticks are anticipated to reappear in the following winter months and the vaccination process is at early stages,, containment measures will most probably be slowly loosened, acting as headwinds towards the Q1 GDP growth print.

CESEE: As of late January-early February, with a few notable exceptions, the epidemiological situation in many countries of the Central, Eastern and South-eastern Europe (CESEE) has continued improving. Having been confronted with an exponential rise in new infections, hospitalizations and fatalities during October and November, all metrics improved in December and stabilized further in January although they remain at relatively high levels. Turning to the growth outlook of 2021, we anticipate the incoming year to be a year of broad-based recovery. That said, the course to full-recovery will most probably be incomplete and bumpy. The resurgence of infections, the risk of a third wave coupled with the fallout from new virus variants and the vaccine supply bottlenecks threaten the rebound effort of the broader CESEE region in 2021-22. Under the assumption that the restrictive measures will most probably remain in place in the first months of the new year, economic activity is expected to remain subdued. Given the pronounced negative base effects, GDP is expected to drop further on an annual basis in Q1, weighing on the FY2021 outcome.

Special Topics

I. Biden Administration's "American Rescue Plan"

Groups of major provisions

In a speech, a few days before his inauguration as the 46th US President, Joe Biden unveiled the first step of his two-fold "rescue and recovery" plan dubbed "American Rescue Plan" aimed to address the near-term economic and social effect of the Covid-19 pandemic. Its budgetary cost is estimated at around $1.9trn (or 8.9% of 2019 GDP) and the US President has signaled his intention for the said stimulus to mark the initial legislative priority of his administration. It comprises of three major groups of provisions (Table 1).

The first one, focused on measures to combat the pandemic directly includes, among others: investment in a national vaccination program, funds for the purchase of rapid tests and investment for reopening the majority of elementary-middle schools (K-8) within 100 days with safety procedures in place (i.e., funds to be used, for instance, for the reduction of class sizes and the improvement of ventilation systems). The second group provides for economic relief to the households mostly hurt by the pandemic and its budgetary cost is estimated around $1trn in total, i.e. over half of the overall rescue plan. It envisions, among others, one-off direct financial assistance of $600 per person, approved in December, to rise to $2,000 (subject to certain income criteria), insurance unemployment benefits to be extended for another six months through end-September and unemployment insurance supplement to be increased from $300 to $400 per week. The third major group of provisions aims at supporting communities, with a particular emphasis on emergency funding for state, local and territorial governments. The American Rescue Plan comes on top of the previous Covid-19 relief packages adopted last year, totaling $3.7bn (or 17.7% of 2019 GDP)[1]. The second step of his two-fold "rescue and recovery" plan dubbed "the Build Back Better Recovery Plan" is expected to target longer-term priorities such as investment in infrastructure, research and development, and clean energy, while it may also contain some details about the US administration's tax policy reform, potentially including increases in the corporate tax, the top individual marginal rate and capital gains as sources of funding to partially offset the cost of the proposed relief package. US President Joe Biden has indicated that he plans to unveil the said plan in February at the State of the Union address.

[1] The Coronavirus Preparedness and Response Supplemental Appropriations Act (6 March 2020), The Families First Coronavirus Response Act (March 18, 2020), The Coronavirus Aid, Relief, and Economic Security Act (March 27, 2020) and The Paycheck Protection Program and Health Care Enhancement Act (April 24, 2020).

Table 1: Biden Administration's "American Rescue Plan"

Provisions of President Biden's American Rescue Plan (approximate cost)	USD bn
Mount a national vaccination program, contain Covid-19, and safely reopen schools	
Funds to helps schools reopen	170
National vaccination/Covid-19 testing program	160
Deliver immediate relief to working families bearing the brunt of the crisis	
Extend unemployment insurance(UI) benefits and additional $400/week	400
Relief to working families ($1,400 per-person cheque)	300
Expansion of Child Tax Credit for one year	160
Assistance to child care providers	40
Rental/housing assistance	35
Supplemental Nutrition Assistance Program (SNAP) for women, infants & childern (WIC)	35
Support communities that are struggling in the wake of Covid-19	
Emergency funding for state, local, and territorial governments	350
Grants to hardest hit small businesses	50
Relief for public transit agencies	20
Other provisions	150
Increase of minimum wage to $15/hour	N/A
Total	**1870**

Source: American Rescue Plan fact sheet, Eurobank Research

Legislative hurdles

A stimulus package has to be approved by both chambers of Congress, the House of Representatives and the Senate. The Democratic Party's majority in the House of Representatives (222-211) where a simple majority is required suggests that the Biden Administration's American Rescue Plan could be easily approved. However, things may get more complicated in the Senate resulting in the US administration struggling to get the full package passed. That is due to the presence of the filibuster that essentially allows a single Senator or a group of Senators to indefinitely delay the vote on a bill proposed by a party short of the required supermajority of 60 seats (i.e., two-thirds majority). Democrats' double victory in the runoff elections in Georgia for two Senate seats in early January, gave them a slim majority. More specifically, they control 50 out of 100 seats – including two independent Senators who normally vote in alignment with the Democratic party – while the Vice President (and Senate President) Kamala Harris also holds a vote, which may prove decisive in marginal votings. That said, if Republicans raise the threat of the filibuster to the proposed American Rescue Plan, Democrats have two options: (i) Follow the regular order under which the 60-vote supermajority threshold is required. Assuming unanimous support within the Democratic caucus, support of at least 10 Republican Senators would be needed to override the filibuster, a scenario that seems highly unlikely given Republicans' strong opposition to the proposed rescue package; or (ii) Follow a legislative process called budget reconciliation, that prevents the use of the filibuster and thereby allows the passage of a bill with simple majority (i.e. 50 + VP tie-break vote) rather than the typical 60-vote threshold. The reconciliation starts with the congressional budget resolution, which instructs budget committees to adjust federal spending, revenues, deficits, and/or the debt limit to meet the targets in the budget.

However, there are certain criteria concerning the measures that may be passed through reconciliation: (i) they should be related to the budget, i.e., adjusting the levels of spending, revenues, the debt limit, or all three, adheres to the budgetary resolution's deficit allowance; (ii) they should have no inflationary impact on the deficit beyond a 10-year horizon; (iii) they should not create any new laws or programs. That said, there are certain items of the American Rescue Plan (e.g. the proposal for an increase in the minimum wage to $15/hour, funding to the states for vaccine rollout efforts) that appear to fall out of the scope of a reconciliation bill, meaning that the Plan will probably have to clear the 60-vote threshold. In addition, the prospect of some moderate Democratic Senators balking about the high budgetary cost of the stimulus package, on the ground that some provisions are less urgent for stabilizing the economy, cannot be ruled out, making it difficult for all of the American Rescue Plan to get passed through reconciliation. As a result, though bi-partisan support for certain provisions may not be totally out of the question (i.e., $1,400 Recovery Rebates per person, expansion of the Child Tax Credit, funding for a national vaccination programme), the ultimate size of the final rescue package could end up smaller than $1.9trn, estimated in the area between $1.0-$1.5trn. But even in this case, a substantial relief package is likely to get passed.

With respect to the timing, it may take for a while before the Biden Administration's package gets passed, probably not before the first major soft deadline of mid-March, when enhanced unemployment benefits are due to expire. This is because the Senate's legislative agenda for the next few weeks is heavy, including, among others, the evaluation and confirmation of a number of Biden cabinet nominations and former US President Donald Trump's impeachment trial that begins in the week of 8 February. In addition, Senate majority leader Schumer and minority leader McConnell have yet to reach an agreement on the administration rules for the Senate including rules under a 50-50 party split and the legislative filibuster.

What the American Rescue Plan means for the US economy

The Biden Administration's relief package is anticipated to provide significant support to the US economic activity near-term, leading to a sharp increase in reflation expectations and fanning tapering talk. According to estimates by the Congressional Budget Office (October 6, 2020), the multipliers of the Covid-19 support measures that were adopted in 2020, range from 0.36 for small businesses wage subsides (PPPs) to 0.88 for funds to states to help them navigate the impact of the pandemic (Table 2). Based on these estimates, the new stimulus package, if approved and implemented in full, could potentially add more than $1.0trn to economic output (4.7% of GDP). Taking into account that some of the package's items will likely be scaled down during the legislative process or even be fully removed, the effect on GDP is expected to be smaller, but still significant. The Chief Economist of the IMF, Gita Gopinath, was quoted saying to Reuters recently that the measures in the proposed package could boost US economic output by 5.0% over the next three years, adding as much as 1.25% to GDP growth in 2021. Note that in its latest World Economic Outlook Update the IMF projects GDP growth of 5.1% in 2021, after a 3.4% contraction in 2020.

Stimulus-driven economic growth should encourage increased labor force participation, leading to a sharply lower unemployment rate this year, close to 5.0% from 6.7% currently (January 2021) but still above the Fed's 4.1% longer-run estimate of the unemployment rate. A pronounced close of the employment gap is anticipated to push inflation higher, with core PCE inflation expected to move modestly up from 1.5%YoY

currently (December 2020) and approach the Fed's 2.0% medium-target at the end of this year. Investors have already reacted to the reflation theme, as market consensus sees tapering of Fed asset purchases to start in early 2022 and the first hike in the fed funds rate to be delivered in H2 2024, assuming that the economy evolves as planned and inflation does not fall short of expectations.

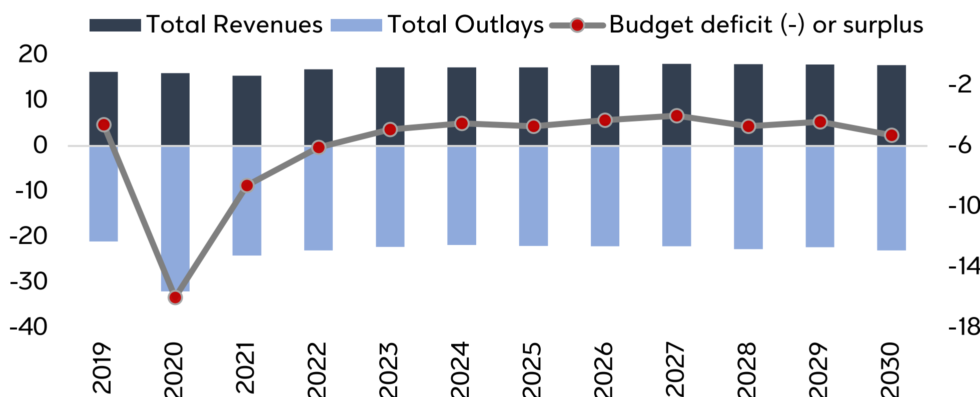
Table 2: Fiscal Multipliers of Covid-19 support measures, as estimated by the CBO

Policy	Multiplier
Covid Relief (2020)	
Paycheck Protection Program	0.36x
Enhanced Unemployment Insurance	0.67x
Recovery Rebates for Individuals	0.60x
Coronavirus Relief Fund for States	0.88x

Source: CBO, Eurobank Research

With respect to budgetary implications, the magnitude of the effect cannot be determined yet as the final size of the relief package and the exact amount earmarked for each provision, remain unclear. According to the latest Update to the Budget Outlook released in September 2020, the Congressional Budget Office baseline scenario estimates that the federal budget deficit should rise from 4.6% of GDP ($984mn) in the fiscal year 2019 to 16.0% of GDP in 2020 ($3.3.bn) before falling to -8.6% of GDP ($1.8bn) in 2021 (Figure 3) This scenario takes into account the relief packages enacted in 2020 in response to the Covid-19 pandemic, but not the subsequent relief plan "The Coronavirus Response and Relief" that was legislated in December. The nonpartisan Committee for a Responsible Federal Budget estimates that the December 2020 fiscal package will boost the fiscal 2021 budget deficit by roughly $750bn (3.3% of GDP), suggesting risks for a budgetary shortfall above 11.0% this year. The additional stimulus expected to be provided by the Biden Administration's package is estimated to increase the 2021 budget deficit by at least $1trn (4.7% of GDP). This means that the 2021 budget deficit is set to rise even further, slightly below the projected 16% of the 2020 GDP.

Figure 3: CBO's baseline projections



Source: Congressional Budget Office baseline budget projections (September 2020), Eurobank Research

II. Vaccination roll-out in the CESEE region, the paradigm of Israel as a small country for the broader region

A few days ago, one year was completed from the outbreak of the Covid-19 pandemic. In late January 2020, the World Health Organization (WHO) declared that the novel coronavirus was a Public Health Emergency of International Concern, the highest level of alarm under international law. Initially, in the absence of any acknowledged medical treatments, governments around the world resorted to other types of interventions in order to cushion the pressure on the public health systems. National governments mostly chose to declare a state of emergency and impose a wide range of restrictions such as social distancing measures, lockdowns, curfews, border shutdowns and quarantines. Undeniably, the still ongoing public health crisis translates into a hard to absorb, broad-based symmetric economic shock with a disproportionally however negative impact among countries, industries and GDP components. As things stand, the single most powerful weapon against the pandemic is massive vaccination, through which herd immunity can be achieved. Massive vaccination is a game changer because it will help contain the spread of the virus through the so-called herd immunity. Herd immunity is achieved when a significant proportion of the population has become immune to the virus, neutralizing its spread. The present note attempts to present the latest vaccination developments in the economies of our focus, namely Bulgaria, Serbia and Cyprus. In addition, it explores some of the lessons from the paradigm of Israel, a small country that ranks first in the global vaccination race having so far inoculated a much higher proportion of its population than any other country.

While **Bulgaria** ranks low in the region in terms of total cases[2] so far, it has taken a heavy death toll. Moreover, the progress of the vaccination is slower compared to its peers with the country being the outlier among 13 CESEE countries. The 7 million people country began the vaccination process together with other European Union states on December 27 with 17,000 doses of the Pfizer-BioNTech vaccine. However, delays in the inoculation process, attributed mainly to poor infrastructure related to the maintenance and the roll out of the vaccines, has led the government to diversify its suppliers by acquiring 2,400 doses and anticipating another 4,000 of the easier to store[3] Moderna vaccine within February. Nevertheless, the vaccine portfolio diversification is rather limited and Bulgaria's vaccination strategy relies primarily on the AstraZeneca vaccine. In fact, Bulgaria had planned to get 4.5mn doses of the said vaccine and have ca. 30% of its population immunized by the summer. However, taking into account the delays that came into light recently regarding the delivery of the vaccine by the producer, it is expected that ***the country will most probably continue to encounter delays*** with any economic headwinds these may bring.

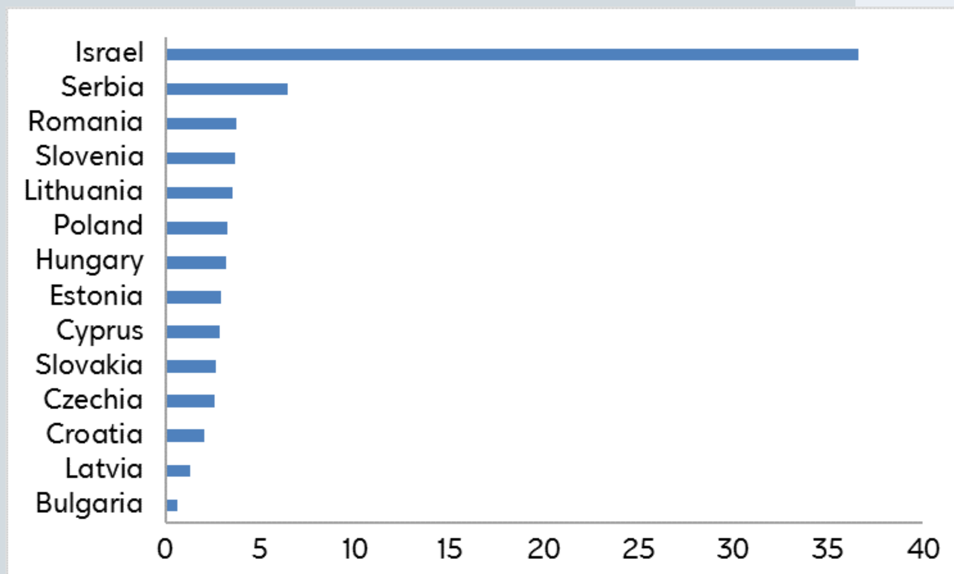
The landscape appears less gloomy in neighboring **Serbia** where the epidemic situation is reversed compared to that in Bulgaria, i.e., higher incidents compared to the region but relatively fewer fatalities. The next day looks brighter as the country ***is currently carrying out CESEE's and EU's fastest vaccine rollout;*** As of February 1, 6.3 citizens per 100 had been vaccinated with only Israel doing better so far in the wider region. In addition, the government has agreed to purchase about 6.5mn vaccines and is about to ink

[2] scaled to the population of each country seen in the graph
[3] The Moderna requires to be kept at -20° compared to the -70° conditionality of the Pfizer-BioNTech.

contracts for 11mn more, roughly sufficient for the entire Serbian population. Meanwhile, Serbia's EU candidateship and not membership status has forced the government to resort to ***alternative vaccines suppliers, such as China and Russia***. Taking into account the evident problematic rollout of the vaccination in the EU, what may have seemed as a shortcoming at first, has turned out to be an advantage in the race for the attainment of herd immunity.

In **Cyprus**, the rapid deterioration of the epidemiological situation in Q3 prompted local authorities to reintroduce social distancing measures, initially at a local level and subsequently at a national level until late January with some gradual relaxation envisaged thereafter. Despite their rise, the number of infections and the death toll remain relatively low until now, compared to other EU countries. As of February 2, the total number of patients who have passed away has now reached 202 (136 men and 66 women), while the total number of confirmed cases is 30,996 in a population of 900,000. The national vaccination program was announced in mid-December of last year and began on December 27th. At the time of writing, Cyprus ranks 26th in vaccination doses administered per 100 people in the relevant World in Data table. Cyprus, as an EU member, participates in all six vaccines procurement agreements signed by the European Commission on behalf of its member states. The requested quantities of doses per company, as they were submitted by the Cypriot Health Ministry are as follows: 1.2 million from AstraZeneca, 200,000 from Johnson & Johnson, 200,000 from Pfizer/BioNTech and 200,000 from Sanofi Pasteur & GlaxoSmithKline Biologicals. Moreover, Cyprus has to get roughly around 300,000 doses from the Curevac vaccine and around 100,000 doses from Moderna. In short, through the EU, Cyprus has ensured that it will receive more than 2 million installments to cover its entire territory, both the Greek Cypriots and the Turkish Cypriots. Given the delays in production and distribution, Cyprus has also asked for help from neighboring Israel.

Figure 4: Total vaccinations per 100 people as of February 1



Source: Our World in Data, Eurobank Research

The paradigm of Israel

Israel is making global headlines because it has achieved to rapidly inoculate a large percentage of its population in a relatively short time. At the time of writing, Israel ranks first world-wide with a wide margin from the second country, now UAE. More than 35% of its population (ca. 3.2mn people) has received the first dose of the vaccine while more than 20% has received the second dose as well. Israel pursued a radical vaccination strategy that rendered the country a paradigmatic case study for rapid inoculation against Covid-19. Israeli government negotiated simultaneously contracts with the pharmaceutical companies Pfizer-BioNTech, Moderna and AstraZeneca and secured vaccines from all three. The deal with Pfizer came with the privilege of accelerated access to its vaccine, conditional on the Israeli authorities providing in return the no-identifiable age, sex and demographic data of vaccinated people. This was made possible by the high efficacy of Israel's universal health care system in which each person has a digitized health record.

Regarding the in vivo effectiveness of the vaccine, according to preliminary data, 14 days after the first dose, a vaccinated group of people showed 33% fewer infections than an unvaccinated group. Furthermore, out of 428,000 Israelis who received a second dose of the vaccine, only 0.014% were contaminated by the virus. Indeed the speed of the whole process and the initial trials point to a successful endeavor which, however, came at a price. The deal with Pfizer has raised privacy issues as, despite the protective clauses in the agreement over personal data, sharing individuals' information with profit-making companies without explicit consent raises some eyebrows. Allegedly, the other edgy aspect of the deal is the price paid as priority access to the vaccine has come at a higher premium, compared to what the EU and US are paying, with the government refuting this reasoning by comparing the higher premium paid with the cost of an extended lockdown in case of delays in the inoculation roll out.

There are two more factors which also underpinned Israel's success story: favorable demographics and geography. Israel's population is relatively small in size and with a rather lower average age. The share of the population aged over 60 – those who are more at risk – is around 16%, much lower in comparison with other advanced economies. Moreover, the land is densely populated so that the logistics of the distribution are much more manageable. Finally, the long-standing geopolitical tensions with its neighbors have equipped both the authorities and the local population with experience in enduring emergencies.

Macro Themes & Implications in CESEE

Vaccine supply bottlenecks and new virus variants make growth recovery prospects for the CESEE region more challenging in the first months of 2021

As of late January-early February, with a few notable exceptions, the epidemiological situation in many countries of the Central, Eastern and South-eastern Europe (CESEE) has continued improving. Having been confronted with an exponential rise in new infections, hospitalizations and fatalities during October and November, all metrics improved in December and stabilized further in January although they remain at relatively high levels. Even though the picture is not homogeneous across countries, the worsening of the epidemiological situation prompted authorities to reinstate stringent health and social distancing measures and restrictions on public and economic activities. The restrictions were initially imposed at the local level but were soon extended at the national level, while some countries even resorted to a national lock-down to avoid further aggravation.

Restrictions resulted in a dramatic decline in mobility, in some cases to levels similar to those of last spring. Nevertheless, the impact of restrictions on economic activity in Q4 could turn out to be less detrimental than in Q2 taking into account the high-frequency indicators releases in Q4. More specifically, industrial production releases surprised positively across the board. Factoring in also the output performance recorded in the first three quarters of 2020, it would be safe to say that on average, all economies of the region will most probably have outperformed the initial pessimistic official and international organizations' forecasts in 2020.

Sentiment indicators as of late 2020-early 2021 conveyed a message of restrained optimism. Having retrenched in November back to their June and July levels when the previous reopening of the economies took place, economic sentiment stabilized in December-January. Obviously, given the rapid deterioration of the epidemic, it would be fair to say that the sentiment trajectory doesn't reveal a sense of panic as in the first wave. In addition, the approval and the distribution of a number of vaccines in December has lifted the depressed morale of consumers and corporates and boosted optimism for the prospects of 2021.

Finally, the economic sentiment releases more or less follow the common pattern of the previous months, which reflects two diverging trends within individual sub-categories. Confidence in industry and construction is broadly holding up better, maintaining most of the previous months' gains. In contrast, confidence among consumers as well as in services and retail trade is retreating. In our view, this most probably reflects renewed market concerns regarding the impact of the second wave of the pandemic and reveals the higher sensitivity of the services sector to the resurgence of the pandemic. The message from the Markit PMI manufacturing releases in January is similar. Despite expectations for the opposite, PMI readings across the region came out solid, staying strong on a month-on-month basis and remaining above the critical 50-threshold. The PMI in Czech remained unchanged at 57, in Hungary it rose to 54.9, which is the highest since

mid-2019, in Poland it stood at 51.9, which is the second highest since July 2018, in Russia it climbed to 50.9 and in Turkey it increased to 54.4, which is the strongest since July 2020. Surprisingly, these readings outpaced those of the core peers of Euro area. A more thorough look reveals that participants appear to be optimistic for future orders but at the same time more concerned about supply chain disruptions, which are becoming more evident.

Turning to the growth outlook of 2021, we anticipate the incoming year to be a year of broad-based recovery. That said, the course to full-recovery will most probably be incomplete and bumpy. The resurgence of infections, the risk of a third wave coupled with the fallout from new virus variants and the vaccine supply bottlenecks threaten the rebound effort of the broader CESEE region in 2021-22.Under the assumption that the restrictive measures will most probably remain in place in the first months of the new year, economic activity is expected to remain subdued. Given the pronounced negative base effects, GDP is expected to drop further on an annual basis in Q1, weighing on the FY2021 outcome. The second or even a third wave of infections, which is anticipated by experts will most probably put a break on the pace of recovery - not limited to the services sector - rendering the full recovery slower than anticipated and, most likely, not possible before 2022. Finally, vaccine supply bottlenecks have started to weigh on the horizon, as demand far outstrips supply at this point. The pharmaceutical companies' commitment for timely production and delivery of vaccines will be the first critical step in order to each herd immunity.

Nevertheless, the situation differs across CESEE countries with several factors to watch in each. Firstly, the degree of each country's secured access to vaccines, if not access to a diversified portfolio of vaccines, and the speed and efficiency of the implementation of the vaccination programs across the region. The logistics of the production, transportation, distribution and execution of the vaccinations on such a massive scale are complicated, potentially requiring additional investments and effort, which entails further delays. Secondly, the ability and willingness of governments to impose restrictions to address a third wave of infections. Third, the institutional and administrative capacity of the countries to absorb and efficiently use the designated funds from the EU's multi-year budget for 2021-27 (€1.8trn) and the Recovery Fund initiative (€750bn).

CESEE Markets Developments & Outlook

Bulgaria

Eurobond yields registered modest increases across all maturities, ranging between 1 to 12 bps. The 2024 tenor was the most active with a yield spike of 12 bps, followed by the 2028 and the 2050 tenors with 7 and 8 bps respectively. On the other hand, yields of local papers dropped between 1 to 12 bps, with the most active ones being the 3- and the 7-year tenor with 10-12 bps yield drops.

Covid-19 protective measures have definitely paid off during the two-month lock down period, leading to new cases dropping below 100 per day. The market is scheduled to open up gradually in the next few months, however, the appearance of mutations is possible to lead to instant reassessment of decisions made. Meanwhile, the country has entered a pre-election period, with parliamentary elections scheduled to take place on April 4.

Serbia

Despite the continuing restrictive measures, with a substantial part of the businesses in the hospitality industry operating under limited working hours, the economy exhibits endurance. In January, a budget surplus of RSD12.8bn was registered instead of an expected deficit of RSD13.2bn, resulting in an RSD25bn over-performance compared to the anticipated figure. In the real economy, industrial production in December increased by 4.1%YoY, 3.5%MoM and for the FY2020 it expanded by 0.4%. The export-import ratio stood at 74.3% in FY2020, a tad improved from the 73.4% recorded in 2019. Concluding, the FX rate fluctuations continued to be carefully monitored by the National Bank of Serbia in January, keeping the cross at the range of 117.50-117.60.

Markets View

Foreign Exchange

EURUSD: General bullish market positioning on the pair and an outperformance of the US economy vs Europe led to a retracement from 1.2349 towards 1.20 support. Difference in inflation expectations also supported the move. The Eurozone Services PMI and the US ISM Services PMI numbers are anticipated to show the direction ahead, at least in the short-run. A break down from the support level, could push the pair even lower to the 1.1950 area, a level that we expect to hold before a move towards the year's highs. A break of this support would open the way for a larger correction towards 1.16 in the medium term.

GBP/USD: The UK seems to be ahead of expectations in terms of the vaccination of the population supporting the pair despite the recent USD strength. Post-Brexit state aid planning and the UK's government asking for the extension of the Brexit grace period are some of the major key headlines currently. January's UK Services PMI numbers reading will set the ground for the upcoming pair's movement for February. From a technical point of view, revisiting the 50 days simple MA level at around 1.353 is possible as the pair consolidates its months-long rally, but it would not be a trend changer. On the upside 1.40 is the next big level if the rally continues.

Rates

EU: The level of the EU yield curve rose in January with the 10y swap rate above -16 basis points. The curve also bear steepened with 30s-10s rising above 57 basis points. The market move was initiated by comments from ECB officials that markets seem to underestimate rate-cut odds. Unwinding of 1y1y received positions followed. Looking forward we expect the bear steepening move to persist. To be more specific the long end of the curve (above 15 years) should stay on positive territory and the 30y swap rate should move towards 20 basis points. The risk to the above view is a reversal of the bullish market sentiment due to a 3rd wave of infections and delayed vaccinations.

US: Yields increased in January with the 10y swap rate above 150 basis points. Steepening of the curve also continued with 30s -5s trading above 105 basis points as US inflation expectations rebounded significantly. The move followed the Georgia Senate election results. We expect buyers to emerge at the long end of the curve and take advantage of the relative cheapness. However, domestic real money in US is quiet in the long end at the time. Therefore, looking forward we expect the bear steepening of the US curve to continue albeit at a slower pace until more information about the fiscal stimulus package emerges.

Emerging Markets credit

Emerging market sovereign bonds had a volatile start to the year with negative total returns due to the swift rise in US rates on the back of the US senate election results despite increasing lock downs and diminished pace of vaccinations. Spread-wise most names ended the month tighter with the exception of Mexico, Brazil and South Africa on country specific reasons. In CEEMEA spreads also ended slightly tighter with Hungary a noticeable outperformer. Turkey continued its impressive recovery tightening on average by 10-15bps as expectations from the new central banker run high. In Asia, South Korean, Chinese and Indonesian 10y sovereign spreads ended more than 10 bps tighter. In LATAM as mentioned earlier it was a tough month as most names trade flat to wider. We believe that the reflation trade will remain intact, and a reversal of the strength in the US dollar as well as improving vaccination outlook will continue to support EM spreads where we see value in the long end. Obviously spreads are tight and carry is the primary target at current valuations in the investment grade space. Qatar is cheap in the AA space, with Colombia and Mexico having most value in the BBB (although a potential downgrade to junk for Mexico cannot be ruled out) while Russia and Kazakhstan screen as expensive. In the HY space we see value in South Africa and Turkey.

Corporate credit

EUR cash corporate spreads were mostly unchanged to a few basis points tighter in the month of January. CDS spreads were mostly flat to a few basis points wider, slightly underperforming cash bonds. Overall credit outperformed the move in equites especially towards the end of month. A generally quiet month in terms of spread moves, with primary market strong as the aggressively priced new issues are not enough to absorb the extra liquidity available. There was slight compression across sectors and rating grades throughout the month in absolute levels, but overall the moves were very small. US IG names in absolute spread moves slightly outperformed EUR IG names, with broad based tightening of -5/-10bps on average, versus -2/-5bps in EUR IG. Auto-mobiles & parts, as well as real estate and financial services were -5/-6bps tighter (in EUR IG), while all other major sectors were broadly unchanged.

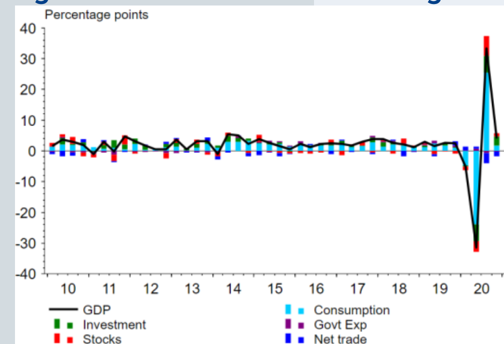
Credit rating-wise BBB- EUR cash paper was -6bps tighter, making it the slight outperformer while other grades were broadly unchanged to a slightly tighter (BB -6bps, BB+ -2.5bps, BBB- -6bp tighter, BBB -2, BBB+ -1, A- flat, A flat, A+ flat, AA- -1bps, AA flat). Technical for cash remains strong, as lighter supply, Central Bank support and amplitude of liquidity continue to be tailwinds. Earnings reporting was overall positive as a considerable amount of companies reported better than expected. On the macro side, despite the major issues on vaccinations roll out globally and the negative turn in various macro data, spreads remain very well supported. We believe that this trend will continue for the next month if no major additional negative Covid-19 related news do not come forth, and any spread widening, is expected mostly as a sympathy reaction to any downturn to equities market and/or significantly higher rates. Mid-term risks for moderate spread widening remain elevated due to higher inflation expectations, any discussions on normalization of monetary policies, and the broadly accepted very tight valuations.

USA

Potential additional fiscal stimulus boosts our 2021 GDP projection

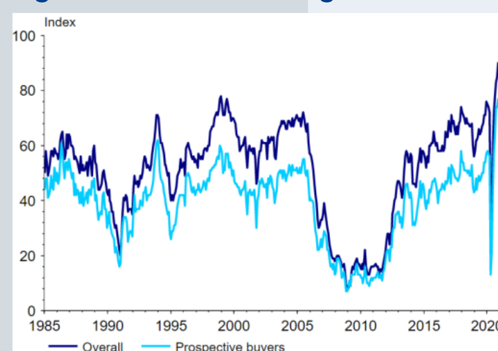
In line with our expectations, real GDP decelerated significantly in the final quarter of 2020 as further fiscal policy support was delayed and Covid-19 infections increased, leading to extensive social distancing measures. According to the BEA's advance estimate, Q4 GDP growth advanced by 4.0%QoQ saar, boosted by solid gains in fixed investment (+25.3%QoQ saar from +86.3% in Q3) and a positive change in private inventories that led to a contribution of +1.0% in overall growth (Figure 5). Business equipment spending maintained firm momentum (+24.9% QoQ saar, adding 1.3pp) likely due to Covid-induced demand for teleworking, while residential investment proved fairly buoyant, capitalizing on low mortgage rates and changing patterns in residential preferences towards suburban single-family housing. Nevertheless, part of the GDP weakness was due to a sharp slowdown in the rate of growth in personal consumption expenditures in both goods and services (+2.5% after advancing 41.0% in Q3); spending on goods fell slightly (-0.4%QoQ) following a surge of 47.2% in the prior quarter, while services slowed down, rising by 4.0% after an increase of 38.0% in Q3. Net exports weighed on growth by 1.5pp amid strong imports, as did government spending at the federal, state and local levels. Overall, economic activity proved fairly resilient to the Covid-19 crisis throughout 2020, with GDP falling by 3.5%, thanks to unprecedented fiscal and monetary support and faster-than-expected vaccine development. Looking ahead, we expect a notable pick-up in economic activity in 2021, boosted by a rebound in personal spending and business fixed investment – both of which were a drag on GDP growth last year – as well as robust residential investment amid a continuing uptrend in new construction activity (Figure 6). The US economy is projected to grow by 5.2% in 2021, with the upward revision reflecting mainly additional fiscal policy support. That said, the Coronavirus Response and Relief Act's $935bn passed by Congress in late-December, along with the federal aid package of around $1.5trn expected to be passed in Q1, will probably help lift economic activity over the next couple of years, with much of the positive effect expected to be front-loaded in 2021.

Figure 5: US Contributions to GDP growth



Source: BEA, Refinitiv Datastream, Eurobank Research

Figure 6: US NAHB housing market index



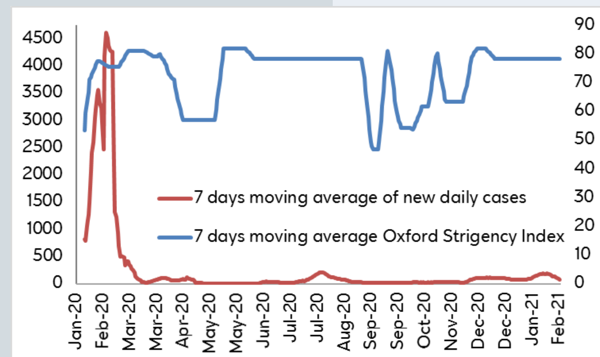
Source: Refinitiv Datastream, Fathom Consulting

China

While January's PMIs point to some loss of steam, YoY Q1-2021 GDP growth print will skyrocket on low base effects.

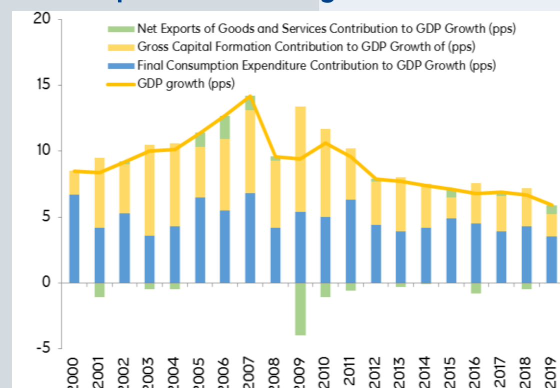
The resurgence of Covid-19 infections in mid-January has been contained with the reinforcement of restrictive measures, wherever necessary. However, as similar upticks are anticipated to reappear in the following winter months and the progress of vaccination is still at early stages, containment measures will most probably be slowly eased, acting as headwinds for the Q1 GDP growth print, which is currently anticipated by the market to exceed +16%YoY, given the low base effect from the 44-year low Q12020 print (-6.8%YoY). December's hard data indicate that the economy remains on track, albeit with some loss of steam on the domestic demand front. Industrial production continued to grow by 7.3%YoY from 7.0% in November and retail sales expanded by 4.6%YoY, which is below the market consensus of 5.5% and the 5.0% print in November. Even though forward looking data, such as the manufacturing PMIs, both the Caixin and the official, continued to move in expansionary grounds in January, they decelerated compared to December (51.5 vs 53 and 51.3 vs 51.9 respectively) and stood below market expectations, implying that the current Covid-19 wave at play around the world has suppressed external demand. The loss of steam was more evident in the non-manufacturing PMI as it eased more sizably (52.4 from 55.7 in December), highlighting the sensitivity of the services sector. In any case, despite the challenging next two months, GDP growth in 2021 is estimated to surpass 8%, which is approaching 2012's performance. In order to achieve such an ambitious result, defensive measures such as lockdowns must be gradually replaced by an increased percentage of inoculations with the ultimate goal being the achievement of herd immunity. That said, the rollout of the vaccination in China poses challenges for the public administration as it does in the rest of the world. While the initial goal, set in late 2020, was for 50mn people to have been vaccinated by mid-February when the Lunar Year celebrations are at their peak and travelling and vacation services are increasing, the target has been reduced to 20mn with less than 10mn already vaccinated by mid-January.

Figure 7: Pandemic tamed with persistent restrictive measures...



Source: Our World in Data, Eurobank Research

Figure 8: Gradual substitution of investments by consumption in the GDP growth contribution



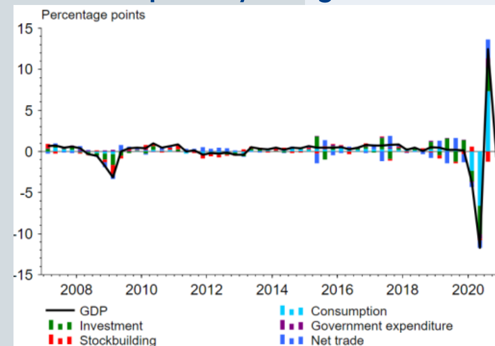
Source: National Bureau of Statistics, China, Eurobank Research

Euro area

The Q4 GDP print set the scene for a double-dip recession in the euro area

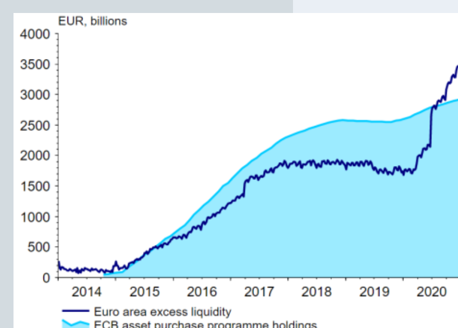
According to Eurostat's preliminary flash estimate for Q4 2020, real GDP contracted by a less than expected 0.7%QoQ (-5.1%YoY) after a sharp rebound of 12.4%QoQ (-4.3%YoY) in Q3 (Figure 9), mirroring a milder negative economic impact of the second Covid-19 wave compared to the spring, as several sectors remained open and people have adapted somewhat to restrictions. Although the detailed expenditure breakdown on an aggregate level is not yet available and the preliminary flash estimate is subject to revision, the expenditure component breakdown already published in some countries suggests that the Q4 GDP decline was mainly attributed to softer personal consumption, which was partially offset by fixed investment and external demand. Germany and Spain proved relatively resilient, registering positive GDP prints (+0.1% and +0.4%QoQ, respectively), while France and Italy were more severely affected by renewed lockdowns (- 1.3% and -2.0%QoQ, respectively). The Q4 GDP print increases the probability for a double-dip recession in the euro area, considering that the softening of economic activity is expected to continue into early 2021 as new strains of the virus pose downside risks to the outlook in terms of potentially reduced efficacy of vaccines and increased transmissibility. Consequently, current (or even tighter) restrictions will likely weigh on personal consumption expenditures in Q1, before we witness a gradual improvement from Q2 onwards as warmer weather and broader vaccinations improve the epidemiological picture and European governments gradually ease restrictions. Overall, we anticipate a strong rebound of 4.2% in 2021, following a hefty contraction of 6.8% in 2020. On the monetary front, at its January monetary policy meeting, the ECB reaffirmed its very accommodative stance announced in December (Figure 10). As widely expected, interest rates remained unchanged, the APP programme will keep running at €20bn/month, and the PEPP envelope of €1,850bn is expected to be used by the end of Q1 2022, with favourable financing conditions (via TLTROs) available until mid-2022. The December outlook was broadly unchanged, with risks skewed modestly to the downside. With the pandemic response in place until the first half of 2022, we do not expect any significant monetary policy change anytime soon, unless there is a sudden and severe deterioration of the economic outlook.

Figure 9: EA contributions to quarterly GDP growth



Source: Refinitiv Datastream, Fathom Consulting

Figure 10: ECB excess liquidity



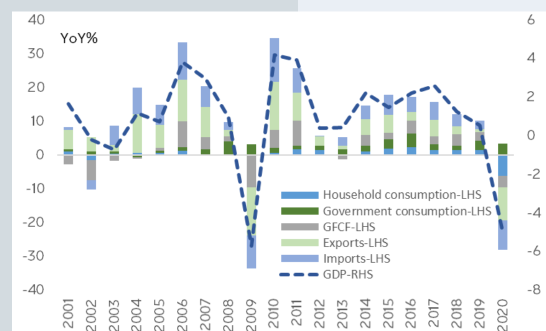
Source: ECB, Refinitiv Datastream, Eurobank Research

Germany

Sizable positive carry-over effect from 2020 into 2021

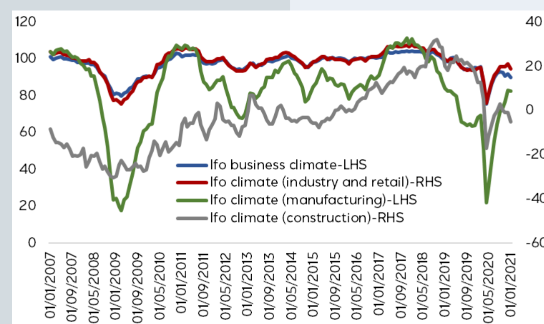
Germany contracted by a lower-than-expected 5.0% in 2020 (Figure 11), as the economy held up relatively well in the final quarter of the year (+0.1%QoQ), presumably supported by a resilient manufacturing sector and improved private consumption ahead of the planned expiration of the temporary VAT cut on 31 December (Q4 GDP details will be published on Feb. 24). However, in line with recent business and consumer surveys, domestic activity is set to deteriorate again in Q1 2021, perhaps experiencing a renewed contraction, affected by notably tighter Covid-19 restrictions adopted since mid-December (e.g. stricter rules on the types of masks that must be worn in certain public places, employers should allow their employees working from home where activities permit) and a two-week extension of the lockdown to 14 February. Growing concerns about the new more infectious Covid-19 variants and the end of the temporary VAT cut, could also weigh on domestic activity in the early months of the year. Supporting the above, the Ifo business climate index fell to a lower than anticipated 90.1 in January from 92.2 in December, Gfk Consumption Climate plunged to -15.6 in January from -7.3 in December, mainly pressured by a hefty drop in the balance of purchasing intentions, while January's Composite PMI fell by 1.2pts to 50.8, mostly hurt by weaker manufacturing. On the positive side, the expected drop in Q1 2021 GDP growth is likely to be somewhat limited, to the tune of 1.0%QoQ, as the export-dependent manufacturing sector —on which Germany relies heavily— should offset some of the economic effect of the Covid-19 restrictive measures thanks to the relatively mild impact of the pandemic in key Asian markets, receding uncertainty from US trade wars under the Joe Biden administration and improved US growth prospects on the back of additional fiscal stimulus. Nevertheless, risks seem clearly skewed to the downside on the view that the more contagious variants of the virus are likely to force the government to extend further the existing lockdown. But even under this adverse scenario, a stronger catching-up effect in the further course of the year, especially from the spring onwards, could materialize, driven by improving private consumption on the back of a gradual easing of restrictions as herd immunity is gradually attained. More importantly, there is a positive carry over effect from 2020 into 2021, estimated at 1.5%, the largest one in the last ten years. As a result, we expect an annual growth rate of 4.0% for 2021.

Figure 11: Germany more resilient than expected in 2020



Source: Federal Statistical Office (Destatis), Eurobank Research

Figure 12: January's IFO business climate decline does not bode well for Q1 GDP



Source: Bloomberg, Eurobank Research

Eurobank

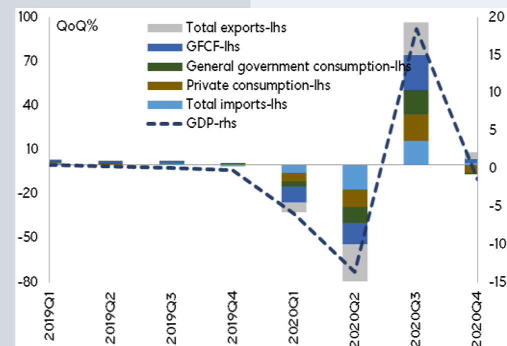
Eurobank Research

France

Third nationwide lockdown may be inevitable

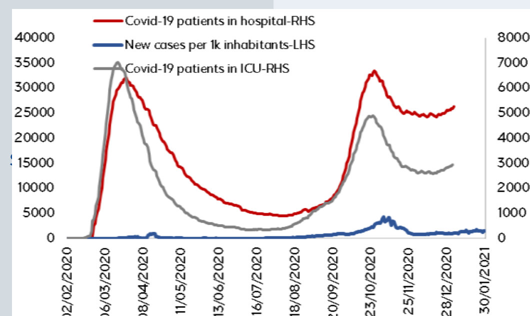
France's Q4 2020 GDP fell by a lower than expected 1.3%QoQ (both BoF and INSEE projected -4.0%QoQ), marking though the fourth contraction in the last five quarters (Figure 13), dented by the second nationwide lockdown and the curfews imposed to curb the second Covid-19 wave. The milder than anticipated decline was primarily due to resilient net trade which contributed positively (0.9pp), thanks to relatively lighter restrictions in France's main EA trading partners (imports: +1.3%QoQ, exports: +4.8%QoQ) and improved global growth. Investment also made a positive contribution (+0.6pp) along with inventories (+0.4pp). The effect of the second lockdown was mainly reflected in household consumption (-5.4%QoQ) and general government consumption (-1.1%QoQ), with final domestic demand (excl. inventories) subtracting 2.7pps. In spite of the smaller than expected Q4 GDP drop, output was left 5.0% below the pre-pandemic level of Q4 2019, while, for the full year, annual GDP growth fell by -8.3%, the largest decline since records began in 1949. This translates into a positive carry over into 2021 to the tune of 3.6%. However, short-term growth prospects look gloomy due to the resurgence in new infections, an increasing share of which accounts to the new more contagious strains, a steadily increase in hospitalizations and ICU utilization (Figure 14), as well as delays in the vaccination program. Hoping to avoid a new nationwide lockdown due to the additional economic costs it would involve, France's President Emmanuel Macron decided in late January the adoption of tougher measures, including, the closure of large non-food shopping centers, greater adherence to working from home, tighter controls at the borders and increased police action against curfew breakers. However, in light of the rising pressure on the public healthcare system and the sustained increase in the spreading of the new strains, a third nationwide lockdown may be inevitable, supporting expectations for a renewed contraction in Q1 2021. Jean-Francois Delfraissy, the President of France's Scientific Council, recently said that a third national lockdown "will probably be necessary" and called for swift government action, arguing that, variants "are the equivalent of a second pandemic". In Q2, GDP growth is likely to remain subdued as most of the restrictions are likely to remain in place. It will likely take until early H2 before herd immunity has been achieved, leading to a lifting of restrictions and a boost in confidence, which are expected to bring the annual 2021 GDP growth rate to 5.6%.

Figure 13: Q4 2020 GDP contraction mainly driven by a sharp drop in private consumption



Source: INSEE, Eurobank Research

Figure 14: Steadily increase in hospitalizations and ICU utilization

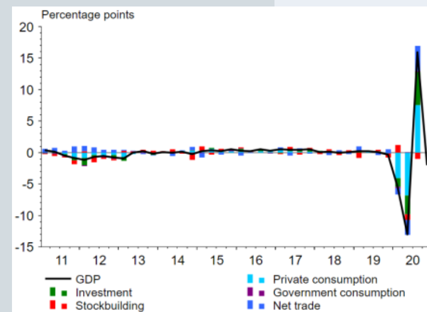


Italy

Subdued activity expected in Q1, compounded by renewed political jitters

The preliminary GDP flash estimate contracted by 2.0%QoQ (-6.6%YoY) in Q4 after a sharp increase of 16%QoQ (-5.1%YoY) in Q3 (Figure 15), with the reinstatement of restrictive measures weighing on the services sector as suggested by decelerating retail sales, softer consumer confidence and lower PMI services readings. The quarterly drop is attributed to a decrease of value added in all main economic sectors (agriculture, forestry and fishing, industry and services), while, on the demand side, there is a negative contribution by both the domestic and the net export components. Looking into 2021, the Markit Manufacturing PMI moved further up to a 34-month high of 55.1 in January from 52.8 in December, with domestic and external demand contributing to a stronger recovery. The EC's Economic Sentiment Indicator strengthened for a second consecutive month in January, rising to 90.2 from 89.8 in December, largely driven by services and retail trade indicators, while the Istat's business confidence indicator advanced to 87.9 in January from 87.7 in the prior month, as an improvement in the construction and market services sectors more than offset deteriorating sentiment in the manufacturing and retail trade sectors. Looking ahead, we envisage a robust GDP rebound of 4.8% in 2021 after a fall of 8.8% in 2020, boosted by sizeable fiscal policy and rising EU inflows. Economic momentum is expected to be stronger in H2 2021 amid higher vaccine rollout speed and improved consumer and business confidence. Nevertheless, risks are tilted to the downside as seemingly still subdued activity at the start of 2021 is being compounded by renewed political jitters. Following the resignation of PM Giuseppe Conte, President Sergio Mattarella couldn't find a solution to the crisis during his formal consultations with party delegations. Former ECB President Mario Draghi accepted Mattarella's offer of appointment as the prime minister designate to form a government. Although an Italian government led by Draghi could potentially maximize the benefits of the recovery funds and influence positively the European policy agenda towards necessary fiscal reforms, it could prove rather difficult for the new government to secure a parliamentary majority. It is also not clear how long such a government, should be formed, could finally last and how effective it could be, given current tensions.

Figure 15: Italy contributions to GDP quarterly growth



Source: Refinitiv Datastream, Fathom Consulting

Figure 16: Italy consumer and business confidence on an uptrend

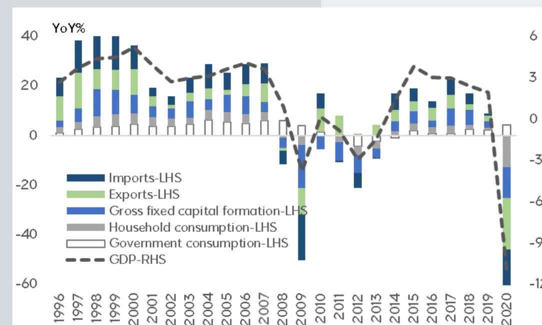
Source: Refinitiv Datastream, Fathom Consulting

Spain

Annual 2020 GDP decline among the deepest in the EA

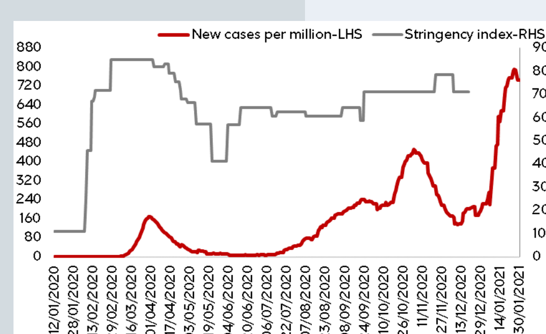
Spain's Q4 2020 GDP surprised to the upside, growing by 0.4%QoQ (-9.1% YoY) against expectations of a contraction, mainly thanks to more localised and milder than in most other EA countries Covid-19 restrictions, particularly as regards capacity constraints and opening hours for hospitality venues. Note that, unlike the first lockdown last spring, most of the responsibility for the adoption and implementation of restrictions has been transferred from the central government to the regional governments. In terms of expenditure breakdown, the main drivers behind Q4 GDP growth was public and household consumption (+4.0%QoQ and +2.5%QoQ, respectively) with the latter likely supported by the high level of savings (15.1% of disposable income in Q3 2020), helping the economy weather the adverse impact of investment (-6.2%QoQ) and net trade (-1.7%QoQ). For the full year, Spain's annual GDP fell by 11.0%, the deepest contraction in recent history (Figure 17) and among the steepest declines in the EA. Looking ahead, risks for Q1 2021 GDP seem skewed to the downside, as Spain is in the midst of a third Covid-19 wave that seems much more intense than the previous two (Figure 18). Although the vaccine rollout has accelerated (3.15 daily vaccine doses administered per 100 people as of Jan. 30, 2021, roughly in line with Italy and above Germany and France), logistical and distributional delays in vaccination supplies will undoubtedly impair the government's target for 3.5mn vaccinations by the end of March (supplies of AstraZeneca account for around 20% of total expected supply). Against this background, some of the largest regions, including Madrid and Valencia, have already tightened/extended containment measures, and several others are expected to follow suit soon to reduce the already high pressure on ICUs (around 45% as of late Jan.), making a strong hit on Q1 GDP highly likely. Assuming that more vaccines become available in the coming weeks, we expect moderate improvement in economic activity in Q2 and a meaningful acceleration in H2 as tourism and pent-up demand should support the recovery from summer onwards, with annual 2021 GDP rising by 5.8%.

Figure 17: Spain experienced in 2020 the worst year of recession in recent history



Source: Eurostat, Eurobank Research

Figure 18: Spain is in the midst of a third more intense Covid-19 wave

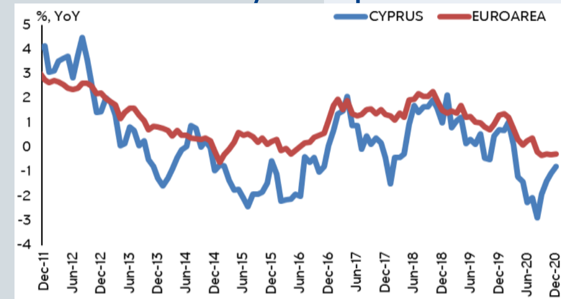


Source: OWID, Eurobank Research

Cyprus

Amended state budget of 2021 endorsed amid political turmoil

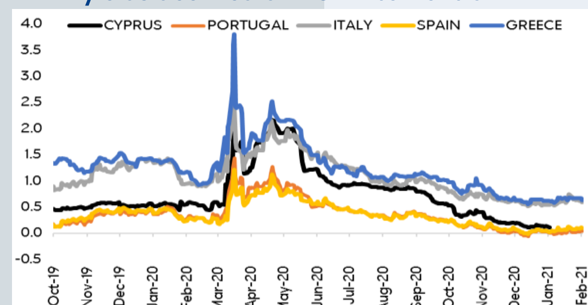
Figure 19: HICP inflation has been in negative territory since April



Source: Eurostat, Eurobank Research

In late January, the parliament endorsed the amended budget with a majority of 29 MP votes in favor from five political parties (DISY, EDEK, Solidarity Movement, Democratic Cooperation, ELAM) vs. 26 MP votes against from three parties (AKEL, DIKO, the Green Party, an independent MP). The Minister of Finance thanked the parties who voted in favor, adding that rejection risks have been averted and described the budget as balanced and coherent. The previous budget draft had been rejected by the parliamentary majority in late December for the first time in the history of the Republic. The rejection illustrates the ongoing political turmoil erupted from the abrupt termination of the Cypriot Investment Programme in November. The refusal of the government to grant the auditor-general access to the programme application files has sparked a fierce political debate with opposition parties. The ruling party DISY depends on the support from smaller parties to pass legislation given that it doesn't enjoy a majority in the parliament. On their part, smaller political parties have been progressively increasing their demands in exchange for their support ahead of the forthcoming parliamentary elections in May. The latter has led to a sharp rise in tensions among parties impeding the legislation procedure and undermining government efficiency. On the banking sector front, the Central Bank (CBC) approved a new loan repayment moratorium until the end of June. The CBC advocated that the new payment holiday is targeted in order to support the liquidity of businesses and households which will face the biggest short-term liquidity problems due to the pandemic. Borrowers who did not utilize the 2020 payment holiday that ended in December 2020 as well as borrowers who obtained a moratorium but didn't fully utilize the nine-month period are eligible. Furthermore, the CBC decided to extend the period of relaxation for loan origination criteria until the end of March aiming to allow easier access to short-term credit to businesses and households. Finally, the volume of non-performing exposures (NPEs) decreased by €195mn in September, bringing the stock of NPEs to €6.3bn, which translates into a decline of 76.9% over the period from December 2014 to September 2020. As a result, the NPEs ratio declined to 21.1% in September, down from 22.3% in June, compared to 27.7% in March and 27.9% in December2019.

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



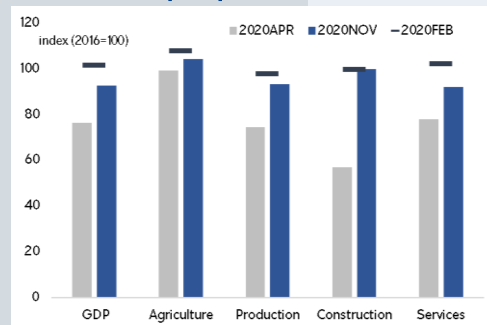
Source: Bloomberg, Eurobank Research

UK

Likely to avoid GDP contraction in Q4 2020 and thus, another technical recession

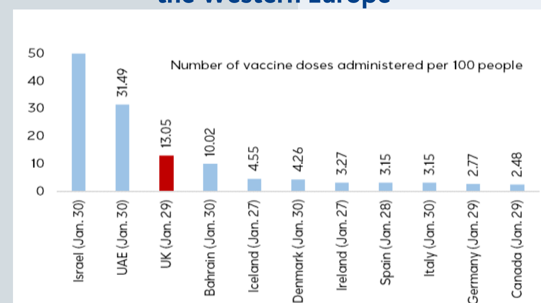
The UK economy proved more resilient than expected to the lockdown imposed in November, as GDP shrunk by a lower-than-anticipated 2.6%MoM, and considerably less than the decline recorded in the spring of 2020 (Figure 21) mainly thanks to relatively looser restrictions (schools, manufacturing and construction continued their operation). The November contraction was driven by services (-3.4%MoM), especially the subsectors of hospitality, retail and cultural and recreation services, which combined accounted for around 80% of the total GDP fall. The production sector fell by just 0.1%MoM remaining 4.7% below the pre-pandemic February level, while construction output posted positive growth of 1.9%MoM, recovering by 0.6% above February's level. In addition to November's GDP upside surprise, October's GDP was revised upward by 0.2pts to 0.6%MoM, supporting optimism that the UK is likely to avoid a GDP contraction in Q4 2020. In fact, GDP would have to fall by more than 1.0%MoM in December for the economy to contract in Q4 2020. Instead, GDP is expected to post a small positive growth over that month following the tentative easing of Covid-19 restrictions ahead of Christmas, bringing the annual growth rate for the full year to -10.2%, revised up from -11.3% previously expected. However, with the UK entering a third stricter lockdown on January 4 to curb the rapid spread of a more infectious strain of the virus, GDP is likely to drop again in January, and probably to a larger extent that in November, due to tighter containment measures (hospitality, schools and non-essential shops are closed). Restrictions are planned to last up to mid-February, on the assumption that — as suggested by PM Boris Johnson — the government will meet the target of having vaccinated by then the four highest priority groups (health and care workers, those aged over 70 and the clinically vulnerable). But with a two-week time lag for vaccines to become effective, Covid-19 restrictions are unlikely to be materially lifted before March. That said, GDP is likely to contract in Q1 2021, as the expected unwinding of stockpiling ahead of the Brexit transition period deadline and Brexit frictions following the UK's exit from the single market and customs union (non-tariff barriers and checks) — despite the post-Brexit trading agreement reached in late December— should also weigh on Q1 2021. However, from Q2 onwards, we expect a rebound in activity as the quick pace of vaccinations should allow a widespread easing of restrictions (Figure 22), with output rising by 4.7% for the full year following an estimated fall around 10.0% in 2020.

Figure 21: Nov GDP left the economy 8.5% below the pre-pandemic Feb. level



Source: ONS, Eurobank Research

Figure 22: The UK is the fastest vaccinator in the Western Europe



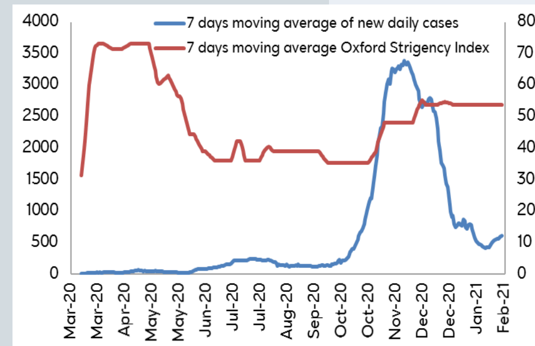
Source: OWID, Eurobank Research (Date of most recent data point in parentheses)

Bulgaria

Economic spillover from the pandemic was kept at bay in 2020, but growth outlook risks remain tilted to the downside in 2021

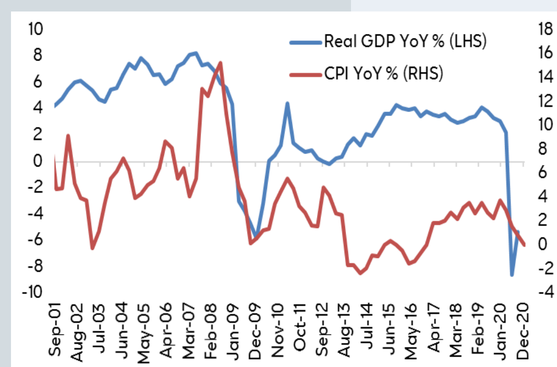
With the GDP having shrunk by -3.84% in the first nine months of 2020, a print no less than -6.0% in the last quarter, which is due in mid-February, will backstop the FY2020 GDP recession at -4.5%. As the EU and the EA are anticipated to encounter economic recessions sharper than -7%, Bulgaria appears to have kept the negative spillovers of the pandemic at bay. However, the containment of the economic repercussions came along with a heavy death toll as Bulgaria ranks 9th worldwide and 5th in the EU, behind Belgium, Slovenia, the Czech Republic and Italy, in terms of deaths per one million people as of January 29. That said, with regard to the stringency of the implemented policies, as measured by the Oxford Covid-19 Government Response Tracker, Bulgaria appears among the EU countries with the less tight measures, following Finland and Malta, since the beginning of the pandemic. Indeed, the Prime Minister himself stated in late January that "the government has dealt with this difficult situation thanks to the most liberal measures". The avoidance of strict measures came presumably as a sequence of the priority for fiscal discipline in a year of robust fiscal expansion around the globe. Since the government decided to contain the fiscal deficit at -3% of GDP, the highly open and small economy of Bulgaria was decided to function under looser containment measures for a substantial period of time during the pandemic. Economic recovery is sensitive to shocks stemming from external demand, appearing substantially uncertain at the time of writing, as the economy is strongly dependent on exports, particularly those related to the processing and assembly of foreign inputs into manufacturing export goods. The outlook in the following quarter will also be challenged by political developments as parliamentary elections will be held on April 4. While according to recent polls the ruling right wing party GERB has the lead by gathering 27% of the votes, the opposing socialists' party, BSP, is lagging by only 3pps. Taking into account this small difference, along with the high political uncertainty, in case of a government change, a lack of efficiency in the public administration may emerge at a time when quick state reflexes are considered crucial.

Figure 23: Additional restrictive measures tamed winter's second wave



Source: Our World in Data, Eurobank Research

Figure 24: ...but came at a cost in terms of GDP growth



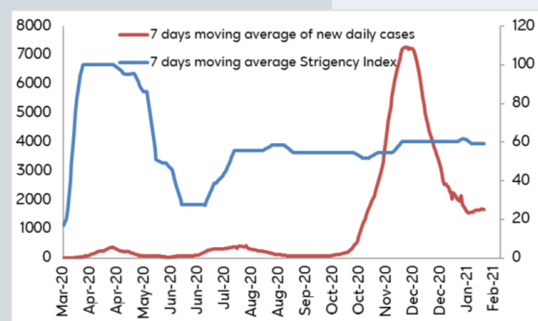
Source: Eurostat, Eurobank Research

Serbia

Robust policy mix to contain 2020's recession and galloping vaccination paves the way for quick recovery in 2021

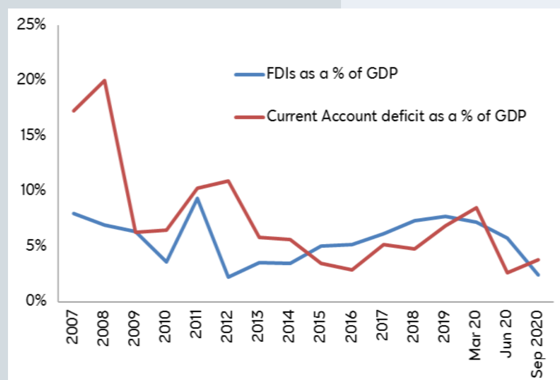
Q4 freshly released GDP growth print sets the economic recession in FY2020 at -0.95%. This performance constitutes a positive development for the country taking into account that the EU had projected an economic recession above -7%. A plethora of factors led to this positive result. Generous fiscal supportive measures accounting for ca 11% of GDP have been routed since the beginning of the pandemic, leading to a fiscal deficit of 8.8% of GDP that drew the attention of the Fiscal Council of country. Moreover, the National Bank of Serbia stepped into 4 interest rate cuts in 2020 translated into 125bps of cumulative easing and to a key policy rate currently standing at 1.00%, following the latest cut in December. Taking into account that the CPI ended the year at 1.3% YoY while it averaged a notch higher, at 1.4% throughout the same period, the key policy rate in real terms is practically negative in an effort to stimulate, inter alia, lending and equivalently investments. The strong growth momentum from which Serbia entered the crisis, i.e. 5.2% YoY GDP growth in Q1, prepared the ground for the remaining quarters while the modest reliance on human contact intensive sectors such as tourism and the relatively large share of agriculture and food-related industries assisted as well. Following the ample fiscal and monetary stimuli in flux in 2020, it is highly probable that expansive policies may have reached their limits in the year ahead. This challenge seems to have been timely noticed by authorities as currently Serbia is carrying out EU's fastest vaccine rollout; 6.3 citizens per 100 have been vaccinated already against the rest EU where the average is 2.68 citizens per 100. The government has so far agreed to purchase about 6.5mn vaccines and is about to ink contracts for 11mn more doses, which are roughly sufficient for the entire population. Serbia's candidateship and not membership status has enabled the government to search for and find alternative vaccines suppliers, such as China and Russia. Taking into account the delayed rollout of the vaccination in the EU, what may have seemed at first sight as a default has turned out to be a positive trigger in the national endeavor to attain herd immunity as soon as possible.

Figure 25: Second wave tamed with a small increase of stringent measures...



Source: European Commission, Eurobank Research

Figure 26: The CAD remains covered by FDIs



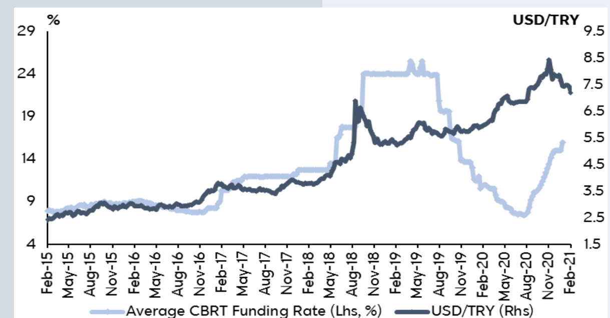
Source: Statistics Office of the Republic of Serbia, Eurobank Research

Turkey

Market sentiment shift continues as CBRT remains on hold

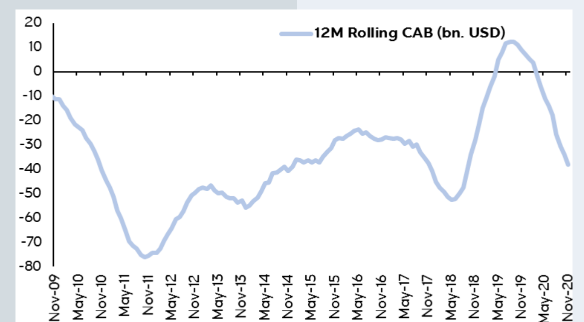
The Central Bank of Turkey (CBRT) satisfied markets' expectations once again in the first MPC of the year in late January. The CBRT left its key policy rate (KPR) – the 1-week repo rate – at 17.0%. Recall that under the leadership of the recently appointed governor Naci Agbal, CBRT has already hiked by a cumulative 675bps since early November. More importantly, in the accompanying statement, CBRT reiterated its commitment to sustain the tightness of the monetary policy stance in the period ahead until strong indicators point to a permanent fall in inflation in line with the targets and price stability. In our view, the latest CBRT decision to remain on hold is another step in the right direction to build policy credibility further, address financial stability risks but also attract portfolio inflows to finance the current account deficit and restore the relatively low, by any metric, FX reserves capacity of CBRT (FX reserves at USD41.1bn in November). On top, the hawkish CBRT rhetoric shows that the leadership is aware of the risks of any premature rate cuts. High inflation remains a key challenge and necessitates CBRT to remain more cautious until it becomes more confident for the inflation trajectory. Inflation has jumped to 14.6% YoY in December compared to 11.9% YoY in October, against the revised 9.4% YoY year-end target in 2021 and the 5% mid-term target. In the same period, core inflation also climbed to 14.3% YoY vs. 11.5% YoY. As a result, the latest hike has brought inflation-adjusted rates to levels similar to the yields offered by emerging-market peers, a move enough to soothe market concerns and offer a decent rate premium reward to satisfy investors' appetite. Nevertheless, in order to succeed from a medium-term perspective, tighter monetary policies also need to be accompanied by a more conventional free markets oriented economic policy. To this effect, there have been many verbal messages from the new leadership, which need, however, to translate into more concrete action. The market sentiment has shifted significantly across Turkish assets over the past two months. Having plunged to an all-time low at 8.52/$ on November 7, the lira rebounded to 7.83/$ at the end of November, continued its year-end rally trading at 7.45/$ in late December and strengthened even further to 7.33/$ at end January. Sentiment improvement towards the lira is also reflected in the small decline of $1bn recorded in the residents' bank deposits dollarization for the first time in the last three months.

Figure 27: Lira rebound continued in December upon the change of leadership in key posts



Source: Bloomberg, Eurobank Research

Figure 28: 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)		
	2020e	2021f	2022f	2020e	2021f	2022f	2020e	2021f	2022f	2020e	2021f	2022f	2020e	2021f	2022f
World	-3.5	5.5	4.2	3.2	2.7	2.9									
Advanced Economies															
USA	-3.5	5.0	3.0	1.2	2.2	2.1	8.1	6.0	5.0	-3.0	-3.3	-3.0	-15.8	-10.3	-6.3
Eurozone	-6.8	4.2	4.0	0.3	1.0	1.2	8.0	9.0	8.6	2.0	2.3	2.3	-9.5	-6.2	-3.7
Germany	-5.0	4.0	3.8	0.4	1.3	1.4	4.0	4.0	3.8	6.3	6.4	6.0	-6.4	-4.4	-2.0
France	-8.3	5.6	4.0	0.5	0.9	1.1	8.2	10.0	9.5	-2.2	-1.7	-1.5	-11.0	-7.6	-5.2
Periphery															
Cyprus	-6.5	3.5	3.0	-1.1	0.5	1.0	7.8	7.5	7.0	-10.0	-9.0	-9.0	-4.5	-1.0	-0.5
Italy	-8.8	4.8	4.6	-0.2	0.5	0.8	9.1	10.5	9.8	3.2	3.0	3.1	-11.3	-7.6	-5.0
Spain	-11.0	5.8	5.2	-0.3	0.6	1.1	16.2	17.8	16.1	0.8	1.6	1.7	-12.2	-8.6	-5.8
Portugal	-7.6	4.7	4.3	-0.1	0.5	1.1	7.4	8.2	7.2	-1.3	-0.5	-0.4	-8.0	-5.4	-3.0
UK	-10.0	4.7	5.7	0.9	1.5	1.9	4.6	6.6	-2.7	-2.7	-3.8	-3.9	-18.2	-8.6	-5.5
Japan	-5.1	2.8	2.2	-0.2	-0.1	0.4	2.8	3.1	2.9	2.9	3.2	3.3	-10.5	-8.0	-5.3
Emerging Economies															
BRICs															
Brazil	-4.5	3.5	2.5	3.2	3.8	3.5	13.4	14.4	13.4	-0.8	-1.2	-1.4	-14.9	-7.2	-6.5
China	2.3	8.4	5.5	2.5	1.5	2.3	3.8	3.8	3.6	1.5	1.4	1.0	-6.9	-5.8	-4.3
India	-8,1	9.2	N/A	6.4	4.6	N/A		NA		1.1	-0.7	N/A	-7.6	-5.5	N/A
Russia	-3.1	3.0	2.5	3.4	3.9	3.8	5.8	5.7	5.3	1.9	2.4	2.9	-4.3	-2.1	-1.0
CESEE															
Bulgaria	-4.5	3.5	4.2	1.7	2.1	2.5	5.1	4.8	4.5	1.2	2.0	1.5	-3.0	-3.9	-2.5
Romania	-5.5	4.0	5.0	2.8	2.7	2.5	5.0	5.3	5.0	-5.5	-5.0	-4.5	-9.0	-6.0	-4.5
Serbia	-1.0	4.5	4..0	1.4	1.8	2.3	13.4	9.4	8.8	-6.4	-5.6	-5.5	-8.9	-3.2	-1.7
Turkey	0.5	3.0	4.0	12.3	13.5	11.0	13.5	13.3	13.0	-5.5	-2.5	-1.5	-5.5	-5.0	-4.5

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

Eurobank Fixed Income Forecasts

	Current	March 2021	June 2021	September 2021	December 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	0.11%	0.17%	0.17%	0.19%	0.20%
3m Libor	0.20%	0.29%	0.30%	0.32%	0.34%
2yr Notes	0.12%	0.18%	0.22%	0.27%	0.31%
10 yr Bonds	1.12%	1.06%	1.19%	1.26%	1.34%
Eurozone					
Refi Rate	0.00%	0.00%	0.00%	0.00%	0.00%
3m Euribor	-0.55%	-0.50%	-0.49%	-0.48%	-0.47%
2yr Bunds	-0.72%	-0.69%	-0.66%	-0.63%	-0.61%
10yr Bunds	-0.47%	-0.51%	-0.43%	-0.35%	-0.32%
UK					
Repo Rate	0.10%	0.10%	0.10%	0.10%	0.15%
3m	0.04%	0.06%	0.07%	0.14%	0.09%
10-yr Gilt	0.36%	0.30%	0.39%	0.43%	0.53%
Switzerland					
3m Libor Target	-0.76%	-0.74%	-0.74%	-0.74%	-0.74%
10-yr Bond	-0.42%	-0.48%	-0.45%	-0.40%	-0.34%

Source: Bloomberg (market implied forecasts)

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