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GLOBAL & REGIONAL MONTHLY

The global economy looks set for a robust growth rebound in the coming quarters, as developed and emerging market economies around the world continue to recover from the Covid-19 pandemic. Manufacturing activity has advanced broadly across regions, while the services recovery has been more uneven. Overall, global GDP is set to advance by 5.5% in 2021, the fastest pace in decades, following the worst global recession since WWII in 2020, fueled by progress in Covid-19 vaccinations, highly expansionary US fiscal policy and excess savings accumulated.

Macro Picture

USA: The tailwinds of vaccinations and unprecedented fiscal stimulus fuel growth in 2021

EA: Rising infections and extended restrictions push the turning point of the economy into May

UK: From Q2, the lift of the lockdown and rapid vaccine rollout should underpin a strong recovery

EM: Central Banks' meetings in several EMs this month point to a commencing monetary tightening cycle

CESEE: Third wave of Covid-19 infections hits the region pushing back expectations for growth recovery in H2-2021

Markets

FX: USD strength on the back of a new fiscal stimulus package and excessive bearish positioning

Rates: EU and US rates diverged this month despite both the ECB and Fed making dovish statements. The market is challenging the Fed

EM: EM yields higher as US rates keep rising, but spreads better. Turkey the clear underperformer on idiosyncratic reasons

Credit: Spreads were unchanged to slightly tighter across ratings and sectors; expected to trade range-bound/moderately wider

Policy Outlook

USA: Tapering announcement not expected before Q4, fed funds rates unchanged until 2023

EA: Very accommodative ECB policy stance, unchanged policy rates in the foreseeable future

UK: The BoE shifts to a "wait-and-see" stance amid two-way risks to the UK economic outlook

CESEE: Central Banks on hold but increasingly aware of inflation risks

Key Downside Risks

Delays in the gradual relaxation of restrictions; new Covid-19 variants, continuing constraints in the supply of vaccines

Persistent rise in inflation

Policy support withdrawn before sustained economic recovery is on track

Continuing rise in US yields may weigh further on flows to non-China EM

Special Topics in this issue:

- Oil Outlook: The imprint of demand and supply on prices

- FOMC reaction to higher UST yields

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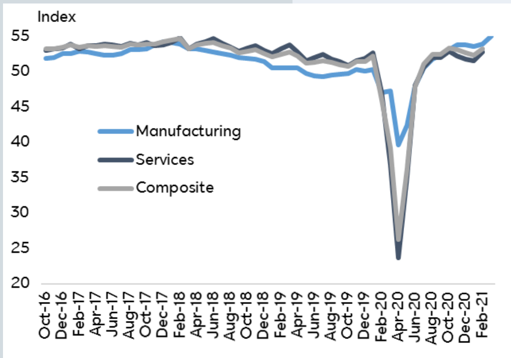
World Economic Outlook

The global economy looks set for a robust growth rebound in the coming quarters as developed and emerging market economies around the world continue to recover from the Covid-19 pandemic. The Global PMI Composite Output Index rose to a four-month high of 53.2 in February signaling expansion for eight consecutive months, while March data confirm that manufacturing activity has rebounded further across regions (Figure 1). The economic recovery is largely driven by the US and China, with their demand increase expected to spill over to the rest of the world, given that the two countries together represent more than 40% of world GDP in PPP terms. US manufacturing activity hit historical highs in March, with the respective ISM index soaring to the strongest overall reading since 1983 (64.7), driven mostly by strong growth in new orders. Nevertheless, the recovery in the services sector seems to be rather uneven, with euro area continuing its downturn albeit at a slower pace. Hurt by virus-related restrictions amid the third Covid-19 wave, the preliminary March services PMI remained in contractionary territory (48.8 from 45.7 in March), though the decline was the weakest since last August.

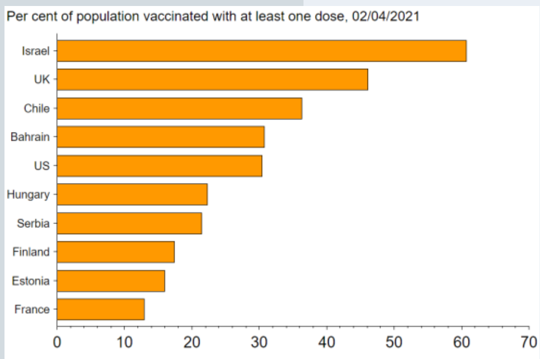
Figure 1: JP Morgan Global PMI



Source: Bloomberg, Markit, Eurobank Research

The pace of the vaccinations rollout is of vital importance for the global economic recovery. The UK and the US have achieved a rapid pace of vaccinations, setting the stage for a return to normalcy by summer, meaning that fewer mobility and activity restrictions will lead to increased demand for services. Over 40% of the British population has already been covered by at least one shot, while the respective percentage for the US stands around 30% (Figure 2). The approval of Johnson & Johnson's one-dose vaccine is expected to increase the vaccine supply, with the US administration planning to administer vaccines to people over 18 by 1 May. On the flipside, the vaccination campaign remains relatively slower in the euro area, with at least one shot vaccinations to roughly 12% of its population at the moment. At the same time, concerns regarding the effectiveness and the safety of the AstraZeneca vaccine have delayed the vaccine rollout, rendering herd immunity more likely towards the end of the year.

Figure 2: The race to roll out the vaccine



Source: Refiniv Datastream, Fathom Consulting, Eurobank Research

Meanwhile, the enormous fiscal policy measures in the US are expected to provide a significant boost to the global economy, lifting exports for several countries. The large US fiscal stimulus could add as much as 0.5pp to the euro area economic growth over the next year, given that the US constitutes one of the main export partners of the region. On top of the $935bn spending bill passed in December 2020 and the $1.9trn aid package signed at the beginning of March, the Biden administration unveiled a $2.3trn infrastructure eight-year spending package ('American Jobs Plan') focused on longer-term priorities, such as infrastructure, clean energy, education, housing and industrial policy.

Overall, global GDP is set to advance by 5.5% in 2021, the fastest pace in decades, following the worst global recession since WWII in 2020, fueled by rapid progress in Covid-19 vaccinations, highly expansionary US fiscal policy and excess accumulated savings. Prospects for higher growth and inflation have exerted upward pressure on sovereign bond yields, increasing central banks' challenges across regions. The Fed reiterated in March its commitment for unchanged policy rates in the foreseeable future, the ECB responded to the recent unwarranted tightening of financing conditions by increasing asset purchases under the PEPP and the BoJ made certain adjustments to its monetary policy framework, inter alia, widening its band around longer-term yields. On the contrary, higher US yields, rising inflation expectations and an appreciated USD has led certain EM central banks to embark on a tightening cycle, particularly Turkey, Russia and Brazil. Looking ahead, the question is whether major central banks will manage to maintain their accommodative stance should markets continue to price in earlier rate hikes, in response to expectorations for a robust economic recovery.

Developed Economies

US: Economic activity was buoyant throughout the winter in spite of the third wave of the pandemic, with Q4 GDP growth revised higher by two-tenths to 4.3%QoQ saar amid upward changes to private inventory accumulation and government spending. Although both spending and inflation data were softer in February, we expect the $2.8trn fiscal measures, coupled with the excess household savings accumulated since the start of the pandemic, to support personal income over the coming months, while positive base effects are likely to drive core PCE significantly higher by mid-2021 (albeit temporarily). Activity seems well positioned for solid growth in 2021 of about 6.0% (upwards revised from 5.5% previously), with double-digit annualized growth rates in Q2 and Q3, fueled by a rapid vaccine rollout that could lead to herd immunity by the summer and an unprecedented fiscal stimulus. Given the Biden administration's proposal for a fiscal recovery package focused on longer-term priorities such as infrastructure, additional fiscal spending spread over multiple years could help sustain fiscal support beyond 2021, with 2022 GDP growth expected around 3.5-4.0%.

Euro area: Q4 2020 GDP was revised downwards by 10bp to -0.7%QoQ, with a sharp decline in private consumption (-3.0%QoQ) only partly offset by changes in inventories and fixed investment (+1.6%QoQ). Although several restrictions have been extended and/or even tightened through Q1 in a large part of the euro area, Covid-19 infections have started to pick up again since mid-February in many euro area countries and certain governments have decided to postpone the expected softening of lockdowns or even restrict mobility further until at least mid-April. With the turning point of the economy likely delayed into May, we expect a generous cyclical rebound in H2 2020, assuming that an accelerated vaccination pace allows for about 70% of the euro area population to be vaccinated by the end of Q3 2021. Overall, we expect GDP to expand by 4.0% in 2021, following a 6.6% contraction in 2020, due to Covid-19 vaccination catch-up, national and EU-level fiscal policy stimulus, as well as very accommodative financing conditions by the ECB.

Emerging Economies

BRIC: A series of reports released in late March by the World Bank (WB) provided us a view for the outlook of the BRIC economies in 2021 and 2022; **Brazil** is forecast to rebound by 3.0% in 2021, from -4.0% in 2020, and slow down to 2.5% in 2022. The **Russia**n economy, from -3.0% in 2020, is expected to expand by +2.9% and +3.2% in 2021 and 2022 respectively. Both prints were slightly revised to the upside since January, when WB's previous forecasts were released. In **India**, where the economic recession was managed to be contained in 2020 to -7.8%, as market expectations earlier in 2020 exceeded a -10% plunge, GDP growth is projected to rebound by 5.8% in 2021 and bounce further at 6.2% in 2022. On the monetary front, in the executive board meetings held in March, the Central Bank of Brazil increased its Key Policy Rate (KPR) by 75bps to 2.75% from a record low of 2.00% and, on the same footing, the Russian Central Bank proceeded with a 25bps hike setting the KPR at 4.50%, pointing to a commencing tightening cycle, amid surging inflationary pressures in the BRIC and wider EM sphere. Finally, in **China**, the economy remained on track amid recovering domestic and, to a lesser extent, international demand while the ambitious target to have 40% of China's population vaccinated by the end of H1-2020 spurs optimism for GDP growth to come above 8% in 2021.

CESEE: As of late February – early March 2021, the improvement pace of the epidemiological situation in many countries of the Central, Eastern and South-eastern Europe (CESEE), which had started in the past two months stalled, making authorities more cautious in activating their reopening plans. Ever since, multiple countries across the region have been confronted again with an exponential rise in Covid-19 infections, hospitalizations and fatalities that hit new record highs. The new wave of infections - the third one since the start of the pandemic - is mostly related to the virus's mutations. The resurgence of infections has raised a lot of uncertainty over the economic outlook of the broader CESEE region, pushing back expectations for a more pronounced growth rebound in H2-2021. The severity and the uncertainty surrounding the duration of the new Covid-19 wave have increased the downside risks for the growth rebound prospects of 2021.

Special Topics

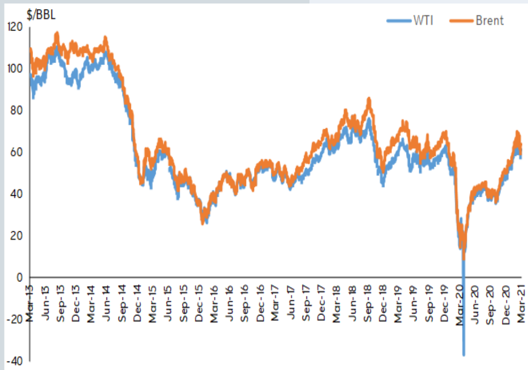
I. Oil Outlook: The imprint of demand and supply on prices

As the first quarter of 2021 is complete and the third wave of the Covid-19 pandemic is fully unfolding in almost every part of the world, in the following lines we attempt to identify the key determinants that will shape the oil market in the near future. In our view, despite the necessary technicalities in oil trading, the market will be broadly driven by the perennial interaction between the forces of demand and supply along with the traditional manipulation of the latter by the OPEC+[1] and the non OPEC[2] oil producing countries.

State of play in the Oil market: Prices have recovered to pre-Covid-19 levels

The past year has been dramatic for the crude oil markets. The Covid-19 pandemic has had a disproportionally negative impact on energy vs. other commodity markets. Economic disruptions from the social distancing and lockdown measures imposed in response to the Covid-19 pandemic, led to steep declines in mobility and subsequently to a collapse in global petroleum demand and increased volatility. The price war between Saudi Arabia and Russia deepened the market turmoil in March. The historic agreement reached in OPEC+, to slash output by the greatest volume in history – nearly 10mbd for an initial period of two months effective from May – provided only a temporary relief and was not enough to balance oil markets. As a result, oil prices crashed during H1-2020 only to start recovering in H2-2020. The two benchmarks of the petroleum industry, West Texas Intermediate (WTI) and Brent crude, registered their lowest prices in the year in late April 2020. For the first time ever, WTI dived into negative territory (Spot:-36.98$/bbl. & Futures:-37.63$/bbl.) on April 20, 2020 for a very short period of time. Accordingly, on the next day, Brent[3] crude spot prices collapsed below 10$/bbl. (Spot: 9.12$/bbl.) and the futures prices tumbled below 20$/bbl. (Future: 19.35$/bbl.), the lowest level in decades. In the next two months, oil prices

Figure 3: Oil prices tumbled during 1H-2021 on global demand collapse from Covid-19 disruption



Source: IEA, Eurobank Research

[1] OPEC+ was founded in 2016 and basically pertains to a cooperative initiative between the 13 OPEC members and 10 more net oil exporting countries, including Russia, which is considered the most prominent among them. OPEC+ countries control over 50% of global oil supplies and about 90% of proven oil reserves. The trigger for the OPEC+ formation was the need for more rigorous control over oil prices on behalf of OPEC countries, following the increased production of shale oil by the US that led, along with other factors, to another oil price crash in 2014.

[2] Non OPEC oil producing countries broadly pertain to the US, Canada, Mexico, Argentina, Brazil, Colombia, Equador, Norway, the UK, Australia, China, India, Malaysia and Egypt

[3] Brent crude is extracted from the North Sea and is also known as London Brent, North Sea Oil, Brent Blend and Brent petroleum. It is a light crude oil, slightly heavier than WTI, and sweet because of its low sulphur content and it is ideal for the refining of diesel fuel, gasoline.

rebounded as countries exited the lockdowns returning above USD 20$/bbl. in early May, above 30$/bbl. in mid-May and above 40$/bbl. in late June, stabilizing at these levels until early November. Following an impressive rally that started in Q4-2020, oil prices recovered to pre-Covid-19 levels in early February 2021 when WTI prices hit 58$/bbl., levels seen one year ago when the pandemic broke out. The swift recovery in oil prices was primarily based on expectations for a strong recovery in global demand, which itself stems from market optimism for a successful rollout of the vaccination programs around the globe. Suppliers' discipline, which contributed to the depletion of accumulated reserves, also supported the trend. The slower-than-planned rollback of OPEC+ supply cuts, along with additional unilateral cuts by Saudi Arabia, reinforced the recovery. Rising geopolitical tensions in the Middle East during this period weighted as well.

Demand: Prevailing uncertainty over the evolution of the pandemic, mostly in H1, weigh on the outlook, but China's GDP growth estimated above 8% implies high oil requirements.

According to recent data released by OPEC[4], the global oil demand in 2020 contracted by 9.6mbd, standing at 90.4mbd. The figure is way below the 2019 levels of almost 100mbd, while the forecast for 2021 currently stands at 96.27mbd. In terms of growth rates, oil demand is estimated to have shrunk by -10%YoY in 2020, while it is anticipated to rebound by +7% in 2021, with 2022 considered the year when demand will return to pre-Covid-19 levels. The demand contraction in 2020 was attributed by 60% to OECD[5] countries and 40% to the non-OECD region with the milder contraction of demand in the non-OECD region broadly attributed to China's rapid economic rebound from the Covid-19 pandemic in 2020. On the same footing, China will drive 2021's rebound as growth in oil demand is expected to contribute 60% on the headline growth of global demand, with the remaining 40% coming from the OECD group. Many analysts distinguish the prospects for 2021 in two phases: H1 and H2. Oil requirements are proving hard to estimate in H1 as the resurgence of Covid-19 prolongs uncertainty. Although vaccination programmes are now underway in a number of countries, the more infectious strain of the virus in the H1-2021 implies that demand will not be picking up before the summer. The USD2.3trn US infrastructure investment package is considered an additional demand stimulating factor, while the same could have been said about the NGEU funds for the EU, were it not for the possible delays caused by the German constitutional court, which renders the timing of the disbursement of funds to the EU economies difficult to define.

Supply: Evaluating the control in prices through OPEC+ curbs put in effect the past 12 months

Although at the beginning of the agreed production cuts, investors and markets received the OPEC+ endeavour with reluctance, a year later supply curbs have proven that they assisted in the rebalancing of the oil market during an extremely turbulent period with severe downside risks. Meanwhile, during March a plethora of important meetings between high level acting agents of the oil market took place. The OPEC+ met on March 4 and driven by cautiousness regarding the recovery in demand, its members surprisingly

[4] https://www.opec.org/opec_web/en/publications/338.htm

[5] The OECD is comprised of 34 Member countries: Australia, Austria, Belgium, Canada, Chile, the Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Israel, Italy, Japan, Korea, Luxembourg, Mexico, the Netherlands, New Zealand, Norway, Poland, Portugal, the Slovak Republic, Slovenia, Spain, Sweden, Switzerland, Turkey, the UK and the US. Non-OECD demand refers to demand from China, BRICS and OPEC members

decided to maintain almost all of the cartel's output curbs, instead of increasing production. Saudi Arabia also extended its voluntary output cut of 1mbd, which was due to expire at the end of March, throughout April leaving room for further extension of the cut. In late March, the OPEC+ Joint Technical Committee met in order to assess the oil demand dynamics prior to the next April 1 OPEC+ meeting. While the meeting of the technical experts signalled a more negative view on the demand outlook, which was further supported by a recommendation from OPEC Secretary-General Mohammad Barkindo in the same day that the coalition remain very cautious, OPEC+ decided to gradually increase oil production over the next three months on the April 1 meeting. Apparently, Saudi Arabia's cautiousness appears to have been dented by Russian and other producers' pressure to raise modestly the oil output. Publications to the press, which however have not been confirmed by any side, state that prior to the April 1 meeting, there was a call between the new U.S. secretary of energy, Jennifer Granholm, and Prince Abdulaziz bin Salman, the Saudi Energy minister, which may have had some impact as well. As a result, OPEC+ latest decision to curb the cuts is translated by experts and the market into a positive view over demand and the economic recovery for at least the next three months, implying also that non-OPEC producers and specifically the US will not increase their oil production.

Heading towards a commodity super-cycle?

The rally of oil prices has given rise to speculation that the market currently stands at the beginning of a commodity super-cycle. The advocates of this idea base their arguments on their predictions for a growing imbalance between future demand and supply. On the demand side, expectations are built upon fast growing demand for energy in the post-pandemic era, which will be financed by overly expansive fiscal policies and underpinned by more environmentally friendly policies and investments. The latter will support demand for all commodities in the short term to help build the necessary infrastructure (i.e. electric vehicles). On the supply side, the chronic underinvestment in the industry even before the pandemic and the time required for exploration drilling to get new projects operational will put a cap on supply in the short-term pushing up prices further. In contrast, oil market pessimists believe that the assumptions behind that scenario are farfetched. They argue that demand for oil will gradually pick up as the Covid-19 pandemic fades away but will not catch up with the pre-pandemic levels any time soon. The pandemic's print on demand is expected to be structural, changing fundamentally the way people interact, travel or do business and holidays thus reducing the demand for oil on a permanent basis. In addition, according to their view, supply discipline may not last given the poor shape of a number of producer countries who rely on the hydrocarbon industry. If current supply cuts are fully reversed and that spare capacity returns to the market, that could be enough to offset the rise in demand and cool off the market.

Conclusion: Where to from here?

Crude oil prices will continue to be volatile. Even when the pandemic is finally under control, many economies will be confronted with the adverse impact of deteriorated fiscal balances and the harmed sentiment in the labour market and consumer spending in 2021. Taking into account the above and despite the prevailing uncertainty stemming primarily from the unchartered dynamics of global demand in the foreseeable future, market consensus anticipates WTI and Brent prices to stand above 60$/bbl. at the end of the year but with modest volatility in the meantime and subject to the smooth rollout of vaccinations around the globe.

II. FOMC reaction to higher UST yields

The majority of US economic data has surprised positively in recent weeks, pointing to an improving growth outlook, mostly supported by the rapid progress in vaccinations and sizable fiscal support designed to limit the human and economic impact of the Covid-19 pandemic (amounting to $5.6trn cumulatively, or around 27% of GDP). Against this background, investors have started to price in a more hawkish medium-term Fed monetary policy outlook, which is potentially at odds with the continued dovish message from Fed Chair Jerome Powell and several of his colleagues (Figure 4). Reflecting investors' anticipation of a brighter US growth outlook and an ensuing resurgence of inflation (5yr5yr forward inflation rate currently close to a 2-½ year high of 2.15%), long-dated sovereign bond yields have embarked on an upward trend since early February (Figure 5). 10-yr UST yields hit a 14-month peak of 1.776% on 30 March, a day before US President Joe Biden unveiled an eagerly awaited $2.3bn infrastructure spending package (dubbed "American Jobs Plan"), the first of a two-part economic plan that will be spread out over eight years and focuses on longer-term priorities, such as infrastructure, construction and clean energy. The second part (called the "American Families Plan") is expected to be unveiled later this month, with a focus on childcare, healthcare and education. 10-yr UST yields are some 80bps higher since the turn of the year and more than double since the summer of last year, as investors test the Fed's determination to keep monetary policy accommodation while the US growth outlook improves and inflation shows tentative signs of acceleration.

Figure 4: Investors are pricing-in a rate hike already in 2022, while the Fed signals unchanged rates until at least end-2023

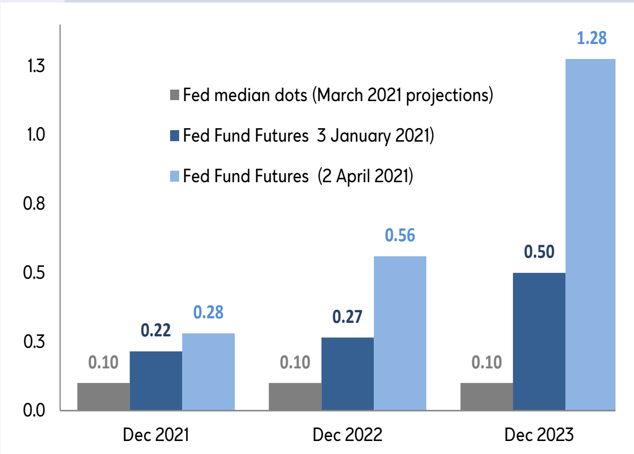
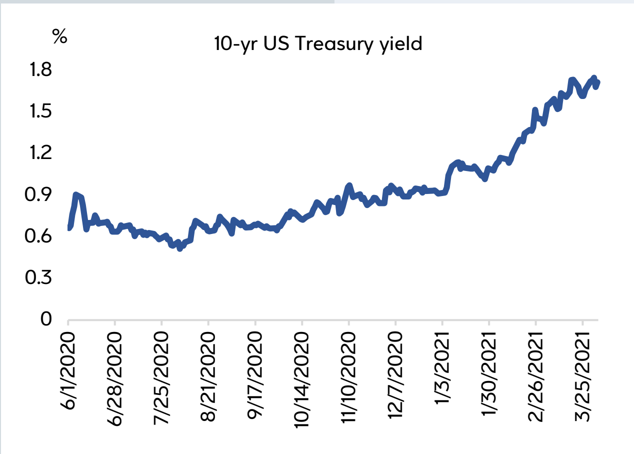


Figure 5: 10-yr US Treasury yields have risen due to higher inflation expectations and a hawkish shift in Fed rate tightening expectations



Source: Bloomberg, Economic Research

Conveying a sense of patience and reinforcing the message that a hawkish shift in Fed rate hike expectations currently priced-in is inconsistent with the Committee's expectations for the monetary policy, the FOMC remained confidently dovish at the latest monetary policy meeting in March, in spite of substantial upgrades to the US outlook, cementing its commitment to the recently adopted flexible average inflation targeting strategy. In the updated Summary of Economic Projections (SEP), 2021 GDP was revised notably upwards at 6.5% from 4.2% in December, core PCE — the Fed's preferred measure of inflation — is now seen at or slightly above the 2.0% longer-run objective over the forecast period, while the unemployment rate is expected to keep falling from 4.5% this year to 3.9% in 2023, just below the long-term estimate.

The much more positive assessment of the US outlook, however, was not enough to lead the majority of Fed participants to pencil in higher interest rates during the forecast period. Instead, according to the updated Fed dot plot (i.e., individual projections for the federal funds rate which are depicted with a dot) 11 out of 18 participants continue to see the target range for the federal funds rate remaining unchanged at least through the end of 2023, suggesting that the Fed intends to tolerate an overshoot of both inflation and employment without feeling pressure to initiate a normalization of its monetary policy. That is because, on the back of prevailing uncertainty over the evolution of the US economy as the pandemic continues, the Fed wants to allow time for the recovery to become more sustainable before communicating any potential policy moves. In other words, as Chair Jerome Powell suggested at the post-meeting press conference, the Fed will wait for actual progress in economic activity before signaling a shift in its policy —either to asset purchases or interest rates — and will not rush to remove policy accommodation based on forecasted progress. He also reiterated his message that it is premature to contemplate tapering and that it will take some time "until substantial further progress" has been achieved with regard to the FOMC's maximum employment and inflation goals which are preconditions for the tapering of bond purchases. The Fed Chair also made clear once again that the Central Bank will refrain from raising interest rates until all requirements are met simultaneously, i.e.: labor market conditions have reached levels consistent with the Committee's assessment of maximum employment and inflation has risen to 2.0% and is on track to moderately exceed that level for some time. Apparently, in spite of tentative signs of improvement, it may take longer for the US labor market to fully regain its pre-Covid trend. In the period since the outbreak of the pandemic, more than 22mn jobs were lost while so far, less than 60% of those have been recovered, leaving employment by some 9mn jobs below pre-crisis levels. According to the most recent data, the unemployment rate dropped to a new post-pandemic low of 6.0% in March. However, official figures underestimate the extent of labor market slack as around 4mn people have given up looking for a job during the pandemic and are therefore not counted as unemployed. According to the Fed Chair, if the participation rate in the labor force were as high as before the pandemic, the actual unemployment rate would be c. 10%. That said, in an environment of elevated labor market slack, as Jerome Powell stressed once again, the expected upward pressure on inflation near-term, mostly driven by base effects and supply-demand imbalances, should be "relatively modest" and "transitory", and therefore, should be overlooked.

As regards the recent increase in long-dated UST yields, the Fed Chair did not touch on the issue as some might have expected. Responding to a relevant question in the Q&A session during the post-meeting press conference, he simply said that various measures of financial conditions remain broadly accommodative and his concern is for them to remain so in order to support economic recovery. The above remarks were in line with comments from several FOMC officials in recent weeks, suggesting that longer-term rates have moved in the right direction in the face of improving US economic conditions and, thus, are acceptable — in contrast to other major Central Banks including the ECB — taking into account that the moves so far have not been disruptive and have not triggered a material or persisting tightening in financial conditions that could jeopardize post-pandemic economic recovery. In fact, policymakers monitor a range of financial conditions indexes for potential negative spillover effects of higher long-term interest rates on other markets (particularly stocks and credit markets) credit availability, credit demand and interest-sensitive sectors of the economy (i.e., housing, autos) that could slow progress in economic recovery. To summarise, recent moves in interest rate markets do not appear to have exerted a material adverse effect on risky assets and, thus, have not yet met the Fed's threshold for a forceful response.

However, on the back of market expectations for a brighter US economic outlook than the Fed's SEP suggested and the risk of higher inflation in the period ahead, especially as vaccinations are progressing fast, investors are likely to continue testing the Central Bank's determination for ultra-accommodative monetary policy. That said, the prospect of even higher long-dated UST yields in the coming weeks cannot be ruled out completely, while the Fed should keep reiterating its dovish rhetoric and signaling that it is ready to react forcefully to support economic recovery and promote accommodative financial conditions. Once it becomes clearer to market participants that the Fed is determined to remain patient awaiting confirmation that the pickup in inflation will prove substantial and not transient before shifting to a less accommodative policy stance, UST yields could temporarily move lower before resuming their upward trend again as the Fed starts sending clear signals that tapering is imminent.

Macro Themes & Implications in CESEE

The third wave of Covid-19 infections puts the CESEE region under severe pressure pushing back expectations for a more pronounced growth rebound in H2-2021

As of late February – early March 2021, the improvement pace of the epidemiological situation in many countries of the Central, Eastern and South-eastern Europe (CESEE) that had started in the past two months stalled. Ever since, multiple countries across the region have been confronted again with an exponential rise in Covid-19 infections, hospitalizations and fatalities that hit new record highs. The new wave of infections - the third one since the start of the pandemic - is mostly related to the virus's mutations. The sharp deterioration has put the CESEE region in the epicenter of global media attention during the "third wave", because the countries have been hit disproportionally harder than their Western Europe peers. During the past weeks the Covid-19 mortality rate has deteriorated so much, that nine out of ten worst-hit countries are located in the CESEE region based on data published last week.

Authorities across the region who had earlier reinstated stringent health and social distancing measures and restrictions on public and economic activities, are struggling to contain the virus spread. The resurgence has rendered some of these countries' authorities more cautious as regards their reopening plans. Nevertheless, under public pressure and growing opposition to restrictions or, in some cases, relatively better epidemiological conditions, some went ahead with relaxing the restrictions. This is illustrated in the trajectory of the Stringency Index, a composite measure by Oxford Covid-19 Government Response Tracker (OxCGRT) project, which records the strictness of government policies.

For instance, Poland recently announced a nationwide quasi-lockdown until at least April 10. Czech Republic opted to extend the strict lockdown in place until after Easter holidays. In Bulgaria, which stands among the European countries mostly hit by resurgence of the pandemic, authorities imposed restrictions on economic activity - albeit softer than in Q2-2020 - via declaring a state of emergency, which was extended until at least the end of April 2021. However, ahead of the parliamentary elections in early April the government decided to ease some of the restrictions, opening up gyms and shopping malls at 50% capacity and restaurants. Hungary announced that non-essential shops will be allowed to reopen with capacity limitations, and the overnight curfew will be shortened by two hours when vaccination target is achieved.

The resurgence of infections has raised a lot of uncertainty over the economic outlook of the broader CESEE region, pushing back expectations for a more pronounced growth rebound in H2-2021. The severity and the uncertainty surrounding the duration of the new Covid-19 wave have increased the downside risks for the growth rebound prospects of 2021. Although the rollout of vaccinations had initially spurred more optimism for the growth prospects of the broader CESEE region in 2021, full return to normal conditions may take much longer to materialize. The resurgence of infections will most probably put a break on the pace of recovery – not limited to the services sector – given that restrictive measures, which have had a negative impact on the economic activity in Q1-2021, will most probably remain in place for the largest part of Q2-2021.

In addition, the logistics of the production, distribution and execution of the vaccination program on such a massive scale may require additional investments and effort, leading potentially to further delays. So far, with a few notable exceptions, the vaccination progress across the region has failed to impress. There are two notable exceptions to that, Serbia and, more recently, Hungary. As of late March, Serbia ranked first in the vaccination race and Hungary second having provided at least one dose to 20.6% and 19.9% of their population respectively. In both cases, to the procurement of vaccines from China and Russia made the difference, avoiding supply bottlenecks. On the negative side, the acceleration of the vaccination program in both countries has not succeeded in preventing the infections and fatalities resurgence. Bulgaria, Russia and Ukraine are lagging far behind with the share of the population that has received at least one dose of the vaccine standing at 5.1%, 4.7% and 0.5% respectively. The case of Russia is a paradox given that the country has produced its own vaccine and its lagging behind clearly illustrates the numerous challenges of the vaccination process.

The March economic sentiment of the region lured market attention in the past week. Sentiment indicators have been on a rising trend in Q1-2021, conveying a message of restrained optimism for the economic outlook. However, on average, the pace of improvement is uneven across the region and more importantly, it still lags behind the euro area. Having retrenched in November to its June and July levels when the previous reopening of the economies took place, economic sentiment stabilized in December and now stands at higher levels by comparison but still below its long-term average. Obviously, given the rapid resurgence of the epidemic, it would be fair to say that the sentiment trajectory does not reveal a deterioration of expectations, let alone a sense of panic. The approval and the distribution of a number of vaccines in December has been a game changer. Moreover, the beginning of vaccination programs – albeit at a slow pace in most cases – has lifted the depressed morale of consumers and corporates and boosted their optimism for the period ahead. In some cases, the partial lifting of restrictions has also helped the improvement of the services sector reading, which outpaced that of industry on a monthly basis.

CESEE Markets Developments & Outlook

Bulgaria

Eurobonds took a breather in March, staying largely unchanged across the board. The most active were these in the long end of the curve, with the 2030, 2035 and 2050 tenors rising by 4 bps each. Local papers on the other hand were more active, with the 5, 7 and 10 year tenors rising between 3 and 8 bps, while the 4 and 6 tenors slid by 3-7 bps. During March, the Ministry of Finance re-opened the 5 year local paper tenor, raising EUR 150M at an average yield of -0.10% with the same tenor having realized an average yield of -0.17% just a few months back, highlighting, thus, the recent trend of the rising cost of financing.

Bulgarian elections are just around the corner, with the outcome continuing to be uncertain due to the 3rd Covid-19 wave. Overall polls indicate three new political formations to enter the parliament and a narrow win for the ruling party GERB.

Serbia

Robust growth is expected to remain on track in 2021 as many institutions, both domestic and international, expect full recovery to pre-pandemic levels this year. However, jitters are emerging on the political front as the latest European Parliament report requested Serbia to deliver "convincing results" in areas such as the judiciary system, the freedom of expression and the fight against corruption. In our view, the RSD will most probably stay relatively stable, within the comfort zone of 117.50 to 118.00, unless some excessive reaction by citizens agitated by the ongoing string of corruption affairs takes place which could, in turn, worry investors.

Looking at the yield curve of the RSD denominated government bonds, it remained broadly stable in March, with all tenors shifting slightly upwards between 5 and 10 bps. The sharpest rise occurred at the long-end of the curve with the 12-year bond rising by 10bps, from 3.25% to 3.35%. The shorter end of the curve, where the mostly traded tenors were the 5-year and 7-year, recorded rises by 5ps, i.e. from 2.20% to 2.25% and from 2.40 to 2.45%, respectively.

Looking ahead, the ongoing global economic recovery could turn into a potential threat for the stability of the Serbian bond market. A potential further rise of 10-year US government bond yields and acceleration of the inflation worldwide could affect flows towards emerging economies, including Serbia. Therefore, a sharp rise of the government bond yields in the near future would not come as a surprise.

Markets View

Foreign Exchange

EUR/USD: The pair broke below its February range and accelerated lower to reach 1.1704 as the interest rate differentials between Europe and US continued to widen, even after an admittedly dovish Fed. The difference in growth prospects between EZ and US is startling as vaccinations and fiscal spending in the latter are moving quickly. Historical and implied volatility remain at low levels, 1 month implied volatility is actually about to break below 5.5%, a level not seen since before the pandemic. Technically, there is potential for further downside near-term towards 1.1600 but we consider any further weakness a buying opportunity for the pair to revisit levels above 1.2000 and this is the market consensus as well. 1.8500 and 1.9750 are the main resistances on the upside while 1.1600 is a major support. It needs to be mentioned that USD was stronger versus all G10 currencies in March, except versus CAD and NOK.

GBP/USD: GBP could not provide any resistance versus the general USD strength in March, especially after its significant rally from 1.15 since March 2020. The pair traded from approximately 1.3955, since our last publication, to a 1.3657 low before reversing to 1.3825. The rate differential between the UK and the US increased sharply in February despite the fact the UK remains one of the most extreme cases of reversal in rates outlook with the market moving from pricing negative rates at the end of 2020 to pricing rate hikes in 2022 within a few months. We see further downside for GBP towards 1.3500. Strong resistance at 1.3950, while support is at 1.3720.

Rates

EU: Despite a volatile month, EU rates moves remained pretty contained, post a dovish EU, and failed to follow the aggressive further rise in US rates. 2s-10s and 10s-30s steepened as the short end remained anchored. The 10y swap rate is hovering around 5bps. 10s-30s traded at 42bps vs 35bps in February. Looking forward we expect the bear steepening move to persist and the selloff in the long end rates to continue towards 60bps. A potential risk to this view is a verbal intervention by the ECB that has repeatedly stated that rates will stay low for the foreseeable future. Implied volatility retraced lower, post a sharp rise in February, with the 3 months 10yr falling from 52% to 46% in sharp contrast with US rates volatility (see comment below).

US: US rates rose sharply in March after the fiscal stimulus package was approved. 10 year swap rates increased by 25bps to 1.73% with 2s-10s steepening by 16bps to 143bps and 10s-30s by 10bps to 184bps, having traded as high as 194bps. The market is clearly challenging the Fed as Powell stated that there was no intention to raise rates before the end of 2023. Looking forward we expect the curve to bear flatten as the rate hike expectations will move closer, in line with the vaccination progress and the reopening of the economies. Implied volatility should remain high for a while due to high uncertainty regarding the path of interest rate hikes. 3 months 10yr implied volatility remains close to last month's high of 85%.

Emerging Markets credit

US rates continued their upward trend in March, dragging EM yields higher, but spreads remained little changed overall with credit curves flattening against a steepening US curve. The clear underperformer was Turkey that dominated the headlines after President Erdogan surprisingly replaced CBT Governor Naci Agbal by Prof. Sahap Kavcioglu, after the CBT raised its policy rate by 200bps to 19%. This led the Turkey 10yr USD spread to widen by 100bps to 520, before retracing to 485 at the time of writing. Russian sovereign bonds also underperformed, admittedly from a very tight level, as more sanctions were unveiled by the EU, the US and other G10 countries. South African spreads were stable as the government announced measures to boost the economy and despite the fact that it lags in terms of vaccinations. In LATAM, Brazil was the obvious underperformer with 10yr bonds widening by 15bps as the pandemic is getting out of hand with no resolution in sight. Mexico and Peru also finished the month wider for similar reasons but overall, the widening there has been orderly. In Asia, sovereign spreads traded firm with Indonesia, Philippines and China closing tighter. Given the recent flattening in EM sovereign credit curves we are cautious on the EM long end, although the post vaccination recovery will be supportive for everyone.

Corporate credit

EUR IG cash corporate spreads were mostly unchanged to slightly tighter in the month of March, with lower grade and higher yielding credits generally outperforming the higher grade ones. CDS spreads were also tighter on a basis, outperforming cash, with compression between HY and IG indices, on admittedly already tight valuations. ECB increased its buying rate and support earlier this month, while supply was in general well-absorbed during the month. Again, credit underperformed the moves in equites, while higher and steeper rates curves especially in US put pressure on longer duration, and some very tight high-rated names. Spreads grinded slowly tighter rather uniformly throughout the month. US IG names spread moves were skewed towards unchanged to wider levels, with core Financials +5/8bps wider followed by Basic Materials and Real Estate ~+3bps wider, while Telecommunications, Oil & Gas and Consumer Services were -3bps tighter. Rest of sectors were broadly unchanged. In EUR IG, Automobiles & Parts were the outperformer -4bps followed by Travel & Leisure -2bps, while Personal household goods (in Consumer goods) were +6bps wider, making it the underperformer. Other major sectors were -1/+1bps generally.

Rating-wise BBB- EUR cash paper was -3.5bps tighter, making it the outperformer of the IG universe, with other grades mostly unchanged (BBB -0.5bps, BBB+ -1bps, A- -0.5bps, A -1bps, A+ unchanged, AA- unchanged, AA +1bps, AA+ -2bps). In the EUR HY universe, CCC was -10 bps tighter, B -60bps, while BB was mostly unchanged. Technical for cash continues to remain strong, with subdued supply expected in April, and ECB support and liquidity still there, both being major tailwinds. EUR rates, despite the recent moves,

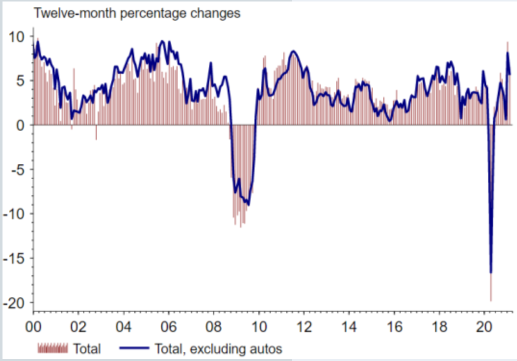
Eurobank

are still on check, and this is also expected to be supportive going forward. We expect therefore that spreads will trade mostly range-bound to slightly wider in the coming month from current very tight valuations. Potential sources of widening, apart from surprise and idiosyncratic events, might come from higher rates and inflation expectations, a subsequent reaction of the equities market, and then a feedback into wider credit, mostly on the US front. Mid-term expected spread direction is range-bound to moderately wider and steeper, given the reopening trade is still on, and inflation expectations and rates are adjusted higher.

USA

Economic activity in 2021 seems poised for the strongest rate of growth since 1984, fueled by progress on Covid-19 vaccinations and supportive fiscal policy

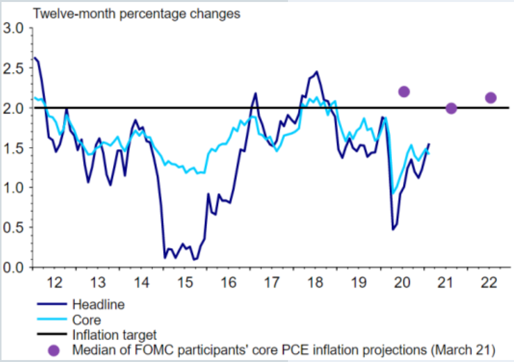
Figure 6: US Retail Sales



Source: Refiniv Datastream, Fathom Consulting, Eurobank Research

Retreating from January's surge, nominal personal income fell by 7.1%MoM in February, due to a drop in government transfers, particularly the one-time payments of $600 stimulus checks in January that were not repeated in February. As a result, real personal consumption declined by 1.2%MoM led by goods consumption (-4.6%MoM), partly reversing January's gains, broadly in line with the February retail sales (Figure 6), which also pulled back after a sharp jump in the prior month. Underlying price pressures remained modest in February (Figure 7), with headline PCE rising 0.2% on the month (1.6%YoY) and core PCE increasing by a mere 0.1%MoM (1.4%YoY). Although both spending and inflation data were softer in February, we expect the $2.8trn fiscal measures ($900bn fiscal stimulus passed last December, followed by the new $1.9trn Covid-19 relief package signed into law in March), coupled with the excess household savings accumulated since the start of the pandemic (~$1.8trn), to support personal income over the coming months, while positive base effects are likely to drive core PCE significantly higher by mid-2021. Activity seems well positioned for solid growth of about 6.0% in 2021, with double-digit annualized growth rates in Q2 and Q3, fueled by a rapid vaccine roll-out that could likely lead to herd immunity by summer and the unprecedented fiscal stimulus. Given the Biden administration's proposal for a fiscal recovery package focused, inter alia, on infrastructure, green energy, education, housing and industrial policy (involving measures worth around $2.3bn), additional fiscal spending spread over multiple years could help sustain fiscal support beyond 2021, with 2022 GDP growth expected around 3.5-4.0%. At the 16-17 March FOMC meeting, many participants upgraded their economic growth projections, with the Fed's median GDP forecast revised significantly upwards to 6.5% for 2021 from 4.2% in December, the unemployment rate was forecast at 4.5% from 5.0% previously and the core PCE inflation projection rose to 2.2% from 1.8%. Neither strong growth nor inflation around the 2.0% target will necessarily lead to rate hikes. Nevertheless, the Fed's dovish signal was clear, with the median 2023 "dot" remaining at the zero lower bound as 7 out of 18 participants were in favor of one or more hikes (compared to 5 out of 17 in December).

Figure 7: US PCE Inflation



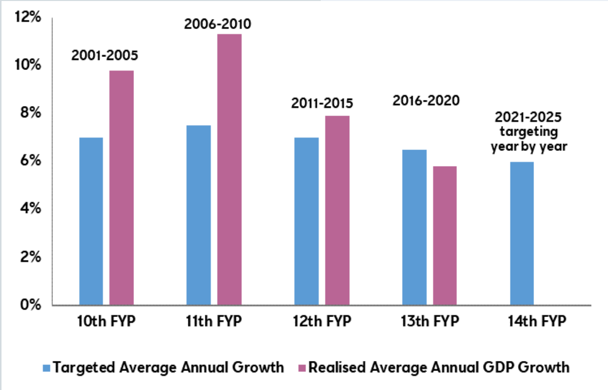
Source: Refiniv Datastream, Fathom Consulting, Eurobank Research

China

The ambitious target to have 40% of its population vaccinated by the end of H1-2021 spurs optimism for outperformance of the 6% official GDP growth target

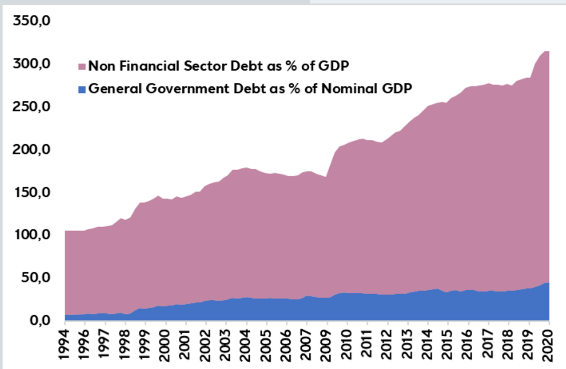
Following the Two Sessions, i.e. the Chinese People's Political Consultative Conference (CPPCC) and the 13th National People's Congress (NPC), Chinese authorities published in mid-March the 14th Five-Year Plan (FYP) that sets the priorities and goals for 2021-2025. The blueprint pertains, among 19 parts and 65 chapters, 20 key quantitative targets which refer to five main categories: economic growth, innovation, livelihood, environment and security, with the latter being a newly introduced one. Referring specifically to the GDP growth target, authorities decided to abandon the specific targeting and presumably to this decision weighted the fact that the 13th FYP target at 6.5% for each year between 2016 and 2020 was missed as the GDP growth averaged for the respective period 5.8%. Had it not been for the pandemic, China could have accomplished the target, albeit marginally. The pandemic shock revealed the inefficiencies of targeting economic performance with a medium term view and therefore, from 2021 onwards economic growth rate target will refer to each year. This year's goal set at 6% is broadly considered more than achievable, implying that policymakers' priority focuses primarily on structural issues such as reducing carbon emissions and deleveraging the public sector. That said, only a few days later, the Central Bank warned of financial risks in the country that have accumulated over the years, as well as shocks from global uncertainties. According to the National Institution for Finance and Development[6], the total debt stood at 315% of GDP at the end of 2020, from 285% at the end of 2019, with more recent evidence, however, pointing to signs of stabilisation. While the government has set the bar low from a quantitative perspective, analysts' consensus stands way above the 6% target. Apparently, the ambitious goal to have 40% of China's population vaccinated by the end of H1-2020, when in early March the rate stood only at 3%, spurs optimism for more robust GDP growth in 2021

Figure 8: More modest and flexible GDP growth targeting between 2021 and 2025...



Source: State Council, National Bureau of Statistics, Eurobank Research

Figure 9:...as private debt accumulation over the years casts shadows on the financial stability



Source: National Institution for Finance and Development, Eurobank Research

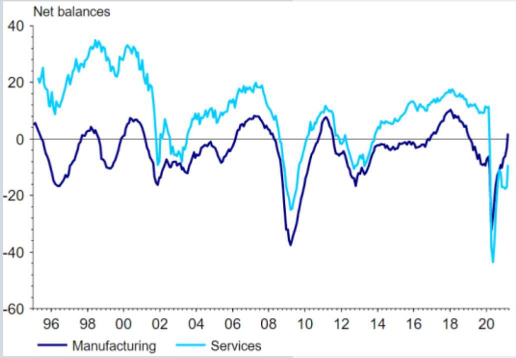
[6] A Chinese government-linked think tank

Euro area

Rising Covid-19 infections and extended mobility restrictions push the turning point of the economy later towards end Q2

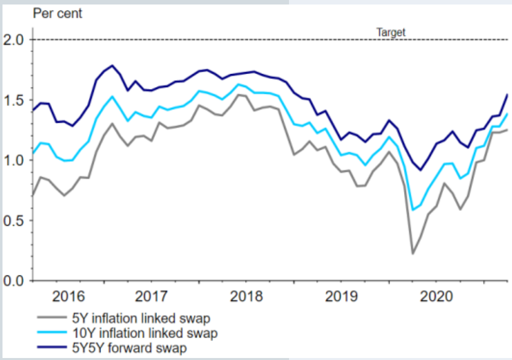
Manufacturing activity continued its strong performance in Q4, whereas services output kept contracting. Leading indicators underscore that the divergence between manufacturing and services extended well into Q1 2021 (Figure 10), with the manufacturing PMI expanding at a record pace of 62.5 in March and the services respective index underperforming and remaining in contractionary territory below the 50.0 threshold that distinguishes expansion from contraction. Covid-19 infections have started to pick up again since mid-February in many euro area countries and, therefore, certain governments have decided to postpone the expected softening of lockdowns or even restrict mobility further until at least mid-April. The threat from the spread of new Covid-19 variants and delays in the vaccination campaigns raise the probability for another GDP contraction in Q1, pushing the expected consumption recovery even further back. With the turning point of the economy likely delayed into May, we expect a generous cyclical rebound in H2 2020, with overall GDP growth projected at 4.0% in 2021, following a 6.6% contraction in 2020. The disbursement of the EU Recovery and Resilience (NGEU) facility grants is expected to start in the summer while fiscal policy should remain supportive in the next couple of years with the EU fiscal rules likely to be suspended until the end of 2022. At its March meeting, the ECB announced a "significant" increase in the pace of asset purchases under the PEPP in response to rising bond yields, likely in the range of €70-80bn/month from €55-60bn in the first months of the year. With a still negative output gap and inflationary pressures well anchored (Figure 11), the ECB's very accommodative monetary policy stance is expected to continue well over the next couple of years (both headline and core inflation are set to accelerate only temporarily during 2021 due to base effects, higher energy prices, supply disruptions and pent-up demand release). Should the €1.85trn PEPP envelope be exhausted by the end of Q1 2022, the ECB could possibly add flexibility to its APP program, providing some indication on the pace of purchases as a function of the inflation outlook and, if needed, temporarily increase asset purchases to prevent any unwarranted monetary conditions tightening.

Figure 10: EC Confidence Indicators point to divergence between manufacturing and services



Source: EC, Refiniv Datastream, Fathom Consulting, Eurobank Research

Figure 11: Euro area inflation expectations



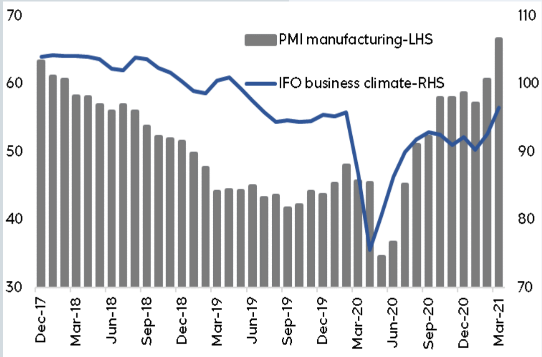
Source: Refiniv Datastream, Fathom Consulting, Eurobank Research

Germany

Q1 GDP likely to contract pressured by lockdown-induced weakness in services

After growing by 0.3%QoQ in Q4 2020, German economic recovery appears to falter in the early months of 2021 mainly due to the ongoing pandemic-related restrictions, bad weather and the reintroduction of higher VAT rates on 1 January. Retail sales dropped by 6.5%MoM in January, the second consecutive monthly decline, while a sustained recovery is still some way off. The GfK consumer climate index jumped from February's -12.7 to -6.2 in March, the highest figure since November of last year, but it is questionable whether the improvement will continue. The relevant survey took place during 4-15 March, suggesting that the events surrounding the AstraZeneca vaccine, the increasing number of infections and the German federal and state governments' recent agreement to extend lockdowns until mid-April — withdrawing thus the moderate easing of restrictions agreed at the beginning of March — have not been taken into account. However, the manufacturing sector remains resilient thanks to the ongoing recovery in global grade and, particularly, strong demand from China and the US. The IHS Markit manufacturing PMI hit an all-time high of 66.6 in March mainly supported by new orders.

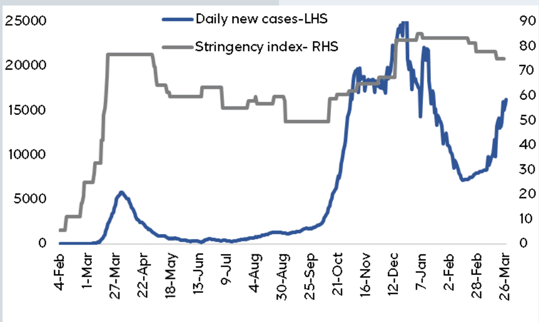
Figure 12: The positive tone of manufacturing surveys bodes well for IP



Source: Bloomberg), Eurobank Research

Echoing the above, the IFO business climate index surged from 92.7pts in February to 96.6pts in March, the largest monthly increase since June 2020 when the economy exited from the first lockdown. The improvement was across all sub-sectors, with manufacturing fairing relatively better. Nevertheless, IP dropped by 2.5%MoM in January, the first decline since April 2020, although the details of the January report revealed a much better picture than the headline. The drop was mainly driven by a 12.2%MoM decline in construction due to bad weather and the increase in VAT rates as well as a 0.5%MoM fall in manufacturing on the back of a 12.1%MoM decline in car production due to disruptions from the shortage of semi-conductors, while the rest of the manufacturing sector performed much better. Overall, the industrial sector is expected to help contain weakness in services and support the German economy to gain traction after an expected renewed GDP contraction in Q1, taking average annual growth for the full year at 3.3%, slightly lower than the 3.5% growth previously expected, in the face of the renewed extension of lockdown measures.

Figure 13: Actvity restrictions were extended further into mid-April due to increasing infections



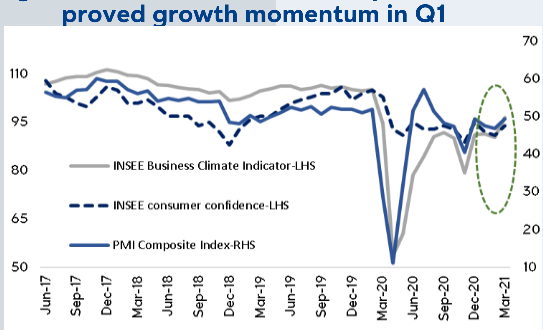
Source: OWID, Eurobank Research

France

New national lockdown to tackle the third Covid-19 wave

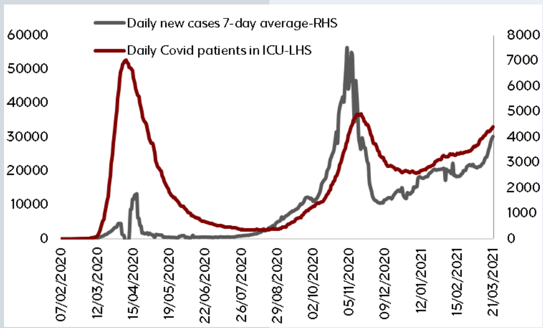
Recent hard data and sentiment indicators point to improved momentum for the economy in Q1 2021 after GDP growth dropped back into negative territory in the prior quarter, pressured by weak final domestic demand mainly due to a hefty decline in household consumption expenditure. Industrial production halted a two-month declining trend in January and rose by 3.4%MoM, largely driven by a strong rebound in manufacturing production. The composite PMI came in at a three-month high of 49.5 in March (+2.5pts), reflecting gains in both manufacturing and services, taking the Q1 average at 48.1, up from 45.9 in the prior quarter. In a similar tone, the INSEE consumer confidence index hit a three-month peak of 94 in March and the INSEE business climate indicator advanced at a post-pandemic high of 96.6 in the same month, with gains widespread across sectors, suggesting that businesses and households got accustomed to the pandemic-related containment measures, reducing thus their impact. However, economic conditions are likely to deteriorate in April after the steady increase in both new infections and the number of Covid-19 patients in ICUs, forced the government to announce that stricter activity restrictions that were previously applied only to Paris and 15 other regions, accounting for 1/3 of the French population and 43% of GDP — similar to those adopted at the national level in November during the second lockdown — were extended to the whole territory on 3 April and will remain in place for four weeks. The restrictions include, the closing of non-essential retail shops and schools, limitations in travel and a 7pm curfew. From May, it is assumed that activity will rebound, while the government's plan to accelerate the vaccination rollout should also help the reopening of the economy (only 11.4% of France's population has received at least one vaccine dose so far). The government has set a target of 10mn (15% of population) to have received one dose of the vaccine by mid-April (i.e. the over 75 years old and more vulnerable categories) and 20mn (30% of population) by mid-May (including the over 50 years old group). If all goes as planned, the insulation of the population will be adequate to allow the government to start gradually lifting restrictions from around mid-May, after what is likely to be a painful month of April. From then onwards, we expect economic activity to step up materially as the pace of vaccinations increases, with GDP growth set to expand by 5.4% in 2021, revised slightly lower from 5.6% previously, also supported by the impact of measures worth €36bn (1.6% of GDP) included in the medium-term national recovery plan ("France Relance").

Figure 14: Sentiment indicators point to improved growth momentum in Q1



Source: INSEE, Bloomberg, Eurobank Research

Figure 15: Steadily increase in new infections and ICU utilization



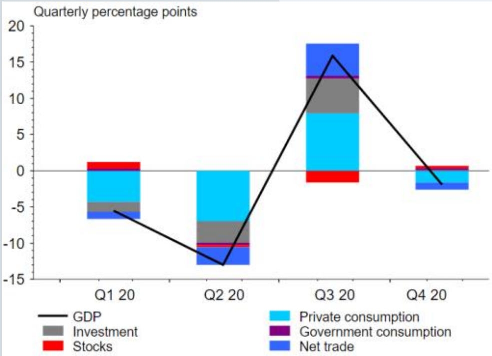
Source: OWID, Eurobank Research

Italy

Draghi's cabinet unveils new fiscal package, further fiscal support likely to follow

Real GDP contracted by 1.9%QoQ in Q4 2020 (Figure 16), with the decline in final consumption expenditure (-6.8%QoQ) partly offset by a modest increase in investment (+0.2%QoQ). The Q4 decline in economic activity has been related to a reduction of hours worked, but firms' expectations on employment have showed positive signals at the beginning of 2021. Latest hard and soft data point to solid momentum in 2021, with industrial production rising by 1.0%MoM in January and business and consumer confidence improving further in February (Figure 17). Meanwhile, the manufacturing PMI edged higher at 59.8 in March, from 56.9 in February, signaling the steepest improvement in manufacturing conditions for 21 years. Both output and new orders increased at the fastest rates for more than three years due to an uptrend in client demand. Although the spread of the virus seemed to have been contained at the start of the year, infections have increased significantly in recent weeks, and the Intensive Care occupancy rate has surged to 39%, well above the critical threshold of 30%. As a result, government has tightened restrictions until at least 6 April, with a nationwide lockdown over the Easter period. Renewed mobility restrictions are expected to dampen economic activity at least through April, while the recent suspension of the AstraZeneca vaccine on concerns about side-effects could further slow the vaccine rollout, increasing the downside risks to Q2 growth. Overall, we expect GDP to increase by 4.2% following a contraction of 8.9% in 2020, with a broad recovery expected in the summer amid a faster pace of the vaccination campaign and the expected softening of restrictive measures. The Next Generation EU fund should be a major contributor to growth over the coming years, adding around 0.5ppt to overall GDP in 2021 and further 2.0ppt cumulatively by 2025 absent any further delays in the rollout of the fund. On a national level, the new Draghi government approved a €32bn fiscal package, providing funding for the national vaccination program and financial support for households and businesses hardly hit by the pandemic, while supporting the labor market through the extension of the ban on layoffs and short-time work schemes. Meanwhile, the government is already considering to take additional fiscal measures worth around €20-30bn, expected to be unveiled by May.

Figure 16: Italy Contributions to GDP growth



Source: EC, Refiniv Datastream, Fathom Consulting, Eurobank Research

Figure 17: Italy Consumer and Business confidence

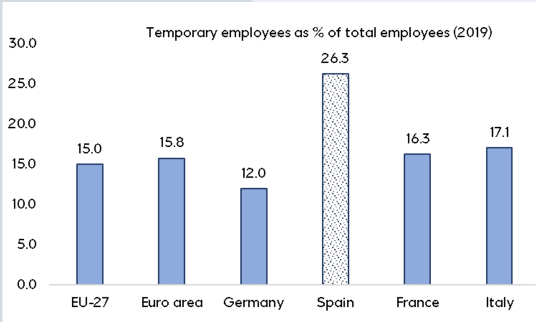
Source: Refiniv Datastream, Fathom Consulting, Eurobank Research

Spain

Q1 GDP likely to contract on ongoing restrictions and labor market deterioration

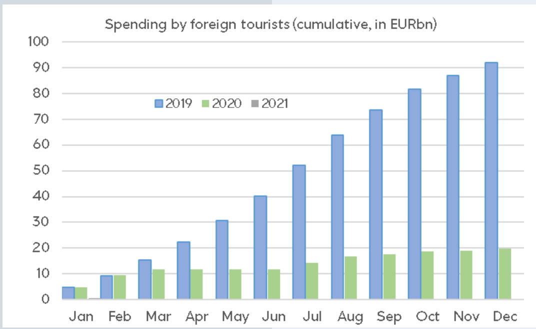
The 7-day average of new confirmed Covid-19 cases have gone up to above 7,000 in late March following a trough near 4,000 earlier in the month. Although still below a peak near 37,000 in mid-January, the increasing risk of the more contagious variants — whose share to the new cases has jumped to nearly 90% — Spanish authorities keep the level of restrictions high to contain the third wave of Covid-19. Against this background, a return of GDP to negative growth in Q1 seems highly likely, taking also into account the weakening of the labor market conditions as the high incidence of temporary labour contracts brought about redundancies. Registered unemployment rose in February for the fifth consecutive month (0.4%MoM) and social security affiliations, a good indicator of employment, dropped by 30k, the first decline since the outbreak of the pandemic in April 2020. Assuming that the vaccination strategy progresses as planned and the government meets its target to vaccinate 70% of adult population with at least one dose by June, we expect a meaningful acceleration in economic activity in H2 as the economy gradual reopens, taking annual GDP at 5.6% for the whole year, while EU recovery funds and an expected improvement in tourism sector should also contribute to a post-pandemic economic recovery. On the fiscal front, the government budget deficit widened by €77.6bn in 2020 to 10.1% of GDP from 2.9% in 2019 and is expected to remain elevated in the coming years as the scarring effects from the pandemic are likely to negatively affect the tax base. Budget revenues fell by €25.5bn and spending increased by €53bn, most of which (around 85% or c. 4% of GDP) channeled for the finance of the Covid-related support measures. A new fiscal package worth €11bn (1% of GDP) was recently approved to support viable companies, mainly in the hospitality sector, that have experienced a drop of at least 30% in turnover due to the pandemic, with the overall fiscal support since the outbreak of the pandemic still standing at c. 24% of GDP (direct fiscal measures, tax deferrals and guarantees), below that in other major EA countries. On politics, Pablo Iglesias, Deputy PM and leader of the left-wing junior coalition partner Unidas Podemos stepped down from the government to run in the upcoming Madrid's snap regional election on 4 May, a move that could potentially ease divisions between the two coalition partners and increase the chances of the government to complete its full term.

Figure 18: Spain has the highest proportion of temporary employees vs. its major EA peers



Source: Eurostat, Eurobank Research

Figure 19: Foreign tourist receipts fell by c. 80% in 2020 and January this year started close to zero

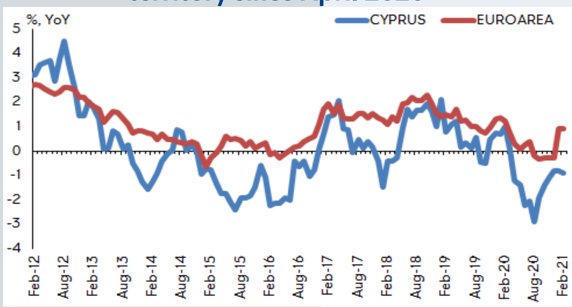


Source: INE, Eurobank Research

Cyprus

IMF warning on reversal of foreclosure framework reforms

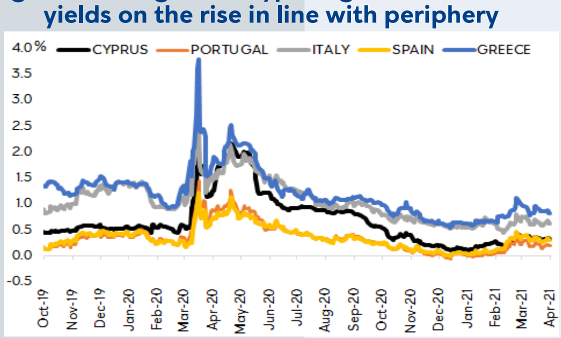
Figure 20: HICP inflation has been in negative territory since April 2020



Source: Eurostat, Eurobank Research

As of late of March, the number of new cases and hospitalizations, which begun accelerating since late February, stabilized at high levels. Local authorities reintroduced social distancing measures as of late Q3 - early Q4 2020, initially at a local level and subsequently at a national level, which were supposed to be lifted in February but authorities have been proceeding cautiously with gradual relaxation. ECDC data show that 13% of the population has received at least the first vaccine dose. The pace of vaccinations is expected to accelerate by April when Cyprus is set to receive 270,000 more doses from the four EMA approved vaccines. The government aims to vaccinate about 60% of the population by the end of June, with Cyprus also posting one of the highest testing rates in the EU. Meanwhile, rating agencies remained on hold in the last round of assessments. In early March, Standard & Poor's affirmed the long-term sovereign rating at BBB- with a stable outlook. The stable outlook balances risks from the pandemic's protracted adverse economic impact against benefits of the EU's RRF transfers, as well as further improvement in the public debt profile. In late March, Fitch also affirmed the long-term sovereign rating at BBB- with a stable outlook. The rating reflects the country's institutional strength as underlined in its per capita GDP and governance indicators that stand well above its BBB peers, plus a record of robust economic growth and sound fiscal policy prior to the Covid-19 shock. These strengths are balanced by high public debt and a weak banking sector. Finally, Moody's postponed the scheduled sovereign rating assessment in mid-February. In late September 2019, Moody's had affirmed the long-term sovereign rating at Ba2 changing the outlook from stable to positive. Moody's is the only agency among the four major ones, which still classifies Cyprus two notches below investment grade status. In its staff concluding statement of the article IV mission, the IMF acknowledged the progress of the banking sector in offloading legacy NPLs and weathering the crisis so far. However, it warned that the reversal of the foreclosure framework reform would obstruct ongoing NPL resolution and jeopardize financial stability. The IMF assessed that current proposals under discussion in parliament risk reducing the threat of foreclosures and create uncertainties by weakening prospects for collateral recovery necessitating additional provisions and capital increases. Additionally, the IMF recommended addressing any uncertainties stemming from the implementation of the 2019 amendments of the Foreclosure Law.

Figure 21: Long-term Cypriot government bond yields on the rise in line with periphery



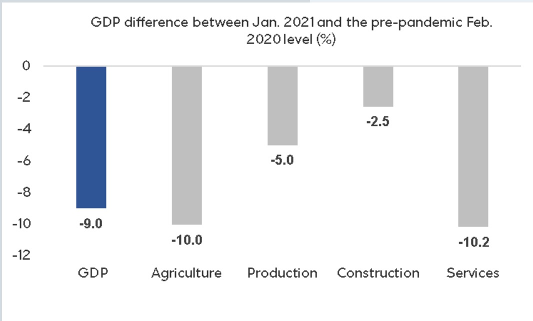
Source: Bloomberg, Eurobank Research

UK

Growing economic resilience to lockdown measures

In spite of the nationwide lockdown measures imposed since January 6 to curb the rapid spread of the more infectious strain of the virus, UK GDP dropped by a lower than expected 2.5%MoM in the first month of the year. Growing resilience of the economy to the second lockdown was also evident in Q4 2020, with GDP revised upwards to 1.3%QoQ according to the second estimate from 1.0%QoQ initially reported, mainly on the back of higher public consumption amid increased spending on the Covid-19 testing scheme. This upgrade was complemented by an upward revision for Q3 GDP (16.9%QoQ from 16.1%QoQ) that was, however, partially offset by a downward revision to Q2 GDP (-19.5%QoQ from -19.0%QoQ). Overall, these changes meant a marginal 0.10ppt upward revision for 2020 GDP at -9.8%, which, nevertheless, was still the largest annual contraction since this data collection started. Looking ahead to the remainder of Q1, earlier hard data and sentiment indicators point to marginal improvement in output as the economy anticipates the easing of current restrictions, according to a roadmap PM Boris Johnson unveiled last month.

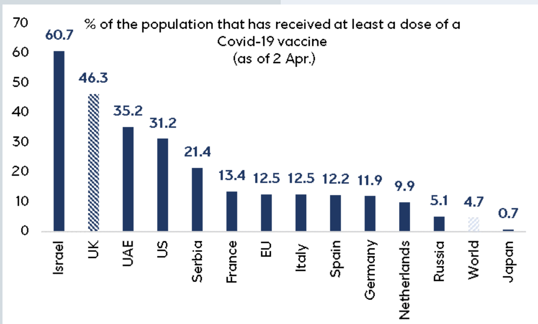
Figure 22: Lower than expected drop in January GDP, but GDP still 9% below pre-pandemic levels



Source: ONS, Eurobank Research

Indicatively, the GfK consumer confidence index showed a solid improvement from January's -23 to a new post-pandemic high of -16 in February, retail sales rose by a higher-than-expected 2.1%MoM in February, partially offsetting January's hefty 8.2%MoM decline, while PMIs for March outperformed expectations across both services (56.8) and manufacturing (58.9) for the second consecutive month. In view of the nationwide lockdown, we still expect UK GDP to contract modesty in Q1 before the economy strongly rebounds from Q2 onwards, mainly supported by: (ı) the impressive pace of the vaccine rollout. As of late March, 32mn citizens, or c. 45.5% of the UK population, have received at least one dose, well ahead of the US and the EU average; (ii) fiscal policy has become more accommodative than expected for the current year. The Spring Budget 2021 revealed fiscal support measures worth £59bn (2.8% of GDP) and a longer than expected five-month extension of the furlough scheme to September 2021, while fiscal consolidation was deferred to 2023; (iii) the government's lockdown easing plan which aims at removing all containment measures by late Q2. Against this background, we now expect UK 2020 GDP to grow by 5.6%, upwards revised from 4.5% previously.

Figure 23: The UK's vaccination rate among the highest globally



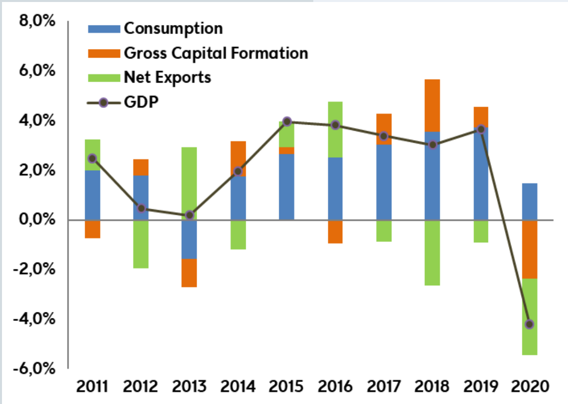
Source: OWID, Eurobank Research

Bulgaria

The -4.2% FY2020 GDP print, albeit negative and below the official forecast of -3.0%, outperformed the EU-27 average of -6.2%

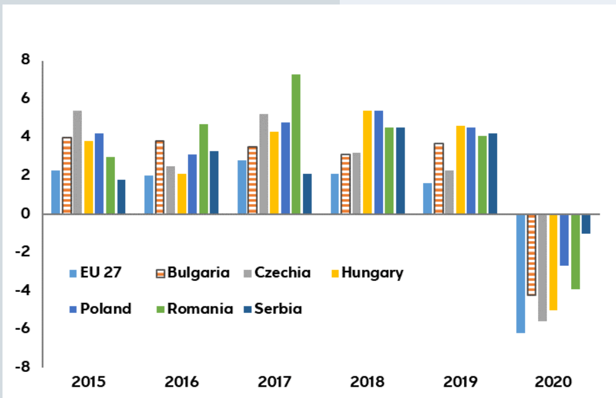
On the same footing with the entire CESEE region, Bulgaria is currently confronted with the third and more severe wave of the pandemic. In the last 12 months, the country has been severely hurt in terms of infections and fatalities with daily Covid-19 cases at this point marking record highs. In this adverse environment, the country entered into a state of emergency that entailed additional restrictive measures as of March 22. These, however, were slightly loosened from April 1, ahead of the parliamentary elections on April 4. The latest polls pointed to a fragmented parliament in which the two main parties in the country, GERB and the BSP, could most probably form a coalition government. In 2020, the economy contracted by -4.2%. The year began with modest economic growth of +2.4% YoY in Q1, which was disrupted in the following quarters with economic contractions of -8.5% YoY in Q2, -5.3% YoY in Q3 and -4.7% YoY in Q4. The FY2020 GDP print, albeit negative and below the official forecast of -3.0%, towers above the EU-27 average of -6.2% and is similar to the contractions in many CESEE countries. Mostly private and to a much lesser extent private consumption prevented the economy from shrinking further, contributing positively to the headline GDP recession print while investments plunged primarily on the back of the government's decision to direct a substantial portion of funds initially budgeted for investments to countercyclical economic measures. Despite the overall recessionary performance in 2020, the prevailing uncertainty over the end of the pandemic and the political risk from the elections, risks remain broadly balanced. We stick to our 3.5% GDP growth forecast for 2021. The well-established fiscal discipline, which acts over time as a buffer for the economy, the reforms facilitated by the ERM II entry and the absorption of NGEU funds are expected to offset the negative impact of the slow speed of the vaccinations and prepare the ground for a stronger rebound in 2022 and 2023.

Figure 24: Consumption prevented the economy from contracting further…



Source: National Statistical Institute, Eurobank Research

Figure 25: …with the FY2020 GDP print similar to the CEE-4 contractions on average



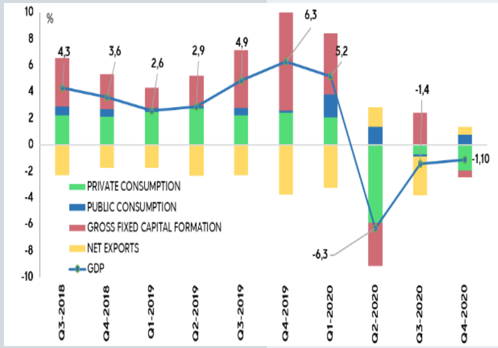
Source: Eurostat, Eurobank Research

Serbia

The 2020 economic over performance brought about credit rating improvement and paved the way for a robust rebound in 2021

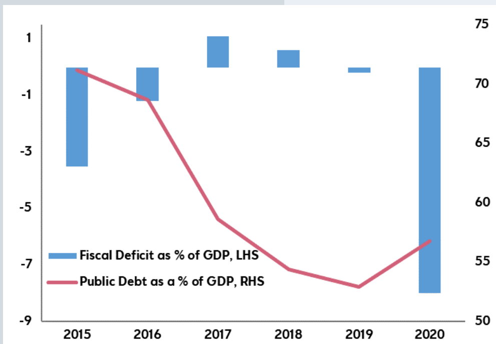
Apart from the Q4 GDP data that pinned the FY2020 GDP recession at -0.98% in 2020, the economic developments that stood out in March include the assessment of the country's sovereign credit rating by Moody's and Fitch rating agencies. Moody's upgraded its rating by one notch to Ba2 from Ba3 setting the outlook to stable from positive, while Fitch affirmed the BB+ rating, keeping the stable outlook. Both rating agencies based their credit assessments primarily on the macroeconomic policy mix that the authorities adopted since the outbreak of the pandemic and the resilience of the economy so far against the tumultuous exogenous shock. According to Moody's, real GDP will expand by 4.7% in 2021, while Fitch's forecast lies 0.5pt higher, coinciding with the official economic growth target at +5% . Our projection, however, continues to be more conservative, forecasting GDP growth of +4.5% in 2021, with risks tilted to the downside and broadly stemming from the vaccination roll out in 2021 in the EU, which is the main trade partner of Serbia. In our view, investments will hold a pivotal role in the economic growth trajectory due to the low base effect that 2020 transferred to 2021. We anticipate the recovery of the services sector, which was gravely affected by the pandemic in 2020, to assist the rebound of private consumption, while the ambitious pipeline of infrastructure projects that is estimated to reach 5.5% of the projected GDP will further give a boost to investments. Public consumption is expected to continue contributing positively, albeit to a lesser extent, and private consumption is anticipated to rebound, given the bounce back in domestic demand after the relaxation and even maybe the withdrawal of stringent social distancing measures. That said, all three components of domestic demand will positively contribute to economic growth, while the net exports component is considered the most difficult to predict, with its dynamics being broadly determined, inter alia, by the domestic and external demand and the high uncertainties around them.

Figure 26: Public consumption and investments supported GDP from shrinking further...



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

Figure 27: ...with supportive measures weighing on public finances



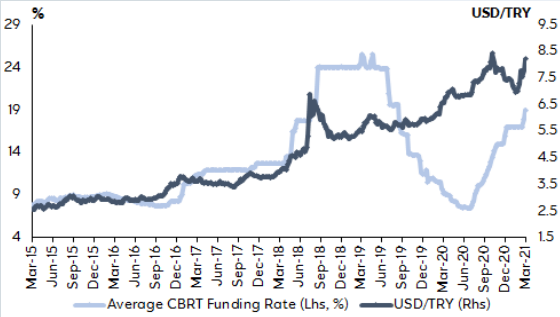
Source: Statistics Office of the Republic of Serbia, Eurobank Research

Turkey

CBRT governor's sudden dismissal pushes domestic markets in financial turmoil

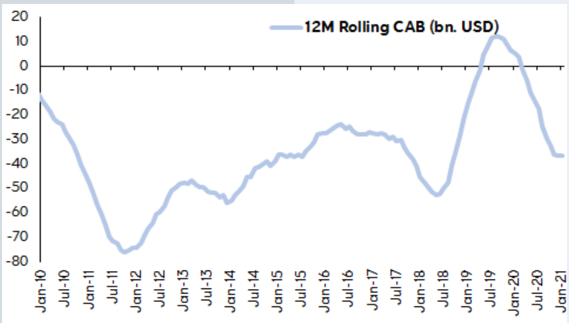
On March 20, the Governor of the Central Bank Naci Agbal was unexpectedly dismissed and replaced by Sahap Kavcioglu who has served as a ruling AKP party MP. The change of leadership, the third since mid-2019, took place in the aftermath of the last MPC meeting two days earlier, in which a sharper than expected 200bps rate hike took place. Under the leadership of Naci Agbal, CBRT had hiked its key policy rate (KPR) – the 1-week repo rate – by a cumulative 875bps to 19% since early November helping to restore some of its lost credibility. The timing of the decision has exacerbated concerns of regressing to unorthodox monetary policies of the past. President Erdogan's strong support for low interest rates has raised fresh doubts about the Central Bank's independence and concerns over CBRT falling significantly behind the curve again. On top, despite many verbal messages, the lack of implementation of a more conventional free markets oriented economic policy, threatens to bring structural deficiencies to the forefront again. To that end, high inflation remains a key challenge. Driven by high food and energy inflation and the continued pass-through from earlier FX depreciation, inflation has climbed further to 15.6% YoY in February up from 15.0% YoY in January, well above the year-end target of 9.4% in 2021 and mid-term target at 5%. In the same period, core inflation also rose sharply to 16.2% up from 15.5%. The unorthodox monetary policies have led to a drawdown in FX reserves in order to defend the lira, which CBRT has not managed to replenish yet. Factoring in the swap agreements, the underlying position of net FX reserves has already declined to negative levels (-USD46bn). The latter has raised concerns that Turkey may not have enough to shoulder a disruption in external financing. External financing needs are high: the corporate sector is short net (Assets-Liabilities) FX by USD157.6bn. Out of the liabilities stock, 33% is short-term. Having improved temporarily to a surplus in 2019, the current account balance dynamics deteriorated rapidly in 2020 due to the Covid-19 pandemic. As a result, CAD widened to -4.9% of GDP from a surplus of +0.9% in 2019 vs a deficit of -2.7% in 2018 and -4.8% in 2017. The unexpected change of leadership has put Turkish assets at the epicenter of international markets' attention. In late March, the lira traded at 8.25/$ lower by 14.5%. The 10Y USD denominated government bond yield skyrocketed by 135bps to 7.3%. The 5Y-CDS climbed by 168bps to 474bps.

Figure 28: Lira came under strong depreciation pressure on concerns for CBRT independence



Source: Bloomberg, Eurobank Research

Figure 29: Macroeconomic imbalances have been widening since mid-2019



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)		
	2020	2021f	2022f	2020	2021f	2022f	2020	2021f	2022f	2020	2021f	2022f	2020	2021f	2022f
World	-3.4	5.5	4.2	3.2	2.8	2.9									
Advanced Economies															
USA	-3.5	6.0	4.0	1.2	2.5	2.1	8.1	5.5	4.2	-3.1	-3.6	-3.6	-14.9	-15.2	-6.8
Eurozone	-6.6	4.0	4.0	0.3	1.5	1.2	7.9	8.5	8.3	2.2	2.5	2.3	-7.9	-6.4	-4.1
Germany	-5.3	3.3	4.1	0.4	2.3	1.4	4.2	4.5	4.8	7.0	7.0	6.8	-4.5	-4.5	-2.0
France	-8.2	5.4	4.0	0.5	1.3	1.1	7.8	9.3	8.8	-2.3	-1.4	-1.5	-9.2	-8.0	-5.2
Periphery															
Cyprus	-5.1	3.5	4.0	-1.1	0.5	1.2	7.8	7.5	7.0	-11.4	-10.0	-9.0	-5.0	-3.5	-2.5
Italy	-8.9	4.2	4.3	-0.1	1.0	0.8	9.1	10.0	9.8	3.6	4.0	4.0	-9.4	-8.5	-5.2
Spain	-11.0	5.5	5.3	-0.3	1.4	1.2	15.5	16.3	15.9	0.7	1.0	1.2	-10.1	-9.8	-7.5
Portugal	-7.6	4.5	4.4	-0.1	0.9	1.2	6.8	8.2	7.2	-1.3	-0.6	-0.4	-8.0	-5.4	-3.2
UK	-9.8	5.6	5.7	0.9	1.6	1.8	4.5	5.8	5.4	-3.6	-4.0	-3.0	-12.1	-10.0	-5.8
Japan	-4.9	2.6	2.7	-0.2	-0.5	0.1	2.8	3.2	3.1	3.3	3.2	3.0	-16.3	-9.6	-7.8
Emerging Economies															
BRICs															
Brazil	-4.0	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	-7.7	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	-4.0	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	-3.9	4.5	5.0	2.3	2.8	2.5	5.0	5.3	5.0	-4.5	-4.0	-5.0	-9.0	-7.0	-5.0
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	-8.0	-3.2	-1.7
Turkey	1.9	4.8	5.0	12.3	15.0	10.0	13.5	13.3	13.0	-5.5	-3.0	-2.5	-5.5	-4.5	-4.0

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

Eurobank

Eurobank Research

Eurobank Fixed Income Forecasts

	Current	June 2021	September 2021	December 2021	March 2022
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%	0.12%	0.13%	0.15%	0.17%
3m Libor	0.20%	0.21%	0.24%	0.27%	0.31%
2yr Notes	0.16%	0.20%	0.25%	0.31%	0.39%
10 yr Bonds	1.67%	1.58%	1.63%	1.71%	1.80%
Eurozone					
Refi Rate	0.00%	0.00%	0.00%	0.00%	0.00%
3m Euribor	-0.54%	-0.50%	-0.49%	-0.48%	-0.46%
2yr Bunds	-0.71%	-0.68%	-0.65%	-0.63%	-0.61%
10yr Bunds	-0.33%	-0.29%	-0.22%	-0.18%	-0.13%
UK					
Repo Rate	0.10%	0.10%	0.10%	0.10%	0.15%
3m	0.09%	0.07%	0.08%	0.08%	0.09%
10-yr Gilt	0.80%	0.73%	0.77%	0.81%	0.89%
Switzerland					
3m Libor Target	-0.75%	-0.74%	-0.73%	-0.73%	-0.73%
10-yr Bond	-0.33%	-0.26%	-0.24%	-0.21%	-0.18%

Source: Bloomberg (market implied forecasts)

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